VOLUME IX No. 47 F R I D A Y March 9, 2007

The Betty Letters

My Dear Grandchild,

I think that I have told you, many times in the past, that I fancy myself to be a pretty good investor. That is to say that I can spot a good thing when I see it, unlike Bo-Bo, my husband, who, as you will recall, nearly caused the entire family fortune to be lost when he got his publicly listed company to invest in that piece of British shipping 'rubbish', some years ago. It was lucky that Bo-Bo knew people in Beijing otherwise, without their financial help, I fear that I would have had to sell my best, Versace handbags in order to assist him in his, and his company's, hour of financial need. Anyway, forgetting about the financial mess that Bo-Bo caused, many years ago, lately I have been studying the equity markets of Hongkong, Shenzhen and Shanghai. I have made earth-shattering determinations: Do not purchase any A and B Shares on these markets; but, be prepared to purchase select H shares on The Stock Exchange of Hongkong Ltd. Surprised? Well, here is my investment logic. The reason that many H shares – those shares that are traded in Hongkong – are selling at very high, price-earnings multiples is because the A shares and the B shares of the same companies, traded on the equity markets of Shenzhen and Shanghai, are being ramped up by very unsophisticated Chinese speculators and investment 'sheep', most of whom know very little about investment strategies and do not know even the simplest of fundamentals in respect of analysing a public company. (At one point, I thought that I could make some money by opening a school to teach investment logic in Shanghai, but, when I suggested this to Bo-Bo, he asked me the reason that the price of gold has not reached $HK1,000 per tael. With such a stupid statement, emanating from a man who, not that long ago, was running a major, publicly listed shipping company in Hongkong, I realised that my idea to open a school in China would drive me completely up the wall) As you are aware, the situation in my country, excluding Hongkong and Macau, of course, is that investors and speculators are permitted, freely, to invest on equity markets without any limitations, provided that it is legal. The laws, relating to investing in the Motherland, are continuing to evolve and, in the meantime, many share prices are going wild as too many people are chasing after too few shares. On Tuesday, February 27, you saw what happened when there was a massive sell-off of stocks and shares on The Shanghai Stock Exchange: It drove down the equity market's Composite Index by 8.40 percent. It was the largest single sell-off on this equity market in a decade. The shock of it reverberated around the world. Hundreds of billions of dollars were lost by Chinese investors. Some of these investors lost nearly all of their savings. Irrational exuberance by Chinese investors, locked into stocks and shares, listed on China's main equity markets, have been (or should have been) of grave concern to Beijing. A sudden collapse of the key indices of China's equity markets could well cause panic, a run on Chinese, Government-controlled banks in order for certain investors to try to put fingers in leaking financial dykes, chaos in the workplace, leading to growing distrust of the Government and, eventually, rioting. The monetary authorities in China must have been looking at the rapidly expanding asset bubble in the country for some time because of the very real prospect of it bursting.

Let's look at what touched off that big sell-off, first: Negative rumours. That is correct. It was not that which anybody of importance had said or done, or any Chinese Government department had said or done, it was just negative rumours about the possibility of

(a) A capital-gains tax on profits, derived from equity trading;

(b) A crackdown by the Authorities on illegal trading in stocks and shares;

(c) A more-regulated environment on the domestic stock markets of the country; and,

(d) Higher interest rates and/or other onerous monetary restrictions.

For the crooks and snooks of China, the last-mentioned point may well have been the most-worrying of the rumours because it would mean an end to their hanky-panky. With regard to (b), this is a very logical thing for China's Government to consider because it would be in everybody's interest to clean up any and all stock-market irregularities. As for the idea of there being a new tax on capital gains, derived from trading in stocks and shares, I cannot see that this is even a problem, actually. In Hongkong, any company which, habitually, earns money from trading in stocks and shares is quite liable to be assessed by The Commissioner of Inland Revenue of Hongkong. Higher interest rates in China? They are an absolute guarantee because the alternative, galloping inflation, would virtually kill the economy of the most-populous country of the world, whose economy is the envy of nearly every other country of the globe. So, about what was all the fuss on Tuesday, February 27? The answer: Fear. Simple, isn't it? Stock markets are driven, one way or the other, by 2 innate propensities of man: Fear and greed. On Tuesday, February 27, the key indices of The Shenzhen Stock Exchange and The Shanghai Stock Exchange suffered dramatic falls due, in large par, to fear. Nothing more than that. Now, you may well ask, at this point, as to when the sell-off of stocks and shares on domestic China markets will end. The answer to that question is when stock and share prices have fallen back to reasonable levels where yields are commensurate with market prices. But there is another factor, also: Beware of Chinese investors, being unable to fulfil financial obligations to banks and stockbrokerage houses with regard to margin requirements! Their inability to meet the call in respect of margin requirements could well spark another, large sell-off – which could well be as big as, if not bigger than, the first major sell-off. In the meantime – because I cannot give you an exact timeline, at this moment – I am going back into stocks and shares, sold on The Stock Exchange of Hongkong Ltd. The Stock Exchange of Hongkong Ltd is a much-better regulated equity market than anything that has yet been established in China. There are H shares, sold on the Main Board and The Growth Enterprise Market of The Stock Exchange of Hongkong Ltd, so that, when the price of some of these shares falls back sufficiently, I shall consider buying some of them, subject to saving some money from the household budget and without Bo-Bo, being apprised of my intentions. But I, definitely, will not be buying shares in companies, such as Shanghai Jin Jiang International Hotels (Group) Company Ltd, which, as at last week, was trading at a prospective price-earnings multiple of 65 times. That is a crazy price, especially for a China-Government-controlled hotel management company. To purchase shares in this company at anywhere near such a prospective price-earnings multiple would suggest that I am courting an unfettered appetite for risk. (The last time that this happened was when I was a nurse and agreed to marry Bo-Bo)

I have decided that, aside from H shares, there are many companies, listed on the 2 stock markets of Hongkong, which have strong fundamentals and whose futures appear to be assured, regardless of any speculative element. Certain banks, for instance, are well positioned to make very healthy gains in the years ahead. Sourcing companies, especially, should do well because, as long as the United States continues to look offshore for goods and services, the prices of which are competitive to similar goods and services, produced in the United States, sourcing companies have a captive market, all things being equal. The hospitality industry of Hongkong, however, could well be facing a difficult time over the next few years because more and more hotel rooms are being created in Macau (about 52,000 more rooms are on the drawing boards, I am told by Bo-Bo) and Chinese tourists, most of whom love a gamble, will consider Macau as an alternative to Hongkong. Manufacturers of what have become essentials in today's world, such as mobile telephones, laptop computers, handy-sized television sets, etc, should continue to see reasonable growth, but companies, offering cut-priced and/or nearly obsolete electronic accessories could be in for a very difficult time because consumer spending is likely to wane. Housing, of course, will have its ups and downs, but, over the long stretch, it has been proved that bricks and mortar are the backbone of any successful economy. Communication companies, such as television broadcasters and broadcasting-related entities, information service companies and companies, servicing such entities, are likely to see continued, and steady, growth. As for regions of the world in which to invest, I do not like the United States because there are too many (real, not perceived) negative economic factors. I maintain that Asia continues to be the place in which to invest, with Hongkong and Japan, high on my list.

One thing that I have learned, over the years, is that people, generally, have short memories for most things (especially a husband's duty to his wife), but when it comes to losing money on equity markets, people tend to have very long memories. Stick with me, My Dear Grandchild, and you will never go wrong.

Talk to you, next week.

Chief Lady

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