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Monthly Newsletter

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SECTION I – CHINESE ECONOMY

Policies

On Oct 29, 2004, the People's Bank of China, the country's central bank, decided to raise the one-year benchmark deposit rate by 27 basis points to 2.25%, and the one-year benchmark lending rate also by 27 basis points to 5.58%. It was the first interest rate hike in the country in nine years. At the same time, it loosened financial institutions' lending rate floating range. In principal, it will stop setting the upper limit of lending rates of financial institutions (excluding urbane and rural credit unions). The main target of this rate hike is investment growth and clearly, mortgage rate increases are aimed at the over-heated real estate market.

According to Beijing's macroeconomic goals set at the beginning of this year, the 2004 new-loan target was RMB2.6 trillion. So far, total new loans issued during the first three quarters reached only RMB1.79 trillion. Therefore, new loans will have to reach RMB810 billion in the fourth quarter to achieve the plan's target. However, new loans in the third quarter accounted for only RMB360 billion and new loans have been declining every quarter this year. Therefore, it is very likely that the actual 2004 new loan figure will be lower than planned. Combined with a higher interest rate, the monetary policy is now very tight. Given that the CPI is becoming stable, the tight monetary policy will continue to keep price levels stable and drive it to decline slightly.

We believe the interest rate hike can be viewed as a positive sign for the Chinese economy. For one thing, it indicates that the Chinese government may finally be willing to deploy market-based policymaking to influence the economy, as opposed to depending purely on old, state-era administrative tools. Besides, interest rate hikes are, at least, a fairer approach than the old central government methods. Earlier this year, when the China Banking Regulatory Commission (CBRC) applied the brakes on bank loans, the general perception was that the nation's banks imposed the same stricter standards across the board. That, however, was not true. The reality was that state-owned banks favored state-owned businesses. This cozy relationship permeated all industries - telecom, chemicals, transportation, and even the steel industry. With a market-oriented approach, favoritism and other improper practices will be reduced, helping improve the effectiveness of economic policies and making it more plausible for Beijing to engineer a soft landing.

We do not expect last Friday's rate hike to have a huge impact on the stock market. To some extend, the markets have already priced in a potential rate hike. Furthermore, most industries will not be hurt, except for the real estate and auto industries which are driven by consumer loans. Given sustained economic growth, China's appetite for oil, raw materials and energy will not see significant decline as there is still a wide demand and supply gap.

While it is possible to see gradual interest rate hikes in the future, we do not believe they are necessary. China's rapid economic growth is a healthy growth and not inflationary. As discussed in previous newsletters, in the next ten to thirty years, it is estimated that an additional 500 to 600 million people will migrate from rural to urban areas, creating not just huge production forces in the cities but also bringing about tremendous social-economic changes, such as massive investments to meet the demand for basic infrastructure needs, and the economic escalation of the consumer spending patterns.

Driven by the double-barrel stimulus of investment and consumer demands, it is very likely that the long-term average Chinese economic growth will be over 10%. Unless there is inflationary pressure, we see little need to curb this growth. And in fact, inflationary pressures appear to be gradually easing. There are two major forces driving inflation: grain and oil. 2004 saw a good harvest, so inflationary pressures from grain have eased. As for oil, most Chinese oil industry experts feel that the current demand and supply situation is balanced. Besides, the major drivers for oil prices are international political events, and not China's economic growth. Therefore, we do not believe that China has to act to curb its economic growth for the sake of stabilizing international oil prices.

Gross Domestic Product

For the first three quarters of 2004, China's GDP totaled RMB9,314.4 billion. Third quarter GDP growth was 9.1%, compared to 9.8% and 9.6% for the first and second quarters, respectively. This is a significant consecutive quarter-over-quarter drop. Therefore, we see China's robust economic growth as showing signs of slowing, with the likelihood of a soft landing. Considering Friday's 27 basis points rate hike and the lower-than-targeted new loans volume, we expect the fourth quarter growth rate to be at a slightly slower pace, while the overall 2004 GDP growth should still be above 9%.

Consumer Price

According to the National Bureau of Statistics of China, in September 2004, the CPI rose by 5.2% over the same month last year, 0.1 percentage points lower than August. The increase was driven mainly by food prices, with a jump of 13.0%, while the prices of non-food goods saw a gain of only 1.3% while service items increased by 2.6%. In September, the CPI threshold of 5% set by Mr. Zhou Xiaochuan, the governor of the People's Bank of China, was surpassed for the fourth consecutive month, which became one of the major reasons for the rate hike. However, the increase was mainly due to food prices which were heavily skewed by seasonal effects and last year's SARS impact. 2004's good harvest will ease the pressure from grain prices. We do not believe a gradually stabilizing CPI figure should trigger more future rate hikes.

Currently, there are two major schools of economists in China holding opposite views on the economy. One is represented by overseas-educated economists who believe the Chinese economy is overheated. The other, comprised of local economists, believe the Chinese economy is not overheated and no tightening policies are necessary.

Retail Sales

In September 2004, the Total Retail Sales of Consumer Goods totaled RMB471.8 billion, representing an annual growth rate of 14.0%, or 0.9 percentage points higher than August's. City retail sales continue to outpace county and under county areas. A retail sales growth rate of 8.8% in real terms is healthy, and this is the first rebound since May. However, this bounce may not be sustainable given higher interest rates as consumers will now have to pay more for mortgage and auto loans. If the slowing trend in the growth of retail sales returns in the coming months, we suspect Chinese leaders will likely be concerned about choking off the country's continued economic growth with further tightening policies.

Industry

In September 2004, the Chinese Value Added of Industry totaled RMB481.2 billion, about RMB26.8 billion higher than August. The figures represent an annual growth rate of 16.1%, about 0.2 percentage points higher than August's growth rate and still lower than June's growth rate of 16.2%.

Cumulative Investment in Fixed Assets from January to September 2004 totaled RMB4,510.2 billion, or a 27.7% increase from a year ago. This rate is 2.6 percentage points lower than that of the January–August period. Although investments from domestic sources grew at a slower pace at 27.8%, Hong Kong, Taiwan and Macao regions and foreign investments continued to be strong, increasing by 35.8% and 59.9%, respectively and up from the January-August pace by 1.7 and 1.6 percentage points, respectively. Investments in industries targeted by the government's tightening policies are showing clear signs of slowing, some even experiencing negative growth. Real estate investment dropped significantly to 28.3%; however, it is still a rapid growth considering the smaller money supply. After Friday's rate hike, we expect real estate investments to slow further in the fourth quarter.

The total amount of import and export in the first three quarters of 2004 was $828.5 billion, or 36.7% higher than a year ago. Exports reached $416.2 billion, up by 35.3%, and imports reached $412.3 billion, up by 38.2%. Although export growth is lower than import growth, the three quarters still created a trade surplus of $3.9 billion. In addition, foreign direct investment contract amounts reached $107.4 billion, up by 35.6%. The trade surplus and FDI contributed to the large increase in the foreign exchange reserve.

SECTION II – STOCK MARKETS

Chinese Stock Markets

During the five-week-period from September 27th to October 29th, all major Chinese indices declined sharply, except for the Hong Kong Hang Seng which posted almost no change. In addition, all of the four Shanghai and Shenzhen indices continued to be below their levels of a year ago.

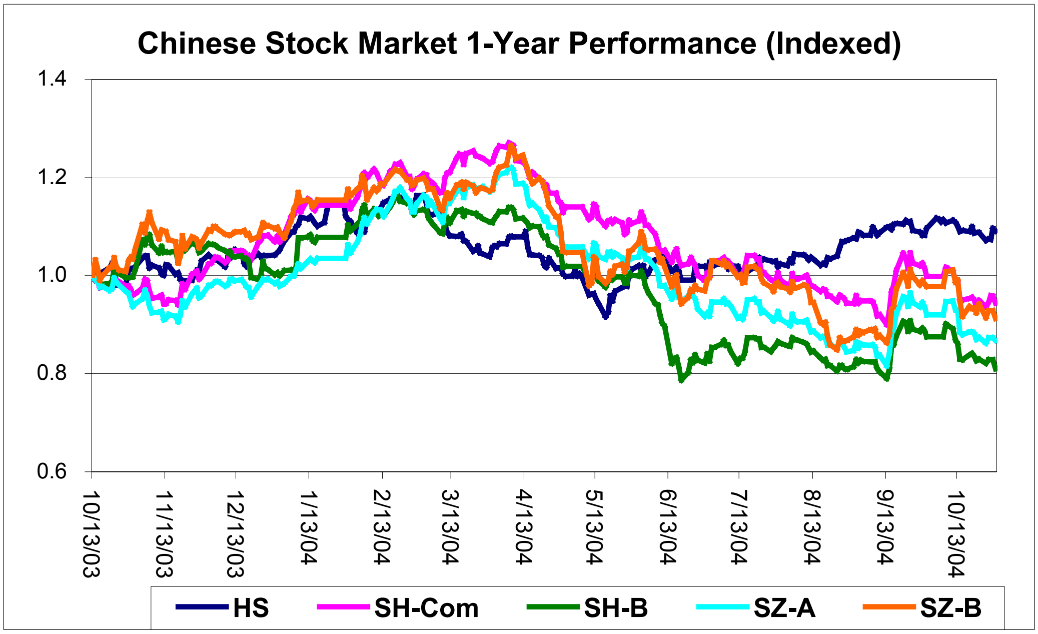
A Share Markets

The Shanghai A share and Shenzhen A share indices declined 9.1% and 9.0%, respectively. With continued anxieties over skyrocketing oil prices and questions still hanging over Beijing's ability to engineer a soft landing, there remain a slew of uncertainties in the stock markets. Although all IPOs are still on hold (until the new securities policy is formally implemented by the China Securities Regulatory Commission), existing public companies announced a large amount of new offerings, helping to push down the markets. In addition, the planned IPO of the Bank of Communications added significant pressure on the banking sector.

Finally, the move by the central bank to lift rates weighed in on the markets, pushing the exchanges down further. While the market has been prepared for a rate hike for quite some time now, the timing, especially in light of the declining trend in September's CPI, took investors by surprise.

B Share and Hong Kong Markets

Both Shanghai B Share and Shenzhen B Share indices dropped 9.4%, while the Hong Kong Hang Seng Index remained almost unchanged. A series of bad news in the A share markets helped pushed down the B share markets. However, since the Hong Kong Hang Seng is more tied to global markets, bad news from mainland China was partially offset by overseas events.



Market data (09/27/04 - 10/29/04):

Index	Open	High	Low	Close	Change
Hang Seng	13,053.6	13,403.0	12,743.4	13,054.7	0.01%
Shanghai Composite	1,452.5	1,437.6	1,289.9	1,320.5	-9.09%
Shanghai B Share	93.9	95.2	85.2	85.1	-9.38%
Shenzhen A Share	383.3	388.0	341.2	348.8	-9.00%
Shenzhen B Share	251.2	254.1	226.8	227.7	-9.37%

Chinese Stocks in the U.S.

Our U.S.-China Opportunities Index declined slightly by 0.45%, affected by both negative news from the Chinese stock markets and positive influences from the U.S. stock markets. The technology sector fared the best, posting a gain of 17.5%. This coincides with a big gain in the NASDAQ during the same period. Airlines and the communication sector fared the worst, posting losses of 4.7% and 4.0%, respectively.

U.S. - China Opportunity Index Data: From 09/27/04 To 10/29/04

Index	Open	High	Low	Close	Change
U.S. - China Opportunity Index	**3,522.4**	**3,702.6**	**3,477.2**	**3,506.5**	**-0.45%**
Sub-Indices					
Technology Sector	82.4	101.6	82.4	96.8	17.48%
Energy Sector	117.3	126.2	117.3	117.6	0.23%
Communication Sector	58.9	61.2	56.0	56.5	-4.00%
Chemical Sector	123.5	135.6	123.5	126.9	2.75%
Mining & Metals Sector	59.6	65.5	56.2	59.2	-0.60%
Airline Sector	88.1	93.5	80.6	83.9	-4.71%
Electric Utilities Sector	63.9	66.4	61.7	64.1	0.23%

Winners and Losers

For the period between 9/27/04 and 10/29/04, Sina Corporation was the top percentage gainer, while China Resources topped our losers' list.

09/27/04 - 10/29/04			
Winners		**Losers**	
Sina Corporation	40%	China Resources	-14%
Shanda Interactive Entertainme	37%	China Unicom	-8%
Netease.com	28%	Sinopec	-8%
Jilin Chemical	25%	Sinopec Beijing Yanhua	-7%
Ctrip.com	19%	China Eastern	-6%

- **Sina Corporation (Ticker: SINA)**

Sina Corporation shares topped percentage winners due to its strong financial performance in the third quarter. On October 26, the company reported a third quarter net income of $14.5 million, or 27 cents a share, representing a 24% increase from a year earlier. Revenue increased by 65% to a record $52.5 million, powered by a 62% rise in advertising revenue. In addition, the company expects its fourth-quarter revenue to be between $54.5 million and $55.5 million, higher than analysts' estimates.

- **Shanda Interactive Entertainment (Ticker: SNDA)**

Shanda Interactive Entertainment shares gained 37%. Two important events lifted Shanda's share price. At the beginning of October, Shanda acquired Qidian, a leading Chinese entertainment literature portal. The acquisition of Qidian offers a rich resource of online literature for developing attractive storylines for online games. Separately, Shanda and eBay EachNet formed a strategic relationship, in which eBay EachNet will advertise on Shanda's games platform, and Shanda will use eBay EachNet's e-commerce platform as its preferred choice. This agreement showcases Shanda's ability to leverage its large member base to generate revenue from online advertising.

- **China Resources Development (Ticker: CHRB)**

China Resources shares lost 14% in the past five weeks after gaining 25% in the previous period. For the second quarter, the company reported a net income of RMB1.25 million, compared with a loss of RMB7.11 million a year ago, which pushed up its stock price in August and September. However, as we correctly pointed out in the previous newsletter, its turnaround was due mainly to the recovery of short-term loan receivables which were provided in 2003. Additionally, its gross profit margin is near zero. With its third quarter earnings release date approaching, the market started to realize the company's shortcomings.

- **China Unicom (Ticker: CHU)**

China Unicom shares tumbled 8% this period, leading the communication sector's decline. In the company's interim report, its net income showed a year-over-year increase of 17.8% during the first half of 2004; however, profitability is squeezed by increased competition, higher selling and market expenses, higher customer defections, and most importantly, a decline in its core GSM business. China Unicom's GSM business, which represents 93% of its operating income, showed lower profitability. Its operating profit dropped 5.6% to RMB4.7 billion during the first half of 2004, following a 9.3% drop in 2003.