

China: Economy grows, monetary policy struggles




Microscope

China's stock-index futures started trading on last Friday, allowing investors to hedge risks from potential asset bubbles and make equities cheaper in the long-term. These products provide more options for investors and ease fluctuations after the Shanghai Composite Index slumped the most among major global markets this year following an 80% rally in 2009. Certainly, it will help tame asset bubbles over time. It will also bring down the long-term PE average and hedge downside risks. The Shanghai Composite Index trades at a historical price-to-earnings ratio of 35.7 times, compared with the current valuation of 28 times, according to Bloomberg. Comparatively, the HSCE Index, which comprises mainland companies trading in HK, trades at 17.9 times earnings. On the positive side, trading volumes for China's A shares should increase with the introduction of stock index futures. China has the world's third largest market by capitalization, briefly overtaking Japan in July 2009. The US is the biggest by capitalization. China's increased trading in equities from index futures will help the nation challenge the US as the world's busiest stock market. 

China's growth jumped in the first quarter, while the inflation was still benign. The economy grew 11.9% from a year earlier, the biggest gain since the second quarter of 2007, according to the statistics bureau. Consumer prices rose less than economists expected, climbing 2.4% in March. Two figures are complicating decisions on when and how to further tighten monetary policy. In detail, industrial production climbed 18.1% in March and retail sales increased 18%. Specifically, car sales leapt 76% in the first quarter from a year earlier, with Mercedes-Benz (China) Ltd. reporting a doubling. Urban fixed-asset investment increased 26.4% in the first quarter from a year earlier. Producer prices rose 5.9% in March. A separate report last week showed that property prices jumped a record 11.7% in March. Economists are split on the likely timing of the nation's first rate increase since 2007, although the central

bank in China has taken measures to withdraw market liquidity. To be certain, tightening measures will continue to include loan curbs, reserve requirements for banks and industry-specific measures to cool asset prices. Sector-wise, the government last week announced further measures to cool the real-estate market, underscoring concern that asset bubbles may be forming after a record increase in values in March. After the GDP announcement, the government announced requirements for bigger home down payments and said it will study extra taxes, including on individuals' profits from property sales. The Shanghai index has fallen 3.4% in 2010, making it the worst performer in Asia, on concern the government will tighten monetary policy to slow record lending growth and soaring property prices. The government has twice

this year required banks to set aside a larger proportion of deposits as reserves this year. China's data reinforced that Asia's recovery was strengthening. Singapore's economy expanded in the first quarter at the fastest pace since at least 1975, with 32.1% yoy growth from the previous quarter. Instead of raising rates like Australia and India, China has targeted a 22% reduction in new loans from a record of \$1.4 trillion last year and twice asked lenders to set aside more cash as reserves, according to Bloomberg. The last time China's growth accelerated to more than 11%, in the first quarter of 2006, the central bank raised rates within a month. China's cabinet signaled caution last week in ending crisis policies, saying first-quarter economic growth was largely driven by stimulus policies and a comparison with low levels in 2009. 

MARKET BRIEFING


YTD % (local curr)

US DJ	11,018 (5.7%)
Nasdaq	2,481 (9.3%)
Euro Stoxx 50	2,949 (-0.6%)
HSI	21,865 (0.0%)
Japan NK225	11,102 (5.3%)
China Shanghai Composite	3,130 (-4.5%)
Singapore	3,007 (3.8%)
India BSE30	17,591 (0.7%)
Brazil BOVESPA	69,421 (1.2%)
Aus All Ord	5,007 (2.6%)
US-10yr Bond	Yield 3.76%

As at 16/04/10


Insight: "Sector Analysis"

Investors usually search for appropriate analysis to find out valuable stocks. Sector analysis may be one of analytical methods to do this. Just as an individual stock tends to rise and fall with the market as a whole, a company's stock will also tend to rise and fall with its sector. Consequently, the performance of an individual stock may depend on the performance of the company's sector. Sectors are groups of companies that perform similar functions within the economy. Sector analysis involves dividing the overall market into sectors and then studying the performance of each sector individually, so that sectors can

be compared to each other or to the market as a whole. A typical sector list may include consumer staples, consumer services, energy, financials, health care, industrials, technology, transportation, real estates and utilities. Some sectors are more volatile than others, reacting more strongly to changes in the overall economy. For example, the technology sector tends to do well when the overall market is rising, and poorly when the overall market is falling. Consumer staples, on the other hand, are more stable, neither rising as much as technology during strong markets, nor falling as much during weak markets. Investors can use sector analysis in three ways: to guide diversification, to find sectors with above-average performance, and to time the market. For the last one, investors can capture the investment cycle. 

Financial "In & Out"

IN: Global equities market would benefit from the improving risk appetite and the asset reallocation by institutional investors and pension due to yield's erosion from safe assets.

OUT: On the other hand, bond assets will face capital outflow amid the optimism that the economy is still recovering while the inflationary pressure is growing. 



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