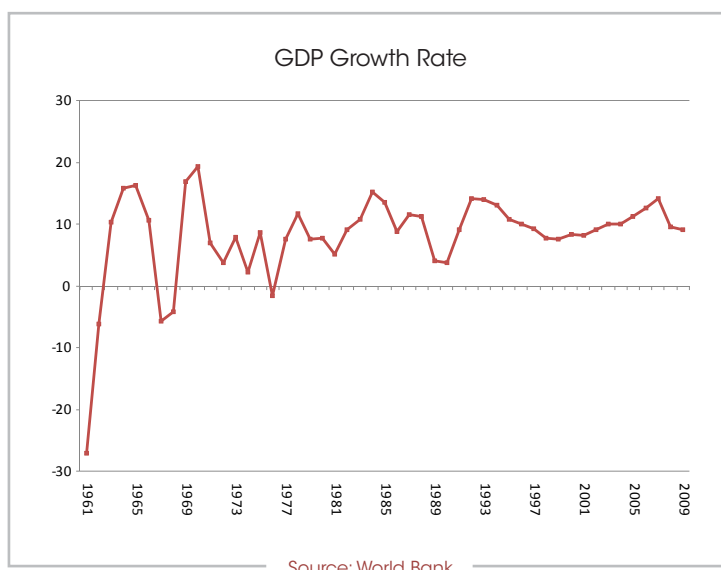


THE rapid rise of China ranks among the greatest economic success stories in history. In just a few short decades, the once underdeveloped and struggling People's Republic has transformed itself into an economic powerhouse. In 2010, the country surpassed Japan to become the second-largest economy in the world. **China is now in the midst of "Shengshi" (盛世), or an age of prosperity.** Double-digit growth rates and increasing stability have made the country a magnet for investment. But investors also have concerns. China's export-led economy appears vulnerable to stresses and slowdowns among its key trading partners. Competition for natural resources could hinder investments in infrastructure, another driver of growth. From those perspectives, some investors look at China and see risks.

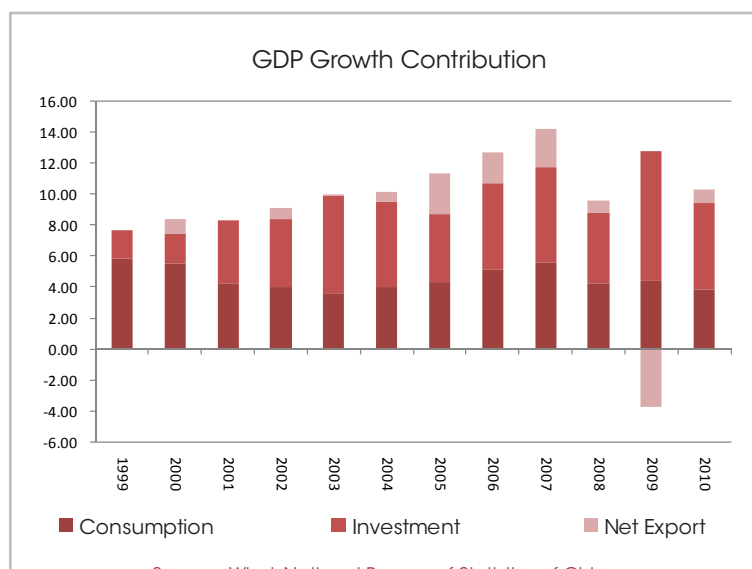
China's economic planners are well aware of those risks. In response, they have embarked upon a phase of significant economic restructuring. **Growth is gradually shifting away from reliance on exports and investment, and towards the growing spending power of Chinese consumers.** Opportunities abound for investors savvy enough to recognize the changes that are taking place. ChinaAMC has identified three key topics of increasing interest to observers of China's economic evolution – consumption, urbanization and strategic emerging industries – as well as the most promising medium- and long-term investment themes based on our detailed research into this changing and dynamic economic environment.

China in Transformation: Opportunities for Investors



CONSUMPTION

During the past decade, China's GDP growth was increasingly dependent on exports and investment. The 2008 global financial crisis, however, hit China's exports hard, as demand dried up in many of China's important markets. Consequently, China's growth slowed substantially in 2009. The events of recent years reinforced an increasing awareness among policymakers that over-dependence on exports was a potentially risky strategy, exposing the country to the impacts of economic problems occurring beyond its own borders. Realizing that an export-led model is not sustainable in the long run, **the Chinese government has been focusing on restructuring the economy to create a more balanced paradigm.** The lopsided nature of China's growth was illustrated by its ratio of, private consumption to GDP: at 36% China not only lagged behind developed countries such as the United States (71%) and the United Kingdom (65%), but also its emerging Asian peers, such as India (58%)¹. On the other hand, China's low consumption to GDP ratio implies that there is great potential for growth in this area of the economy.



Rising disposable income is one of the most important drivers of consumption. Government plans to raise the minimum wages of workers and the threshold for individual income tax should stimulate and support consumer spending. **Government policies** – including promoting the service sector, accelerating urbanization, encouraging private investment and income distribution reform – **will also stimulate consumption.** It is expected that China's consumers will account for about 12% of total world consumption by 2020².

◆ Industry Opportunities as a result of Growing Consumption

Growth in consumption will have a barbell shape. The potential for growth among industries catering to low-income consumers remains huge as those consumers are benefiting from policies supporting higher incomes as well as acquiring basic consumer goods. On the higher end, luxury cars, watches, handbags and other luxury goods are generating extraordinary growth rates as the emerging class of super rich enjoy the rewards of their labors and investments.

Retailers have strong growth potential. The grocery retail market is the largest retail segment in China. Modern grocery retail sales grew at a CAGR of 8.9% between 2005 and 2010. In fact, **modern retail was only 15% of all grocery retail in 2000, but has grown to 60% of the market in 2010.** However, the sector remains fragmented, suggesting huge potential for consolidation opportunities. **Internet retail is expected to become a more significant channel,** though it is still a small portion of retail distribution in China now. Supported by increasing internet penetration, internet retailing demonstrated a CAGR of 37% between 2005 and 2010 and is expected to grow at a CAGR of 23% from 2010 to 2015³.

Chinese people are embracing luxury brands. **Louis Vuitton, Rolex, Lamborghini, De Beers and Vertu are brands sought after by consumers with means.** Increasing wealth among the middle- and high-income classes have stimulated demand for elite brands. During the past few years, the growth rate in sales of luxury goods in China has been the highest in the world. The Chinese Academy of Social Science estimated that **sales of luxury goods in 2010 totaled RMB 68.4 billion (USD 10.4 billion⁴),** and expects that it will become the world's largest in total value by 2015.

Education is another booming industry in China. There is an ancient Chinese saying that, "The worth of other pursuits is small, the study of books excels them all". The Chinese have valued education as a means of improving one's status in life since the Sui dynasty in 605 A.D. Nowadays, the competition to study at the top universities is so intense that **the chances of being admitted to one of the country's top 100 universities, such as Tsinghua and Beijing, are only at about 5% in China compared with 28% in the United States⁵.** Since the Chinese education system is examination-focused, parents won't hesitate to spend more on their children's private tutoring, especially under the one-child policy, in hopes of gaining admission to a top university, thereby improving the family's future prospects.

¹ Source: Haver, CEIC and Citi

² Source: Morgan Stanley

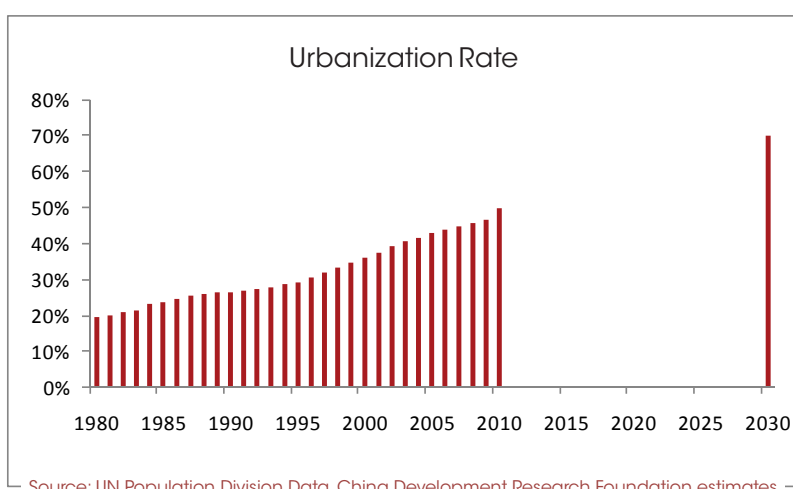
³ Source: Euromonitor

⁴ Based on USD/CNY exchange rate from Bloomberg as of 31st December, 2010

⁵ Source: iResearch, www.usnews.com

URBANIZATION

Urbanization is another phenomenon widely regarded as a key engine of China's mid- and long-term growth. **In 2010, China's urbanization rate was around 47%⁶, which not only lagged way behind developed economies such as the United States and Japan, but also emerging Asian countries such as The Philippines and Indonesia.** The urbanization rate in China has been growing at around 1% each year since 1980 and the trend is pointing to 70% of the population living in urban areas by 2030⁷. The 1% annual increase represents a stream of 13 million people flowing from rural areas to urban cities every year. That is equivalent to one-fifth the population of the UK. As a result, an urgent need for the expansion of cities is emerging. The growth in infrastructure and services needed to meet this expansion will be a strong stimulus for economic growth.



Urbanization rates are escalating in western and central China as industries expand to those regions. Regional disparity is large in China: the urbanization ratios in coastal areas are close to 60%, but only 30%-45% in inner provinces⁸. While the east is trying to restructure its economy towards more service-oriented industries, the central and the western regions are still undergoing intensive industrialization. This trend is mainly the result of rising labor costs in eastern China that have prompted manufacturers to move their plants to the western and central regions.

In order to increase urbanization and make use of greater labor productivity from rural Chinese, the government is experimenting with land reform and household registration system reform. **The former aims to clarify land ownership and secure peasants' land entitlements in rural areas, while the later is intended to ease constraints on rural dwellers migrating to the cities.** Both reforms, if successful, will facilitate labor flow and accelerate urbanization.

◆ Industry Opportunities as a result of Urbanization

Urban citizens generally earn higher incomes and consume higher-quality, more expensive goods. At the same time, urbanization triggers substantial needs for transportation, schools, commercial real estate and social housing. Industries such as real estate, construction materials, and mechanical equipment are likely to benefit from urbanization, as are industries that cater to consumers.

Industries related to social housing are promising too. China's government has set some ambitious targets for construction of social housing, often called public housing in the West. Ten million social housing units worth RMB 1.3 trillion (USD 196.8 billion) are expected to begin construction in 2011⁹. This will benefit the building and construction materials industries, such as cement and steel.

Machinery is another industry worth attention. During the past five years, China recorded a 26.1% annual growth rate in its total fixed asset investment with RMB 27.8 trillion (USD 4.2 trillion¹⁰) in 2010¹¹. Given the existing projects in commuter rail lines, social housing, highway and other construction, fixed asset investment growth will remain strong. Consequently, the recent high growth rates in the machinery sector will continue for the foreseeable future.

⁶ Source: UN Population Division Data

⁷ Source: China Development Research Foundation estimates

⁸ Source: CEIC, Deutsche Bank

⁹ Source: Ministry of Housing and Urban-Rural Development of the People's Republic of China

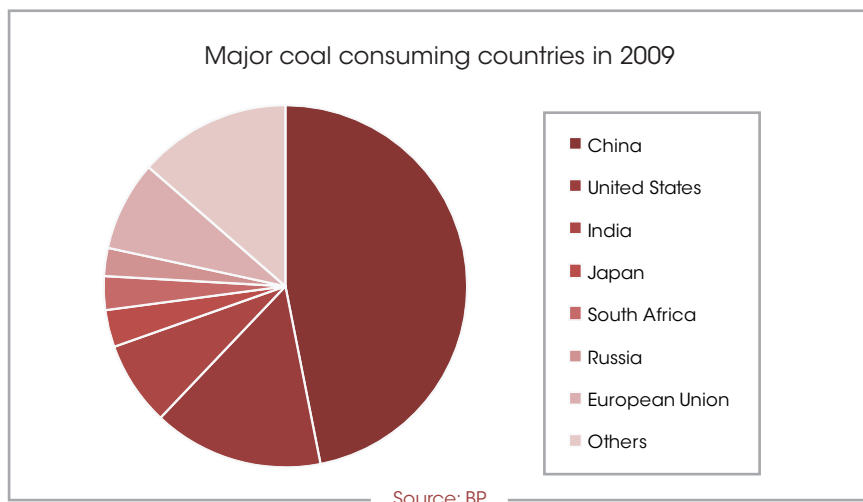
¹⁰ Based on USD/CNY exchange rate from Bloomberg as of 31st December, 2010

¹¹ Source: National Bureau of Statistics of China

STRATEGIC EMERGING INDUSTRIES

Premier Wen Jiabao (溫家寶) once declared that China's economy was "unsteady, unbalanced, uncoordinated and unsustainable." Problems associated with China's growth include severe pollution, huge energy consumption and low technology. All pose threats to continued economic expansion. To tackle the problems, in 2010 the State Council designated seven strategic emerging industries (SEIs) as the next priorities for economic development. **The seven SEIs are: 1) Energy Saving and Environmental Protection; 2) New Generation of Information Technology; 3) Biotechnology; 4) High-end Equipment Manufacturing; 5) New Energy; 6) New Materials; and 7) New Energy Vehicles.** These SEIs will help China move up the value chain and develop its own expertise in advanced and emerging technologies. By promoting these SEIs, China is working to transform itself from an exporter of labor-intensive, low-end products to a supplier of high value-added products.

In addition, these SEIs will no doubt be treated favorably by government policies and incentives, such as subsidies, tax concessions, government infrastructure construction, easy financing and technology support. As a whole, **the seven industries, which contribute less than 5% to GDP now, are projected to contribute 8% to GDP by 2015 and 15% by 2020¹².**



◆ Industry Opportunities in SEIs

Aviation manufacturing is a key development area. China's ambition is to compete with Boeing and Airbus in aircraft manufacturing. Investments in its project to produce commercial jetliners are expected to be as much as RMB 30 billion (USD 4.5 billion¹³) each for R&D and manufacturing during the next three to five years. Total investment in the project could be as high as RMB 200 billion¹⁴ (USD 30.3 billion¹⁵). On the demand side, Boeing has estimated that China will need 4,330 new airplanes valued at USD 480 billion over the next 20 years to service its own aviation needs.

New energy is another hot industry. China has become the world's largest coal consumer with a 47% share of total world consumption in 2009 (triple that of the United States)¹⁶. **Non-fuel energy makes up only 8% of overall consumption, but is targeted to reach 15% by 2015 according to the National Development and Reform Commission (NDRC).** China is desperate to reverse the serious degrading of its environment. In response, emphasis is being placed on developing a new generation of solar energy, nuclear energy and smart grid technology.

LOOKING AHEAD

China has reached a critical moment when economic restructuring is inevitable in order to sustain growth, solve problems and enhance social stability. Together, rising consumption, ongoing urbanization and strategic emerging industries are serving as strong drivers for the country's economic growth. ChinaAMC believes they are essential to the success of economic restructuring. In the medium and long term, we believe these themes will serve as incubators for some of the top performing companies as well as new opportunities for global investors.

¹² Source: National Development and Reform Commission

¹³ Source: Bloomberg; based on USD/CNY exchange rate as of 31st December, 2010

¹⁴ Source: Chairman of Commercial Aircraft Corporation of China, Zhang Qingwei

¹⁵ Based on USD/CNY exchange rate from Bloomberg as of 31st December, 2010

¹⁶ Source: BP

Important Information:

This presentation is prepared by China Asset Management (Hong Kong) Limited ("CAMHK"). This presentation is intended only for the general information of the clients and prospects of CAMHK. This material does not constitute a distribution or an offer to invest in any securities, nor does it constitute any investment advice or recommendation to acquire or dispose of any securities or enter into any transactions. This material has not taken into account your investment strategy, financial condition or your particular circumstances. No representation or warranty is made as to the efficacy of any particular strategy or the actual returns that may be achieved. Before acting on any information contained in this material, you should consider whether any investment, securities or strategy is suitable for your particular circumstance and, if necessary, seek independent professional advice.

Investment involves risks. Past performance is not indicative to future results, future return is not guaranteed, and a loss of your original capital may occur. The information in this material reflects prevailing market condition and our judgment as of this date, which are subject to change. In preparing this material, we have relied upon and assumed without independent verification, the reliability of all information available from public sources, but we do not represent that it is complete or accurate. CAMHK, its affiliates, directors, officers or employees accept no liability for any error or omission relating to any information contained in this material; and will not be liable for any damages or costs arising out of or in any way connected with the use of the information contained herein.

This material is produced by CAMHK; none of the information in this material can be reproduced or published without the consent of CAMHK.