

January 30, 2014

Press Release

Nikko Asset Management Co., Ltd.

Chinese shadow banking concerns expand

- *Iron ore expected to fall \$20 per ton by 2018*
- *Japan updated indicators show Abenomics succeeding*

The impact of bad debts in China's shadow banking system is likely more important to the global economy than Fed policy, latest research from Nikko Asset Management (Nikko AM) shows. Unfortunately, due to a lack of transparency and the extremely complicated system, even well-informed global investors cannot grasp the true nature of China's financial difficulties. Several property trusts have already defaulted, but with rising land prices and generous credit, these have managed to be "worked out;" Recent defaults in the mining and industrial sectors with questionable collateral will likely have more serious repercussions, however.

"Local governments have less capacity to offer rescues considering their own funding issues, and so we expect that many more defaults are likely this year," said John F. Vail, Chief Global Strategist at Nikko AM's Tokyo head office. "Meanwhile, other efforts to increase regulation of the shadow banking sector are bound to reduce liquidity, especially to troubled borrowers, and this has some possibility of accelerating into a more serious credit crunch. Thus, we have long been cautious on Chinese equities and despite low valuations, we continue to believe that corporate profit margins will be under pressure and that bank earnings understate the true problem of bad debts."

In other findings, iron ore is expected to fall in price from its current price level of around \$130 per ton towards \$110-\$120 per ton by 2018, as a result of increased supply from Australia and Brazil. As a key component in steel products, demand for iron ore has surged as a result of China's ongoing urbanisation process. The inability of iron ore producers to increase supply incrementally has led to a quadrupling of the iron ore price over the past 10 years.

"Looking forward to 2018, assuming the forecasted supply comes to the market, this should have the impact of reducing the iron ore price by around \$20 per ton," said James Eginton, a research analyst at Nikko AM's subsidiary, Tyndall AM in Australia. "Thus, the outlook for steel makers has begun to brighten with the potential for margin expansion and improved financial performance over the longer term."

In Japan, inflation is moving strongly upward, with pipeline inflation rising 0.8% month-on-month in December (3.3% year-on-year). There are also strong signs that this is flowing through to retail prices, with the goods portion of the Consumer Price Index rising 0.7% month-on-month in November and up 5.4% on a 6-month annualised basis.

In an update to our previous report on the Abenomics Wealth Effect, the latest data from the Bank of Japan shows that ¥84 trillion (\$805 billion) of household financial new worth (excluding real estate) was created in the 12 months to September 2013, summing to ¥1.24 quadrillion of net financial assets, a record high. The impact of more wealth on consumption will be key to the success of Abenomics.

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For inquiries, please contact:

Tokyo

Corporate Communications

Kyoko Wada, Naho Yohda

Tel: +81-3-6447-6775

Email: corpcom@nikkoam.com

International

Jo Nhan, Marketing Communications Manager

Tel: +852-3940-3939

Email: Jo.Nhan@nikkoam.com

Singapore

Jeanie Cheah, Senior Marketing Manager

Tel: +65-6500-5793

Email: Jeanie.Cheah@nikkoam.com

About Nikko Asset Management

Nikko Asset Management (Nikko AM) is a leader in the Asian financial services industry, with over \$160 billion in assets under management as of September 30, 2013. Established in 1959, the firm has 22 offices in 10 countries and enjoys one of the largest distributor networks in the region, serving both retail and institutional clients. More than 300 banks, brokers, financial advisors and life insurance companies distribute the company's products.

Nikko AM manages a wide range of equity and fixed income strategies in both active and passive formats, leveraging the talents of more than 250 investment professionals. In 2013 alone, Nikko AM won awards for excellence in asset management from Lipper, Mercer, AsianInvestor, R&I, among others.

The company's management team is highly diverse and experienced, and is committed to running the company according to international best practices. Nikko AM's independence from the limitations imposed on many captive asset management companies allows it to focus on the interests of clients. At the same time, the company enjoys a stable base of shareholders, with majority ownership held by Sumitomo Mitsui Trust Holdings and a smaller stake by DBS Bank.

For more information, please visit <http://en.nikkoam.com/>

* Consolidated assets under management and sub-advisory of Nikko AM and its subsidiaries as of 30 September 2013.