

Fund objective

The Fund is designed for long-term investors who wish to build capital over a number of years, regardless of market conditions, by taking long and short positions primarily in equities or equity related derivative contracts of companies located in China (People's Republic Of China, and its Special Administrative Regions, Hong Kong and Macau) or companies that are not located in China but derive a majority (over 50%) of their income from China.

Fund Information

Fund Manager

Ezra Sun

Fund Size

\$87.3 million

NAV per share

\$106.51

Launch price

\$100.00

Dividend payment

Annually (September)

Inception date

02 Oct 2009

Sedol

B4QQFR1

ISIN

IE00B4QQFR16

Bloomberg Ticker

VERAIUS

Index

MSCI Golden Dragon Index

Sector

AsiaHedge Long/Short Chinese Composite

Domicile

Ireland

Structure

ICVC

Tax status

UK Distributor Status

Dealing

Daily by 4.30 p.m.

Management fee (%)

1.0 (institutional A Class)

1.5 (retail)

Performance fee (%)

20% with high water mark

Custodian

HSBC Institutional Trust Services (Ireland) Ltd

Administrator

HSBC Securities Services (Ireland) Ltd

Manager

Veritas Asset Management (UK) Ltd

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Authorised and Regulated by the

Financial Services Authority

**Veritas China Fund
(USD 'A' Institutional Class)**

Fund performance to 30th June 2010

Current UK regulatory requirements preclude the inclusion of performance data until the Fund has a one-year track record

Fund holdings as at 30th June 2010

		Top Ten Long Holdings	
Long	65.0%	Zhejiang Expressway	2.9%
Short	27.0%	Nine Dragons Paper Holdings	2.5%
		ICBC	2.4%
Gross	92.0%	Sound Global	2.4%
Net	38.0%	Beijing Enterprises	2.3%
		Intime Department Stores	2.3%
		Lianhua Supermarket Holdings Co.	2.3%
		China High Speed Transmission Equip	2.2%
Long	49	Digital China	2.1%
Short	10	Zhejiang Supor Cookware	2.1%

Country allocation

	Long	Short	Gross	Net
China	26.1%	11.5%	37.6%	14.6%
Hong Kong	28.0%	15.5%	43.5%	12.5%
Singapore	5.8%	0.0%	5.8%	5.8%
Taiwan	5.1%	0.0%	5.1%	5.1%
Total	65.0%	27.0%	92.0%	38.0%

Sector allocation

	Long	Short	Gross	Net
Energy	0.2%	3.6%	3.8%	-3.4%
Materials	6.9%	0.0%	6.9%	6.9%
Industrials	15.5%	0.0%	15.5%	15.5%
Consumer Discretionary	5.2%	0.7%	5.9%	4.5%
Consumer Staples	18.9%	0.0%	18.9%	18.9%
Health Care	4.3%	0.0%	4.3%	4.3%
Financials	8.3%	14.3%	22.6%	-6.0%
Information Technology	5.7%	0.0%	5.7%	5.7%
Telecommunication Services	0.0%	0.0%	0.0%	0.0%
Utilities	0.0%	0.0%	0.0%	0.0%
Futures & Options	0.0%	8.4%	8.4%	-8.4%
Total	65.0%	27.0%	92.0%	38.0%

Important Information

If you are in doubt about the suitability of this fund you should seek advice from your Investment Advisor. This document constitutes neither an offer to sell nor solicitation to purchase securities in Veritas China Fund (a sub-fund of Veritas Funds plc). Such an offer may only be made via an official application form which should be read in conjunction with the prospectus and may be obtained from the offices of the Administrator HSBC, Tel: 00 353 (1) 635 6799. The minimum initial subscription for the Institutional Share Class A is \$50,000 / €50,000 / £30,000 and the minimum subsequent investment is \$25,000 / €25,000 / £15,000. For the Retail Share Class, the minimum initial and subsequent investment \$15,000 / €15,000 / £7,000.

The global economic growth in recent months continued to be strong. However, investors are now more concerned that global growth may have peaked. Indeed, recent economic growth data are suggesting some signs of softening. For example, the OECD composite leading indicator (CLI) index fell marginally to 10.1% in April from 10.6% in March. The US manufacturing PMI declined slightly to 59.7% in May from 60.4% in April, whilst European PMI fell from 57.5 in April to 55.6 in June. The US GDP also showed some signs of moderation to 2.7% in 1Q10, down from 5.6% in 4Q09. The net result of these is the return of fear as evidenced by the VIX index rising to a high of 48.2 from 17.6 at the start of the quarter. The corollary of this is that the weighted USD index also rose above the 88 level from 81 at the beginning of the quarter. The strength of the USD has historically been bearish for Asian equities, and this time is no different.

The major and very real risk lies with the huge and unsustainable fiscal deficits in many sovereigns. In May, a defining moment was reached as the market forced the governments of Greece, Portugal and Spain to a sharp fiscal contraction to reign in deficits. This will have the effect of slowing growth at the margin. Fortunately for the Euro, Greece is only 2.7% of European GDP, Portugal only 1.8% and even the larger Spain only 11.5%. Hence, the problems in peripheral Europe are unlikely to cause a global double dip unless we have contagion to the financial system. The real elephant in the room where the most severe risk lies is in the highly leveraged, triple A rated, large economies of France, United Kingdom and the US. Several of the French banks CDS are now at higher levels than that reached during the Lehman bankruptcy in September 2008. The United States is expected to run a deficit of USD1.6 trillion, equivalent to 10% of GDP. Other than the risks of defaults, the huge deficits mean that massive sovereign bond issuance in the US, UK and Europe will have to attract huge amounts of private capital thus eventually crowding out some private investment. The expiry of the EUR442 billion sovereign debt on July 1 was cited as a factor for the sharp fall in global markets towards the end of June.

In contrast to the severe indebtedness and fragility of the developed world, the emerging market economies continued to roar ahead, especially in the two mega economies of China and India. We remain unwavering in our view that China is not in the midst of a massive over-investment bubble. It is true that China's growth of 11.9% in the first quarter is too rapid, but a classic over-investment bubble like that of Thailand and other South East Asian countries in the mid 1990s all have similar characteristics of very low returns on capital. This is clearly not the case in China where industrial profits rose 81.6% in May, in contrast to the lows of -37.3% in February 2009.

The Chinese economy in the past month or two however, has shown some deceleration. In our view, that is an indication that the economy is responding to policy tightening and indicates the fact that the policy makers are still firmly in control of the pace of growth and that the economy has not, as some China bears suggest, run out of control. Predictably, however, many commentators now see the slow down as the prelude to a hard landing in China and started to predict the collapse of the Chinese economy. We disagree with the pessimistic forecasts prevalent in the marketplace. The latest economic data in May of retail sales of 18.7%, industrial production of 16.5%, fixed asset investment of 25.9%, and exports of 48.5% all suggest that the economic growth whilst moderating, remains buoyant. China's decision on the 19 June to end the RMB peg and adopt a currency movement with reference to a basket of currencies suggests that it is confident that growth is not a major concern in the medium term. The RMB stopped appreciating against the USD in September 2008 when growth slowed dramatically. Whilst the recent anti-property measures will have the impact of slowing growth at the margin, the overall economy is unlikely to collapse as the government has avoided the use of blunt instruments such as interest rates and RRR to curb property speculation. We continue to believe that strong China growth is a major positive for Asia.

The consumer continued to be a core theme of the fund this year. We are of the view that the boom in consumption that took place in Japan in the 1980s and the US in the 1990s will happen to China in the next 10 years as baby boomers attain rising productivity and salaries. The high profile strikes in Chinese Honda car factories suggests that labour availability is becoming scarce and salaries will rise, and hence stimulate consumption. In contrast to the depressed global outlook for wages in the developed world, workers in China have something big to smile about this year. Minimum wage will rise significantly this year in China – Beijing (20%), Shanghai (17%), Guangzhou (20%), outer Shenzhen (22%) and Xiamen (20%). Some of the less developed provinces announced even more aggressive minimum wage increases, e.g. the 33% hike in Hubei and 29% in Wuhan. Within the consumer sector, we are investors in the departmental store operators, food and beverage companies and sports-wear retailers in China. This may raise concerns about inflation in China, but the moderation of growth is offsetting the inflationary pressure that was built up during the expansion of the past year. Given the huge global output gap and the steady increase in unit of labour productivity. We continue to think that inflation risk is low for China.

As investors reading previous quarterly updates would know, whilst we are of the fundamental view that China is not in the midst of a massive property bubble, we have taken a tactical short in a number of Chinese property stocks. We are continuing with this trade as we believe that the government will act to prevent a US style housing crisis and to prevent the escalating prices from being out of reach of the middle class. In mid April, draconian anti-speculation measures were announced after the executive meeting of the State Council. The most eye-catching measure was the mortgage tightening – down payments for first-time homebuyers with flats larger than 90sqm was increased to 30% from 20% and down payments on second homes rose to 50% from 40%. Banks were also instructed to be more stringent in processing mortgage approvals.

Given the strong divide in views about China, we think it is important to point out that notwithstanding the glitzy pictures of Beijing Olympics and the gargantuan Shanghai Expo, China is still at an early stage of development. The Chinese did not need to be extraordinarily clever or innovative to maintain the sort of growth that it has grown used to in the past ten, twenty years. What has changed however is that it is increasingly looking inward for development and the recent depegging of the RMB is in our view a watershed event heralding the beginning of a more domestically driven economy and a departure (albeit a reluctant one) from a mercantilist past.

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