Jim Trippon's
China Stock Digest
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China Stock Digest ®

Profiting from Tomorrow's Economy Today™

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Predictions, Profits and Potential for China Stocks 2006

An Economic Earthquake

Dear Subscriber:

The biggest economic story of the year hit the newswires last month, but most investors around the world heard little or nothing about it. Here's what happened. The People's Republic of China (PRC) took a deeper look at its economic growth statistics and concluded it had made an error, a big one. They discovered that the size of the economy had been underestimated by $280 billion.

In a world preoccupied with war and terrorism, that might seem like a footnote. I see it as anything but. China's new growth figures are the equivalent of an earthquake or a tsunami on the world's economic scene.

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Many comfortable assumptions have been shaken badly. Observers in the European Union noted with particular alarm that China had suddenly replaced Italy as the world's sixth-largest economy. Europolitix.com worried aloud, "The Asian dragon now threatens the French number five ranking." We believe that France has already been left behind by the Chinese economic juggernaut.

It's extremely important for investors to take a deeper look at the meaning of these numbers. The Chinese government revised its economic estimates after a one-year economic census that discovered $280 billion in hidden economic output last year. Just how big is this discovery? To put it in perspective, the census result means that China has discovered a new internal economy equal in size to the economies of entire countries. This hidden Chinese economy is on a par with the economies of Turkey or Indonesia.

The newly discovered productivity of the Chinese economy boosts China's gross domestic product (GDP) for 2004 to almost $2 trillion. That is a colossal jump of 17 percent. This unexpected jump in China's GDP will also transform every statistic that shapes our understanding of China, most importantly, our concept of the nation's growth rate.

It is already common knowledge that China's economy is the fastest growing in the world. Previous measurements by a diverse range of experts reported that the Chinese economy was expanding at a phenomenal rate of approximately 9 percent every year for the past two decades. But some economists have argued that the Chinese economy has really been growing much more aggressively. These analysts have consistently estimated an economic growth rate of more than 11 percent. Now the estimates on the high side have been proven correct. The Chinese growth rate is still being recalculated, but it could register as high as 13 percent for 2005!

The shape of the world economy is changing so quickly that it will soon be unrecognizable to those who are not following the China story. If we extrapolate this new picture of China's economic growth into 2006, we expect that China will emerge this year in the undisputed number four position: ***the world's fourth-largest economy!*** It will surpass the United Kingdom in size, leaving only Germany, Japan and the United States greater than China in terms of GDP. (In fact, China has already surpassed the UK in terms of exports to the United States.)

China still has a long way to go before it eclipses the United States economy, which had a GDP of $11.7 trillion last year. But the day is coming. There are now predictions that China will overtake the U.S. in 2035, five years earlier than previously expected.

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The World Bank has another way of measuring economic scale, the **"PPP"** method: Purchasing Power Parity. In terms of total purchasing power, the Chinese economy is now the second largest on the planet, once again following only the United States.

What does all this mean to investors? Cynics and pessimists will point out that China's economic output per person is little more than $1,700. In terms of income per person, China was ranked 134th in the world in 2003 according to the World Bank.

This is a classic question of the pessimist seeing the glass as half empty and the optimist seeing the glass as half full. We see the glass as half full, not so much because we are optimists, but because we are investors.

What It All Means to Investors

One of the lingering worries that has kept the Chinese stock market from growing as quickly as the nation's economy is a nagging question about the nature of Chinese growth figures. Economists have long worried that the country's economic growth was being driven by investment-driven capacity expansion. In other words, some observers feared that the growth figures were not real or sustainable.

As economist Weijian Shan fretted in the ***Far Eastern Economic Review***, "Investments now account for than 50% of [China's] gross domestic product, far more than any other country at any time in the history of economic development. This relentless capacity expansion has led to economy-wide overcapacity and overcompetition to such an extent that the profit margins of the firms are constantly squeezed." Mr. Shan argued that the prices of exports to the U.S. had fallen by more than a quarter while raw material prices had gone up by 20%. In his opinion, that meant declining profits and declining returns for shareholders.

Other economists worried that the heavy inflows of investment capital would overheat the economy, creating a disastrous inflationary spiral. Of course that hasn't happened. Inflation at the Consumer Price Index (CPI) level remains at a very low 1.9% rate despite an increase in retail sales of 13 percent over the past year. It is clear that inflation is not out of control. The economy has not overheated. Why are the pessimists wrong?

The newest GDP numbers absolutely transform our understanding of the Chinese economy, and they make it much more attractive as an investment arena. Previous statistics were calculated from data provided by institutions such as large factories, a method left over from the days of the centrally planned, Communist Party–controlled economy. In a free market economy, these "supply-side" figures entirely missed the cash component of the economy.

Supply-side economic numbers fail to take into account the amount of all money that consumers actually spend. This ongoing error has thoroughly distorted the picture of the Chinese economy for decades and given economists countless sleepless nights. The new numbers reveal a picture of China that is far more balanced and hopeful than we had dared imagine.

What has been revealed is a giant ***service economy*** within China. North Americans take the service economy for granted because so much of our economic activity is based on value-added services and knowledge-based products. This previously unmeasured portion of the Chinese economy turns out to be 40 percent as large as the entire economy of India. It is a huge economic engine that will drive many of the companies we are following.

The discovery of this service economy is vitally important to China's business future. Fears that the Chinese economy was in a bubble, driven largely by excessive investment, have been eased considerably. Even the most pessimistic economists will have to agree with the ***China Stock Digest*** that the newly discovered size of the service economy is unqualified good news. It shows that the national economy is much more diversified and healthier than anyone had known.

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There are some optimistic economists, and Dong Tao of Credit Suisse First Boston is one of them. He believes that China may still be underestimating the size of its service sector by another $200 billion. These calculations of a much-larger-than-expected Chinese GDP mean that there is much less reason to worry about pessimistic predictions that China might be headed for an economic tumble.

As investors, we now have greater confidence. We have far less reason to worry that China's economic growth might be an illusion created by excessive capital investment. Investing in a broader, knowledge-based economy makes more sense as we see Chinese consumerism and the service sector grow.

What's Ahead for 2006?

We expect 2006 to be another banner year for the Chinese economy.

First of all, we can put aside the old, often-repeated warnings of a dangerous inflationary spiral in China. In fact, one of the country's leading economists predicts that the national economy will slow fractionally in 2006. Yao Jingyuan, the chief economist at the National Bureau of ***statistics***, expects China's gross domestic product will expand at a rate between 8 and 9 percent during the coming year.

That's a healthy clip but not inflationary. We believe that continued growth in economic production and demand will continue to stimulate the performance of our preferred investments while stopping short of overheating the economy.

Let's examine another shift in the economy. It is widely believed that China's export boom will begin to ease off. The country's trade surplus is expected to come in at $100 billion during 2005, more than triple the previous year's $32 billion surplus. Even if the country's export growth rate moderates, there will probably be continuing friction with China's trading partners, especially the United States. The U.S. consumes about 40 percent of China's exports, according to the World Bank.

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There are profound issues swirling around China's export surplus. Most Chinese trading partners agree that the national currency, the yuan (also known as the renminbi) is being kept artificially low. The low valuation of the Chinese currency makes exports more attractive to foreign buyers, and some say that gives China an unfair advantage.

The most radical voices in the U.S. Congress are demanding tariffs of 27.5 percent on all goods imported from China. They argue that would be a fair and justified step to protect American jobs, because they say 27.5 percent is exactly the amount they believe the yuan has been undervalued.

Whatever the merits of their arguments might be, such an action is highly unlikely to happen. The consequences would be disastrous on both sides of the planet. If such tariffs were imposed, Chinese exports would be slashed. China's ability to purchase U.S. Treasury bonds and its ability to sustain America's indebtedness would be crippled. The consequences for the American economy would be as severe for the United States as they would for China. There may be a lot of bluster coming out of Washington, but few politicians would risk such a potentially suicidal step.

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We don't see such a disaster on the horizon. Much more likely is continuing pressure from China's trading partners to adjust the yuan. If history is any guide, such changes will be relatively slight and measured.

A little history: On July 21, 2005, the People's Bank of China (PBOC) and advisors to President Hu Jintao announced that the yuan's ten-year-long peg to the U.S. dollar would be ended. Instead, the PBOC decided to adopt a floating exchange rate based on a basket of leading currencies including the dollar, the euro and the yen. The bank has kept the exact nature of its floating mechanism shrouded in obscurity, but the results tell the story.

The yuan has been allowed to appreciate by about 2 percent in relation to the dollar. The move has mollified some critics but not those who were looking for a 27 percent shift in value. It appears that Chinese currency will continue to be managed in a narrow band, and the cost of Chinese exports will not change appreciably.

The future of the Chinese economy for 2006 was set out at an official conference in Beijing in early December of last year. Among the key objectives:

- Fast, stable, sustainable growth
- More competitive domestic enterprises
- Boosting rural development

The December meeting of the Central Committee of the Communist Party of China and the State Council issued a proclamation on the future that can be construed as government policy for the coming year. In the Chinese fashion, this meeting was attended by President Hu Jintao and Premier Wen Jiabao, signifying official endorsement of its conclusions at the highest levels of national leadership. It is up to investors to read between the lines.

The meeting declared that fast, stable growth is "imperative for increasing national strength and relieving contradictions in social and economic development." In other words, China plans to stimulate economic growth. The nation still needs to fight high unemployment and reduce the continuing blight of poverty.

In a tip to investors, the statement said, "The government will continue to rein in excessive investment in such overheated sectors as steel, cement, aluminum and copper."

Probably the most telling statement announced that the key to fast and stable growth lies in "increasing domestic demand, sticking to prudent fiscal and monetary policies and improving macro-regulation." This was interpreted by Lin Yueqin of the Economic Research Institute of the Chinese Academy of Social Science as meaning that the nation's highest leadership is determined to make China's economy develop in a "sustainable way." It is a noble-sounding goal, but what is the message hidden in the tea leaves? It is all about internal growth and development.

Growing from Within

"*Increased domestic demand*" is the key phrase we hear from many Chinese government officials. Anticipating some slackening of China's export boom, the government has focused on the developing economy within China's borders.

Yao Jingyuan, chief economist at the National Bureau of Statistics, says China's own consumption will play an increasingly important role in the coming year. But he cautions, "It's unlikely that consumption-boosting measures will work overnight, so investment will continue to be the largest engine of growth next year."

In the effort to sustain its economic boom through internal growth, China is attempting to boost domestic demand by increasing the money supply while easing consumer credit. As China's middle class continues to expand, retail sales have already started to increase. The World Bank reports that retail sales rose 13 percent year over year in 2004. China's National Bureau of Statistics says that trend is continuing this year. It reports that retail sales in November shot up another 12.4 percent over the same month last year. Total spending was $73 billion.

How big is the potential here? Remember the **"PPP"** rating. Measured by purchasing power parity, China is the number two nation in the world, ranking behind only the United States. For example, consider the staggering size of the wireless phone market. China has approximately 300 million cell phone subscribers, and the domestic market is far from saturated. It is estimated that about four million mobile phones are sold in China every month.

Compare that to the United States, where there are approximately 155 million cell phone subscribers and the market is relatively mature.

It is sometimes difficult to appreciate the changes that a country like China is experiencing without actually going there in person. On my most recent visit to China, I was struck by the number of luxury cars crowding the roads. It was amazing to see the number of Toyota, Buick and Lexus automobiles on the streets of cities that were once jammed only with bicycles.

Statistics can be misleading in a country as diverse as China because they paper over the wide gap between urban wealth and chronic rural poverty. On a per capita basis, China's gross domestic product is a humble $1,700. But this relatively low average conceals the fact that millions of people in China's huge cities are substantially better off. The Chinese Academy of Social Sciences reports that as many as 150 million people are now members of the middle class.

A quarter of a century ago, only eight million households were defined as middle class. Now the number of middle-class households is approaching fifty million.

Who are these new Chinese? The blue uniform of Chairman Mao is long gone. So is the angry image of dissent in Tien An Min Square. The Chinese middle class is now much like any other in the world: white collar, college educated and ambitious. Unemployment is still high, approaching 10 percent, and so the level of competition for a good job is fierce.

Total household income in an average middle- class family is $36,000, and purchasing power can exceed $12,000. Because China enjoys a household savings rate of 40 percent, the potential to expand internal consumption is enormous. This growing pool of wealth is transforming China's internal economy, and these changes impact our investment recommendations.

A study by Grey Global Group of Beijing found that the members of the younger generation in China are very confident about their futures and driven to get ahead in the business world. Money and self-image are important to this new breed of Chinese consumer. They are willing to experiment by buying new gadgets and wearing trendy clothes. More than half say they need to take risks to be successful, and Grey Global interprets this finding as the emergence of a huge unmet demand for new trends from consumer product companies.

The era of Chinese consumerism is the next big step in this nation's economic growth. Per capita production, or GDP, is expected to increase almost 100 percent to $7,500 during

2007. The emergence of an increasingly wealthy Chinese middle class means consumer demand within China is quickly becoming a powerful and highly important economic force.

As disposable income increases, we expect to see the pool of Internet subscribers within China grow substantially. We expect the market for appliances, especially luxury appliances, to increase. And there is little doubt that demand for automobiles, oil, energy and housing will continue to rise as millions of Chinese migrate to the major cities.

The Chinese Market Mystery

The *Far Eastern Economic Review* recently published an article entitled "The Mystery of China's Sinking Stocks." The author, a respected economist and investor named Weijian Shan, tried to explain what he called "one of the greatest paradoxes of the Chinese economy." The problem, as he put it, is that the Chinese internal stock market, called the A share market, "has lost half of its value in the past five years, while the economy has grown by 50 percent."

> China has approximately 300 million cell phone subscribers, and the domestic market is far from saturated.

This is a significant problem for Chinese investors and officials, but it is one that we at the ***China Stock Digest*** intend to steer our readers well away from. Avoiding the "sinking stock" problem and avoiding confusion requires an understanding of China's alphabet soup of equities. This was briefly explained in our introductory report, and I'll briefly go over the details again to make sure there is no confusion or needless anxiety. (If you want to skip this list, just keep in mind that we recommend trading only in ADRs.) Here are the kinds of Chinese stocks on various markets.

- A shares are usually held only by Chinese residents and are denominated in yuan (also known as renminbi), the local currency of the People's Republic of China. As of 2003, qualified foreign institutional investors, or QFIIs, were authorized to trade in A shares in Shanghai and Shenzhen. QFIIs must have at least $10 billion in assets under management.
- B shares are designated for foreign investors and are denominated in foreign currencies on the Shanghai and Shenzhen exchanges.
- C shares are owned by state-run corporations and are not yet publicly traded
- H shares are stocks of companies incorporated in China and listed on the Hong Kong Stock Exchange and foreign exchanges such as Singapore.
- N shares are stocks of companies incorporated in China and listed on the New York Stock Exchange (NYSE), sometimes as over-the-counter (OTC) shares.
- L shares are stocks of companies incorporated in China and listed on the London Exchange.
- ADRs and ADSs are American Depository Receipts and American Depository Shares traded on the New York Stock Exchange.
- GDRs, or Global Depository Receipts, are traded largely on the London Stock Exchange.

When dealing with companies from the People's Republic of China, we want to focus exclusively on companies that are listed on the New York Stock Exchange as ADRs or ADSs. There's a very important reason. In order to qualify as an ADR or ADS, foreign companies must adhere to the stringent disclosure requirements of the NYSE in order to maintain their listing. We feel strongly that sticking with companies that meet these standards gives us an essential layer of protection against investment risk.

What's more, we want to invest in companies that furnish investors with real-time trading data and multiple sources of news about current corporate events. We feel that companies that are traded on the NYSE are much more likely to meet this standard.

With regard to stocks that trade in Hong Kong and Taipei, we feel that the regulatory systems there are quite advanced, and we feel we can put much more reliance on the information released by those companies and traded as ADRs.

Returning now to the so-called mystery of China's sinking stocks, the problem occurs mostly with A shares, in other words, shares traded within China. Remarkably, the Chinese government has declared as many as two-thirds of the shares of all companies listed on Chinese internal markets as "nontradable." This clumsy attempt to manipulate and stabilize the market has had exactly the opposite effect.

It would be a waste of time to explain the many byzantine complications created by the government's interference in the free market. Suffice it to say that Chinese government manipulation has effectively diminished the value of investors' holdings by diminishing shareholders' rights and freedoms.

The Chinese government's actions have driven many investors away from the Shanghai and Shenzhen markets. We, too, have stayed well away from those internal markets. We cannot recommend investments in companies that face the threat of state manipulation.

We at the* China Stock Digest *will continue to restrict our choices to companies from China, Hong Kong and Taiwan that qualify to be listed on the New York Stock Exchange or the NASDAQ as ADRs.

We want to invest in companies that furnish investors with real time trading data and multiple sources of news about current corporate events. We feel that companies which are traded on the NYSE are much more likely to meet this standard.

One measure of the performance of Chinese stocks trading on U.S. stock exchanges is the Halter Index(tm) (symbol HXC), calculated by the American Stock Exchange, or AMEX. Unlike the "sinking stocks" on the Shanghai exchange, the Halter Index(tm) shows an aggregate of Chinese stocks trading as ADRs rose by 12 percent last year. That compares to an 18 percent drop over twelve months for stocks traded exclusively on the Shanghai market.

We at the ***China Stock Digest*** aim to help our subscribers do better than the broad indexes. The Chinese economy is changing quickly, and the basket of stocks represented by an index exposes investors to companies which may experience sudden and severe reverses. Index investors are committed to such companies. With our newsletters and e-mail alerts, the ***China Stock Digest*** aims to steer investors away from companies that are showing weakness and toward companies that are gaining competitive advantages.

Growing China's Internal Business Sector

We look forward to even-greater expansion within China as a result of new laws introduced last December. China has drastically lowered the minimum capital required for domestic companies to begin operations. The new capital requirement, which came into force on January 1, 2006, is set at $3,700 for limited liability companies in all industries.

Previously, entrepreneurs who wished to open a manufacturing or wholesaling business were required to put down $62,000. Entrepreneurs who wished to get their start in retailing had to put down a minimum of $37,000. Establishing a new service enterprise required a minimum investment of $12,000. It is a wonder that any new businesses were established under the old rules.

The new law also lowers the cash threshold in another way. As much as 70 percent of the total registered capital of a new business may be in non-cash contributions such as intellectual property or technology. This leaves a good deal of room for interpretation.

The Chinese government has clearly come to understand that it needs to help, not hinder, the entrepreneurial spirit. Prior to this reform, China had the eighth-highest minimum capital requirement in the world, equivalent to 947 percent of the country's average annual income per capita, $1,290. Only Ethiopia, Jordan, Madagascar, Saudi Arabia, Syria, the West Bank and Gaza, and Yemen imposed higher start-up capital requirements.

At the urging of the World Bank, China also reduced the amount of cash required up front. Now only $743, or 20 percent of the lowered minimum capital, needs to be paid when opening a business, with the remainder paid over a two-year period. With this new reform, the capital that a new business would need to start operations is 56 percent of income per capita. That is similar to the amount required in Germany and lower than the requirement in Japan or Korea.

Judging from other countries that have implemented similar reforms, the World Bank believes that these reforms will eventually increase China's number of newly registered businesses. For example, following the elimination of capital requirements in France in 2003, business registrations jumped 18 percent. Similarly, reforms in Serbia and Montenegro in 2004 brought almost 42 percent more registrations relative to the previous year.

We are also pleased to note that China has lowered personal income taxes. In 2006 anyone earning less than the equivalent of $200 per month will pay no personal income tax. This may not seem like a big deal in the U.S., but when you consider that an office worker in a modern building in Beijing might earn only $80/month, the impact starts to register. China is an extremely pro-business environment.

> We believe that unleashing the forces of entrepreneurship will have a ripple effect that may be difficult to quantify immediately but are important nonetheless.

These reforms may be slow to bear fruit on a macroeconomic scale. But China is a vast country with an enormous population. We believe that unleashing the forces of entrepreneurship will have a ripple effect that may be difficult to quantify immediately but is important nonetheless.

As believers in the free enterprise system, we recognize that great enterprises can be born in humble places. We remember the roots of the modern computer industry in Silicon Valley garages. Whether it be Apple Computer, Microsoft, eBay or Hewlett-Packard, we believe that great invention, bold innovation and creative entrepreneurship enrich everyone.

We do not fear the growth of China in the world economic picture. We welcome it. And we aim to participate in it.

As the only China market letter with "boots on the ground" in China 24/7, ***China Stock Digest*** is working hard to find opportunity for our readers. Let's take a look at three new ideas this month, with new stocks from our China markets in Shanghai, Hong Kong and Taipei.

Energy from Asia: China Petroleum & Chemical Corp.

China Petroleum & Chemical Corp.
(NYSE: SNP ADR $49.60)

When it comes to oil and gas, China is taking its place as the Texas of the 21st century. Bigger is better, and China Petroleum & Chemical fits the bill impressively.

China Petroleum & Chemical Corp., based in Shanghai, is best known by its abbreviated name, Sinopec Corp. (not to be confused with the state-owned parent Sinopec Group, which is still a partial owner).

Sinopec Corp. is China's second-largest producer of oil and natural gas. As a fully vertically integrated petroleum, energy and petrochemical company, Sinopec stands out as a world-class player, but we feel it is still reasonably priced.

Sinopec has proven reserves of 3.3 billion barrels of oil and 2.9 trillion cu. ft. of gas, and it owns more than 29,400 gas stations. The company's diverse businesses include oil and gas exploration and production crude oil refining and processing, transportation, distribution and marketing, and the production, and distribution of petrochemical products.

In November 2005, Sinopec Corp. won best corporate governance and most respected listed company award and ranked number one among Chinese listed companies. The ranking is made by ***World Executive Weekly***, ***World Finance Lab*** and ***Wall Street Wire***, whose ranking is based on systematic evaluation of equity, share capital structure and information disclosure.

Sinopec's growth statistics are breathtaking. Sales grew by 46 percent in 2004 and profits did even better, rising by 66 percent. Total sales were almost $75 billion. To the company's credit, Sinopec achieved this feat while trimming its vast workforce by more than 2%.

Despite its high sales volume, Sinopec's market cap remains in a conservative range below $40 billion. The company's price-to-earning's ratio varies between 7.3 and 8.2.

We appreciate such reasonable values in a company that continues to explore and increase its reserves annually. What's more, Sinopec offers investors a dividend of approximately 3.5 percent.

One reason for Sinopec's relatively low valuation has been Chinese government price controls on refined petroleum, a measure designed to protect impoverished rural areas from oil price spikes. In one of its last acts before the New Year, the government announced that it would give it a onetime subsidy of $1.17 billion to compensate for artificially low domestic oil-product prices. It will be a continuing struggle for the government to balance the needs of the poorest consumers with the business interests of companies like Sinopec. We see the government subsidy as an important signal that business interests will not be ignored going into the future.

> As unabashed capitalists, we intend to invest our resources with the plain intent of seeing Chinese enterprises grow and seeing our investment dollars grow right along with them.

Most analysts regard Sinopec as low risk, and we agree. Given the company's attractive valuation and income potential, we see it as a valuable long-term holding in a diversified China portfolio. We are expecting share appreciation and steady returns.

Sinopec is well above its 52-week low, currently in the $35 range, but it remains well short of the 52 week high of 48.10.

Sinopec's strength as an investment lies not only in its potential to grow with the relentlessly expanding Chinese demand. It also lies to demand, but also in its valuation compared to other international oil and gas shares.

If Chinese large-cap stocks gain the acceptance that other multinational oil and gas firms have achieved, we can look forward to P/E ratios more in line with companies like Shell and BP.

The effect on your investment portfolio would be highly desirable, indeed. We're picking Sinopec as a long-term buy and hold.

Your PC's New Name: LENOVO GROUP LTD.

LENOVO GROUP LTD. (OTC ADR LNVGY $9.16)

Lenovo, based in Hong Kong, was one of the great Chinese-American business stories of last year, and it promises the same for the year ahead. Lenovo sent shock waves through the PC industry when it acquired the International Business Machines Corporation's (IBM) Personal Computing Division.

The company manufactures and sells desktop personal computers, notebook computers, mobile handsets, servers and peripherals. Lenovo is also a PC manufacturer in the Asia-Pacific market (excluding Japan). The company has an additional product line, which includes mobile handsets, servers, peripherals and digital entertainment products for the Chinese market.

Lenovo's astonishing move was followed by a long silence in the North American market as the company quietly and profitably continued with its PC business in China. (In China, Lenovo's notebook offerings are called the Soleil, Tianyi and Xuri.) In North America, Lenovo is now teaming up with Office Depot to sell its new Lenovo ThinkPad notebooks in 1,000 retail outlets.

Lenovo's star product will be its premium-priced, titanium-encased ThinkPad Z60t, which will retail for $2,300. The company is featuring a biometric recognition device to read its owner's fingerprints for maximum security. ThinkPad notebook prices for models offered through Office Depot start at $699. Online customers will be offered the ThinkPad Express portfolio. We believe the company is wise to stake a position in the sale of top-end products as well as price-competitive computers in order to balance a reputation for quality and low price.

In the fiercely competitive PC market, Lenovo's future is difficult to predict, but the company is reentering the field of battle at a time when the number one computer maker, Dell, is seeing profits under pressure.

Lenovo and IBM have entered a strategic alliance designed to provide customers preferred access to IBM's customer service organization and global financing. As part of its five-year commitment, IBM will also provide warranty services and offer Lenovo customers leasing and financing arrangements. Lenovo's executive headquarters are in Purchase, New York, with principal operations in Beijing, China, and Raleigh, North Carolina, with a sales organization established worldwide. The company employs more than 19,000 people.

The company's most recent financial reports indicate that the strategy is working. In November, Lenovo announced second-quarter financial results for the 2005/2006 fiscal year had risen 404 percent with revenues of $3.67 billion. EBITDA rose 270 percent to $122 million, and profit attributable to shareholders was up 22 percent. Lenovo's notebook business achieved record shipments in the second quarter, evidence of its leadership position in the commercial segment of the market and its focus on the high-end segment of the mature PC market. PC shipments have grown 13 percent year over year.

This quarter is the first reflecting a full three months' contribution from Lenovo's acquisition of IBM's former Personal Computing Division. The company boasts that the "new Lenovo" is already showing signs of achieving its potential.

We are impressed by Lenovo's push into emerging markets. Although not all foreign operations have been profitable, revenue and volume in China and India both outpaced the overall PC industry in which the company competes. Within China, Lenovo's consolidated revenue was $1.31 billion. The company says customer satisfaction is high, and we applaud its improvement over IBM's chronic underperformance in PC sales and profitability.

But perhaps the most important metric in the dog-eat-dog computer business is the company's profit margin. Lenovo reports overall gross margin increased 2 percentage points to 14 percent from the prior year.

We are following Lenovo with active interest as it continues its expansion into underserved markets and it continues to create peripheral products including wireless handsets. We anticipate Lenovo's future lies in its ability to serve North American markets with the advantages of Chinese labor rates and IBM's mature sales and marketing channels. We also look forward to Lenovo's aggressive expansion in third world markets where it has earned its credentials under the company's old banner: The Legend Group.

> Sinopec's growth statistics are breathtaking. Sales grew by 46% in 2004 and profits did even better, rising by 66%. Total sales were almost $75 billion.

Dialing for Profits: Chunghwa Telecom Ltd.

Chunghwa Telecom (NYSE ADR: CHT $18.35)

Chunghwa, based in Taiwan, continues to impress us as a source of reasonable growth and an excellent income stream.

Chunghwa is the big gun among Taiwan's telecommunications operators. Formerly a government directorate, Chunghwa was spun off in 1996 holding an immense legacy of Taiwanese customers and an international infrastructure, an advantage that the company holds over competitors in Taiwan's telecommunications market to this day. Chunghwa is an integrated telecommunications giant with a fully developed domestic infrastructure as well.

Chunghwa's hold on 98 percent of Taiwan's fixed-line telephone customer base shows the depth of the company's penetration and its grip on the domestic market. The company's principal services include fixed-line services, including local, domestic long-distance and international long-distance telephone services. Chunghwa is a major player in wireless services, including cellular and paging services and Internet and data services, asymmetrical digital subscriber line services and leased-line services. It also provides such other telecommunications services as multimedia on demand, satellite services, telephone directories and billing handling services.

Chunghwa's financials show a company that remains conservatively priced with a P/E just under 6, compared to an industry average of 162. Chunghwa is not currently priced for stellar growth. Sales have remained steady, but the stock's performance was hit by an increase in costs of services, marketing expenses, administrative expenses, and higher research and development expenses.

Chunghwa remains well off its price highs for the year. Shares fell from a 52-week high of $22.35 last August, when the company announced a secondary offering of 135 million American Depositary Shares (ADSs) at $18.85. (Chunghwa first hit the American market with an offering of almost a billion shares at $14.24 in July of 2003.)

> In November, Lenovo announced second quarter financial results for the 2005/2006 fiscal year had risen 404% with revenues of $3.67 billion.

Chunghwa's operating results for the third quarter in particular demonstrate respectable growth in a maturing market. We are impressed that Chunghwa continues to find and exploit new revenue sources. The company recently reported revenue increases of 3.5 percent for the third quarter of 2005 based on solid mobile and Internet and data service growth. Even more impressive was net income growth (compared to the same quarter last year) of 13.4 percent.

As the company persistently expands data and DSL sales, Chunghwa continues to be the leading mobile operator in Taiwan in terms of both revenue and subscriber market share with 35.2 percent and 39.6 percent respectively, as of the end of August 2005, according the Directorate General of Telecommunications.

What's more, it appears to be a relatively low- risk investment. Taking into account Chunghwa's reasonable valuations and historically low volatility (for a telecom stock), the company seems poised to be a relatively reliable earner for the long run. The fact that the Taiwanese government continues to hold approximately a 50 percent interest in Chunghwa suggests a strong stabilization of risk.

In short, don't turn to Chunghwa for eye-popping share appreciation. This is a company to consider as part of a broad-based income strategy among dividend-producing stocks. The current dividend is 8.5 percent. Nothing is risk free, and diversification is always important in every portfolio, but Chunghwa's dividend is too good to ignore completely.

We think Chunghwa merits consideration in the short term for income and as a long-term holding for relatively low-risk stability and growth.

Opportunity Comes with Risks

The rise of Chinese consumerism may begin to reduce the trade imbalance that has struck fear into the hearts of many American economists. The United States is unlikely to become competitive with Chinese labor costs in the foreseeable future. America must invent new services and knowledge-based products that will appeal to China's growing middle class. However, there is one major caveat.

America remains a powerful innovator. China has the potential to become a powerful partner to American innovation and knowledge-based industries. But this will not happen unless China shows it is serious about theft of intellectual property. Neither nation will benefit if American films, music and software are stolen and sold for a pittance on every street corner. As China's economy shifts increasingly to a service-based and knowledge-based foundation, they, too, will benefit if intellectual property rights are paid more than lip service.

Because China has a population of 1.3 billion people, we have not yet begun to explore its full potential. True, the emergence of China will put new pressures on world energy supplies.

Chinese industrial development has become notorious for its disregard for worker safety and environmental protection. In 2006 we will be on the lookout for investment opportunities that will participate in China's effort to generate new energy sources, to manage pollution and to build new service industries.

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The world is entering a new phase of economic development that will be neither simple nor brief. We at the ***China Stock Digest*** have no doubt that China will emerge as the world's largest economy. We know it cannot achieve this goal without ongoing capitalist reform and investment.

As unabashed capitalists, we intend to invest our resources with the plain intent of seeing Chinese enterprises grow and seeing our investment dollars grow right along with them. Our job is to find the winners early and to help our subscribers share in our research. We are also on the lookout for enterprises that are failing, and we are pledged to send out "sell" signals quickly when necessary.

We believe that nothing helps economies grow like enlightened capitalism. And nothing returns profits to investors like well-informed capitalism.

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Join ***China Stock Digest*** at the Orlando World Money Show, February 1 through 4, 2006, and register for a chance to win a trip for two to China. Just come by our booth (Booth 1300) to fill out a registration form. (No purchase is necessary/void where prohibited.)

This year we will be teaching three workshops at the Orlando World Money Show:

Wednesday, Feb. 1, 2006 9:55 AM–10:40 AM	The Four Stock Exchanges in China: An Insider's Look
Thursday, Feb. 2, 2006 2:35 PM–3:20 PM	China's Stocks: Tips and Traps for Investors
Friday, Feb. 3, 2006 11:45 AM–12:15 PM	Profit from China's Booming Economy in 2006
Saturday, Feb. 4, 2006 9:45 AM–10:15 AM	The Four Stock Exchanges in China: Encore Presentation

For more information or for tickets to the show, visit the Money Show online at www.worldmoneyshow.com or call 800-970-4355 to register.

Your guide to China,

James M. Trippon

PS: Please join me in Orlando for the free World Money Show, February 1–4, 2006. Register by calling 800-970-4355 or www.worldmoneyshow.com.

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Jim Trippon is America's foremost authority on China investing, using proven investing techniques and principles. Jim is known both as the *"Advisor to America's Millionaires"* ™ and, more recently as, *"The Sage of Shanghai"* ™. A former Price Waterhouse CPA who has worked inside China; Jim has invested in China's financial markets for years." He is the personal financial advisor to some of America's wealthiest families. Jim Trippon, a best-selling author and a member of the Shanghai Foreign Correspondents Club, is frequently quoted in the press and speaks at major investment conferences.