



Aberdeen

China/Hong Kong Update

Market Overview

- China and Hong Kong equities were buoyed by optimism that Beijing would ease tightening measures in light of decelerating growth. Of particular note was the slowdown in second-quarter growth, while other macroeconomic indicators such as industrial output and property prices told a similar story.
- Solid company earnings and relief over European bank stress test results also helped investor confidence. The Shanghai Composite Index rallied 10%, its biggest monthly gain in a year.
- China's central bank, meanwhile, reiterated that it would maintain relatively loose monetary policy for the rest of 2010. Concerns about local government debt persisted, with an estimated 20% of such loans at risk of default, prompting scrutiny by the banking regulator. We share these concerns but the ultimate parent, the state, has very deep pockets.
- In other developments, China stepped up efforts to promote the internationalisation of the yuan, allowing Hong Kong banks to sell yuan-based financial products. Hong Kong passed its first minimum wage bill, which will affect businesses dependent on low-cost labour.
- Even though weaker growth this year has been largely policy-induced, investors are increasingly nervous that the Chinese economy could face a sharp downturn. The government is scaling back stimulus, just as the prospects for exports are deteriorating. Expanding domestic demand is more important than ever.
- The good news is that accelerating urbanisation and wage growth should encourage greater consumption. Also, policymakers' increased focus on the quality, rather than the quantity, of growth could speed up reforms and spur long-awaited economic restructuring. We remain vigilant over our holdings, which are characterised by solid balance sheets, experienced management and sound business practices.

Model Portfolio News

During the month, we initiated a position in Li & Fung, a professionally managed trading company with sound financials and good corporate governance.

Note:

The changes mentioned in this part refer to our model portfolio, which is the basis for actual portfolios we manage that have similar investment objectives. However, there might be minor variations among these, so the above descriptions might not apply to the actual portfolios.

Corporate News

Our holdings reported good results during the month. **Kingmaker Footwear** and **Hung Hing Printing's** focus on margins paid off as both posted rising profits despite weak sales in developed markets. **ASM Pacific Technology** also produced an extremely robust set of results thanks to solid demand and ongoing cost cuts. **Hang Lung Group** and **Hang Lung Properties'** full-year performance was boosted by positive rental reversion and buoyant residential sales in Hong Kong. Solid net interest income and lower provisions lifted **Public Financial's** first-half profits. **China Mobile** added another 5.6 million subscribers in June, bringing its total number of subscribers to 554 million.

In other news, rejigging within the **Swire Pacific** group ended with Swire owning 75% of **HAECO** after it failed to garner enough shareholder support for a full takeover.

We hold all the companies highlighted.

Key Economic Numbers

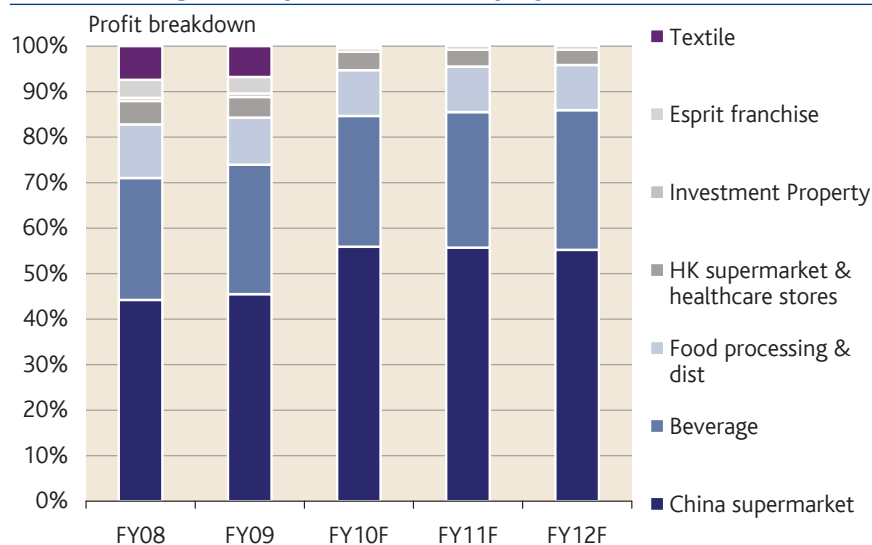
10.3% After expanding 11.9% in the first quarter, China's GDP growth eased to 10.3% year-on-year in the second quarter. Its growth rate, however, remains a bright spot amid the global uncertainty.

0.1% Property prices dipped 0.1% in June from the previous month. The decline was the first in nearly 18 months and a sign that Beijing's policy tightening is starting to bite.

2.9% Inflation softened to 2.9% year-on-year in June, owing to a steep decline in vegetable prices. But inflation expectations remain, given the relatively poor grain harvest, along with rising labour costs and rents.

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Focus – China Resources Enterprise: Transforming into a pure consumer play



Source: Company data, Nomura estimates, July 2010

China Resources Enterprise (CRE) used to have a portfolio of non-core assets, which included a textile business and minority stakes in ports. Over the years, it divested many of those peripheral businesses to focus on three core activities – retail, beverage, and food processing and distribution. Today, CRE is a leading consumer goods conglomerate that owns the top beer brand and one of the largest supermarket chains in China, and is a key beneficiary of the mainland's strong consumption growth.

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