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Subject: From Beijing
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Hi Jeffrey

Here are some cryptic notes from the China conference.

Big picture:

Enthusiasm still rampant-- lots of questions how to get even more invested. Some Asians thinking of selling USD/US and moving core investment exposure to onshore china, willing to give up liquidity to perceived macro/fundamental relative safety.

Urban Migration:

+300MM expected to migrate into cities over next decade driving consumer demand and construction demand(currently 54% of population is still agricultural)
+At current GDP/capita levels we. should see an increased use of Small/Midcap Retailers, tourism, healthcare, hotels

Other Macro:

+Chinese real rates by bearish economists: -5 to -15%; capital in effect is free
+Chinese bank lending is equivalent to deferred fiscal spending since govt dictates where lending should go and is the ultimate credit backstop
+Chinese banks play the effective role of the municipal market in the US
+Consumption story may happen sooner than people expect as social tensions are emerging re Foxconn suicided, honda plant strikes, KFC strikes-- all being resolved with massive wage increases

Commodities/China:

+middle of supercycle-not just china but also india- multiple decade cycle
+Long commodities- more electricity used in China than entire western hemisphere within 20yrs.

+500% coal power increase in 6yrs
+80% of electricity is from coal
+50% steel and cement global consumption
+1bn ton of new coal demand globally in 3 yrs (nb. US only Cap n trade seems trivial in this context)
+most chinese coal not where electricity is needed-infrastructure needed to move coal
+Nat'l gas doesn't ship well little existing piping network

Investment opties:

1. Asian focused HF strategies(currently only about 8% of all HF assets- opty for alpha not necessarily beta)
2. Chinese consumer plays: Lenovo, hyundai, small cap retailers(ekonomos working on list).
3. A shares now closer to 18-20x pe for 20% growth stocks- may be worth a look(broaden our usage of our QFII quota for more clients)
4. A/H shares spread arbitrage- limited A share availability drives natural arb.
5. Coal especially seabourne energy coal. Imports of coal expected to be 150mm tonnes (was an exporter 4 years ago). Peabody Energy as a coal play? Also large emphasis on green coal technology. Should look at the companies who provide this technology.
6. New technology converts CO2 into cement
7. \$200TN of financial assets vs \$1TN in physical gold(paulsen's story)
8. Short yen vs \$ in long dated options- Perry's top trade

a few more things to add:

Och Ziff: buying small and mid cap stocks; privately placed converts; own A shares vs H shares as soon as they move to a discount (currently at a 5% premium). Rocky road to change from export model to domestic consumption.

Highbridge: all about domestic consumption plays (Hyundai). Bullish on coal. 50% mortgage LTV and recourse makes banks less susceptible to housing slowdown. Volatility of liquidity is biggest issue

Perry Capital:

- short jpy. QE will start soon. Currently 23% of tax receipts spent on interest. A 100bps increase in rates would see that increase to 36%. Public interests is for a weaker jpy, not higher rates so why pay fixed in swaps. Just short jpy.

US ambassador:

Q1 was low point of China-US relations due to arms sales to Taiwan, Obama met Dhali Lama and trade tariffs. Agree on need for peace and stability, regional security, climate control, green energy, open Chinese markets.

CB needs a free and clear period in global markets prior to a CNY reval. Will be a big issue in the Nov senate elections.

John Paulson on gold:

- he is very bullish
- sees prices over 2000/oz
- his basic idea is that the monetary base has expanded by 140% since 2008 and as soon as bank lending resumes, the velocity of money will explode which will be inflationary.
- total US credit is 350% of GDP. This leaves Washington with two options 1) contraction or 2) inflate the economy.
- only \$1trillion of total gold vs \$200trillion of financial assets so it does not require much of an allocation shift to have a big impact on prices

Jing Ulrich:

- exports 47% to Asia, 22% europe and 20% N America
- real estate makes up 25% of gdp
- transaction volume to drop 80% in major cities. Will lead to pent up demand. As soon as confidence returns this will get unleashed. Prob Q1 event. Expect a 20% drop in prices in Beijing and Shanghai.
- home sales lead new construction starts. This will lead to lower demand for commodities in Q3 and Q4. Ally and Copper to suffer. Also steel prices.
- manageable exposure of banks to housing slow down
- bearish on RE stocks until transaction volume picks up
Top Picks - short Ally and steel companies. Short term nervous on copper but long term v bullish as biggest users of copper are transportation, refining, power and construction
- State wants more consumption and services. Over \$4 trillion in bank savings by individuals. When public has more of a social safety net they will spend. Govt working on that.
- high speed rail spending \$100bln in 09 and 130bln in '10. This is shrinking the country and allow for prosperity to move inland. Good for retailers.
Top Picks: mid to low level consumption; casual dining; electronics; travel; services
- wages make up on average 10% of total costs so companies can absorb some wage increases.

Paul

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