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Prudential sees Chinese share market rallying

SINGAPORE, Nov 14 (Reuters) - China's domestic A-share market is poised for a long rally as excessive pessimism has made valuations cheap, a portfolio manager at the funds arm of British insurer Prudential <PRU.L> said on Monday.

David Cheung also said Hong Kong-listed firms in China's service sector -- such as banks, insurers and telecommunications firms -- would be winners over the next three to five years but manufacturers such as car and garment makers could be losers.

China's stock market indices are the worst performers in Asia so far in 2005, down between 14 and 20 percent, hurt by a plan to float \$250 billion in non-tradeable state holdings in listed firms.

"Sentiment is not there right now. Investors are still very bearish but that's exactly what marks the beginning of a bull market," Cheung, who picks stocks in the Greater China region and co-manages the S\$372 million (\$219 million) PRU Dragon Peacock Fund, which invests in China and India, told reporters.

"The market is trading at around 11-12 times," he added, referring to the price-earnings ratio. "Given the growth profile of China, I think it's extremely cheap. As a result I am looking for a multi-year rally in the A-share market." The benchmark Shanghai Composite Index <.SSEC> seemed to be picking up in the third quarter but then fell back again and is down some 14 percent in the year to date.

The Hong Kong-based fund manager said the trigger for the rally would probably come as weightings for China's A-share market are increased in major benchmarks such as the MSCI and FTSE indices. China has said it would more than double the amount that foreign firms are allowed to invest in its primary stock and debt markets to \$10 billion from \$4 billion. China's capital markets are currently closed to all but a few dozen firms.

"China shares will become more investable," said Cheung. A government plan to encourage the growth of the service sector and a likely move to bring corporate tax rates for local firms in line with concessional rates for foreign companies will give a boost to financial services and telecoms firms, he said.

But competition was leading to a squeeze on margins in industries such as automobiles and garment manufacturing, he said. Prudential has investments of about \$3 billion in the Hong Kong and Chinese stock markets, the fund manager said.

The PRU Dragon Peacock Fund includes China Mobile (Hong Kong) Ltd <0941.HK>, China's top offshore oil and gas producer CNOOC Ltd. <0883.HK> and China Life Insurance <2628.HK> among its top 10 holdings.

The fund returned 25.1 percent in the 12 months to end-October compared with a 29.7 percent return for its benchmark, which is comprised equally of the MSCI India and China indices. Cheung said the fund underperformed the benchmark as its objective was capital preservation and its stock picks did not closely reflect the indices. But this strategy had lower volatility than the benchmark, he said.

(\$1=1.699 Singapore Dollar)

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