China International
Fund Management

MARKET INSIGHTS

Voice of the Bund

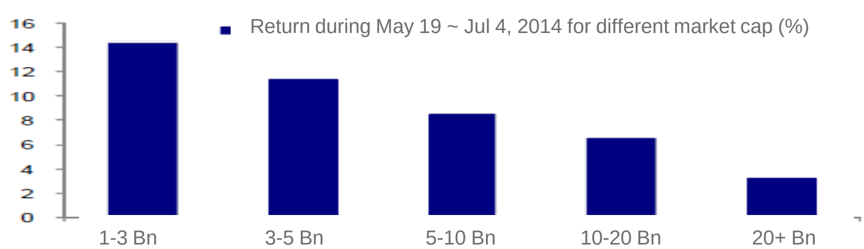
2014 – July

Exploring the best of both worlds

Market Review

- **Small-cap-rebound continued in June 2014:** A-share market continued the rebound that started on May 19, with main board indices ended almost flat, CSI 300 up by 0.4%, SSE up by 0.45%, SSE 50 (tracked 50 largest stocks) up by 0.02% and ChiNext gained 6.57%. Improved macro economic outlook due to mini-stimulus and resumption of IPOs boosted stock valuation, especially for small cap growth stocks.
- **Craze for new IPOs:** New IPO rules led to new issuers having lower offering prices compared to sector peers and higher IPO Oversubscriptions. The strong demand locked up more capital (RMB 380Bn) for the 1st batch of IPO issuers, which drove up the liquidity fluctuation for the 3rd week of June. But after the short-lived funding cost hike, market sentiment improved and all IPOs stocks surged to daily limit for consecutive weeks or longer so far.
- As there were few new funds flowing into the A-share stock market, theme rotation continued with funds continuously switching their focuses. Online education, aircraft carrier, network security, food security took turns to lead the rally. Retail, property and transportation were the worst performing sectors.
- **Bond market rallied 1H 2014:** As the property sales and prices maintained a downward trend and interbank liquidity turned out to be loose around the half-year-end, bond market continued the bull rally with credit outperforming rates, led by 1-year commercial paper.

Investors favored small cap in the current rally



Source: Wind, Haitong Securities

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Key Events Digest

■ **Economy: improving yet uncertainty remains**

•HSBC PMI rose to 50.8 in June, a 7-month high, and the first time it is above the 50 expansionary level in 6 months.

•The FAI increased by 17.2% YoY for January-May, 0.1% lower than that of January-April. The increase in Infrastructure investment basically offset the slowdown in property investment.

■ **Uncertainty from property remain:** The average new home price for 100 cities declined 0.5% MoM to￥10923 per square meter in June, a second monthly drop. Home sales fell 28% YoY in June for the 13 largest cities. And the inventory remains elevated with 15.8 months of supply, which is 5.8 months higher YoY.

Data of cement, steel, heavy trucks and excavators did not reflect improvement.

■ **More fine tuning policies to stabilize the economy**

A series of stimulus have been rolled out to counter the drag from the sluggish property market. We view them as stabilization rather than a strong boost to the economy. We expect more fine-tuning polices to come in July, which will support the rebound.

Time	Department	Policies
6/9/2014	PBoC	Targeted Reserve Required Ratio (RRR) cuts: Reduced RRR by 0.5% for agricultural banks, microfinance in order to provide credits to targeted areas such as agriculture sector focusing on farmer, rural area and small-macro business
6/11/2014	State Council	Lowest value-added tax rate of 3% were applied to water and small hydro power charges companies since July 1, 2014
6/16/2014	PBoC	Targeted RRR cuts were extended to commercial banks against loans for small and medium enterprise (SME) and agricultural businesses
6/18/2014	PBoC	Created Pledged Supplementary Lending(PSL) which aims at providing medium-term liquidity to financial institutions and improving transmission mechanism for yield curves
6/23/2014	Heilongjiang Provence Government	Carried out $300 billion RMB stimulation plan
6/30/2014	CBRC	Adjusted calculation method for loan-to-deposit ratio for commercial banks in order to boost credit to target the agricultural and SME businesses

Sector in Focus

Cell Immunotherapy: an exciting frontier

Recently, cell immunotherapy continues to evolve at an astounding pace. A steady stream of IPOs and new companies are formed to capitalize the advancement in the field and fulfill investor interests.

■ **Investor interests are growing rapidly:** new investors shift their attention to cell therapy because more cell therapy-related companies have accessed capital markets, clinical programs are more advanced and proof of concept has been established.

Unlike conventional chemotherapy and radiotherapy which use x-rays or drugs to kill cancer cells as well as normal cells, cell immunotherapy provokes immune system into attacking the tumor cells. It was No. 1 among the top 10 scientific breakthroughs in 2013 rated by Science. Many international pharmaceutical companies have completed CAR-T cell immunotherapy Phase Ⅱ clinical research.

■ **Huge potential** : In 2012, China had 3.07 million newly diagnosed cancer cases, which accounted for 21.8% of the global total.

■ **Tip of the iceberg**: Currently cell immunotherapy is still at clinical stage in China. In short-term, business model and earning potential are not clear. But as more comprehensive regulations will be imposed and companies evolve their pipeline for more rationally targeted indications, we believe the likelihood of clinical and regulatory success will increase even further.

Market Outlook

- China's structural shift in economy is at a challenging stage since traditional economic driver is fading and emerging industries are slowly taking the lead as key drivers. We are looking for opportunities in both traditional sectors which would benefit from mini-stimulus and also growth sectors that are expected to become future engines.
- The economy is stabilizing, however with the high base from last 3Q, more policies are expected to help GDP reach the state's target. Declining interest rate will benefit stocks with attractive valuation that are sensitive to interest rate. The sectors include property sector which would benefit from the relaxed purchase restrictions and speeded up mortgage lending process, insurance sector and thermal power sector which would benefit from drop in coal prices.
- Beware of downward revision pressure as the earning season is starting. Overall, market is optimistic about the earning growth in 2014, with consensus at 17.1%, higher than the 14.9% in 2013. However, it is possible to get revised downward after 1H reports. Media, environmental protection and tourism are expected to flourish while coal, liquor, retail and apparels are expected to be gloomy.
- Growth stocks face pressure from both earnings and possible funds dilution from the New Third Board's expansion. Therefore we think the height of current rebound is limited with new themes emerging. We suggest focusing on defense, electric car, financial IT and paying attention to themes like intelligent devices, new energy and economic zones.
- For the bond market, we suggest obtaining some profit currently and looking for opportunities when the market pulls back. Since the economic stabilization hold rates from going lower and the new rule for bond collateral in exchange has acted as catalyst to affect lower grade bonds.

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