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market update

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Correction in China Equity Markets

China markets fell significantly 31 January 2007. A-shares fell by over 5%, H-shares, red chips and the Hang Seng index fell by close to 2%.

China markets in general have performed strongly over the past year. A-shares were up over 125%, H-shares doubles and the Hang Seng Index rose by 36%. Fund inflows into the China equity market were especially strong at the tail end of 2006 and into 2007. In the last two months A-shares have risen by about 32.5%.

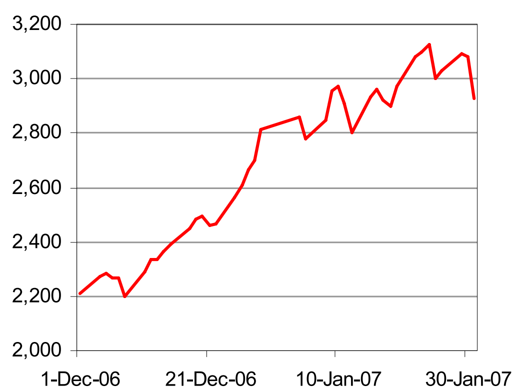
The fall was triggered by investor expectations that the Chinese authorities may implement measures to stem activity in the equity markets. This followed comments from an influential Chinese official, Cheng Siwei, Vice Chairman, China National People's Congress, who stated that there is a bubble in markets and that investors should be concerned about the risks.

Given the rapid rise in the A-share market, and the possibility of further policy measures, short term market consolidation is possible.

Though valuations have risen for China shares and A-shares in particular, they still remain reasonable, and should be supported by strong earnings growth in 2007.

Despite volatility in the short term, the growth story for China in 2007 is still strong. Positive momentum has been underpinned by strong economic growth (close to 10% annually in the last few years) and growing domestic consumption. While the government has instituted austerity measures in the past to cool the economy, it is still on track for strong growth of around 9%, in 2007.

Shanghai A-share Index



Source: Bloomberg

	2007 PBV (x)	2007 PE (x)	Mkt cap (US$bn)	No. of listed companies
'H' Shares	3.1	15.1	432.1	141
Red chips	3.0	15.3	377.7	89
Shanghai A	3.9	18.8	911.2	832
Shenzhen A	3.7	17.2	217.8	566
Shanghai B	2.3	17.6	6.3	54
Shenzhen B	2.9	15.0	10.1	55

Sources: BNP Paribas

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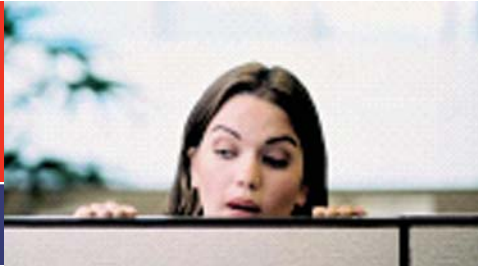

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Despite volatility in the short term, the growth story for China continues to be strong. As the China market performance still lags behind other large emerging markets such Brazil, Russia, India over the past three years, we believe China shares will have the potential to catch up due to strong economic growth (close to 10% annually in the last few years), growing domestic consumption and strong investments. While the government has instituted austerity measures in the past to cool the economy, it is still on track for growth of around 9% in 2007.

Corporate earnings for Chinese companies should also continue to remain strong with earnings growth of 30% in 2006 and 15% in 2007, driven by domestic consumption. The China market is trading at a forecast price-to-earnings ratio of 20.3 times in 2006, and 17.6 times in 2007.

There are also several short to medium term drivers for the market and they include:

- Potential Qualified Domestic Institutional Investor Scheme (QDII) approvals
- Corporate reform in the A-share market
- Potential revaluation of the Renminbi
- Lowering of profit tax for listed companies
- Positive investor sentiment in the run-up to the Olympics

In 2007, there may also be some volatility as a result of slowing global growth. In addition, China's ballooning trade surplus may lead to trade frictions with its major trading partners such as the US and Europe. Recent market strength may also lead to a surge in cash raising activities including IPOs and share placements and trigger some profit taking. This however, should not significantly affect the positive growth trend for the China equity market.

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