

International money is likely to pour into the city, with property companies and stocks gaining the most, writes Chris Oliver

PICKING THE WINNERS

Paul Pong, director of Pegasus Fund Managers

China Southern Airlines

Yuan revaluation would alleviate its liability and interest payments, and enhance profitability. According to estimates, the airline will increase its earnings per share 56.6 per cent with every 1 per cent appreciation in the yuan

Sinopec

Cost of imported raw material will decrease, improving profitability and offsetting the impact on high oil prices

Tsingtao Beer

Imported wheat, one of the major raw materials, accounts for 18 per cent of costs. Appreciation of the yuan will lower production costs and improve profitability

Brook McConnell, president of South Ocean Management

Heng Tai Consumables

The company imports US dollar-denominated consumables to China and is paid in yuan

Road King Infrastructure

Toll-road projects in China are funded with dollar-denominated debt, while revenue is in yuan

Philip Morris (Altria Group)

Mainlanders are the biggest smokers in the world. A strong currency gives them more purchasing power for US brands such as Marlboro

Spenser White, chief Asian equity strategist for Merrill Lynch

Travelsky Technology

China's largest air-travel reservations system may fare better as a stronger yuan boosts the ability of individuals

Heng Tai Consumables

It should benefit over the longer term from the increased buying power of Chinese consumers and businesses

Beauty China Holdings

This Singapore-based company sells Colour Zone cosmetics and skin-care products

Andy Mantel, managing director of Pacific Sun Investment Management

Zhenhai Refining

It will benefit from the lower cost of imported crude. Books sales in yuan

China Resources

Good cash flow in yuan and some costs are in foreign currencies

Anhui Expressway

Strong cash-flow business in yuan



Yuan revaluation sets stage for boom in HK

Changes to China's currency regime will set the stage for a potential boom in Hong Kong stock and property markets that appears to mirror the financial conditions that led to the Asian crash of 1997.

Instead of fleeing an overvalued Hong Kong dollar, international money flows were soon likely to deluge the city in a bid to bargain hunt assets now devalued against regional currencies, JPMorgan economist Ben Sempfordor said.

"Because the [Hong Kong dollar] peg is fixed it means the prices of good and services, and assets have to compensate," he said. "The same way an over-valued exchange rate resulted in massive price deflation, an undervalued exchange rate results in price inflation."

Thursday's upward 2.1 per cent revaluation of the yuan and the adoption of a managed float against a basket of currencies, sets the stage for a meaningful appreciation of Asian currencies. JPMorgan forecasts the yuan will rise a cumulative 7 per cent by the year's end, to trade at 7.8 yuan against the US dollar. A further 8 per cent appreciation is forecast next year.

Most economists believe last week's move by Beijing is a starting point for yuan appreciation of around 5 per cent or more annually.

Historically, countries with strong annual gross domestic product growth rates between 7 and 8 per cent could expect their currencies to appreciate 30 to 70 per cent during a 10-year period, said Deutsche Bank.

If these revaluation trends hold, Hong Kong will be in the reverse perfect-storm scenario, saddled with a chronically weak currency, booming economic growth and red-hot asset markets.

"It simply means Hong Kong is more competitive relative to the region, which implies larger current-account balances, rising asset prices, all the sorts of things you associate with a booming economy," Mr Sempfordor said.

Among the beneficiaries geared to the local rebound are conglomerates such as Cheung Kong (Holdings), Sun Hung Kai Properties, New World Development and Hang Lung Group.

Consensus analyst opinion is that rising capital inflows will limit interest rates, while mainland cash will spill across the border in search of hard assets. Macquarie raised its 12-month price target on Cheung Kong to \$98.80, a 17 per cent premium to its present level.

Mr Sempfordor is less certain revaluation spells good news for

Asia, but he says it should help balance the global economy by realigning the region towards domestic consumption and away from export-led growth. "I don't think it signals a bull market," he said of the region, but he does expect a short-term rally. Strapped with a faltering currency, Hong Kong was the only market in a genuine bull, he said.

"Singapore stands to benefit a lot. Hong Kong is like a balloon, there is a huge impact here"

Bill Belchere
Macquarie regional economist

Macquarie regional economist Bill Belchere is more upbeat, believing the revaluation signals the return of region-wide asset-price reflation. "It sets in motion the great Asian reflation which was stalling and sputtering over the last quarter," he said. "I think they [China] set off a bull market that could last for quite a while."

On Friday, Macquarie boosted

its year-end target for the Hang Seng Index from 15,500 to 17,550, about 20 per cent above current levels. At the target level the market would be priced at 15.3 times 2006 earnings and a 3.4 per cent yield, according to the bank's forecasts.

Although interest rates were rising, Mr Belchere said it would have little effect on the strong yuan demand, with China's current account balance running a surplus equivalent to 6 per cent of GDP. "What this points to is a continuing demand to appreciate the currency," he said. "This means yield curves across Asia remain below the US yield curve and that is to some extent stimulative."

The domino effect of rising currencies across Asia will lead to further flows into the region as speculators bet on a continuation of the trend. Malaysia, Korea, Hong Kong and perhaps Japan would receive most of the hot money. "Singapore stands to benefit a lot," Mr Belchere said. "Hong Kong is like a balloon, there is a huge impact here."

He also believes the global manufacturing cycle will rebound, adding to the bottom line in Hong Kong's export and logistics leveraged economy. Recent data supports this view, and Japan, Asia, Europe and even Europe were

clearly on the mend, while strong US jobs growth and rising income levels point to an upturn, he said.

"There are a lot of indicators we are going to get a bit of a lift here as we move towards the end of the year," he said. "Rather than a global economy that is falling apart, it has been incredibly resilient."

Macquarie forecasts the Hong Kong dollar will decline 3.4 per cent next year on an export weighted basis. The depreciation is a boon to regionally focused goods and services, and especially positive for the high-income job market.

Other winners were companies with large holdings of yuan-denominated assets, including Hopewell Highway, Kerry Properties, and Keppel Land, Macquarie said.

Hong Kong banks could also benefit from the decline in inter-bank borrowing rates when speculative dollar flows return.

Looking at the impact of the revaluation on the mainland, ABN Amro recommends investors head for companies with strong earnings growth and debt denominated in foreign currencies. Among favourites are fixed-line telecoms, toll-road operators, and retailers.

Airlines, power utilities, brewers and refiners are likely beneficiaries.

JPMorgan eyes lucrative Indian property market

Dominic Whiting

A fund management arm of JPMorgan wants to team up with an Indian developer to build housing and offices in India.

JPMorgan Asset Management is also keen to invest in Japan and China. In Hong Kong to launch a fund investing in global real estate investment trusts (reits), JPMorgan Asset Management's property chief said building was expected to start in India in 2006.

"We would want to partner with the best developers," said New York-based Joseph Azelby of his plans in India. "There's a fast growing middle class and entire communities are springing up."

Since India eased rules in February on foreign investment in a thriving property market, several US real estate investors such as investment bank Morgan Stanley, pension fund Calpers and private developer Hines International have been looking for deals.

Indian firms are keen for foreign capital and expertise to help them expand from their regional bases.

In a fragmented market, developers DLF Universal and listed Unitech are among the biggest names in the north, K Raheja Corp and Hiranandani Group dominate in Mumbai, and RMZ Corp is building business parks in the south.

Mr Azelby said it also wanted to invest in China and Japan, but gave no details. "I'm here to build a real estate investment platform. We're just getting started."

JPMorgan Asset Management is launching a "Global Property Income Fund" in Hong Kong, Singapore and Macau that will invest in property trusts around the world. It is targeting net dividend yields of 3.5 to 4 per cent per year.

Initially about 65 per cent of the fund will go into US trusts, with Australia the next preferred market, Mr Azelby said. But as Asia's property trust market grows from a capitalisation of \$27 billion now, the fund would allocate more to Japan and Singapore, he said.

The Asian real estate market is still a minuscule portion of the US\$1.3 trillion of investment-grade property in the region. He said the fund would invest in office, industrial,

retail and residential properties, but would consider alternatives such as hotels and golf courses.

Some analysts said the market would mimic the past 25 years of growth in Australia's market, where listed property trusts own 60 per cent of \$103 billion (\$612.5 billion) of high-grade property.

Mr Azelby said rising interest rates should not deter investors, because economic growth could raise rental incomes at property-trust-owned buildings just as quickly. "There is that built in hedge. The chances are there will also be rising fundamentals," he said. "And rising interest rates can be good for some sectors such as rental apartments because fewer people will be buying homes."

JPMorgan Asset Management holds US\$30 billion of direct property assets and US\$7 billion of property securities, such as reits, which pay most of the rental income from their buildings to investors in regular dividends.

Mr Azelby said there were signs of a bubble in US real estate prices, but not all markets were excessively priced. "You have to separate the single family housing market from the commercial real estate market," he said. "In the US, there is a bit of concern that single family homes have far exceeded price levels that most people would say are rational."

The return profile of commercial real estate is still quite attractive relative to a fixed income or an equity portfolio.

In the past two years real estate funds have outperformed. On average, the 26 real estate funds authorised for distribution in Hong Kong have risen 30 per cent in one year and 82 per cent during three years, Lipper data shows.

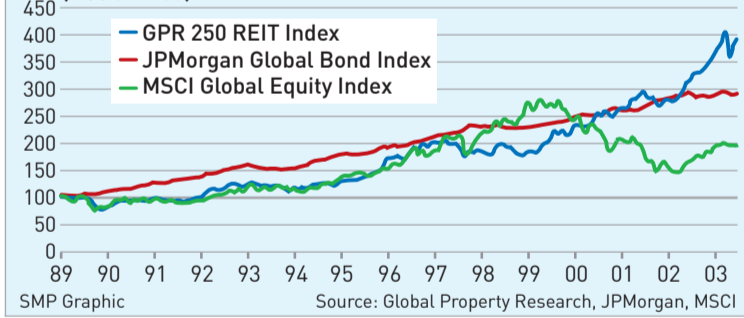
Scott Bladdell, New York-based head of JPMorgan Asset Management's reits team, said investors were attracted by the safety of an investment product backed by hard assets, and linked to inflation through flexible rental rates.

"They throw off a lot of cash, in that way they are like bonds, but they do grow, so it's a nice combination of high income and modest growth year after year," he said.

Reuters

RETURN INDICES

(Dec 89=100)



Gamblers get a chance to bet on storms

Denise Kalette

Three University of Miami professors are setting up a futures market that will enable people to bet on where a hurricane will strike.

The professors — two of them economists, the third a meteorologist — are hoping the collective wisdom of the marketplace will prove more accurate than US government forecasters and help homeowners decide with more certainty whether to evacuate.

The project is called the Miami Hurricane Event Market, or Mahem. Forecasters, insurers, homeowners and other members of the public will be able to invest in shares representing coastal spots where they think a storm will strike. Those who forecast most accurately will get a payout.

"The point is to use markets as a way of collecting and processing information" about where a dangerous storm will strike, said David Kelly, an economist. "Information

from many, many models is brought in to help figure out where the hurricane is going to land."

The director of the National Hurricane Centre, Max Mayfield, was sceptical about the project. "If they think they're going to help us forecast hurricanes, I don't see how," he said.

The professors say they are not making money on the venture. Traders are limited to US\$500 in spending per hurricane season, June to the end of November. AP

Vintage concept finds niche appeal

SMALL WORLD
CHRIS OLIVER

After nine years in business, the second-hand vintage shop Flea+Cents is almost as much a novelty as the collection of vintage furniture and home accessories it sells.

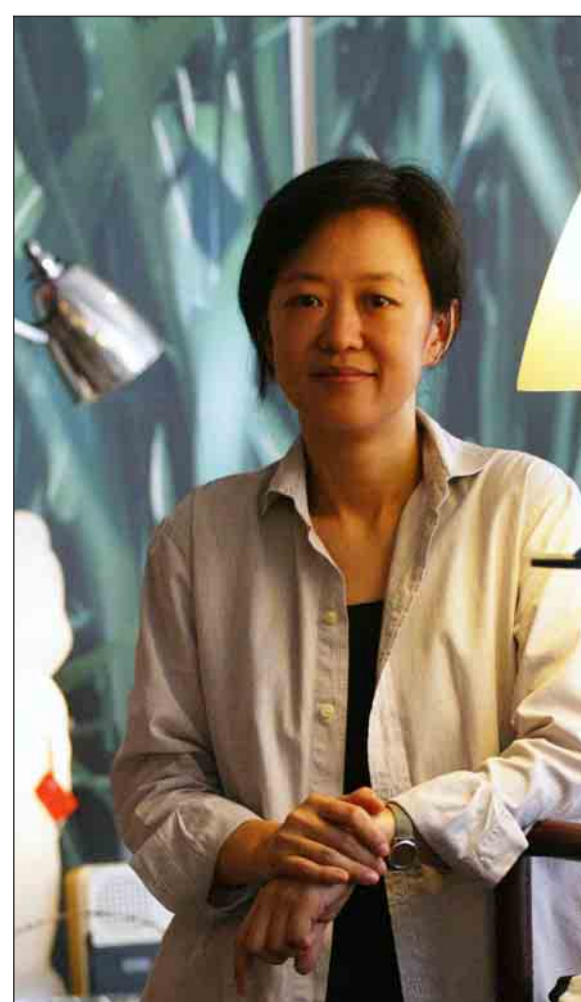
Since it opened on Wing Fung Street in 1996, the shop has matured into a 1,800 sq ft showroom on Queen's Road East, but it remains very much a low-volume business directed at repeat customers.

Aside from its niche market among the professional design community and local collectors, the shop also appeals to international visitors, mainly Japanese and Singaporean buyers, who heard about it by word of mouth.

"I don't know how they find us," said founder and interior designer Jane Chang, adding the shop has neither an advertising budget, nor any direct marketing.

Featuring an eclectic mix of household items dating from the 1950s and later, the showroom is like a modern design museum of furniture, lighting and decorative tableware. Ms Chang describes the collection as a lifestyle retail concept that crosses the line between antiques and home furnishings, a concept that fits with her design sensibilities.

"I really enjoy the development of the shop because it is not really fast-tracked to business, it is more relaxing," she says. "I think collect-



Jane Chang, co-founder of Flea+Cents, says the business cannot go too far beyond commercial rules otherwise it would become a charity group.
Photo: Dustin Shum

ables should have this kind of mood to sell." Vintage items are sourced in Hong Kong and abroad, with most of them coming from

Britain. She buys from friends and vintage dealers who have a knack for understanding the retail theme. The shop also sells modern cre-

ations of current designers which she believes will one day be viewed as classics. "Perhaps in 20 years you will find this in a vintage shop," she says, pointing to an aluminium ashtray.

She adds the pricing strategy is designed to fit within a broad budget but says the target is to meet an international pricing standard for vintage items. "We are priced about the same around the world, plus import and shipment costs, on average they are all middle range items," she says.

While the store is run for profit, Ms Chang says commercial pressures are muted by the dual role of the space. Along one end is a shared design studio, which allows her to spread operating costs across the two businesses. The two businesses function in a mutually beneficial relationship: it is a meeting space for potential clients and design industry professionals.

Although removed from the hard-sell approach, Ms Chan says the retail side is more than a self-indulgent exercise.

"I think, of course, we have to make a balance, we can't go too far beyond commercial rules otherwise we become a charity group."

She says Flea+Cents is evaluating the possibility of expanding either in Hong Kong or abroad, but she wants to wait to find the right feel between the business' potential partners.

"The hardest part is the long hours," she says. "We are open seven days a week. It can be tough."

www.fleacent.com

