

Fund Focus – JF Hong Kong[^]

August 2010

- The Fund invests in a single market, primarily Hong Kong, and is therefore subject to greater concentration risk than a more diversified investment.
- The Fund may invest in emerging and developing markets and thus may have significant exposure to liquidity and the relevant currency risk. The Fund's price movement may go down or up sharply over a short time span.
- Investors may be subject to substantial losses.

Fund Quarterly Review – 2Q' 2010

- ◆ Hong Kong equities were weighed down by heightened global risk aversion and incrementally tighter liquidity. The primary culprits were continued European economic weakness and selective tightening measures by the Chinese government, notably in the property sector. Given the causes for this downturn, property and exports were predictably the hardest hit sectors. However, the mid-June announcement by the Chinese government that the RMB would be de-pegged from the USD, implying the potential for at least moderate appreciation, helped the market regain its footing. For the quarter, the HSI (Total Return) fell 3.5% in HKD, with the property subindex falling 9.2%.
- ◆ The Hong Kong government also announced measures to moderate the property market. Primary sales continues to be below trend as developers wait for better sentiments while secondary sales and prices have held up well. Economic activity continued to pick up in Hong Kong, as evidenced by strong trade data driven by intra-Asian trade. However, there were signs of a liquidity slowdown with a rising HIBOR, weakening exchange rate, and slowing deposit growth. Inflation picked up moderately to 2.5% yoy increase in May, although this is likely to be tempered by slowing global economic momentum. The Fund slightly outperformed the benchmark in USD in 2Q'10.

Performance – JF Hong Kong[^]

	2005	2006	2007	2008	2009	2010 YTD
Calendar year return (%)	+2.5	+38.0	+51.2	-50.4	+57.3	-5.7
		1 year	3 years	4 years	5 years	Since inception*
Cumulative return (%)		+10.3	-1.0	+40.3	+56.7	+189.0

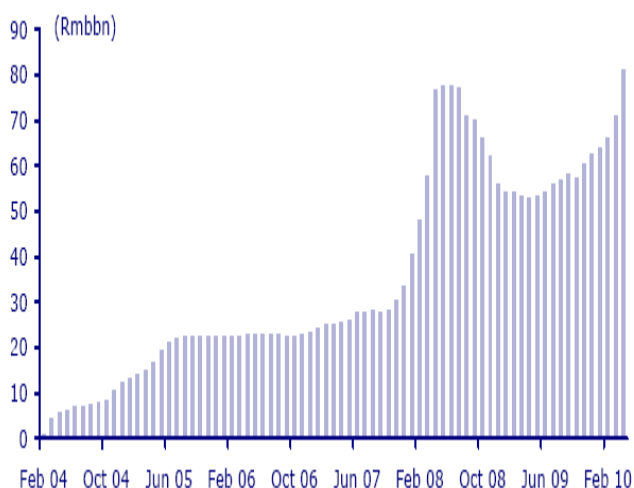
[^] JF share class of JPMorgan Funds. Source: JPMAM (NAV to NAV in USD with income reinvested). Data valid as at 30 June 2010. * The Fund's inception date was 18 May 2001.

Outlook & Strategy

- ◆ While the liquidity situation in Hong Kong appears to have hit a temporary setback, we maintain our view that global policymakers including China will not tighten monetary policy prematurely. Indeed, there is talk of a second fiscal stimulus in China that could further fuel liquidity and growth in Hong Kong.
- ◆ Sentiment remains key for short-term performance but the market is supported by strong fundamentals and reasonable valuations. Property counters should benefit from a pick-up in activity while banks are able to find avenues of growth in China-related lending.
- ◆ The RMB de-peg announcement should be viewed positively given its ability to defuse potential protectionist tensions. Over the long run, the Hong Kong economy and equities stand to benefit both from incoming capital capitalizing on the RMB appreciation as well as the internationalization of the RMB for trade and other purposes. We remain buyers of asset reflation and domestic consumption proxies and have turned more cautious on external recovery themes.

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RMB deposits in Hong Kong



RMB Appreciation's impact on Hong Kong

- Hong Kong acts as a liquidity funnel for funds flowing in and out of China. Here, investors can buy RMB-denominated bonds, shares of locally listed Chinese companies and even deposit RMB to play appreciation. A stronger currency may trigger a surge of liquidity in Hong Kong, pushing its central bank, the Hong Kong Monetary Authority, to lower interest rates to maintain its currency peg.

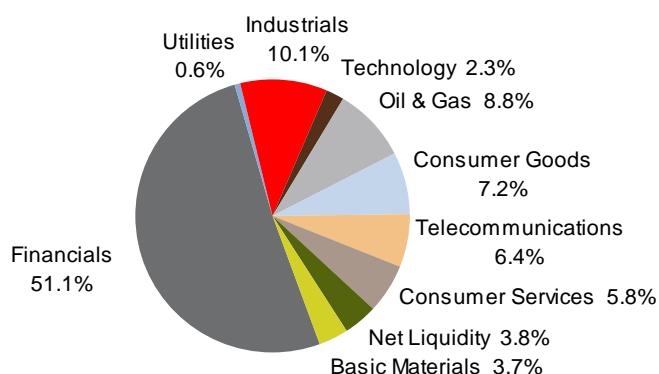
Centa-City Leading Index of Hong Kong property prices



Source: HKMA, Centadata, CLSA Asia-Pacific Markets (Currencies boost Asian buying power, Summer 2010)

A depreciating HK dollar against the RMB and low funding costs would make local assets cheaper for Mainland buyers. Property prices would surge, especially at the high end. Appreciation is also likely to make foreign-currency loans more attractive for borrowers from China, which would benefit local banks with a strong Mainland client base such as Bank of China (HK) and ICBC Asia.

Sector breakdown



Source: JPMAM. Data valid as at 30 June 2010

Top 5 Holdings

Holding	Sector	%
China Construction Bank Corp.	Financials	8.1
HSBC Holdings PLC	Financials	7.7
CNOOC Ltd.	Oil & Gas	6.3
China Mobile Ltd.	Telecommunications	6.0
Industrial & Commercial Bank of China Ltd.	Financials	5.8

Data valid as at 31 May 2010

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