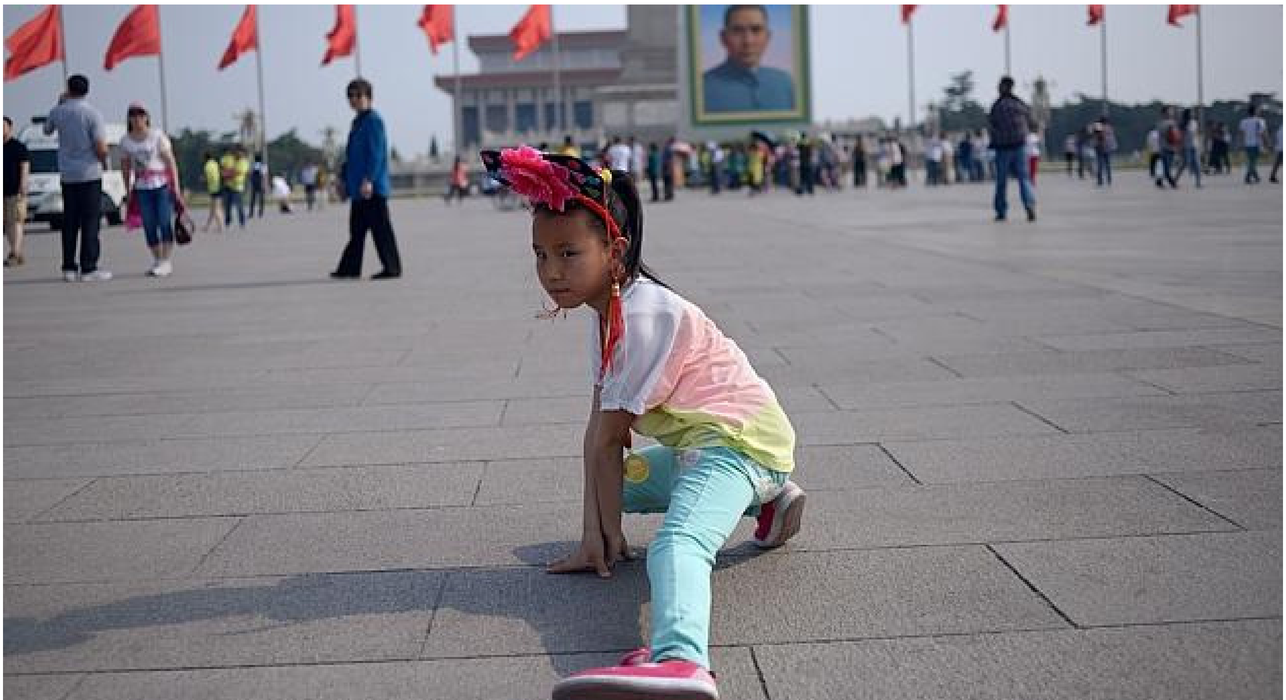
THE AUSTRALIAN

China presents new opportunities for investors

STIRLING LARKIN THE AUSTRALIAN MAY 02, 2015 12:00AM



The recent rally in Chinese stockmarkets has more to do with political puppetry than market fundamentals. Source: AFP

Martin Luther King Jr once said that we don't have to see the entire staircase, all that we need to do to progress is to take the first step.

When it comes to investing directly into Chinese mainland bourses, Australian investors, retail and sophisticated alike, remain particularly reluctant to take such a step.

This is despite the fact that other foreign individual and institutional global investors are not only cleverly taking these steps but are now several paces up the staircase, well ahead of us.

The Australian global investor remains consciously indifferent to the recent stellar performances seen on Shanghai's CSI300 index, the successful listing of Alibaba on the NYSE and the fact that China remains an economy representing one fifth of the world's entire population still growing at "5 per cent plus" per annum.

Coffee shop banter along George and Collins streets may be filled with white-collar professionals chatting about all things Chinese but when these same "China acolytes" are asked whether they would be willing to make any investment, risky or conservative, directly into China, the answer always, ironically, appears to be a "no".

Even though the year is now 2015, most of these ‘‘pundits’’ remain more preoccupied with grumbling about why China is no longer buying our iron ore, that it no longer needs, at prices seen in economic times well past.

This hypocrisy, if played out in reverse, would see Chinese salesmen try to sell Australians’ VHS video cassettes at a unit price fixed at 1985 pricing in the year 2015.

Clearly, that wouldn’t make sense and defies the basic logic of commerce and trade, let alone reasonableness.

Professional fault finders would then rehash the old argument that China still harbours “shadow cities” where ‘‘irrational exuberance’’ led to overzealous regional officials building cities that were never needed.

But again, this diatribe has been discredited many years ago by those who appreciate that Chinese construct infrastructure for the decades ahead.

Many of these touted “shadow cities” are now, in fact, being populated and prospering.

Visiting several of these myself, such as the new cities of Central Shanxi Province, there’s nothing ‘‘shadowy’’ about them.

Further still, according to a new OECD report and as the graph illustrates, the UN had itself, until very recently, significantly underestimated the size and capacity of growth in China’s megacities, defined as those with more than 10 million people.

But what makes this story particularly interesting is not the foreigners’ misconceptions, the Chinese whispers or even the classic economics in play but, rather, the formidable gravity of the Chinese Communist Party’s pull as a central markets puppeteer.

Much is written about the scientific aspects of markets within China but at this point in time, such science becomes irrelevant when contextualised against the politics.

Conceptualised differently, understanding why the Chinese stockmarkets are rallying has little to do with market fundamentals and far more to do with political puppetry.

There is no conspiracy at hand — all that is transpiring is that the Communist Party’s political apparatus is demonstrating how its authoritarian style of market architecture will now work and presumably continue into the foreseeable future.

On this, the forward-looking global investor is very interested to know what further architectural amendments will be announced by the politburo at the upcoming fifth plenary session of the 18th National Communist Party Congress in the Chinese autumn (October) of 2015.

Perceptive ultra high net worth (UHNW) overseas global investors have already identified this upcoming watershed moment and are tactically taking positions in anticipation.

To fathom why many Australian global investors continue to misread the situation, it is important to quickly understand where our misconception began.

In short, Western capitalism’s understanding of markets is deeply rooted in the original theories of the first recognised major economist, Adam Smith.

Smith argued individuals seek their own economic self-interests, which, by their very nature, allow an “invisible hand” to best allocate capital with resources, labour and investment.

By contrast, the CCP’s authoritarian approach to markets flies in the face of this premise, because, the state represented by the CCP in China, directs the metaphorical hands. Whether this is philosophically right or wrong is a debate for another day.

But what it means for Australian investors is that they need to rapidly awaken to how other markets function, particularly in light of the fact that China's markets will indubitably dominate our side of the Pacific, both in scale and velocity, in the coming decades.

Perceptive foreign UHNW investors understood that the first step the Communist Party took was to allow Chinese domestic individuals to speculate on real estate assets.

Appreciating that the Chinese banking system was originally built to predominantly assist state owned enterprises (SOEs) and not domestic consumers (as seen in the West), these UHNWs respected why what we refer to as "shadow banking" investment solutions — banking solutions provided by non-banks — were allowed to proliferate in the way that they did.

It was a purposely permitted buffer for the excesses that were accumulating in the overly invested domestic real estate market.

Today, these same perceptive global investors understand that the CCP's redirection of allowable domestic investment from real estate and "shadow banking" investments towards Chinese stockmarkets is both a part of the CCP's grander plans and also its current tacit objective.

The Australian's China correspondent, Scott Murdoch, correctly reported in his April 25 story the oddities being seen by the Chinese government who were both concerned and yet at the same time stoking domestic Chinese investors to pile into their own bullish stockmarkets.

Maybe when considering Martin Luther King Jr's advice, the first step Australian global investors should take is to accept that not all staircases lead us to the same destinations.

Larkin Group is a wholesale wealth adviser focusing on high yielding global investments.
www.larkingroup.com.au