Bin Yuan Capital China Equity Strategy – First Quarter 2015

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

The first quarter of 2015 kicked off with a strong capital market and a weak economy. PMI softened to 49.6 in March. Power demand remained at low level, down 6.3% year on year in January and February combined. The recovery of property sales in fourth quarter of 2014 driven by policy loosening has not continued into this quarter. In contrast, capital market has moved up strongly. A share market was up by 14.6% and H share market received a gain of 8.1%.

For our H portfolio, positive contributors in first quarter were information technology, power equipment, railway and defense stocks. The fund has started to buy A share stocks during this quarter. Two A-share names, one in the appliance sector and one in the power equipment sector, have both contributed positively to the fund.

The consumer and financial holdings have lagged during this quarter. The share price of the coffee and bread chain stores continued weakness due to the change of management. We believe that the market has been over-reacting to it. The company business strategy will remain on track. The transition from pure bread shops to coffee and bread chain stores has shown sign of success. We have seen positive development in its store re-modeling putting more emphasis on end user experiences. We like its business model and maintain confidence on the company doing well in future.

China Economy Outlook and Portfolio Positioning

<u>Pro-growth reforms</u>

Chinese economic growth has been decelerating during this quarter and the downward trend should remain for forseeable future. Since the liabilities at country level are increasing much faster than the return on the country's assets, the economic policies will be established to reverse this unfavorable situation. To improve productivity through restructuring the government industrial and commercial entities and to improve quality of life via more investment, will both help Chinese economy stay on normalized growth track.

Pro-market driven capapital allocation

In the past years, the fixed asset investment led economy has resulted financial resources mis-allocation, as well as mis-match between assets and liabilities duration. The current administration is in favor of market-driven financial assets allocation. And the govenment believes that the stock market system will be more efficient than the banking system to channel financial resources. Thus we have already witnessed the liquidity has been largely directed into the stock market.

Risk free rate normalization

Minister of Finance announced that the scale of local government debt swap from LGFV could well exceed RMB 1 trillion. The State Council announced that the Deposit Insurance Scheme will be officially launched on 1 May 2015. The combination of these two policies is the prerequisite to break the rigid payment. They will facilitate the interest rate liberalization and lower the risk free rate in China, and will subsequently reduce the capital mis-allocation problem.

Asset quality concern on banks is alleviated and the well managed banks with strong franchises will become long term winners.

International strategy

Currently strong RMB does not help strong GDP growth but is good for abundant capacity consolidation and stable inflation. 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" and Asian Infrastructure Investment Bank (AIIB) both make sense in this regard. AIIB has attracted 51 applicants to become founding members by the closing day on March 31, indicating the increasing acceptance of Chinese economic power by the rest of world and paving the way for China to achieve its international strategy.

Property loosening

China's mortgage policies were loosened to lower the down payment ratio for second home from 60% to 40%. The movement could largely improve the affordability in tier

1 cities. However, the real problem of over-supply in lower tier cities can not be resolved in the near term.

Cross market opportunities

After a strong run of 65.5% since Oct 2014, the valuation of China A share market is at premium to H share market. Table 1 and 2 has shown the valuation comparison among two markets by boards and by sectors.

We think high quality of H share names which are cheaper than A shares will eventually catch up with performance in the next 12 months. The sectors such as food and beverage, household appliances and power equipment in A share are still traded at discount to its visible growth. We are selectively picking the best names of long-term themes and continue to screen out mispriced stocks.

Table 1:

	PE 2014	**PB**
China A share	18.62	2.63
Shanghai mainboard	14.29	2.11
Shenzhen mainboard	28.28	3.27
Small and medium board	51.78	5.31
GEM board	84.13	8.01
China H share	10.19	1.42

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Table 2:

	A PE 2014	A PB	H PE 2014	H PB
Energy	17.56	1.67	11.89	1.03
Materials	53.08	3.09	8.84	1.22
Industrials	32.28	3.42	16.28	1.53
Consumer Discretionary	27.23	3.92	17.47	1.92
Consumer Staples	31.87	4.55	25.28	4.33
Healthcare	46.26	5.85	19.26	3.09
Finance	9.71	1.68	9.69	1.40
Information Technology	75.12	7.05	30.57	8.77
Telecom	35.81	2.35	13.71	2.38
Utility	18.32	2.81	15.93	2.26

The SH-HK Through Train has given Bin Yuan a good 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. At this moment, Hong Kong stock exchange with cheaper valuation becomes very attractive to mainland investors.

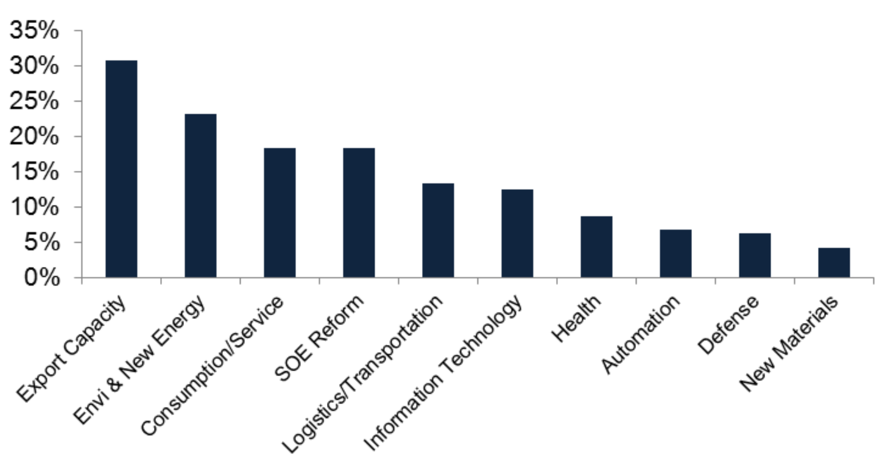
How we position in investments

Chinese economy is undergoing structural changes and the future growth will be gradually driven by efficiency improvement instead of volume expansion. We believe the higher efficiency will come from:

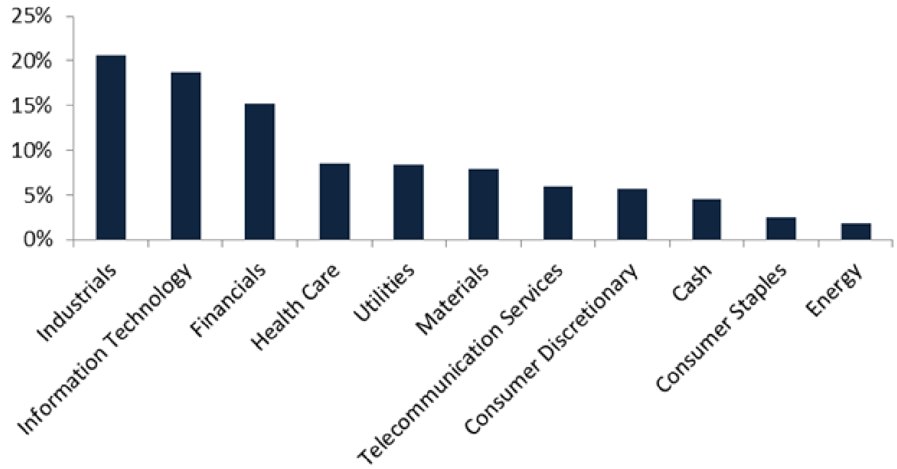
- The export of capacity
- Automation
- New materials
- Logistics
- SOE reform
- Higher quality of life in terms of healthcare and clean environment.

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.

By theme:



By sector:



Sincerely,

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