

China has made remarkable achievements in many aspects over the past 20 years, including its impressive economic growth and rapid capital market developments. The sheer size of the market, the further growth potential and its increasing prominence in the world's stage have brought China under the limelight for many investors around the world.

We share our investment team's insights on a quarterly basis to provide you with the keys to investing in China. Each issue, we include a topical piece, an interview with our investment professional plus an at-a-glance guide to investment opportunities. Enjoy your reading!

### Biography

Joseph Tang joined Invesco Great Wall as Head of Investments in September 2006. In August 2007, Joseph became Investment Director at Invesco Hong Kong, specializing in China A-shares and managing Qualified Foreign Institutional Investor (QFII) portfolios. Before joining Invesco Hong Kong, Joseph was the Greater China Equity Strategist at Credit Suisse Private Bank from December 2004 to August 2006. Prior to that he spent seven years in research on the sell-side, including being Head of Research at Sun Hung Kai Securities from September 2000 to November 2004. Joseph also had six years of experience covering the Asia ex Japan stock markets when he managed portfolios at Daiwa Investment Advisors (HK) Ltd, East Asia Hamon and subsequently BZW Investment Management (HK) Ltd. Joseph graduated with a Master of Science degree in Finance from the University of Lancaster, UK.



Joseph Tang,  
Investment Director

## Meet Our Investment Professional

### Q1. With the required reserve ratio (RRR) cut in late November 2011, should we expect an interest rate cut anytime soon? How will this affect investment sentiment?

We believe the Chinese government will continue to remain flexible to do some fine tuning and selective easing as needed. With the unexciting macro data expected for the fourth quarter of 2011 and first quarter of 2012, this will leave more buffers for the government to loosen its monetary policy, via RRR cuts and other measures. While we are convinced that government policy is on an easing trend, we believe the magnitude would not be comparable to that of the global financial crisis in 2008. Looking

ahead, we expect the Chinese equity markets to remain volatile. In addition to the uncertain outlook in the developed world, we saw a line-up of initial public offerings and fundraising activities which absorbed some liquidity and capped market uptrend. We believe the consensus market sentiment is too bearish. The first half of 2012 will continue to be volatile, but the Chinese equity market is unlikely to deliver further disappointment due to muted expectation, while the second half will be predominantly dictated by external conditions.

### Q2. Consumer price index (CPI) inflation has come off meaningfully from 5.5% in October to 4.1% in December 2011. What is your outlook for the inflation?

With the December CPI inflation rate released at a lower-than-expected level, consensus is pricing in a more subdued inflationary environment for 2012. In our view, it may be premature to expect a sharp decline from the current level in the near term, with upcoming data point likely affected by seasonality issues, including the winter season which may result in volatility in food prices, and noise from the Chinese New Year (which occurred in early February). Although the near-term CPI may be difficult to predict, the key is that we should have seen the peak in the current economic cycle, and so the CPI going forward should generally trend down. Coupled with limited excess liquidity in the system, this allows the People's Bank of China (PBoC) to adopt flexible measures to procure growth if needed.

### Q3. Despite compelling valuation, domestic A-shares have significantly underperformed the offshore H-shares. Why is this the case?

In general, domestic A-shares tend to overshoot on both upside (for example in 2007) and downside, as market participants are dominated by retail investors. Compared to offshore H-shares, with their pool of sophisticated, international investors, domestic participants pay less attention to valuation metrics. While the RRR cut is undoubtedly a positive signal that the central bank is fine tuning its policies, overall sentiment in the domestic market remained mixed as recent economic data continued to suggest decelerating growth in the Chinese economy. Official statements on the economic outlook have grown increasingly cautious recently. The market view is that whether or not the Chinese government can orchestrate a soft-landing scenario would depend on the speed and magnitude of the fine-tuning measures to be introduced. Moreover, there are negative headlines specific to the domestic A-shares market, such as the recent consultation on the international board. In our view, the impact of the launch of the international board on domestic liquidity would be limited, judging from the prevailing lack of interest in Qualified Domestic Institutional Investor products.

### Investment implication

As global emission standards and wastage rules are tightened, production costs will inevitably increase for Chinese manufacturers, forcing them to transition from low-margin original equipment manufacturers to higher value-added industries. The FYP projects that service sectors will account for 47% of the gross domestic product by 2015.

The need for transformation will speed up consolidation in the industry, cannibalizing overcapacity and highly polluting sectors. Upgrading to higher value-added industries and services will have a positive ripple effect by generating higher income jobs, in line with the planned income distribution reform targets of 7% real income growth (versus 5% in the 11th FYP) and thereby promote domestic consumption.

As with every reform and strategic initiative, we are aware that the transition is not going to happen overnight. Nevertheless, recent policies outline important milestones for the medium term which will serve as guidance for provincial and municipal governments. Not only will the environmental protection plan bring China closer to international standards, it will also promote economic activity in various segments of environmental protection and encourage the transition from primary industries to value-added sectors. As investment managers, we believe it is critical to develop a thorough understanding of China's new environmental policies in order to identify any underlying investment opportunities that may arise.

## Building an Environmentally Friendly China

China has long been criticized for being too relaxed with regard to its stance on environmental preservation and resource/energy wastage vis-a-vis its phenomenal export-led economic growth. In the 12th Five Year Plan (FYP), environmental protection has been identified as one of the strategic emerging industries, and various levels of government are now paying greater attention to the issue. The National Environmental Protection Conference, held every five years, took place in November 2011 and introduced the key details of the 12th FYP Environmental Protection Plan. In late December 2011, the State Council officially issued the National Environmental Protection Plan, which requires compliance from all levels of government, as well as ministries, commissions and all departments under the State Council.

Statistically, China's investment in environmental protection lags that of the major developed economies. Expressed in sales or output of the environmental protection sector as a percentage of gross domestic product (GDP), China trails with 2.6% (in 2007), compared to 10.6% to 15.1% of Japan (in 2010), and mirrors the 2003 level of 2.7% of the US<sup>1</sup>. The statistic is even more disproportionate if expressed versus GDP growth, given the robust pace of growth in China. With the environment now taking a more prominent position in government policy, there is vast potential for related sectors to expand and narrow the gap with China's peers in the developed economies.

Many of the 12th FYP environmental projects and initiatives have been set out with the objective to improve the Chinese people's livelihoods. The latest FYP highlights the urgent need to control air pollution, improve water quality and enhance soil protection. Reduction of pollutant emissions is identified as a top priority, with China devoting itself to reduce carbon dioxide and nitrogen emissions. Emphasis will be placed on regulating thermal power generators and the use of coal-fired plants, with 'Atmospheric Pollutants Emission Standards' to be rolled out in 2012.

Water infrastructure is another highlighted area. Data reveals that portions of the population and of livestock suffered from temporary water scarcity during periods of severe droughts in 2011. The shortage is exacerbated by the disparity between population and available resources, in that China accounts for about 20% of the world's population but possesses only 6.5% of the world's water resources<sup>2</sup>. This underpins the rationale to spend a total of RMB 4 trillion (about US\$630 billion) in water infrastructure over the next 10 years, doubling the 2010 level.

Finally, being some of the world's most populated areas, Chinese cities generate one-third of the total waste produced in the world. Currently, only 40% of Chinese cities have adopted a waste treatment fee charge mechanism. The industry is still in its infancy, but it should enjoy robust growth as policies are unified over time. A number of key beneficiaries can be identified along the supply chain from this structural change. Obvious candidates include equipment and service providers. Within water infrastructure, opportunities arise from facilities needed to develop and manage water resources, including delivery, treatment, supply and distribution. Waste treatment operations are already open for commercialization and foreign investment.

<sup>1</sup> Shenyin & Wanguo Securities - 'Opportunities from tariff reform in the power sector and standardization in the environmental protection sector', 5 December 2011.

<sup>2</sup> Nomura Equity Research - Asia Water and Environment, 14 December 2011.

## Doorway to China's Growth

Local know-how is critical to understanding the market place and the companies in China. With the strong backing from our China joint venture investment operation, Invesco's Hong Kong-based investment team is in a very good position to capitalize on the growth potential that this market has to offer. Immediate opportunities for you include the following:

### Invesco PRC Equity Fund<sup>1</sup>

- Objective:** The fund aims to achieve long-term capital growth by investing in transferable securities of companies with substantial exposure to Mainland China.
- Universe:** Hong Kong-listed H-shares, red chips and China plays, plus Shanghai and Shenzhen-listed A- and B-shares.
- Fund Managers:** Samantha Ho (since November 2004) and Joseph Tang (since July 2007)

### Invesco Greater China Equity Fund<sup>1</sup>

- Objective:** The fund aims to achieve long-term capital growth by investing in securities of the Greater China markets.
- Universe:** Hong Kong stocks, Hong Kong-listed H-shares, red chips and China plays, Shanghai and Shenzhen-listed A- and B-shares, and Taiwanese equities.
- Fund Manager:** Mike Shiao (since December 2006) and Lorraine Kuo (since November 2011)

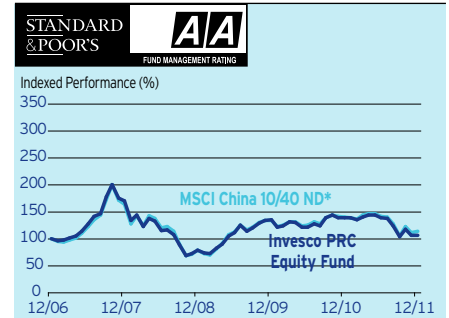
### Invesco China Opportunity Fund<sup>2</sup> & Invesco China Opportunity Fund II<sup>3</sup>

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|----------------------|---|--|
|                      | <b>Invesco China Opportunity Fund</b>   | <b>Invesco China Opportunity Fund II</b>   |
| <b>Objective:</b>    | The fund aims to achieve mid-to long-term capital growth by investing the assets predominantly in Renminbi securities issued by domestic Chinese corporations and other Chinese securities. | The fund seeks to achieve long-term capital growth by primarily investing in Renminbi securities issued by domestic Chinese corporations and other Chinese securities. |
| <b>Universe:</b>     | Shanghai and Shenzhen-listed A-shares   |  |
| <b>Fund Manager:</b> | Joseph Tang (since November 2007)   |  |

#### Fund Information at a Glance

	Invesco PRC Equity Fund <sup>1</sup>	Invesco Greater China Equity Fund <sup>1</sup>	Invesco China Opportunity Fund <sup>2</sup>	Invesco China Opportunity Fund II <sup>3</sup>
Launch Date	October 1995	July 1992	June 2005	February 2007
Fund Size	US\$1.37 bn	US\$596.54 m	US\$22.19 m	US\$32.27 m
Fund Based Currency	US dollar	US dollar	US dollar	US dollar
Reference Index	MSCI China 10/40 ND*	MSCI Golden Dragon ND*	FTSE China A-200	FTSE China A-200
Annual Management Fee	A: 2.00% C: 1.50%	A: 1.50% C: 1.00%	A: 1.5%	A: 1.25%
Minimum Investment	A: US\$1,500 C: US\$250,000	A: US\$1,500 C: US\$250,000	A: US\$100,000	A: US\$500,000
Bloomberg Code	A: INVPRDA ID C: INVPRDB ID	A: INVPGCI LX C: INVPGCC LX	INVCHNO KY	INVCHO2 KY

Source: Invesco, as at 30 December 2011.



**Invesco PRC Equity Fund returns 6.1% over five years.**

Source: © 2012 Morningstar, A share (Distribution), NAV to NAV, in USD with dividend re-invested, as at 30 December 2011. Calendar year performance: 2007: 70.2%; 2008: -53.9%; 2009: 72.7%; 2010: 3.1%; 2011 (as at 30 December 2011): -24.0%.



**Invesco Greater China Equity Fund returns 22.5% over five years.**

Source: © 2012 Morningstar, A share, NAV to NAV, in USD with dividend re-invested, as at 30 December 2011. Calendar year performance: 2007: 61.1%; 2008: -51.5%; 2009: 69.2%; 2010: 13.1%; 2011 (as at 30 December 2011): -18.1%.

**Invesco China Opportunity Fund was launched in June 2005, since launch return is 145.3%.**

**Invesco China Opportunity Fund II was launched in February 2007, since launch return is 2.5%.**

<sup>1</sup> The fund is registered as a restricted foreign scheme in Singapore and will be distributed only to the accredited investors and certain other persons in Singapore.

<sup>2</sup> The fund is not authorized by the Securities and Futures Commission in Hong Kong and therefore not available for sale to the public in Hong Kong. The fund has not been authorized or registered with the Monetary Authority of Singapore and therefore not available for sale to the public in Singapore.

<sup>3</sup> The fund is not authorized by the Securities and Futures Commission in Hong Kong and therefore not available for sale to the public in Hong Kong.

\* Effective 1 January 2009, the reference index of the Invesco PRC Equity Fund was changed from MSCI China to MSCI China 10/40 ND.

Effective 1 April 2008, the reference index of the Invesco Greater China Equity Fund was changed from MSCI Zhong Hua to MSCI Golden Dragon ND. Performance of the current indexes applies retrospectively.

All data as at 30 December 2011, sourced from Invesco unless otherwise stated.

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