

October 2011

House Commentary

GOOD BYE EURO – HELLO RMB?

One currency after another does not seem to appear safe anymore these days. First it was the USD, pressured by America's total 'fiscal gap' funding shortfall of \$211 trillion (and by extension the pegged HKD), then the Euro who's days may be numbered as both the possibility of a Eurozone breakup or several Eurozone member national bankruptcies are now being openly discussed, and then the Swiss Franc with its Euro peg (that is, if they can keep it).

So investors seem to be getting increasingly nervous about which currency still represents a safe haven now, and it seems that the recent craze about getting hold of the Chinese RMB that has engulfed Hong Kong investors in particular does not seem to be all ill-founded. China is deemed to overtake the United States as the world's number one economy by 2016 in real economic output terms, according to the International Monetary Fund (IMF), with a consistently strong GDP of 9.5% in Q2 of 2011.

Even the much-talked about local government debt problem may not be as bad as it tends to be perceived by most analysts. China's total debt level including both national and local governments still remains well below that of the average levels in the West, while the country's tax revenues jumped 30% in the first half of 2011 to 5 trillion Yuan, which should go a long way to enhance China's ability and financial strength to deal with any potential bad debt fallout.

Yet, for investors, three main problems remain: Firstly, since the RMB is not freely traded, it can be difficult or troublesome to get hold of cash or

bonds in the currency. Secondly, although RMB inflation recently eased to 6.2% in August, this number is still vastly higher than the yield on any RMB deposit or bonds, hence investors are going backwards in purchasing power terms net of inflation already in today's present environment. And thirdly, what should happen if inflation was to accelerate globally, as a result of further QE measures in the West?

For all of these reasons, a better way to gain RMB exposure rather than queuing up for RMB bonds yielding 1.5% (or minus 4.7% net of present inflation) may be, very simply, to gain exposure to Chinese stocks/equities or stock funds with RMB income (many of which happen to be trading at rather attractive prices after the recent pullback). After all, stocks represent companies, and companies, as long as they have got a competitive edge in the market, can put up prices for goods and services sold in line with inflation and can thereby 'float' on inflation – unlike bonds or cash which do not have an intrinsic value but are fully exposed to inflation risks as they rely on government promises of purchasing power of currency.

Importantly, it should be well understood in this regard also that such Chinese stocks or funds do not have to be RMB denominated in order to offer RMB exposure, because as long as the income of the underlying assets is derived mostly from the mainland, this currency of the underlying asset/income will be the actual currency exposure and performance driver, rather than the currency of denomination of the equity or fund (i.e. HKD) or fund (i.e. USD.)

Investment Committee, Tyche Group Limited

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TYCHE SEMINAR

Wednesday, 26 October 2011, 6:30pm to 8:00pm

Registration : 6:15pm

Podium Floor, Executive Club, Central Plaza, 18 Harbour Road, Wanchai, Hong Kong

TYCHE MARKET REVIEW AND OUTLOOK

We have been witnessing turbulent times again recently, awaking memories of and comparisons with the 2008 financial crisis. But while the Western countries indeed don't appear to be in any good shape at all given the huge sovereign debt overhang, and while this sovereign debt crisis certainly poses major challenges and risks for the entire world, it can also bring along opportunities for investors.

For example, most emerging market economies are faced with much lower debt as a percentage of GDP than the developed world, and are poised to overtake the developed countries' share of world GDP in the near future (if they have not already done so when considering PPP adjusted GDP rather than nominal GDP).

In particular when we look at the banking sector, we can clearly see that the 2008 financial crisis actually appears to have made way for rising giants from emerging markets (especially the major Chinese banks which have literally come from nowhere in 2006, to claim a 26.4% market share in 2010), and this trend may further accelerate given the second wave of Western banks problems happening right now.

At the same time, the same emerging markets including China have sold off quite sharply recently, hence it may be an opportune time to gain some exposure to good companies in relatively healthy economies and attractively valued currencies.

However, caution should still remain the priority when investing nowadays in our view, given the unpredictability of the nature of the unfolding Western countries debt crisis, and hence positions of relatively high volatility should only

be entered into for the medium-longer term, and as part of a diversified and un-leveraged portfolio that also includes a solid exposure to gold/precious metals for financial crisis and inflation protection.

Please join us at our October Seminar presented in English by Julian Galvin (Associate Director) and Martin Hennecke (Associate Director), for a review of these topics and the market outlook going forwards. As always, we aim to make our Seminars as interactive as possible, with questions from the audience most welcome.

Top 30 banks worldwide

	# of banks		% market cap.	
	2006	2010	2006	2010
USA	10	6	39.8	25.0
United Kingdom	4	4	12.5	13.1
France	3	1	7.8	2.7
Japan	3	1	11.9	2.6
Netherlands and Belgium	3	0	6.9	0
Spain	2	1	6.5	3.1
Switzerland	2	1	7.5	2.1
Canada	1	3	1.8	6.6
Italy	1	0	2.9	0
Germany	1	0	2.4	0
Australia	0	4	0	8.8
Brazil	0	3	0	7.1
China	0	5	0	26.4
Russia	0	1	0	2.6

Source: IMF, BanksDaily.com, DB Research

As seats are limited, so please register early 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

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

Name(s) (please print)

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