China Region Stabilizes In April

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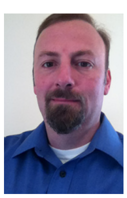

Activity in the China region stabilized in April, the JP Morgan China Region Fund at a 4 month high with narrowing discount; should we be waiting for the other shoe to drop?

China, Waiting For The Other Shoe To Drop

Activity in the China region stabilized in April in the absence of regulatory interference. The calm was just what the market needed to instill a little confidence in uncertain times. Economic data firmed a little too, another positive for the market, although overall GDP continues to slow. All in all it was just what the managers at the JPMorgan China Region were looking for, a little stability.

From the January Fund Fact Sheet

"Chinese policymakers continued to lose credibility with markets due to opacity, inconsistency and a lack of intra-institutional coordination. While central banks in other major economies have generally been stabilizing forces in recent years, the PBOC has thus far not been. That said, given the growth bias of our portfolio, we only require stability rather than an improbable recovery in either policy credibility or the broader economy, and market dislocations are generally opportunities to add to our holdings in consumer, media, healthcare and technology."

What they got may have been more than they hoped, a little stability and economic rebound. To be honest, the month did not start off well in terms of data. The Asian Development bank lowered its GDP outlook for 2016 to 6.5%, and to 6.3% in 2017, simultaneous to a downgrade in credit rating from S&P. The rating was cut to AA- with negative outlook based on slower than expected recovery. This was followed by better than expected PMI readings which show China's economy expanding at the strongest rate in nearly a year. Services PMI rose to 52.2, up from 51.2, but the real surprise was in manufacturing. Manufacturing PMI rose to 50.2 and ending months of contraction.

Other signs of stabilization include 6.7% GDP in the first quarter and growth in retail sales, industrial output and exports. The negative is that GDP slowed to it's lowest rate since hitting it's peak pre-financial crisis, the positive is that it is well within the governments target range. Exports surged, up 18.8% in March, the first month of growth in 9. Inflation also showed some sign of stabilizing, CPI continues to rise at a rate above 2% while PPI contracted less than expected.

Additional support for the market came in the form of PBOC activity. The bank signaled at the beginning of the month it would soon come to the aid of consumer credit markets and begin encouraging businesses to issue debt. Later in the month the bank injected near record amounts of cash into the economy in order to stave off shortage associated with tax payments and loan maturities.

China Region Fund In A Stabilizing China

Performance at the JFC since the January report has been pretty good. Stabilizing markets has allowed NAV and share prices to increase at a rate greater than the benchmarks, and for the NAV discount to shrink. On a share basis prices have increased more than 17%, well above the 12% posted by the benchmark. NAV increased at a rate roughly 14% in that time, allowing share prices to come closer in line with the historical average discount. NAV is running near $17 now, near the 2016 high, leaving shares at a roughly -10% discount. This discount is below the 6 month and 3 year averages, near -13% in both cases, less than ideal for value investors but indicative of confidence in the region and the fund.

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In the review Chinese macro data, FOMC outlook and oil markets are cited as positive factors which offset a weak earnings among Chinese companies. This, along with rising real estate and commodity prices, helped to drive equity indices in Hong Kong, mainland China and Taiwan higher. Taiwan was the laggard due to stagnant export demand and lingering anti-trust uncertainty over some high profile mergers. Outlook is good, the PBOC's easing bias should help ongoing stabilization, providing a positive backdrop for corporate growth. The caveat is that managers see continued deterioration in the industrial base which is lead ing them toward more consumer based investments.

The portfolio has seen some fundamental changes as well. Fund manager Emerson Yip has liquidated portions in order to raise a 4.7% cash position intended for the purposes of redeployment in undervalued sectors. Sectors affected include utilities (-2.9%), materials (-2.8%), telecommunication services (-1.7%), financials (-1.2%), consumer staples (-1.1%) and energy (-0.9%). While this was going on there were some notable additions to the portfolio as well. These occurred in the consumer discretionary sector (+3.7%), information technology (+1.2%), healthcare (+0.8%) and the industrials (+0.2%). In terms of affected market exposure Taiwan saw the largest decrease in portfolio allotment, -6.2%. Hong Kong listed China "P" chips saw the largest increase in exposure, +5.2%. The next largest changes were China "H" shares (-2.9%) and Hong Kong based business (+1.2%).

Some Final Thoughts

The JP Morgan China Region Fund has certainly seem some improvement over the past month. The fund has seen an increase in NAV and share prices, is beating the benchmarks and poised to benefit from stabilization in the Chinese economic arena. Add in a dividend that has seen a steady rise since the financial crisis and it's value as a long term investment into the Chinese markets only improves. The only negative at this time that I see, aside from underlying risk inherent in China, is valuation relative to NAV. It is likely that the discount will come back into the line with the historic average in the near to short term, the question is, will share prices fall or will China's markets continue to improve?

When you look past the headlines shouting about slowing Chinese growth and realize the country and the region are expected to grow at a rate greater than 6% into the next 3 to 5 years growth and income opportunity become a little more clear. Based on current conditions it looks like China's markets will continue to improve to me, which means JFC's share price is likely fairly valued in the near to short term, and quite possibly undervalued for those with a longer term time horizon.