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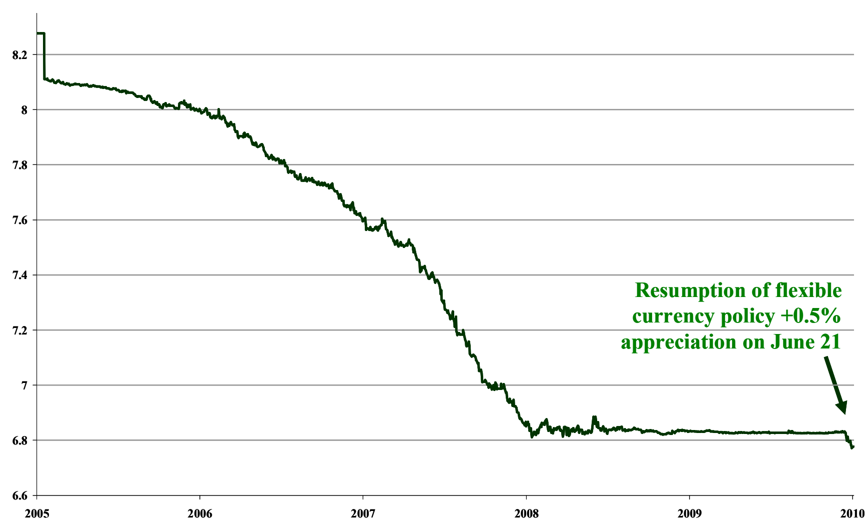
MARKET INTELLIGENCE

Recent Developments in RMB Revaluation

RMB exchange rate relaxed

On Saturday, the People's Bank of China (PBOC) announced the relaxation of the exchange rate via the reform of the RMB Exchange Regime. This marks the return of the pre-crisis RMB exchange rate regime initially set in July 2005, which was later frozen in mid-2008 due to the global financial crisis. RMB will now be reflected to link with a basket of currencies with the same currency bands (currently, it is at 0.5% per day, although the full amount has never been used).

5-year RMB/USD Rate



Source: Bloomberg, Value Partners, June 2010

Why relax the RMB exchange rate now, and what appreciation can we expect in 2010?

The Chinese authority's decision to increase flexibility in the RMB shows that they are more confident with economic recovery and will use the exchange rate as a tool to dampen inflation risks. The decision to relax the exchange rate has been widely praised by global leaders. The immediate political ramifications, however, are likely to be larger than the financial factors, given the implied slow rate of appreciation. Consensus appreciation expectations will be low, in the single-digit range in 2010.

Value Partners Limited

Email: vpl@vp.com.hk
Telephone: (852) 2880 9263
Facsimile: (852) 2564 8487
Address: 9th Floor
Nexxus Building
41 Connaught
Rd. Central
Hong Kong

www.valuepartners.com.hk

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No one-off move

PBOC denied the possibility of any one-time adjustment, specifying that the RMB is not significantly undervalued given the shrinking current account surplus and rising input costs. A certain degree of control of the exchange rate will remain, to avoid excessive fluctuations that would potentially damage China's economy. Volatility of the RMB exchange rate is expected to increase, the trading band is expected to be widened, and the RMB will appreciate gradually. This stance is in line with our expectations.

Implications for relaxation & impact on markets

Over the longer term, this reform will be healthy for maintaining stable growth in the Chinese economy.

It is positive for:

- The overall China market. With positive sentiment for RMB related investments, this may provide more of a sentiment boost to the H-share market than the A-share market.
- Importers. As direct benefactors, companies that require raw materials from overseas, such as steel mills, equipment builders, paper or airlines, will benefit from lower import costs.
- Firms with significant foreign currency denominated costs/liabilities and RMB denominated income/assets.
- Indirectly, finance sectors such as property and banks will benefit, as local wealth increases and foreign investors use these companies as RMB asset plays.

Negative for:

- Primarily the exporters, OEM production and manufacturing.

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.