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- More than 20 years investment experience
- Responsible for portfolio management, research and trading within the region
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What Are Dim Sum Bonds?

Dim sum bonds, or offshore RMB bonds, are Chinese yuan-denominated bonds issued and settled outside mainland China. Although a single currency, there are two main types of bonds; CNH bonds or dim sum bonds that are traded offshore in Hong Kong and CNY synthetic bonds that are settled in USD. CNH bonds are settled based on offshore Renminbi (RMB) exchange rates, whereas synthetic CNY bonds are settled in US dollars based on onshore RMB rates.

The dim sum bond market began in July 2007 when the Chinese government authorized mainland banks to issue RMB bonds in Hong Kong. A series of reforms continued over the following years, with the most significant capital market developments occurring in July 2010.

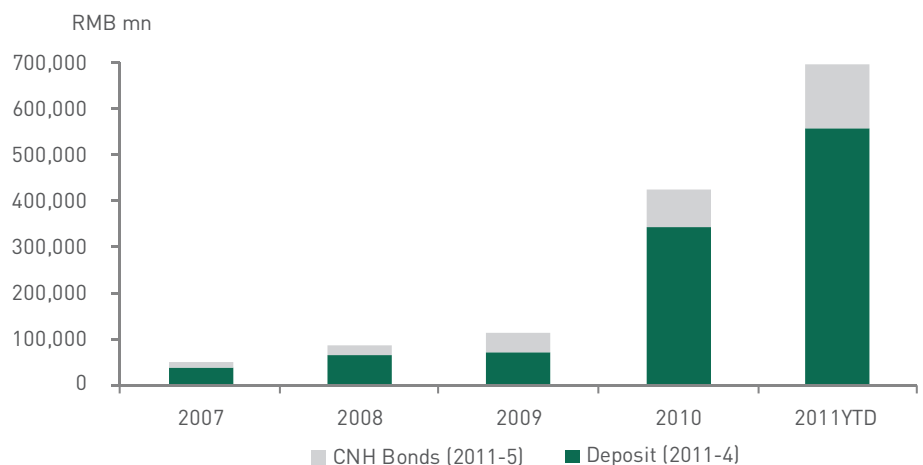
In addition to Chinese and foreign corporations, banks and supranational entities being permitted to issue RMB

bonds in Hong Kong, limits on daily foreign exchange conversion of Hong Kong-based companies were relaxed and a local clearing system was also set up. Since these improvements in market infrastructure we have seen a growing demand for investable RMB-linked assets, and we expect this trend to continue.

Today, the offshore RMB bond market is flourishing. Total issuance of dim sum bonds amounted to around RMB 111 billion as at the end of June 2011¹. The majority of these issues were CNH bonds. Currently, the total outstanding amount of dim sum bonds is less than around 25% of the offshore RMB deposits. While most of the dim sum bonds are currently being issued by entities based in Hong Kong or China, there is an increasing number of foreign corporations and financial institutions tapping into RMB financing in Hong Kong.

¹ Source: Bloomberg.

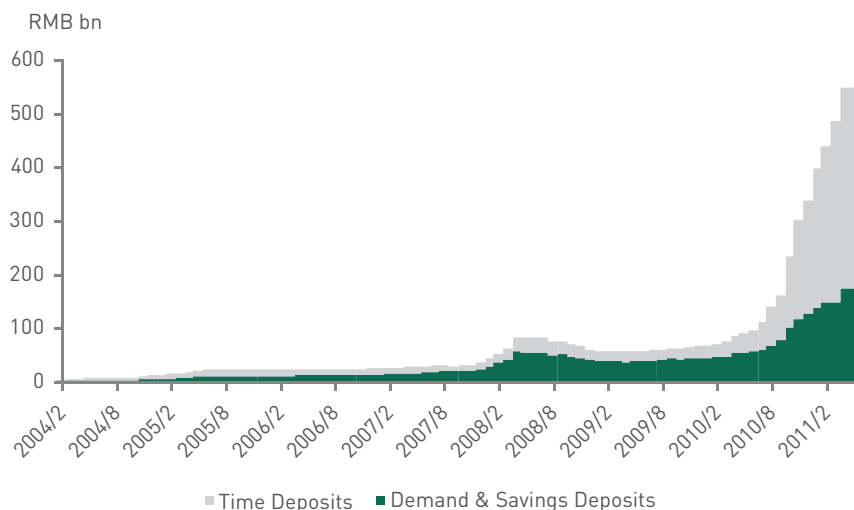
FIGURE 1 Offshore RMB Bond Issuance Approx. 25% of Deposits Outstanding



Source: Bloomberg, May 2011.

FIGURE 2

RMB Deposits in Hong Kong



Source: Bloomberg, May 2011.

What Makes Dim Sum Bonds Attractive Now?

- Positive market fundamentals, supported by China’s strong economic growth
- Increasing importance of the yuan as an international currency
- Expectation for appreciation of the Renminbi
- Desirable asset class with demand exceeding supply
- Less vulnerable to interest rates, with duration generally shorter than other USD-based Asia bonds
- Relatively stable market as RMB bonds typically held to maturity

From a macro-economic perspective, strong economic growth in China and its increasing importance on the world stage as the second largest economy remain supportive of the growing demand for RMB denominated assets. The increasing importance of the Chinese yuan as an international currency has also added to the attraction of RMB bonds, further promoting the development and liquidity of this market. One of the main attractions of the asset class is the potential for

enhanced returns from investing in RMB which many view as currently undervalued. Historically, RMB deposits have provided an option to participate in the anticipated currency appreciation, however interest rates on deposits are relatively low.

Currently, there are limited means for foreign investors who do not hold the appropriate licenses to invest in onshore equity or bond markets to access the onshore RMB market. As a result, we expect offshore RMB bonds to become one of the most important pipelines for fundraising by Chinese entities, providing

foreign capital with greater access to China.

In addition to a relatively attractive yield in the current interest rate environment in markets such as Hong Kong and Singapore, dim sum bonds can also provide diversification benefits for traditional G3-currency based investors and act as a revenue hedging tool for corporations that receive RMB.

Market Outlook

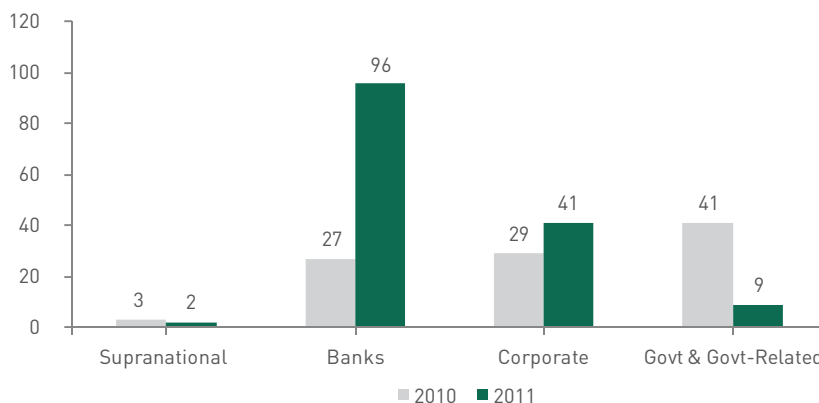
With a more easily tradable RMB in Hong Kong and outstanding RMB issuances expected to rise further, this relatively small market is expected to experience continued growth.

We view the dim sum bond market as a credit market rather than a rate market as most of the bonds are unrated. The average duration of the universe is around 2-3 years based on the HSBC RMB Bond Index. Meanwhile, there are no effective measures to hedge the interest rate or credit risks.

Therefore given that most of the dim sum issuers are unrated corporates, we believe that a proven and rigorous credit selection process will be a key differentiator to successful investing in this new and exciting market going forward. ■

FIGURE 3

Offshore RMB Bond Issues are Mostly Banks and Corporate Bonds



Source: Bloomberg, May 2011.

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