KraneShares Weekly

Major News and Events:

China Moves to Strengthen Environmental Laws

Chinese legislators have passed the first amendments to the country's environmental protection laws in 25 years, promising greater powers for environmental authorities and harsher penalties for polluters according to the Guardian.

The amendments, which the Standing Committee of the National People's Congress recently passed after two years of debate, will remove limits on fines for polluting factories, which are currently so low that many enterprises just pay them rather than take long-term anti-pollution measures. The amendments are also expected to encourage *"studies on the impact environmental quality causes on public health, urging prevention and control of pollution-related diseases,"* according to the China news agency Xinhua.

Over the past year, the Chinese government has begun to place a stronger emphasis on environmental protection. At an annual parliamentary meeting in March, Premier Li Keqiang said that the government will *"resolutely declare war against pollution as we declared war against poverty".*

Environmental groups say that China's greatest environmental problems have come from a gap between legislation and implementation. *"If you look at China's air pollution or water pollution control laws, they're pretty good compared to global standards,"* said Ma Tianjie, program director for mainland work at Greenpeace East Asia. Early indications show that there is a greater willingness by local governments to enforce the new laws.

World's largest auto makers outline billions in new investments in China

Top executives of the world's largest auto makers recently attended Beijing's big auto show, outlining billions in new investments for factories and technical centers, and presenting new models specifically designed for the affluent as well as the growing middle class in the world's largest car market.

Industry executives are also shifting some of their efforts in China's more mature megacities such as Beijing and Shanghai, from selling consumers their first cars to instituting the promotions used in the U.S. to lock them in as repeat buyers.

Mercedes-Benz, for example, used the Beijing show to launch a new financing product that mimics the lease deals that account for nearly half of luxury-vehicle deliveries in the U.S., according to Edmunds.com. Volkswagen is encouraging dealers to start marketing certified used vehicles.

As the larger cities mature and clamp down on new-vehicle registrations in an effort to limit pollution, Western auto executives are also turning their focus on China's developing tier two, three and four cities which are larger than many cities in the U.S. or Western Europe.

Ford's Lincoln luxury-car brand said last week that by 2016 it wants to have 60 dealerships in 50 Chinese cities, many of them second- or third-tier markets. Mercedes-Benz intends to add dealerships in 40 new cities as part of a plan to open 100 new stores this year, according Daimler AG Chairman Dieter Zetsche.

China Smartphone Maker Xiaomi Plans to Expand Outside the Country

Xiaomi, the Chinese smartphone maker, announced on Wednesday that it is planning to enter ten countries this year. By year-end the company plans for sales in India, Brazil, and Russia as well as Indonesia, Malaysia, Mexico, the Philippines, Thailand, Turkey, and Vietnam. Xiaomi is already selling phones in Mainland China, Hong Kong, Taiwan, and Singapore.

Xiaomi's Mi3 in China is considerably cheaper than the iPhone 5c—1,999 yuan versus 4,488. The Xiaomi phone also has a larger and sharper screen and a camera with higher-density pixels.

Xiaomi, which sold its first phone in September 2011, plans to ship

100 million phones next year according to Forbes. The company is said to be particularly well positioned in the newest markets. It is willing to accept razor-thin margins, pricing its phones in China just slightly above cost. *"It's definitely disrupting everyone,"* says IDC's Ryan Lai. *"Now consumers expect phones with high-end specs at low prices."*

If successful in emerging markets Xiaomi will have achieved economies of scale that will allow it to launch an assault on developed countries.

Xiaomi is not invulnerable, however. One explanation why it is expanding into new markets is not to take over the world but to escape its home country. Even though it is a fearsome competitor, its ability to grow Chinese smartphone sales looks limited at best.

China's Industrial Sector Businesses Showed Increased Revenues for Q1

Chinese industrial businesses reported improving profitability in March, pushing profits for the whole first quarter onto a faster track. Profits of industrial companies rose by 10.1 percent in the first quarter, compared with a 9.4-percent increase recorded in the first two months and up 10.7% year on year.

The National Bureau of Statistics attributed the improvement last month to the rebounded profitability in the telecommunication sector, whose profits surged by 63.4 percent from a 14.1-percent decline in the first two months.

In the first quarter, profits of private firms rose the fastest at 14.2 percent to reach 419.1 billion yuan. State-owned and state-holding industrial enterprises achieved total profits of 354.8 billion yuan, up 2.9 percent year on year.

Companies in the manufacturing sector enjoyed a 13.9-percent rise to stand at one trillion yuan in the period.

The majority of industrial profits in the first quarter came from auto manufacturing, power and heat generation, electrical machinery production and telecommunication equipment production.

US Companies Announce Stronger China Sales

Several major U.S. companies cited strong China demand in their recent earnings releases according to Investors Business Daily.

China has proven to be a strong growth engine for Apple, with its new partner China Mobile helping push fiscal Q2 iPhone sales to more than 43 million, far more than expected. China sales accounted for nearly 25% of Apple's total quarterly revenue, up 13% from a year earlier.

Caterpillar has struggled with a global commodity slump that's hit mining-equipment demand. Overall sales were flat — actually ending a five-quarter decline. But China sales rose 30% vs. a year earlier. The company also noted that economic growth in China of around 7.5% this year "should support improvements in the machine industry and increase commodity demand."

Yum Brands, parent of KFC, Taco Bell and Pizza Hut, said that its China-division sales grew 17% year over year, with restaurant margins increasing almost 7% and operating profit up 80%. Yum added that it expects to open at least 700 restaurants in China this year.

Starbucks saw net revenues in its China/Asia-Pacific region grow 24% year over year to $265.3 million during its fiscal Q2, driven in part by nearly 700 stores opening over the past year. Comparable store sales were up 7%.

United Technologies says that new equipment orders at its Otis Elevator unit increased 9% from Q1 '13, led by 27% growth in China.

McDonald's, which reported lackluster Q1 earnings — blamed on lower U.S. same-store sales and unusually severe winter weather throughout much of the United States — still reported solid sales in China. Comparable sales grew 6.6% for the first quarter, and McDonald's plans to open 300 new restaurants there this year.

Local Broker Insight:*

SWS Research—

As negative factors in the capital markets are digested, small-cap companies in emerging industries that represent future development trends are expected to see a short-term rebound. We favor the ChiNext board index, expecting to see a small rebound to 1,400 points. The room for growth is not large, but there are trading opportunities.

http://www.sywg.com.hk/catalog/securities/english/ser_06.html

Huarong Securities—

The PBOC reduced the reserve requirement ratio of rural financial institutions by between 0.5 and 2 percentage points, effective April 25. In the short term, the amount of funds that will be released is small, and the effect will be limited. In the long term, this may be the beginning of a new period of reserve requirement ratio cuts, which is positive for a transition in macroeconomic management, guiding credit into agriculture as well as guiding medium and long-term interest rates lower.

http://www.chamc.com.cn/en

Galaxy Securities—

Fiscal expenditure in 1Q was 3 trillion yuan, an increase of around 9% year over year. Nevertheless, many fiscal expenditure items are fixed, such as education, medical care, social security and urban affairs. This means that increasing fiscal expenditures to stabilize growth will only be functional if there is a large amount of private capital investment.

http://www.chinastock.com.hk/en/ACG/ContactUs/index.aspx

Dealogic—

According to data from Dealogic, Chinese enterprises have completed over US$29 billion worth of overseas acquisition deals in 2014 so far, a historical high for the time period, reports caijing.com. Chinese enterprises have conducted over US$8.5 billion worth of acquisitions in Europe alone.

http://www.dealogic.com/media/market-insights/ecm-statshot/

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Investing involves risk, including possible loss of principal. There can be no assurance that the Funds will achieve their stated objectives. The Funds focus their investments primarily with Chinese issuers and issuers with economic ties to China. The Funds are subject to political, social or economic instability within China which may cause decline in value. Fluctuations in currency of foreign countries may have an adverse effect to domestic currency values. Emerging markets involve heightened risk related to the same factors as well as increase volatility and lower trading volume. Current and future holdings are subject to risk.

Narrowly focused investments typically exhibit higher volatility. Internet companies are subject to rapid changes in technology, worldwide competition, rapid obsolescence of products and services, loss of patent protections, evolving industry standards and frequent new product productions. Such changes may have an adverse impact on performance.

The ability of the KraneShares Bosera MSCI China A ETF to achieve its investment objective is dependent on the continuous availability of A Shares and the ability to obtain, if necessary, additional A Shares quota. If the Fund is unable to obtain sufficient exposure due to the limited availability of A Share quota, the Fund could seek exposure to the component securities of the Underlying Index by investing in depositary receipts. The Fund may, in some cases, also invest in Hong Kong listed versions of the component securities and B Shares issued by the same companies that issue A Shares in the Underlying Index. The Fund may also use derivatives or invest in ETFs that provide comparable exposures. Investments in derivatives, including swap contracts and index futures in particular, may pose risks in addition to those associated with investing directly in securities or other investments, including illiquidity of the derivatives, imperfect correlations with underlying investments, lack of availability and counterparty risk. The use of swap agreements entails certain risks, which may be different from, and possibly greater than, the risks associated with investing directly in the underlying asset.

The Fund, may be concentrated in the financial services sector. Those companies may be adversely impacted by many factors, including, government regulations, economic conditions, credit rating downgrades, changes in interest rates, and decreased liquidity in credit markets. This sector has experienced significant losses in the recent past, and the impact of more stringent capital requirements and of recent or future regulation on any individual financial company or on the sector as a whole cannot be predicted.

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