Forget The Shadows, Focus On Substance

Premium China Funds Management

Jonathan Wu
Associate Director | Head of Distribution and Operations
Disclaimer

This presentation is not financial product advice and is intended to provide information only. It does not take into account your individual objectives, financial situation or needs. You should assess whether the information is appropriate for you and consider talking to a financial adviser before making an investment decision.

The information is taken from sources which are believed to be accurate but Premium China Funds Management accepts no liability of any kind to any person who relies on the information contained in the presentation. Unless expressly stated none of the information should be taken to be a recommendation.

Premium China Funds Management is the trading name of Premium China Funds Management Pty Ltd ACN 113 856 214, Australian Financial Services Licence No 291570.

Information in this presentation is believed to be accurate as at 7th April 2014.

Macquarie Investment Management Limited ABN 66 002 867 003 AFS License 237 492 (MIML) is the issuer of units in the fund. Investors should consider the Product Disclosure Statement (PDS) relating to the Fund in deciding whether to acquire or continue to hold units in the fund. The PDS is available from www.premiumchinafunds.com.au

MIML is not an authorized deposit-taking institution for the purposes of the Banking Act (Cth) 1959. MIML’s obligations do not represent deposits with, or other liabilities Macquarie Bank Limited does not guarantee or otherwise provide assurance in respect of the obligations of MIML.
The Blind Men and the Elephant
The Media’s Impact on Sentiment
Economic Update
Case Study – Sinoforest
Compelling Case for China
The Blind Men and the Elephant

It's a fan!

It's a wall!

It's a spear!

It's a rope!

It's a snake!

It's a tree!
The Media’s Impact on Sentiment

People Jump at Shadows, Not Knowing the Risks
Is This So Bad?

GDP growth rate of 8.7%:
The global financial crisis.
Is This So Bad?

- China: +1.2 (32% of growth in 2014)
- Other Asia: +0.8
- Other Emerging Markets: +0.9
- US: +0.5
- Euro Area: +0.1
- Other Advanced Economies: +0.2
- World: +3.6

Source: KKR
### China Does Assist the World in FI


<table>
<thead>
<tr>
<th>Country</th>
<th>Investment (billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>30.50</td>
</tr>
<tr>
<td>France</td>
<td>30.47</td>
</tr>
<tr>
<td>China</td>
<td>20.78</td>
</tr>
<tr>
<td>India</td>
<td>15.11</td>
</tr>
<tr>
<td>United States</td>
<td>12.08</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>7.49</td>
</tr>
<tr>
<td>Italy</td>
<td>5.57</td>
</tr>
<tr>
<td>Switzerland</td>
<td>5.37</td>
</tr>
<tr>
<td>Canada</td>
<td>4.86</td>
</tr>
<tr>
<td>Kuwait</td>
<td>4.47</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th>Industry</th>
<th>Investment (billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil and natural gas</td>
<td>8.09</td>
</tr>
<tr>
<td>Metals &amp; minerals</td>
<td>6.67</td>
</tr>
<tr>
<td>Banking</td>
<td>5.61</td>
</tr>
<tr>
<td>Machinery</td>
<td>0.11</td>
</tr>
<tr>
<td>Other industries</td>
<td>0.28</td>
</tr>
</tbody>
</table>

Source: Freshfields Bruckhaus Deringer; Fengxiuxia / China Daily
Anyone Seen a Chart Similar to This?

Local government debt grew 36-fold in 13 years!

China local government debt

- CNY trn (RHS)
- % of GDP

Source: China National Audit Office, SG Cross Asset Research/Economics
# Debt Concerns Overplayed

## Global Domestic Debt Comparison (%GDP)

<table>
<thead>
<tr>
<th>Country</th>
<th>Corporate</th>
<th>Household</th>
<th>Public Sector</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>125</td>
<td>32</td>
<td>56*</td>
<td>213</td>
</tr>
<tr>
<td>Australia</td>
<td>99</td>
<td>101</td>
<td>27</td>
<td>227</td>
</tr>
<tr>
<td>U.S.</td>
<td>112</td>
<td>85</td>
<td>106</td>
<td>303</td>
</tr>
<tr>
<td>Korea</td>
<td>161</td>
<td>107</td>
<td>34</td>
<td>302</td>
</tr>
<tr>
<td>Italy</td>
<td>130</td>
<td>66</td>
<td>127</td>
<td>323</td>
</tr>
<tr>
<td>UK</td>
<td>116</td>
<td>101</td>
<td>90</td>
<td>307</td>
</tr>
<tr>
<td>Spain</td>
<td>185</td>
<td>76</td>
<td>84</td>
<td>355</td>
</tr>
<tr>
<td>Japan</td>
<td>158</td>
<td>77</td>
<td>235</td>
<td>470</td>
</tr>
</tbody>
</table>

* Includes local gov't debt of 33% of GDP. Source: IMF, BCA, AMP Capital
China's Scary Housing Bubble

Moody's Investors Service downgraded China's property sector to "negative" from "stable," warning that the government's measures may dampen demand.

- The New York Times, Thursday, April 14, 2011

Ordos, China: A Modern Ghost Town

The only problem: the district was originally designed to house, support and entertain 1 million people, yet hardly anyone lives there.

- Time Photos
Anyone Seen This?
Anyone Seen This?
How About This?
No Property Bubble Set to Burst

Housing bubble? No

- Household debt is at 30% of GDP
- Average deposits are around 40% of value
- 90% of new home buyers are owner occupied
- Little securitization of mortgage debt so it is not packaged and sold to investors
- Household income rose 12% per annum on average from 2006-2013, while house prices rose 9% per annum over the same period

Chart 14: China’s property affordability index

![Chart showing property affordability index](chart.png)

Source: CEIC, BoA Merrill Lynch Global Research

China Property Sector 1-year forward P/E (since 2006)

![P/E chart](chart2.png)

Source: Bloomberg, BoA Merrill Lynch Global Research estimates
Meaningful Exposures to Asia?

Dec 2003

- United States: 50%
- Europe: 21%
- Japan: 11%
- Asia ex Japan: 4%
- Greater China: 6%
- Others: 6%
- Australia: 2%

Dec 2013

- United States: 40%
- Europe: 18%
- Japan: 8%
- Asia ex Japan: 8%
- Greater China: 13%
- Others: 11%
- Australia: 2%

Source: World Federation of Exchanges, 2014 (London Stock Exchange is no longer part of the World Federation of Exchanges, adjusted accordingly)
Long-Term Outperformance

10-Year Cumulative Performance Comparison

Source: Lonsec, Data Source: Financial Express
Economic Update

Unlocking Hidden Growth
Urbanisation A Key Driver of Growth

**Productivity**
- concentration of human and physical capital increases productivity
- shifts from lower value agricultural labor to higher value skilled job

**Income**
- per capita GDP increases
- increasing gain in consumption share of GDP

**Demand**
- boosts internal demand for property, infrastructure as well as goods and services
- growing internet penetration and access to e-commerce

**Independence**
- economy becomes less reliant on exports for growth
- internal demand results in economies being less susceptible to capital flows
Era of Rapid Productivity Growth

Per cent of United States output per person

Consumption Potential to be Unlocked

Average Consumption Expenditure in 2012

Third Plenary Session: Reform “Decision”

Total of 60 policy shifts covering 15 major areas. Government has a self imposed deadline to achieve decisive results by 2020

Efficient Capital Allocation - Market role upgraded from “Basic” to “Decisive role”

• Price liberalization covers a broad set of sectors including utility, water, transportation, and communication.
• Interest rate deregulation will take an “accelerated” pace

Privatization:
• Encouragement of competition with SOEs in opening of previously protected sectors (i.e banking, healthcare)

Social reforms (Via Urbanization)
• Loosened restrictions in single-child policy
• Relaxing Hukou requirements gradually
• Rural land reform to lift low-end wealth
• Removal of re-education camps

New Political Adjustments
• Establishment of State Security Council
• Establishment of Central Reform Leading Group
• New performance assessment criteria for local governments
  • Less emphasis on growth
  • Emphasize environmental, tech innovation, local debt, social security, healthcare
• Central and local government ceding controls in economic intervention
Who Will Benefit?

- Ageing population and government focus to roll out universal healthcare
- Emphasis on environmental protection and reduction of pollution
- Financial reforms to broaden the capital markets and increase the issuance of financial products
- Deregulations to bring natural gas and oil prices closer to global levels
- Relaxation of one-child policy and rising living standards

- Healthcare
- Clean Energy
- Insurance Companies & Brokers
- Oil & Energy
- Automobile
Case Study - Sinoforest

Food for Thought
History

- Formed in 1994 as one of the premier commercial forest plantation operators in China.
- Listed on the TSE (Toronto Stock Exchange in 1995). By November 2010, the company’s market reached over $5bn USD.
- On 2\textsuperscript{nd} June 2011, share price plummeted over 80% on the back of a report by Muddy waters with allegations relating to fraudulently inflating its assets and earnings.
- It was tainted with the term “Multi-billion dollar Ponzi scheme”.
- Company now restructured after claiming for bankruptcy protection from Canadian authorities. Now called Emerald Plantation Holdings Limited, which re-issued shares to note holders of Sinoforest.
Compelling Case for China

Valuations at Historical Lows
## Chinese Valuations at Historical Lows

### Forward P/E

<table>
<thead>
<tr>
<th></th>
<th>Hang Seng China Enterprise Index (H-shares)</th>
<th>CSI 300 Index (A-shares)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current valuation</td>
<td>6.9x</td>
<td>8.3</td>
</tr>
<tr>
<td>7 year average</td>
<td>11.8x</td>
<td>17.1x</td>
</tr>
</tbody>
</table>

### 7 year H-share & A-share forward P/E

Source: Bloomberg, April 2014

---

**Note:** The table provides a comparison of current and average P/E ratios for the Hang Seng China Enterprise Index (H-shares) and the CSI 300 Index (A-shares). The graph illustrates the trend of forward P/E over a 7-year period for both indices.
Valuation Comparison Across World – P/E

Consensus 2014 Forward P/E

Source: CSI, FactSet, I/B/E/S, MSCI, Goldman Sachs Global Investment Research, Feb 2014
## What Others Think?

Projected medium term returns, %pa, pre fees & taxes

<table>
<thead>
<tr>
<th></th>
<th>Current Yield #</th>
<th>+ Growth</th>
<th>= Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>World Equities</td>
<td>4.8^</td>
<td>4.2</td>
<td>9.0</td>
</tr>
<tr>
<td><strong>Asia ex Japan Equities</strong></td>
<td><strong>3.3^</strong></td>
<td><strong>7.0</strong></td>
<td><strong>10.3</strong></td>
</tr>
<tr>
<td>Emerging Equities</td>
<td>1.5^</td>
<td>6.3</td>
<td>7.8</td>
</tr>
<tr>
<td>Australian Equities</td>
<td>4.4 (5.7*)</td>
<td>4.7</td>
<td>9.1 (10.4*)</td>
</tr>
<tr>
<td>Unlisted Commercial Property</td>
<td>6.0</td>
<td>2.5</td>
<td>8.5</td>
</tr>
<tr>
<td>Australian REITS</td>
<td>5.6</td>
<td>2.5</td>
<td>8.1</td>
</tr>
<tr>
<td>Global REITS</td>
<td>5.9^</td>
<td>2.0</td>
<td>8.0</td>
</tr>
<tr>
<td>Unlisted Infrastructure</td>
<td>6.0</td>
<td>3.8</td>
<td>9.8</td>
</tr>
<tr>
<td>Australian Government Bonds</td>
<td>3.6</td>
<td>0</td>
<td>3.6</td>
</tr>
<tr>
<td>Australian Corporate Debt</td>
<td>4.6</td>
<td>0</td>
<td>4.6</td>
</tr>
<tr>
<td>Australian Cash</td>
<td>3.2</td>
<td>0</td>
<td>3.2</td>
</tr>
<tr>
<td>Diversified Growth Mix</td>
<td></td>
<td></td>
<td>7.8</td>
</tr>
</tbody>
</table>

# Current dividend yield for shares, distributions/net rental yields for property and 5 year bond yield for bonds. ^ Includes forward points. * With franking credits added in. Source: AMP Capital March 2014
Best-In-Class Performance

The flagship product Value Partners Classic Fund (A Units) ranked No. 1 in annualized total return and annualized volatility amongst its peer group\(^1\) in the Greater China Equity sector.

Risk/ Reward Tradeoff\(^1\)
1 April 1993 to 28 February 2014

Source: Morningstar (for fund data and category average), Bloomberg (for market indices) and HSBC Institutional Trust Services (Asia) Limited as at 28 February 2014, in USD, NAV to NAV, with dividends reinvested. Performance data is net of all fees. Performance of Value Partners Classic Fund – A Units over past five years: 2014(YTD): -3.3%; 2013: +11.2%; 2012: +14.0%; 2011: -17.2%; 2010: +20.2%; 2009: +82.9%.\(^1\) Peer group includes all funds with performance history started before 1 April 1993 in the category of Greater China Equity (offshore domiciled open-end funds). All funds in the Hong Kong Equity and China Equity categories (offshore domiciled open-end funds) with performance history started before April 1993 are shown as reference only.
In Summary

- China is the growth engine to the World
- Don’t read too much into the headlines, remember the context of the information provided to you!
- China does have a Rule of Law, remember this!
- China’s consumer market has not really started, but its only a matter of time!
- Medium term outlook forecasts show that investment in China/Asia will generate the most optimum returns
- Best way to target China is via the Third Plenum reforms, don’t miss the China boat!
- If you want to invest in Asia...

THINK ASIA, THINK PREMIUM