

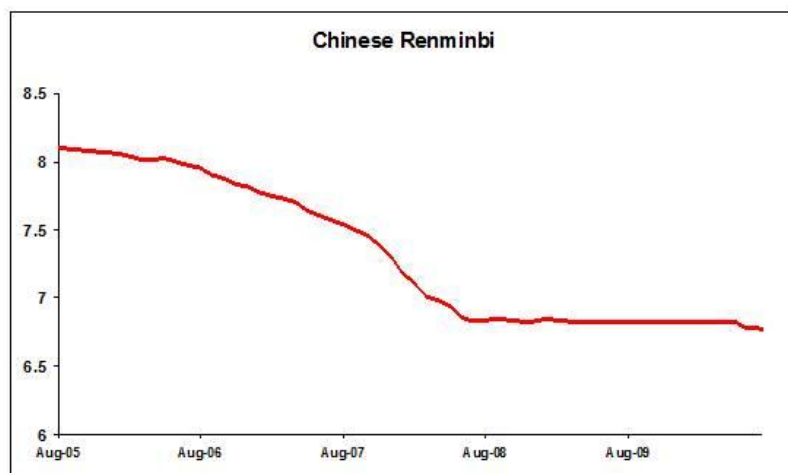
China's Latest Diversification Away From Dollar Assets -- JGBs

According to a daily Japanese financial news report, China has stepped up its purchases of Japanese government bonds (JGB) since the beginning of 2010. The pace has accelerated in the month of May and June as net buying has increased to USD 8 billion and 5 billion respectively. The year to date China's net purchase of JGB has increased to USD 19 billion from the recent record of USD 3 billion in 2005.

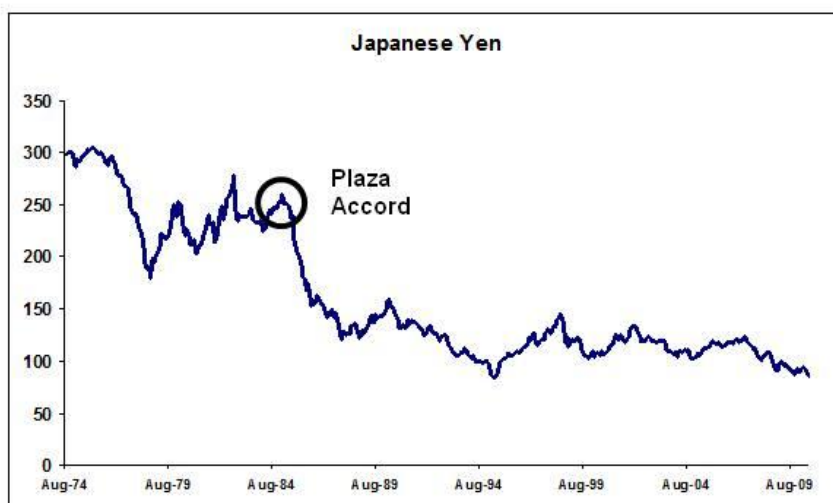
Although economists and some policy-makers have argued that China should reduce its over-dependence on dollar assets in its foreign reserve management. A few observations can be made from its recent investment behavior:

1. China seems concerned about the economic outlook and increasingly huge budget deficit in the US. It has become increasingly uncomfortable holding an estimated 70% of its total foreign reserves in dollar assets;
2. As China is worried about the ramifications of the sovereign debt crisis in some European countries it seems not keen in shifting large allocation of dollar assets to European bonds;
3. Its investments into resource rich countries such as Australia, Brazil, Kazakhstan is likely to increase further;
4. Its purchase of low yields (below 1%) JGBs suggests that China's primary goal is to protect its reserves rather than to enhance returns. Liquidity and potential currency gains must have been the other secondary goals.

China has accumulated massive foreign reserve of USD 2.5 trillion. The size is more than double that of 2nd place Japan. With trade surplus accumulation at an annual rate of USD 150-200 billion and foreign direct investment inflows increasing at about USD 100 billion per year, China's foreign reserves is like to exceed USD 3 trillion by the end of next year. The sharp increase in China wealth accumulation is similar to what Japan had experienced in the early 1980s when it became the largest creditor country in the world.



RMB now resembles the Japanese Yen before Plaza Accord in 1985



I believe the Chinese Renminbi's long term appreciation is underway, similar to what Japan had experienced after the Plaza Accord in 1985. The pace of strengthening may not be as sudden and sharp as seen in the Japanese Yen, but the direction seems pretty clear. When the renminbi appreciates, it is hard to see the other Asian currencies, such as the Korean Won, the Singapore Dollar, the Taiwan NT and the Hong Kong Dollar not appreciating with it. All these economies have also benefited from strong growth in China.

The market seems resigned to the fact that Asian currencies must appreciate further in the coming years. What the market has not discounted is the possibility of China making a strategic decision to include Asian bonds in its reserve management. Considering the risk averse attitude of China, it seems almost a foregone

conclusion that it would be mopping up Asian bonds in the coming years. When this happens, we might possibly see one of the strongest bull market in Asian bonds.

Heong Chye LIM
Chief Investment Officer
APS Komaba Asset Management Pte Ltd

Important Notice

This publication is strictly for information purposes only and should not be construed as an offer or solicitation to deal in the securities/investments mentioned herein. Unless stated otherwise, any opinions expressed are based on our internal forecasts and should not be relied upon as indicating any guarantee of return from an investment in our products. **Past performance and any forecasts made are not necessarily indicative of future or likely performance of our products.** We have made every effort to ensure that the information provided herein is accurate. Please note, however, that some data has been derived from sources that we believe to be reliable but is not guaranteed. Exchange rates are obtained from generally reliable sources for a date at or near the end of the statement period and are for valuation purposes only. These rates may not be the same as those used in actual currency transactions.