THE CHINA FUND

INVESTMENT MANAGER'S REPORT

Performance

The China Fund's net asset value per share decreased 9.7% in the six months to 30 September 2002. This compares with a 13.3% decrease in the CLSA China World Index in the same period.

The Company identified market leaders, such as Denway and TCL, with strong positions in domestic consumer markets early in the year. This had contributed substantially to the outperformance of the China Fund. The Company's overweight position in the oil and export related stocks as well as its avoidance of private enterprises also helped performance. At the end of the period, the Company was 38.8% invested in Red Chips, 36.4% in H shares, 5.9% in 'B' shares and the remainder in Hong Kong companies with substantial business in China. Cash accounted for 6.1% of the portfolio.

The Company received subscriptions for 15,949 shares and repurchases of 18,238 shares during this period.

Economic Review

China's economic growth accelerated, mainly fuelled by stronger than expected export growth. GDP in the first three quarters of 2002 recorded an increase of 7.6%, 8.0% and 8.1% respectively. Exports went up strongly by 17.9% in the second quarter and the growth rate reached as much as 24.9% in August, with the electronics sector being the main driver. The strong export numbers illustrated the fact that China has become increasingly attractive to foreign companies as their production bases due to its cheap production cost, reasonable political stability as well as huge potentials in its domestic markets.

Fixed asset investment, which has been a major growth engine for the economy in the past few years, continued to grow strongly by 24.2% in the first eight months of 2002. The growth was mainly driven by property investments, which were up 30%, and export-oriented industries especially machinery & electronics which was up 41%. The investments were partly funded by strong foreign direct investments, which increased by 26% during the period. Industrial output growth remained strong at 10.9% in the first quarter and 12.5% in the second quarter.

Domestic consumption was slightly weaker than expected and the growth rate declined from 10.1% in 2001 to around 9% at present. However, figures in recent months have indicated that retail sales growth is likely to be maintained at current levels.

Stock Market Review

Prior to China's accession to the World Trade Organisation, the market had tremendous concerns over the challenges that Chinese companies would encounter after domestic markets are opened to foreign competition. Investors' confidence was partly restored by China's economic strength as well as by good financial results posted by some Chinese companies. Chinese stocks had a strong rally in the first six months of 2002 but were subsequently sold off by profit-taking activities in July. Companies that have strong market positions in the domestic market, such as Denway and TCL, were among the best performing stocks. Export related stocks such as Cosco Pacific, a container leasing company with port operations in both mainland China and Hong Kong, also performed strongly. Industry restructuring continued to be a major investment theme and expectations of merger and acquisition activities had driven up share prices especially in the power and aviation sectors.

Like the lackluster A share markets, both Shanghai and Shenzhen B shares were range bound during the period as there was no clear driver for performance. The upcoming launch of the Qualified Foreign Institutional Investor (QFII) system, which allows overseas investors to access to the domestic A share markets, should put further pressure on the B shares.

Outlook

There are signs that economic growth may have peaked and exports should moderate after an extremely strong performance this year. Exports will however remain as a major growth driver for the economy. The uncertainty in US economic recovery has caused some concerns on the outlook for exports, but this is expected to be offset partly by China's ability to gain market share from other countries. Fixed asset investments are likely to slow down as the government tries to reduce spending in order to restrain the surging fiscal deficit. The government also intends to cool the overheated property market by enforcing restrictions on property investments, a key component of fixed-asset investments in the past few years. All the above factors point to a slower GDP growth from this quarter. However, a 7% growth rate is still expected to be achieved in 2003.

China is undergoing a transitional period where political power will be transferred to a new generation of leadership in the 16th Party Congress in November. This has caused some concerns on the continuity of government policies, especially with regards to political reforms and industry restructuring. A smooth transfer is anticipated. It is inevitable however, that there may be occasional mixed signals on policy directions in the next 6 months, resulting in market volatility.

The Company is finding an increasing number of investment ideas, given the wider universe of investible stocks and the improving quality of the companies. The on-going privatization of China's state-owned enterprises has markedly improved the quality of Chinese management. Operational efficiencies have also been raised. Tax reforms, which aim at unifying the tax treatment of domestic and foreign companies, would put Chinese companies at fairer positions to compete with foreign companies. Moreover, government has been encouraging the development of private enterprises, which should add more dynamism to the economy. The QFII system could commence as early as the end of this year. This would help rationalize domestic investment environment and introduce a more transparent management style and international investment standards.

Going forward, the investment focus will continue to be on companies that are major beneficiaries of industry restructuring as well as those with better earnings clarity. The Company will continue to invest in companies with leading market positions. It will continue to monitor closely the level of regulatory risk in key industries, especially those that are undergoing restructuring process. Due to an active pipeline of new companies to be listed and the potential accessibility of the A shares, the Company looks forward to a myriad of new investment opportunities.

Deutsche Asset Management (Asia) Limited

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