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-0.38%	+0.62%		+6.08%		-22.93%				
5881.5000	\$0.78		\$4.01		\$0.79				

China offers great opportunities for investors as economy transforms

STIRLING LARKIN THE AUSTRALIAN FEBRUARY 21, 2015 12:00AM



The year of the goat will mint more new tycoons in China, with 24 new billionaires in January alone via 20 new IPOs. Source: AP

IN a year in which double-digit returns are expected for US investments, some Australian ultra high net worth (UHNW) investors are asking whether they should still consider mainland China as a viable investment alternative?

To answer this question, one needs to understand the phenomenal transformation afoot within the Asian wealth market and China in particular.

Many investors don't fully recognise what is happening in these economies and choose instead to concentrate on more sensationalistic reports that focus on China's current headwinds.

Asia is changing and driving this from the centre is the Middle Kingdom of China.

This trend is more than simply a story surrounding the successes of Alibaba or any one-off stockmarket rally, as seen on the Shanghai Composite in late 2014.

For example, what is widely known but poorly appreciated is how President Xi is transforming China from an industrial driven to a consumption-led economic model.

Further compounding these misconceptions is that much of Australian commentary focuses on the immediate implications for Australian counterparties — such as listed iron ore or coal exporters — and too little is made of the bigger picture which has long-term ramifications for the actual prosperity of the Chinese economy itself.

Ironically, on this point, the majority have failed to notice that as the graph suggests, the consumption of coal in China fell outright in 2014, for the first time since 1998.

All that aside, for informed Australian UHNW investors considering sophisticated Chinese investments in 2015, several key transformation criteria are, thankfully, being met and in so doing presenting lucrative investment windows that may not be readily apparent to other investment communities.

The boon in Chinese stockmarkets in 2014 was an interesting case in point.

The China Securities Regulatory Commission, China's primary securities regulator, made it well known in early 2014 that they were working closely and collaboratively with China's federal government to reform stockmarket margin lending.

These efforts were intended to help redirect domestic investment away from speculative real estate investing — often being financed via “shadow banking” institutions — and towards China's largely under-supported stock exchanges.

Although this sharp rally has since dissipated, savvy global investors are still closely watching these markets, with good reason.

For example, before this week's new Lunar Year began, China minted 24 new billionaires in the month of January alone via 20 new initial public offers on China's bourses.

In another timely example, following the exceptionally successful NYSE listing of Alibaba in 2014, the company's finance arm, Ant Financial, is rumoured to be seeking its own public listing in early 2016, which will, no doubt, also be well received by global investors.

However, not all is boding well for China's listed entities given the collapse in global commodity prices, falling profits of China's industrial sector, weakening property investment and the recent sharp fiscal contraction made by the Chinese government.

Since heavy industrial corporations make up a sizeable proportion of China's publicly traded sector, this fall is bad news for listed company earnings.

State-owned banks, which make up another large portion of China's stock market indices, also face earnings pressure as expected interest rate cuts hurt their margins and bad loans writedowns accelerate.

Of course, many of these factors are interrelated and you cannot expect success in all while transferring the emphasis from one economic model to the next. Savvy global investors fully accept this.

Given the re-emphasis towards domestic Chinese consumption, the recent news that, with the exception of the property and utilities sectors, the Chinese private sector has recently performed very well is being celebrated by the long-term foreign investor.

This was exemplified by the recent announcement that profit growth at private companies exceeded

those of state-owned enterprises by an average 7 per cent in third-quarter 2014.

Australian UHNW investors are also taking comfort from the news that to ensure continued financial stability the People's Bank of China has taken decisive steps this month to shore up support for financial institutions, supporting private companies during the particularly demanding Chinese New Year period.

In any expectation to outperform double-digit US returns this year, the global investor requires some confidence in the currency denomination of the investments being made. On the question of Chinese yuan strength, there is an argument circulating that even with the US Federal Reserve expected to raise interest rates, which is likely to lead to a rise in the US dollar, the strength of the yuan may be greater still in the foreseeable future.

This is because after years of keeping their currency undervalued, Beijing has learned that a strong currency serves its needs best: cutting its commodities import bill, giving consumers more purchasing power and forcing low-end exporters up the value chain.

China's vision for the yuan to be Asia's anchor currency would be significantly undermined by any competitive devaluation and therefore a strong and possibly even stronger yuan is here to stay.

Unlike Australia's Reserve Bank or even the US Federal Reserve, which cannot persuasively intervene in the trajectory of their own currencies, when it comes to the yuan, the PBOC in China can meaningfully intervene, if required or desired.

At a time when Chinese, Americans, Europeans and Australians have become accustomed to asset values going up due to the massive monetary expansion of the past 30 years, it is critical to remember that as the "cheap money" dries up, even in the Chinese domestic market, our investment focus in China must be squarely on those opportunities that will not heavily rely on easy credit in this next stage of the cycle.

Informed global investors who know what to look for will be able to identify these opportunities which are readily attainable in the viable investment alternative of China.

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