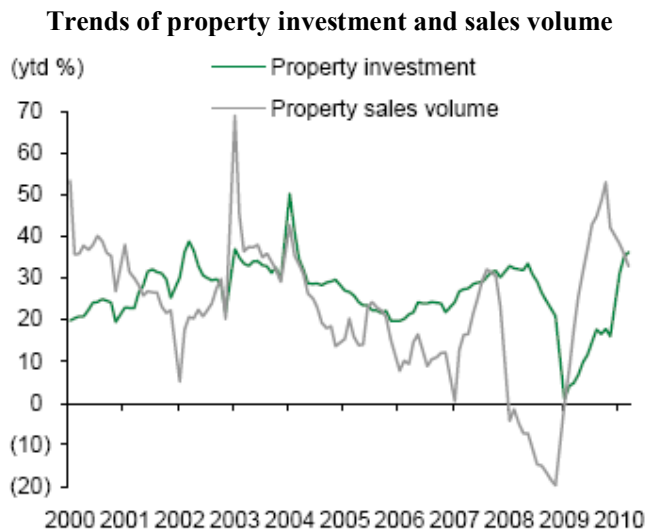


Concerns over the Chinese Property Bubble

Over the past month we have received many investors' inquiries regarding to the possible Chinese property bubble. The main concern is the effects of the central government's clampdown on property market speculation.

As we see greater policy impacts on the first tier property market (Beijing, Shanghai, Guangzhou and Shenzhen), the prices are relatively reasonable and affordable in the second and third tier (less developed inland) cities. The media, in some sense, is exaggerating the seriousness of the property overpricing problem.



Source: UN, CICC Research 2010

Due to lack of investment channels to the Chinese nationals, the property market has been, for many years, considered as an effective investment tool and value storage vehicle. We do not expect to see great surge in the property market for the following reasons:

- The mortgage loans- sales ratio is still low (47%) compared to the developed countries. Many property speculators even purchase with 100% down payments. We will not see as many forced sales due to financial stress as we observe in the western countries.
- Lack of alternative investment vehicles
- There is a strong demand in the residential market from the newly weds and new migrants to the city (urbanization).
- The demand in residential property is enhanced by raising household income.

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- Many developers still have good cash levels. New supply will gradually come on to market in 2H 2010. We might have to wait until late 3Q or 4Q to see across the board price cuts, provided the current tight control policies are still in place.
- Recent PBoC announcement on forming a more flexible RMB exchange regime will postpone or reduce the likelihood of a rate increase.

In a nutshell, we expect to see price cuts driven by tight policies and increased supply, but not sharp declines.

At Value Partners, we have foreseen the policy effects and cut back weightings of the property sector in our portfolios in the first quarter this year. Currently the Chinese property companies are all trading at large discounts, and the stock prices might correct further, presenting many value investing opportunities. We have a few developers with healthy balance sheet and land procurement capability on our watch list. We are positive towards the sector in medium to long term; however, in short term, we believe the market will further price in the policy effects.

Exacerbated by the recent spread of the Euro zone debt problems, the Beijing Government has recognized the fragility of global markets, and, hence, is likely to adopt a wait-and-see approach on further tightening measures in the short term, in order to observe the effectiveness of the existing policy and to avoid overshooting. We are now less concerned about the policy risk than we previously did, but still remain cautious over the sector for the immediate future.

Our experience with China is that it can be very painful to over-anticipate a bubble, because the investor who becomes too cautious too quickly during periods of abundant liquidity simply misses out too much on the upside. With China, it seems that for every bubble that causes a crash, three or four are anticipated but doesn't happen because of government intervention.

The Beijing government's right to rule is tied to employment and stability. Its ability to both produce and kill bubbles should not be under-estimated. Indeed, Beijing can be tougher and more conservative than many people expect; during the last economic cycle; it wasn't until July 2008 that the Chinese government officially ended its program (started in 2004) of economic tightening to fight inflation and overheating, well after the need for tightening had ceased. The government just wanted to be sure.

Value Partners applies a disciplined value investing approach that focuses on conducting our own in-depth investment research for stocks in the Asia-Pacific Region. While stock selection is the main driver of our strong investment performance, we also take into account how macro-economic events impact on the market. Through this document, we provide you with insights we have found and commentary on recent market developments.