Bin Yuan Capital China Equity Strategy - First Quarter 2014

Market Overview

Both A and H shares markets have been weak during the first quarter of 2014. Concerns on the economic structural problems such as property bubble, bank off-balance sheet issues and liquidity still exist.

A solar EPC name was also a major performance contributor during the period. It is one of the top EPC players in distributed solar projects, which we think entry barrier is relatively high in terms of technology and channel. We are bullish on distributed solar system in a long-term perspective, considering the fact that heavy consumption of coal and fuel in China has incurred severe environmental damages. Without long distance transmission and wastage, distributed power system could help to maximize the utilization of resource and space, and in a more efficient and economical way.

Portfolio Positioning

It is highly visible that the economic growth has peaked off and it is becoming a consensus that China growth is no longer sustainable to be driven by investment. The government focus will be on the economic structural reform. By government policy force, domestic living quality improvement will be overweighed export-oriented economy. Thus we stay positive with domestic theme and have bought on dips on some high quality companies that will benefit from this long term trend. We initiated a wind operator during the period. It is the industrial leader with best wind resources, and it could benefit from rising utilization as a result of increasing grid connection.

The slowdown of the GDP growth has put most of the capital goods companies in difficult positions. We have noticed that some of the infrastructure development related stocks are heavily oversold and have become most disliked names in the market. This sector has been consolidating and value is emerging. We have started to accumulate exposures to this sector by including a construction machinery name during the period.

During the quarter, we constantly review our existing holdings. We have trimmed/sold some of the overbought stocks in our portfolio, while maintaining certain level of weights or switching to more attractive alternatives.

The fund has mainly invested in companies which are involved in environmental protection, new energy, automation, healthcare, long cycle consumers, logistics related transportation and information technology.

Chinese Economy Outlook

As expected, concerns on property sector, non-performing loans and off-balance-sheet items have started to surface in China. Those problems were caused by capital misallocation, duration mismatch of financial assets and over-capacity in most of the manufacturing sectors. We believe the RMB is 15-20% overvalued against US dollar. We think continued strong RMB currency and distorted interest rate will hurt Chinese economy. Chinese economy is not competitive enough to maintain current currency rate against US dollar. The hot money in recent years has brought in additional needless liquidity which postponed some of the problems within the financial system.

We believe the gradual depreciation of RMB, together with finance reform, would help to increase the real export competitiveness, to curb high property price, to reverse the trend of capital misallocation, and to deleverage corporate balance sheets.

The visibility of the economy is still low at this moment. We expect the picture will become clearer in the upcoming 3Q and 4Q. It is positive that most of the business participants and government leadership are aware of the economy issues. It is a question of how to deal with these issues that has accumulated in the past years.

In the longer term, we maintain our view that the new leadership is able to execute the reform. The background of new leadership gives us the confidence. The reform is expected to happen in the area of fiscal, financial system, administration, rural land and income redistribution.

Although the market will stay weak with high volatility and no trend, we would not expect a sharp decline given that most of the concerns have already factored in for a while. This in a way is positive, as most of the investors have been aware of the risks; the difference is that the negative concerns are surfacing. Market is building a short term bottom base.

Our investment themes are consistent with our view on China economy and have been illustrated in portfolio positioning session. We like those sectors that have visible growth potential. Consistently, we stay with quality companies with attractive valuations.

Sincerely,

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