

MANAGER'S REPORT**PERFORMANCE**

	01 July 2003 To 30 June 2004	01 July 2002 To 30 June 2003
New Era PRC Fund	52.30%	6.65%
Benchmark: MSCI China Free Index	41.80%	2.67%

Chinese shares were among the best-performing asset classes in the world in 2003, but shares began to pull back in the first half of 2004 from fear of “austerity measures” introduced by the Chinese government.

The second half of 2003 was characterized by the compelling growth story in China and its potential currency appreciation. In the backdrop was the strong Chinese economy, export growth of over 20%, and high consumer demand. Compared to previous China “euphoria”, the outperformance of Chinese shares in 2003 was unique as share prices were driven by strong earnings. H shares’ profit grew by more than 90%.

After a stellar year in 2003, China shares pulled back in the first half of 2004. Driven by concerns over over-investment, the government has stepped in to tighten credit by slowing loan growth to specific sectors and also raising banks’ reserve requirement ratios. This has triggered debates over whether the government can manage a soft landing or hard landing at the end. As inflation moved up to close to 5% on a strong economy and rising costs, investors were also worried that interest rates would start to move up.

Commodity shares like Chalco and Angang Steel were among the hardest hit, as China’s investment demand, which has been the key behind the surge in global commodity prices last year, was set to slow. On the other hand, consumption stocks like Tong Ren Tang and Anhui Expressway performed well as consumption showed no signs of slowing down.

We maintain our long term positive view on China. However, we believe the market will remain volatile as investors are still trying to grasp the actual impact of the austerity measures. However, we believe the government will manage an economic soft landing at the end, as consumption overtakes investment as the future economic driver.

We therefore maintain our positive stance towards consumption shares as the middle class boom will create demand for consumer products such as cars, properties and medical. With raw material prices likely to peak, we think it is also a good time to identify those competitive exporters which will continue to gain export market shares by leveraging on the competitive labour force in China.

The global economic recovery should bode well for China for 2004. However, as China shares are being re-rated, valuation is no longer at a distressed level. As such, stock picking will become very important.