Manager's Report

Performance

	1 July 2005 to 30 June 2006	1 July 2004 to 30 June 2005
New Era PRC Fund	38.80%	27.94%
Benchmark: MSCI China Free Index	40.77%	20.17%

Over the year to 30 June 2006 the MSCI China Index rose by 40.8% in US dollar terms, significantly outperforming the MSCI World Index return of 17.5%. The market was driven higher by substantial inflows into emerging markets on the back of strong global economic growth and rising risk appetite.

In July 2005, investors were surprised when the Chinese government moved to appreciate the renminbi (RMB) by 2.1% against the US dollar and replaced the peg to the dollar with a basket of currencies. This led to renewed interest in Chinese consumption plays and property stocks in Hong Kong and China. Economic data continued to be strong and investors became less sceptical on the sustainability of China's growth. However, corporate earnings momentum slowed and margins were squeezed in downstream areas. Signs of declining oil prices and the suggestion that the US cycle of interest rate rises might be over also helped markets in the region.

After a strong early performance, the Chinese market corrected somewhat in October as investors focused on a possible human pandemic of avian flu. Reforms were announced to make state-owned Chinese A shares tradable by offering compensation (normally in the form of free shares) to investors. Since the government has stated that compensation will only be made to A share investors, this development failed to excite either the B or H share markets.

Positive sentiment towards Chinese shares was restored in November and December, as the market was encouraged by local economic news. Despite scepticism about the sustainability of China's economic growth rate, data showed that investment and exports continued to grow at over 25%. The expansion of China's trade surplus, however, raised concerns of deteriorating trade relations with the US and anticipation that the currency would continue to strengthen. Late in 2005, positive sentiment in the US, particularly signs of rising consumer confidence, helped propel China's market higher. Chinese domestic consumption growth numbers were healthy, with particular strength in retail sales.

The small currency revaluation had little impact during the period, but capital market reforms were broadly welcomed. Record high equity issuance and underlying worries of confused corporate agendas – for example, the purchase of overseas assets for strategic purposes – somewhat detracted from an otherwise positive performance.

China performed particularly strongly in the first quarter of 2006 as there were large inflows into emerging markets. It then held up well in the second quarter even as global equity markets corrected substantially on concerns about rising interest rates and a decline in the appetite for risk.

The Chinese economy continued to grow very strongly in 2006 with robust GDP growth of 10.2% in the first quarter driven by surging fixed asset investment which increased 28% from the previous year. Car sales grew 47% in the first half to 1.8m vehicles. To prevent the economy over-heating, the government announced a series of austerity measures targeting sectors such as property and cement and the central bank increased the lending rate by 27 basis points. The government's latest Five Year Plan included a focus on growth acceleration in the more rural central region which has lagged in the economic development of China and is positive for domestic demand. The government is also addressing the environment more seriously which is a long-term positive. Concerns over the austerity measures and muted investor interest resulted in the cancellation of the Initial Public Offering (IPO) of Shui On Land.