

## MARKET REVIEW AND OUTLOOK FOR SECOND HALF 2010

The road to economic recovery is never as smooth as one expects and this one has been no different. The two major items dominating the markets and the financial press during the first half of this year was the European sovereign bond market and the rating downgrades for Greece and Spain. This led to the sharp and dramatic fall of the EUR against the USD and other major currencies. Secondly, we saw the overheating of the Chinese economy and property market, combined with the on-going talks and pressures from the USA on China to appreciate the Renminbi (RMB). In response to these economic events, the global markets all reacted differently.

Some Stock markets started to tumble at the beginning of the year due to investor concern and uncertainty over the European debt crisis. During the period between 5 January and 18 June, the Heng Seng Index (HSI) dropped from 22,279 to 20,286 and accumulated a loss of 9%. The Chinese market had a much deeper correction during the same period with the Shanghai Composite Index (SCI) plummeting 23.4% from 3,282 to 2,513. However, not all markets were hit this hard by the European debt crisis. The Indian market was almost unaffected with the SENSEX 30 Index dropping only slightly from 17,686 to 17,570. The US market too was also almost unaffected with the Dow Jones Industrial Average (DJIA) only falling 1.1% from 10,572 to 10,450.

Although the emerging markets such as Russia and Brazil were among the worst performers during this phase of the crisis as hot money was withdrawn from these markets and sheltered in perceived safe-haven assets such as gold and US Dollars, the good news is these markets tend to rebound more quickly than other developed markets.

On the currency front, the most notable development

during the first half of 2010 was the continuous fall of EUR against the US Dollar and other major world currencies and posted a new 4 year low against the US Dollar. Because of the European debt crisis, the EUR has depreciated more than 15% against the USD trading at 1.45 at the beginning of the year to 1.24 today.

On the GBP cross the EUR also depreciated more than 8% from 1.12 at the beginning of the year to 1.2 today. Similarly the EUR had depreciated more than 12% against the AUD from 1.6 to 1.4 during the same period. The weakness of the EUR is primarily due to deep-rooted economic and sovereign debt crisis happening in most Eurozone countries.

On the other hand, Asian currencies such as the RMB are undervalued on a purchasing power basis. The sharp decline of the EUR against the USD and other major world currencies means that the RMB has also effectively appreciated against the EUR. During the same period, the RMB was pegged against the US Dollar at around 6.83, however, as a result of pressure from the US and the international community, the RMB is set to appreciate further. The only questions are *when, how and to what extent?*

With the exception of gold, most commodities went down during the first half of this year. Gold went up from USD 1,100 per ounce to USD 1,250 per ounce, a gain of 13.6%. Silver had a moderate rise, only went up 6% from USD 18 per ounce to USD 19 per ounce. Gold has acted as the safe heaven during this phase of the financial crisis. Precious metals such as gold have been the best performer among other commodities during the past 6 months. Whilst Crude oil had a sluggish performance as Oil prices fluctuated between USD 75 and USD 80 a barrel.

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## The Outlook for rest of 2010

For the next 6 to 12 months, the financial markets will most likely continue to be volatile as European leaders struggle to bring this debt crisis under control. However, the road to recovery in Asian and global emerging markets will not stop, as these economies continue to improve, so too will interest rates rise again and inflation is certainly around the corner.

Our expectation is for Hot money to flow back into the equity markets and stock prices are set to bounce back. For long term investors, this should be the perfect moment to accumulate and build up exposure to equities particularly in Asia and emerging markets. China's economy has achieved an impressive 8.5% GDP growth in 2009, and is forecast to

reach 9.5% in 2010. China will certainly continue to be one of the fastest growing economies in the next 6 to 12 months and with the RMB set to appreciate further within the next 12 months this market is not one that investors should ignore.

Gold and other precious metals still remain the perfect investment for hedging against rising interest rates and inflation and when investing for the long term, it is always wise to include 10% to 15% of gold and precious metals in a diversified portfolio.

*Investment Committee, Tyche Group Ltd*

## TYCHE FORUMS

Wednesday, 21 July 2010, 18:15 registration for 18:30 to 20:00

Podium Floor, at the Central Plaza Executive Club, Central Plaza, 18 Harbour Road

### INVESTMENT OPPORTUNITIES FOR 2010 AND BEYOND

As stated in this issue of Market Truth newsletter, the road to economic recovery is never as smooth as one expects. However, this should not be an excuse to take the "wait-and-see" attitude and hold up your investment plans. Whatever the state of the economy, the financial market is full of investment opportunities, some of which can be very attractive and profitable. Of course, all investments come with risk and we should take measures to reduce the risk as much as possible. The issues for the investor are how to identify profitable investment opportunities and reduce the risk.

In our July Seminar, we will review what actually happened in the global market during the first half of this year. We will also show you where the profitable investment opportunities are and how you can reduce the downside risk. We will not just make an economic forecast but also provide you practical advice based on sound rationale. Both first time and experienced investors should benefit from the seminar.

Please join us at our July Seminar presented in English by Julian Galvin (Associate Director) and Martin Hennecke (Associate Director), for a review of the global markets and investment opportunities in the second half of 2010. As always, we aim to make our seminars as interactive as possible, and questions from the audience are most welcome.

**Our seminars are often oversubscribed, so please register early for you and your friends to avoid disappointment. Please register in any of the following ways: phone (852) 2525 3639; fax (852) 2525 3679; or e-mail [forum@tyche-group.com](mailto:forum@tyche-group.com)**

Please register me for your seminar on (please tick):

Name(s) (please print) .....

Phone ..... e-mail .....

### About TYCHE Group

- Tyche Group is a premier independent financial advisory firm based in Hong Kong. Its principles and practices can be defined as the process of providing advice and assistance to clients for the purposes of achieving financial goals.
- Tyche Group specializes in holistic financial planning and investment advice. We offer a one-hour meeting with an SFC-registered adviser to your overall requirements and objectives, at no cost to you and with no obligation to proceed further. To arrange a meeting, register online or call or fax us. We will contact you.

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## Investment Overview

### The End of the 'Cheap Labour' Era?

Since the provisions of the labour contract law were implemented in Jan 2008, (which strengthened the protection of workers' rights and benefits) mainland enterprises are now facing new challenges. Foxconn Technology and Honda Motor in Guangzhou have raised workers salaries to nearly 122% and 34% respectively. The wage hike trend has now spread from the Pearl River Delta to the Yangtze River Delta areas. Investors worry whether the trend will slow down the economic growth in China, or it will help to promote domestic consumption?

After the Chinese reformation, a huge supply of cheap labour became available and China became the "world factory". However, the cheap labour model has now come to an end and China has paid a price for its rapid economic growth.

The Mainland's recent 'labour-movement' incidents are the by-products of the uneven economic development and social changes that have taken place over the years. Although domestic incomes have increased, the rate at which they are increasing is much lower than the average annual GDP growth rate this has led to a decrease in the income ratio in relation to GDP.

According to the National Bureau of Statistics, labour income as a percentage of GDP in 1996 was 53.4%, by 2009 this had significantly reduced to 37.7%. This has not only limited the growth in domestic consumption but also led to a huge financial gap between the rich and the poor.

As a result of the one child policy, the new generation tend to be more independent, and have higher expectations with regard to wages and benefits. As a consequence, they may 'burn out' from work and other related pressures as we have witnessed with the Foxconn tragedy over and over again.

What effect will the demand for increasing wages (sweeping across the nation) have on China? The major concern is that foreign companies will seek cheaper labour markets elsewhere and this will bring a negative impact on the economy. In fact, labour costs in China are now higher than those of Vietnam, India and other Asian counties which are only about RMB 500-600 per month, far below China's current minimum wage.

Although the substantial salary increases will affect companies' profit margin, other factors need to be considered such as efficiency, infrastructure, logistics, tax rates and working conditions. China still retains certain advantages in these areas, and part of these costs can be passed on to consumers.

Therefore, in the long term while some foreign companies may move out of the low end labour model, in the short term the number withdrawing should be minimal.

While China's manufacturing industry has been working on low value-added projects, this change may now give enterprises an opportunity to optimize their industrial structures and move to high-value development in order to increase their profitability and to speed up the economic transformation.

The Central Government has been implementing policies to increase consumer demand, these will help to stimulate the domestic consumption instead of relying heavily on foreign capital, investment and export sector. However, due to the lower income of the general public, this stimulus has created a bottleneck, as the increase in consumption is minimal. China has approximately 2.2 million workers, if wages will be increased by RMB 500 per month in the next few years, the potential consumption will be near RMB 100 billion.

However, a further wage rise may push up the inflation. The price index in May is 3.1%, which is higher than the 3% target of Central government so with stronger purchasing power, the inflation rate in the long run may increase.

In fact, a rising tide has gradually spread from manufacturing to services, Shenyang KFC has increased its wage bill by 28.5% for about 2,350 employees, raising wages from RMB 700 to RMB 900. Fourteen provinces and cities, including Jiangsu, Guangdong, Shanghai and Shenzhen, have increased the minimum wage by more than 10%. In some regions the increase is 20% or more.

### 14 Provinces Raised Minimum Wage In The First Half Year

| Province  | Highest Class (RMB) | Lowest Class (RMB) | Average Growth (%) |
|-----------|---------------------|--------------------|--------------------|
| Hubei     | 900                 | 600                | 28.9               |
| Hunan     | 850                 | 600                | 27.8               |
| Fujian    | 900                 | 600                | 24.5               |
| Jilin     | 820                 | 680                | 22.9               |
| Shaanxi   | 760                 | 580                | 22.7               |
| Shandong  | 920                 | 600                | 21.2               |
| Guangdong | 1030                | 710                | 21.1               |
| Beijing   | 960                 | -                  | 20.0               |
| Ningxia   | 710                 | 605                | 18.0               |
| Shanghai  | 1120                | -                  | 16.7               |
| Shanxi    | 850                 | 640                | 15.5               |
| Zhejiang  | 1100                | 800                | 15.3               |
| Jiangsu   | 960                 | 670                | 13.1               |
| Tianjin   | 920                 | -                  | 12.2               |

The gap between the rich and the poor has become a social problem. The Gini coefficient which measures the inequality of income is about 0.5, while the accepted level is 0.4. With the one child policy, the labour force will reach a peak in the next few years and due to the decreasing labour supply in the future, wages will be pushed up.

It is expected that adjusting wage disparity will be one of the key focal areas in China's 12<sup>th</sup> Five Year Plan (2011-2015). The Central government will implement different policies, including reducing monopoly based model, raising the minimum wage and improving the tax mechanism to ease social conflict, so that people can share the fruits of economic growth.

## MPF Management

### Should I Choose A Mixed Fund?

According to the statistics of MPFA as of March 31, 2010, the net asset value of MPF is HKD 3,173 billion, of which 44.3% are 'Mixed Funds' (such as stable, balanced and growth fund) valued at HKD 1,408 Billion. Investors often believe that choosing a mixed fund will be good stable choice for the long term, however, during the financial tsunami in 2008, these funds also recorded substantial losses; people then realized the importance of active management.

Due to limitations under the regulations, the mixed fund managers do not have flexibility in the ratio of bonds to shares. Using HSBC balanced fund as an example, their stock range is 55-85% and for bonds 15-45%, which means that even if the fund manager believes there will be correction in the market; they still have to hold at least 55% of equities in the portfolio.

If you do not want to select the mixed fund, is there any other alternative? We recommend members using the Equity and Bond Funds, to establish their own MPF portfolio for a better return. Using HSBC as an example, the moderate members can choose either the HSBC SuperTrust Plus Balanced Fund, or choose their own bond and equity ratios, to build a balanced portfolio.

If you had followed this approach and allocated 55% to the Hong Kong and Chinese Equity Fund and 45% to the Guaranteed Fund (in which 95% of are bonds and cash).

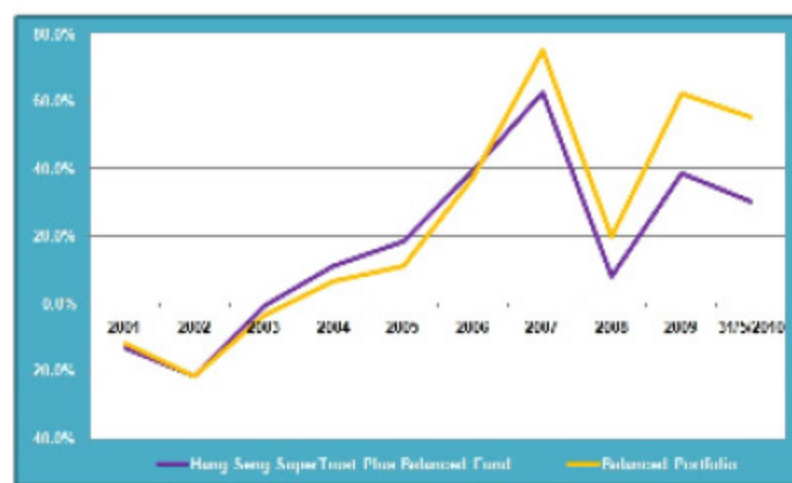
## MPF Movement

**MPFA and the 19 services providers are now working on standardizing the form**

- MPFA is currently working with the service providers in regards of developing a standard form to facilitate members in switching.
- The mandatory contribution account will be listed out when it first launched, and the preserved account and the existing voluntary contribution from both the employers and employees will be included in the form in the nearest future. MPFA implies that the standardized transfer form is still under discussion at the moment.

"It was the best of times. It was the worst of times", the end of cheap labour will bring in another opportunity to China. With the increase in wages, China will find other ways to attract foreign investors. A rise in wages will help to alleviate social conflict, stimulate domestic consumption and speed up the industrial optimization structure.

MPF Division  
TYCHE Group



From 2001 till the end of May 2010, the cumulative return on the HSBC SuperTrust Plus Balanced Fund was 30.2%, while the latter return is 55.2%. Using the period of 2005 to the end of May 2010, the difference is more significant. The former return is 17.3%, while the latter return is 45.5%.

The reason behind the significant difference in returns is because the Mixed Funds have set foot in North America and Europe, over the years, the return in these regions has underperformed the Hong Kong Equity, the return in the Mixed Funds is therefore lower. Thus, members should consider their risk tolerance and make use of the Equity Funds and Bond Funds, to get a better return.

**As MPF intermediaries reached 2.7 million, it brings up the regulatory issues**

- By the end of April 2010, there are a total of 27,795 registered MPF intermediaries; Under Secretary for Financial Services and the Treasury Bureau Ms. Julia Leung indicated that the Government will strengthen the supervision on intermediaries.
- All intermediaries should be registered with the MPFA and comply with the relevant codes of conduct. Also, guidelines are made for regulating the trustee and the intermediaries, and will enhance the intermediary training requirements.

We welcome any questions regarding MPF, including investment management and regulation, etc. We are pleased to share our views with you. We believe managing your pension fund place an important role for your future. We can be reached at:

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