

CHINA'S RISE - PHASE II (The End of the Beginning)

An Executive Summary of InvestorInsight's recently released position paper entitled "A CASE FOR INVESTING IN CHINA"

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The cradle of one of the oldest civilizations on earth is the scene of the most extraordinary economic and financial transformation in history. In the last 30 years, the People's Republic of China has been home to the fastest growing major economy the world has ever seen. This is a country where change is taking place on an unprecedented scale and at an unprecedented rate, where people are living lives unimaginable just a few years ago. This communist nation has learned how to cash in on capitalism and private enterprise. As a result, the country and its people are growing richer and more powerful each day.

It is impossible to ignore the economic growth phenomenon that has unfolded in China over the past three decades. In 1978, Chairman Deng Xiaoping, the architect of "The New Socialist Market Economy", initiated an unprecedented social and economic transformation that ended Chairman Mao Zedong's devastating Cultural Revolution.

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<http://ce.investorawareness.org/CT00213201MjMyMjk3MDAA.html>

Social Experiment Succeeds

The successful implementation of this ambitious and revolutionary social experiment laid the foundation for what has become the world's most dynamic economy. With average annual growth rates since 1992 near 10% (hailed by The Economist in 2005 as "The Great Leap Forward" and "A Model of Reform"), China has emerged as an economic powerhouse.

The People's Republic now accounts for 13% of global gross domestic product (GDP), based on purchasing power parity (PPP) exchange rates, and most economists agree that soon, China will surpass Japan in GDP making it the second largest economy on earth. In 2005, China's economy became second behind the U.S. when evaluated based on purchasing power and it has been suggested that China could reach parity with the U.S. by 2020.

China's accession to the World Trade Organization (WTO) and the overwhelming success of the 2008 Olympics attest to the PRC's growing importance on the world economic stage.

China's economy continues to expand in all directions and the country's emergence as an economic superpower is a success story in and of itself. But this is only the end of the beginning. As global economies falter under the weight of what is now widely considered to be the most severe worldwide financial crisis and deepest global recession since the 1930s, China is uniquely positioned to weather this economic storm. With the strongest balance sheet on earth, Beijing has put the world on notice that the PRC is ready, willing, able and anxious to take their "rightful" place as leaders of a global economy.

The Golden Rule Applies

History suggests that the Golden Rule will prove itself once again. Like it or not, world leaders are coming to grips with the fact that China is in much better shape than any other major economy. As a result, they will increasingly be setting global economic agendas. And the citizens of the Peoples' Republic truly believe doing so is their destiny. Even in the face of global economic uncertainty, these are exciting times for China.

China is certainly not immune to the global economic downturn. However, as the rest of the world slips into a deep recession, China continues to experience impressive economic growth. The PRC is fiscally sound and, as the country evolves, huge budget surpluses expand and enormous trade surpluses grow. Further, China is not burdened by debt and has the largest FOREX reserves in the world. But most importantly, due to the closed nature of their financial markets, China has not suffered from the illiquidity and deleveraging dynamics that currently plague most major economies. In fact, Chinese banks are now among the most profitable on earth. As the rest of the world scrambles to navigate their way through tough times, China is setting a new course for its future once again. Using its considerable resources to sustain growth, create employment, and dramatically increase domestic consumption in ways that significantly reduce reliance on exports, the China miracle continues.

In an authoritarian political society, Chinese leaders have the ability to adjust fiscal and monetary policy quickly. In response to the global financial meltdown, in the fall of 2008, Chinese leaders made a dramatic macroeconomic shift away from preventing economic overheating and controlling inflation to insuring "stable and relatively fast growth." The official proclamation was, "Growth Above All Else" and this new policy has become the nation's top economic agenda. It will certainly be the major driver of the next phase of China's evolution.

A US\$586 Billion Stimulus Package

To prime the pump, Beijing announced it would spend an estimated 4 trillion yuan, (about \$586 billion U.S. dollars), over the next two years in 10 major areas, with US\$15 billion being spent in the last six weeks of 2008. This new stance focuses on "proactive fiscal policy and an appropriately accommodative monetary policy." The plan is the largest in China's long history and, in relation to total GDP, is the largest stimulus package ever initiated by a major economy. The two year Chinese stimulus is 13% of GDP compared to 1% to 2% in the U.S. and E.U. Chinese state media called the plan "a wide-ranging effort to offset adverse global economic conditions by boosting domestic demand."

On December 10, 2008, Bloomberg reported, "The government will increase spending by a 'relatively big margin' and cut taxes next year to increase support for job creation, agriculture, social security, education, energy conservation and small and medium-sized enterprises. It will also seek to insure 'healthy and stable' growth of the nation's capital and property markets." On November 10th, the Wall Street Journal quoted a Merrill Lynch report that said Beijing emphasized that the fiscal stimulus be implemented quickly and the scale of the stimulus be large. They continued, "We reiterated our view that despite the rapidly slowing aggregate demand (both domestic and external) in China, expansionary fiscal policies could prevent growth from falling below 8.0% in 2009." Merrill went on to forecast, "China accounts for +80% of global growth in 2009; big policy stimulus; consumer not constrained by debt; valuations cheaper, renmibi stable."

Historically, deep worldwide recessions redirect sovereign wealth homeward. Unlike the U.S. and Europe that are forced to run monetary printing presses overtime and/or initiate massive tax and spend policies while borrowing unprecedented sums from nations like China to stimulate their economies, Beijing is awash in cash. Going forward, if domestic demand falters, Beijing can use their huge surpluses to support their economy with even higher spending and lower taxes.

The global growth slowdown means big stimulus programs in China - and they can afford them. The current plan focuses on transportation infrastructure, environmental projects, and housing; productive investments that will boost growth and create employment that in turn can drive domestic consumption. This is in stark contrast to much of the investment in overcapacity made by the private sector that caused China to overheat in 2007. Expect more measures to stimulate consumption, including policies to support domestic stock markets and property transactions, and increased social infrastructure spending to boost disposable income. Further, lower commodity prices, lower inflation and lower interest rates in 2009 are a bullish combination for China domestic consumption themes.

Productivity Drives Opportunity

No doubt, the unprecedented rise of the Chinese consumer is significant. But equally important are the dramatic gains in productivity that huge investments in infrastructure bring. These advancements add up to one key take-away for investors: productivity increases should create a new cycle of investment, economic growth, and prosperity that will benefit all participants, public and private. Historically, productivity is a catalyst for investment and higher stock market returns. In the West, especially in the U.S., rising productivity resulted in rapid economic expansion accompanied by a financing and stock market boom for new and expanding businesses.

As spectacular as China's rise has been, it has not been all good news for investors. In the fall of 2008, the world experienced a spectacular reversal of fortune. From 2003 to 2007, Chinese equities enjoyed an historic rally. In the fall of 2007, valuations of Chinese equities were some of the highest in the world. However, by the end of 2008 they were among the lowest. The best performing market in 2007 was the worst performing market in 2008. China outperformed in the first part of 2008 but then viciously collapsed in the second half of the year.

As global stock markets declined, risk appetite dramatically reversed. In times of economic downturn, it is not uncommon for markets to experience a flight to safety. Investors tend to withdraw from foreign markets to concentrate on the home scene they know best. Therefore, Global Emerging Markets are often the first to take the hit as investors tend to sell anything they can't pronounce. Further, as Small Cap Global Emerging Markets (including China) were dominated by alternative investments of leveraged hedge funds, unprecedented redemptions and margin calls led to forced liquidations that fueled an overall deterioration of the China equities space.

A "Stock-picker's Paradise"

Today, China-based companies with solid balance sheets, seasoned management teams and high rates of growth trade at deep discounts to similar companies in more developed markets. For knowledgeable investors with an understanding of the China space, opportunity abounds. As the world works its way out of the current financial mess, China

will emerge much stronger, wiser and wealthier. And, as investors return to the stock market, the fundamental strengths of Chinese companies will become obvious.

Certainly the fundamentals are clear. China has enormous excess savings as shown by its massive current account surplus. The country is swimming in cash. Unlike current conditions in the West, Chinese consumers are not drowning in debt and the economy is not constrained by banks. Household savings is high and credit card use is almost nonexistent. To sustain growth and fuel domestic consumption in the world's largest market, the US\$2 trillion in foreign assets Beijing controls leaves plenty of leeway to expand credit to businesses and consumers alike.

The dynamics are in place for the next great boom in Chinese companies and their publicly traded equities. As China implements the most meaningful stimulus package in its history, growth will continue. As the rest of the world works its way out of the worst global financial crisis since the 1930s, China will use its extensive resources to invest in infrastructure, its banks and its domestic capital markets. This will dynamically increase productivity that will in turn bring an overall rise in the standard of living across all segments of Chinese society. These investments will create employment that, in turn, generates disposable income that, in turn, will drive domestic consumption. There is a clear indication that this is a resurgent market with enormous potential and investment opportunity.

In the short and mid-term, we believe that as investors' attitudes change, Chinese equities listed in the U.S. may be among the first to break out. In a report last fall entitled "China's New Deal: Beijing announces sweeping stimulus program" JP Morgan suggested, "In view of these significant announcements, we believe sentiment towards China stocks will improve significantly".

In the aforementioned Merrill Lynch report, analysts opined that, "Next year promises to be a 'Stock-picker's Paradise' once volatility and correlation abates."

In the next several quarters, the market will separate the men from the boys, the informed investors from those that can only say, "I wish I had known that!" As the Chinese stimulus package kicks in, with fundamentals improving in the second half of this year, we believe the probability of a rebound in Chinese companies listed on U.S. markets is high. Fear of redemptions and margin calls meant "cash was king" going into 2009. But after the Chinese equity space deteriorated in the fall of 2008, stocks have gotten cheaper and more attractive.

China Is Our Favorite Emerging Market

When U.S. money market funds pay less than 1%, it takes almost 100 years to double one's money. Eventually, cash will come off the sidelines and Chinese companies with solid fundamentals, excellent balance sheets, seasoned management teams and good earnings visibility will stand out. Loaded with cash, some of these dynamic and resourceful companies will use proven M&A strategies to go shopping in the West, acquiring assets and market share on the cheap, and valuations could break out.

In the "2009 Year Ahead" report mentioned above, Merrill went on to suggest ; "Looking for a reasonably cheap market with a chunky current account surplus, stimulus in the offing and a stable exchange rate? China's got all that. In addition, our Global Economic team forecasts China will account for over 80% of global growth in 2009; the consumer is

unconstrained by debt; the economy is unconstrained by banks. China is thus our favorite Emerging Market, at least until the global cycle turns."

The bottom line is that the People's Republic is better positioned to survive the global economic storm than any nation on earth. Flush with cash, credit and the ambition to become global players sooner than later, China is uniquely positioned to take advantage of the fear and tumbling stock markets in America and Europe to increase its international presence.

We believe that China is on the brink of a long-term economic and stock market boom—driven by rising levels of productivity and dramatic increases in domestic consumption—which will provide investment opportunities within and beyond its public equity markets.

Unprecedented Opportunities

Although macroeconomic conditions in China are stronger than any major economy on earth, valuations of Chinese companies listed on U.S. exchanges are severely depressed - the space is dramatically oversold. Current dynamics offer investors experienced in the space an unprecedented opportunity to exploit inequalities in the market to generate superior returns.

At Chinamerica, with six years of boots on-the-ground in the PRC, management has developed significant direct investment experience. In addition to being lead investor in multiple high profile transactions in the Chinese APO space, we have helped portfolio companies secure hundreds of millions of dollars in follow-on financings. We have helped companies recruit CFOs and independent boards of directors and helped management teams navigate their way from the OTCBB to major U.S. stock exchanges. We have engineered financial structures that have been adopted internationally. We have developed deep and valuable relationships in China and the U.S. that uniquely position Chinamerica to exploit what is certain to be the next investment cycle in China's rise.

As the China miracle moves into its next phase of evolution, Chinamerica stands ready, willing, able and anxious to capitalize on the significant investment opportunities at hand.

About the Authors

Beau Johnson is Founder and Managing Director of Chinamerica Holdings, LLC an SEC Registered Investment Adviser and a General Partner of Chinamerica Fund, LP. Since 1985, Mr. Johnson has also been CEO of Executech Financial Advisors, LLC, a financial publishing firm that was also registered with the SEC as Registered Investment Adviser. He has over 30 years' experience in general securities, investment banking, capital formation, mergers and acquisitions, venture capital, corporate development, financial publishing and sales and marketing management. Mr. Johnson has been publisher, co-publisher and/or senior editor of Small Cap Manager, Analysts Spotlight, The Dutton Report and The Momentum Investor, on-line publications with one of the financial newsletter industry's largest circulations. Mr. Johnson provides editorial commentary on China and the Small Cap segments of U.S. capital markets to a readership of over 1,000,000 retail investors and 75,000 institutional and professional investors. He has held executive and board level positions in both high growth and turnaround environments and founded, developed and sold several oil and gas exploration companies. Mr. Johnson served as President of two NASD (now FINRA) member Broker Dealers and has owned and/or controlled franchise offices of three national NASD

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Haiping Ni is the Director of Asian Investment for Access America Global Investments. He joined Access America after graduating from the Jones School of Business at Rice University with an MBA. Prior to his graduate studies, Mr. Ni was the Vice Director of the Shanghai, China office of the Tianjin Economic-Technological Development Area (TEDA), a special foreign direct investment industrial zone in China. While at TEDA, he was instrumental in establishing the Shanghai office and was in charge of sourcing and negotiating transactions originated from North America and Europe. He represented TEDA as a member at the Economist Intelligence Unit (Shanghai), built TEDA's Shanghai network and increased investment deal flow, provided consulting service for potential investors, conducted research on emerging industries and investment trends, analyzed the competitive advantages of peer industrial zones, and provided strategic advice to TEDA's executive management. Prior to his promotion to Vice Director, Mr. Ni was the Team Leader and Project Manager of the Overseas Investment Section where he closed direct foreign investment transactions valued at over \$120 million with three Fortune 500 companies. In addition to the MBA from Rice, Mr. Ni has a Bachelor of Arts Degree from Tianjin Foreign Studies University, Tianjin, China. He is fluent in English and Mandarin Chinese.