Bin Yuan Capital China Equity Strategy – Fourth Quarter 2014

China Market Review and Performance Attribution (H share only, A share is available upon request)

Interest rate cut

Two key events in China were given the greatest attention during the quarter: Hong Kong- Shanghai through train became effective and the central bank lowered interest rate.

All Chinese economic data has showed no sign of reverse to growth in 3rd Quarter and early 4th Quarter. Money supply was at its lowest level in the past 6 years. December CPI was lowered to only 0.8%, PPI was recorded negatively at -3.3% and meanwhile PMI stayed below growth level. To prevent GDP growth decelerating to below expected level, the central bank hence decided to cut the lending rate by 15-40 basis points with immediate effect on November 22.

The significant effect of the rate cut to the economy still need time to reveal, but it did reduce market concern on the balance sheet risk in the financial system. The financial sector in the A share market responded rapidly and strongly. The trading volume has sharply increased and reached historical height, hitting 1 trillion yuan per day in mid December. The sharp increase in market volume, mostly from new money with up to 20% high leverage, has pushed up the sector by 60% (Securities companies were up by 150-200%) in the last two months of 2014! The financial sector has contributed around 40% out of the 51% return for the CSI300 index in 2014. If excluding financials, the market in fact recorded slightly down in the 4th Quarter. As for the oversea Greater China Market, although the large cap stocks in H share market have followed the A shares large cap momentum, it moved in much milder extent.

Performance attribution

Bin Yuan Cayman Fund has not benefited from A shares upswing given that the fund has limited exposure to the A share market as well as H shares was less sensitive to the rate cut. The net outflows from Hong Kong Market led by global funds, uncertainty in Russian economic status, continuously falling oil price and the sell-off of small/mid cap stocks have brought multiple negative impacts on the fund performance during the quarter.

The underperformance in consumers and healthcare stocks was the largest retraction to the fund's return of the quarter. New energy stocks were also hurt by the weak oil price.

One of our consumer names was oversold as it's been implicated in Taiwan food safety scandal. The involved category was very tiny but it did cause a huge damage to the investors' sentiment. The company is well positioned to become a famous brand chain stores in China and those US cities with large Chinese American populations, providing open-shelf yet delicate coffee and bread. We like its business model and believe it has a very large possibility to become a scalable franchise. Its differentiated product/service offering is attractive to both China mainlanders and US consumers. We are positive on its store re-modeling strategy, which aims to put more emphasis on end-user experiences. This sub-segment could still grow fast in the next few years although the consumer market segments in a whole become very competitive in China. We believe those who are able to focus on developing best services and products will win in the future.

Healthcare is a long cycle business. We keep our positive long term view on high quality healthcare companies. The new energy industry is at its very early stage and we will hold on to those stocks that we believe can be long term winners.

The top performer in our portfolio continued to be the railway stocks. We have confidence in the trend that China will export higher value added goods and service globally with attractive cost performance ratio.

Adding to the "dogs"

The selloff of some of the stocks we like in Hong Kong have getting cheaper. The discount and premium relationship for many that are dual listed in both A and H has reversed. We are buying or adding those "dogs" at the end of the quarter.

The HK-SH Through Train has given Bin Yuan a better opportunity to select investments across exchanges. Combined with potential RQFII, the fund will be participating more in finding discount opportunities among stocks in different exchanges.

China Economy Outlook and Portfolio Positioning

The key challenge for China economy is still the structural issues. Those areas need to be improved in future are the misallocation of capital through banking system, Over-supply in manufacturing and mass infrastructure built up in short time period, and the closed capital policy.

Capital misallocation

The high savings ratio in China is positive to provide buffer to financial risks. However, due to the banking industry is highly regulated and the lending direction is policy driven, the loans are heavily leaned to the government owned entities. As a result, the less efficient and productive SOEs have enjoyed cheap funding while the more dynamic private sector is suffered from either getting capital or high borrowing cost.

The reform is at its early stage to channel more capital from the banking system to private sector. Meanwhile other reform is also happening, which is to channel capital from the household deposit to the financial markets. The data in table 1 shows that household in China has invested significant less money in the stock market compared to those in the US.

Table 1:

(US $trillion)	**China**	**US**
Stock market cap	7.0	37
Household deposit	6.5	0.61
Deposit / Stock market cap	93%	1.65%

Both of the changes will benefit Chinese economy in the long run as capital market is a much more efficient place to allocate capital. The efficient fund flow can help to improve the productivity through increased competition and innovation from private sector. The equity market simultaneously will grow much bigger.

Recapitalization of the banks

It is difficult to predict how long the momentum will last for those financial stocks in the A share market, but we believe the rate cut can only reduce the market perception of the balance sheet risk in the financial system. The real non-performing debt problem has not been removed but postponed instead. If the momentum continues, the banks will very likely to raise capital and transfer the problems to the equity investors. The banks will recapitalize their balance sheets by absorbing funds from household savings.

Economy growth

As of today, it is still difficult to see any strong catalyst that could maintain a strong GDP growth. Consolidation will continue to digest the remaining heavy capacity investment in manufacturing sector. It is positive to see inventory level such as steel started to improve. An economic hard landing is not likely to happen, but it will trap China to grow slower for a long time unless some of the reforms execute successfully. The growth will come from innovation in technology, services and productivity improvement, not from the infrastructure anymore as China's mass infrastructure build-up has peaked.

Today's objectives for the Chinese government are not high growth, but to prevent the economy to slow down too fast and in the meantime, to better improve its asset return. To be able to keep the interest rate low, it has to keep the inflation low by supporting its overvalued currency. The weak commodity price is positive for China as China is a big consumer of commodities itself. Moreover, the weak commodity price is becoming a natural hedge to the overvalued RMB for China to reach its objective to stay at a targeted growth level with low inflation until capacity consolidation improves.

To increase the return on RMB and hold its value, China will be more aggressively export RMB together with supporting domestic corporations to do business overseas. "One Belt and One Road" makes sense in this regard.

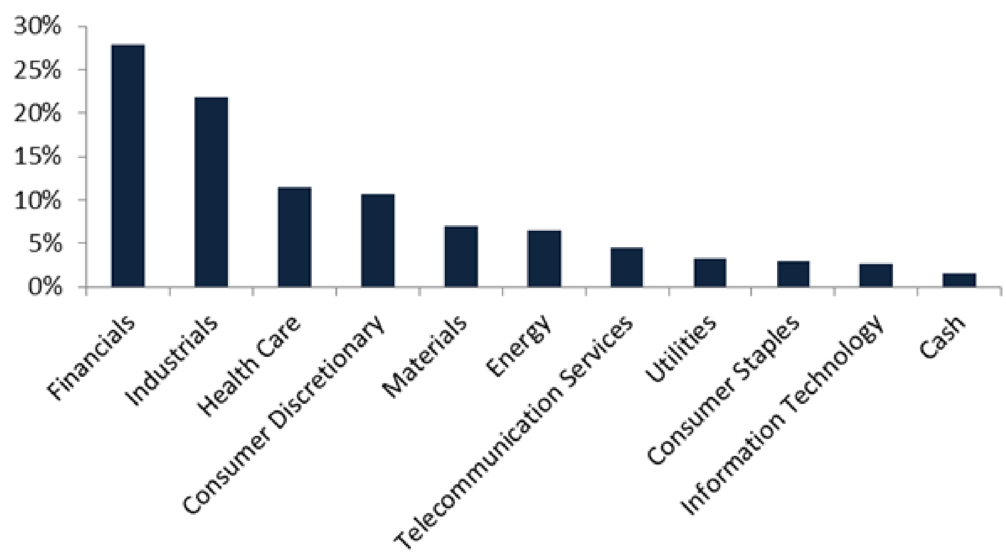
State owned enterprises restructurings could also help to improve efficiency of assets if implement successfully, and we are closely watching the trend.

How we position in investments

In the above discussion, we summarize at a top level that Chinese economy is in a process of improving its inefficient balance sheet by improving the return of assets and reducing the cost of the liabilities. We foresee plenty of opportunities emerging in the area of yield enhancement, productivity improvement, funding cost reduction, social burden alleviation, and pollution clearance. Our current portfolio positioning is consistent with a number of the long-run structural themes over the next 3-5 or even longer years that we have annually reviewed:

1. Rising awareness in food safety and information safety
2. Healthcare and health insurance
3. Leisure spending
4. Increasing portion of direct financing and mixed ownership
5. High value-added capacity export and domestically industry consolidation
6. Productivity improvement driven by advanced technology including automation, new material and IT
7. Efficiency enhancement resulting from development of logistics, public transportation and supply chain simplification
8. Development of renewable energy and energy savings
9. Environmental protection

Our portfolio exposure is as below (H share only, A share is available upon request), and our focus will still be on identifying long-term themes and stock selection.



Sincerely,

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