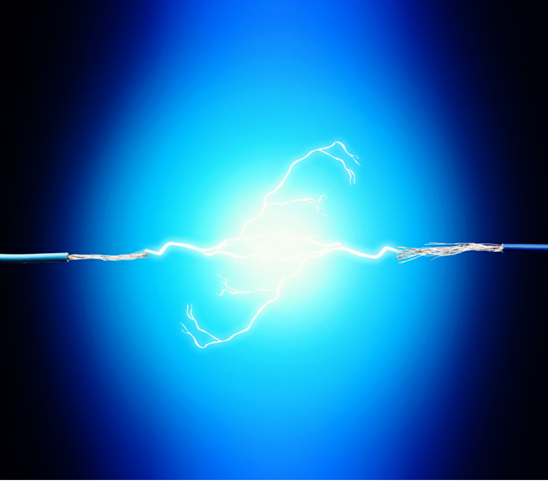

Mirae Asset - flash

Short Circuit

Investment Team; Mirae Asset Global Investments (HK) Limited

Chinese financial markets started the New Year with a loud thump, unnerving investors globally. The sharp fall in the China on-shore A-share market and CNYUSD were reminiscent of what happened last summer. In the following pages, we shall attempt help make sense of the current confusion and panic, and discuss how we think best to position for the coming year.

- *Recent China A-share market slump was exacerbated by the new circuit breaker mechanism. Do not panic over A-share market movements as it is retail sentiment driven. In Mirae Asset Asia Sector Leader Equity Fund and Mirae Asset Asia Great Consumer Equity Fund, we have very minimal exposure to A-shares, and prefer off-shore H-share market for China exposure.*
- *CNY has been weak vs. USD but stable vs. trade-weighted basket of currencies. We expect CNY to remain stable against the basket, which means likely further weakness and volatility vs. USD.*
- *Asia remains very attractive from a valuation perspective. Historically, investors stood a very high probability of achieving positive returns in subsequent 12 months by investing at these levels (1.26x Price-to-Book as of 7th Jan 2016)*
- *We are well-positioned with a portfolio of high quality sector-leading companies that are benefiting from structural tailwinds. We maintain our base-case scenario of a China "soft-landing" with diverging growth between "Good" and "Bad" China, amid sufficient state ammunition to stabilize / catalyze growth in the near term.*

A-share market slump: short-circuited by the new circuit breaker

Chinese regulators introduced a new circuit breaker mechanism in 2016 with the intention of reducing market volatility in times of severe risk aversion. Contrary to what was intended, the new circuit breaker mechanism actually exacerbated market panic, halting trading for two out of the first four trading days of the year. Below are some key points on the circuit breaker mechanism:

- Benchmark index: CSI-300 Index
- Thresholds & durations: ±5% index movements lead to a 15-minute break while ±7% index movements lead to a trading halt for the rest of the day

Circuit breakers have been adopted by a number of countries, including the US, Korea and Japan, and overall have performed well. One reason why the circuit breaker mechanism failed to act as a stabilizer could be because the 5% and 7% thresholds are likely too close to each other and added to investors' fears. As a comparison, the US has set three thresholds of 7%, 13% and 20%, and Korea has set three thresholds of 8%, 15% and 20%. The **high retail investor makeup (90%) of the A-share market** was also a key reason for the volatility.

As a result of the market panic and confusion, **regulators have suspended the circuit breaker mechanism on Friday 8th**

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January. This is a good move as it provides more liquidity and trading hours for price discovery to calm panic. Investors responded positively to this development; the Shanghai Composite recovered by 2% on Friday.

Do not panic over the A-share market!

The sharp fall in the A-share market also caused some market participants to be concerned over the health of the economy. We believe the **A-share market is a very poor indicator of the underlying economy**, so don't panic over its performance.

Between July 2014 and July 2015, the Shanghai Composite index more than doubled despite continued deterioration of underlying economic fundamentals: reported GDP growth decelerated from 7.4% to 6.9%; Fixed Asset Investments growth slowed from 17% to 11%; Steel and Cement production growth went into negative territory.

As mentioned earlier, the A-share market is dominated by retail investors, making this very much a sentiment-driven market. **Despite having corrected by 40% in recent months, the A-share market is still over-valued**, in our view. Given how far it had rallied prior to the correction and the current state of the economy, we would not be surprised if the A-share market correct further from current levels.

As a result of the irrational market behavior and large valuation gap, we continue to prefer off-shore H-shares over on-shore A-shares. **A-shares exposure remains very minimal** in Mirae's flagship regional funds, Mirae Asset Asia Sector Leader Equity Fund and Mirae Asset Asia Great Consumer Equity Fund.

Shanghai Composite Index vs. GDP Growth

Source: Bloomberg, Mirae Asset, as of 7 Jan 2016

Forward PE ratio (MSCI China vs. Shanghai Composite)

Source: Bloomberg, Mirae Asset, as of 6 Jan 2016

CNY volatility: weaker vs. USD; stable vs. trade-weighted basket

Financial markets have also been surprised by the sharp depreciation of the CNY vs. USD, down by 1.5% since 2016 and over 4% since last November.

Short Circuit

Markets traditionally look at currencies as exchange rates against a single partner, almost invariably the USD. However, on 11th December 2015, the China Foreign Exchange Trade System introduced a trade-weighted basket of currencies (CFETS CNY index), sending a strong signal to investors move away from focusing on the bilateral USD-CNY relationship.

The People's Bank of China has let the CNY slide vs. the USD since August last year, but **in Real Effective Exchange Rate (REER, i.e. trade-weighted basket) terms, the currency has actually been stable**.

Going forward, **we expect the CNY to remain stable against a basket of currencies, and moderately weaker against USD**. Under this scenario, we expect USDCNY to reach 6.8-7.0 by the end of the year, or around 5% further depreciation. We also expect USDCNY volatility to remain higher than what the market has grown used to as we adapt to trade-weighted basket.

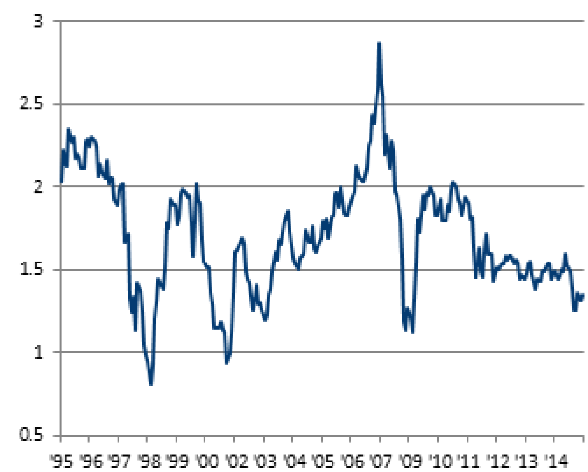
CFETS CNY Index (Trade-Weighted Basket)

Source: Bloomberg, Mirae Asset, as of 7 Jan 2016

Valuations remain very attractive in Asia

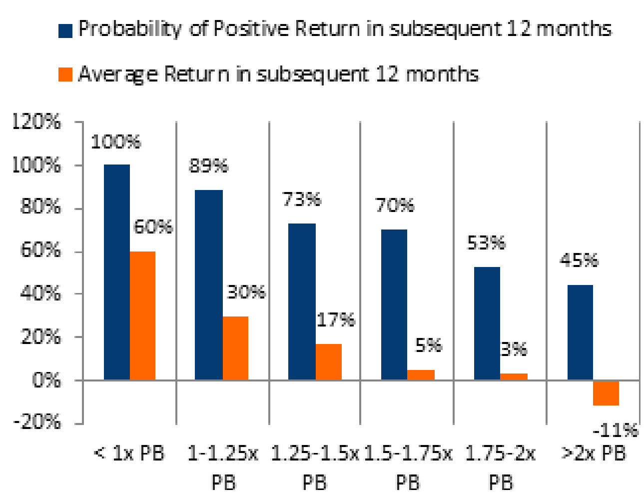
Asian equity valuations remain very attractive at current levels (1.26x Price-to-Book as of 7th Jan 2016). **Historically, investors stood a very high probability of achieving positive returns in subsequent 12 months by investing at these levels.**

MSCI Asia ex Japan Price-to-Book Ratio



Source: Bloomberg, Mirae Asset, as of Dec 2015

MSCI AxJ Valuation and Subsequent 12-month return



Source: Bloomberg, Mirae Asset, as of Dec 2015

Portfolio implications

We believe **we are well-positioned for a slower growth scenario.** China is going through a cyclical downturn, which is why we believe it is important to be active and selective, and position in high quality companies in areas where we still see strong structural tailwind. These areas are **internet / e-commerce, healthcare, insurance, tourism, and clean environment**.

Clearly we are witnessing slowdown in the segment of the economy dominated by investment and manufacturing activities. On the other hand, the consumption-driven new economy remains strong and vibrant. The essential question one must consider is if or when does the formerly mentioned “Bad China” impact the latter “Good China”?

As we monitor the economy for any warning signs around wage growth and unemployment, we believe there remains sufficient ammunition for China to stabilize / catalyze growth, underpinning **our base case scenario for a “soft-landing” in China**: $3.5tn foreign exchange reserves, high Loan-to-Deposit Ratio, large current account surplus, low fiscal deficit, supply-side reforms.

As we go further into 2016, **we expect to see market volatility to remain heightened** driven by boom-bust investor sentiment, particularly in regards to China. This kind of market volatility, however, is not necessarily negative for stock-pickers like us. By focusing on company fundamentals and making sure the companies we invest in continue to deliver, we believe volatile market conditions in 2016 will provide us with attractive entry opportunities.

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