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SHOW ME THE MONEY

China still presents a buying opportunity

The country's consumption boom is set to be more spectacular than its investment and export boom

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MARKETS have been rather jittery after Beijing announced numerous measures to cool down its domestic economy. Is this the end of the bull market which started last March? Or is this just a correction?

Personally, I think the measures implemented by the Chinese government are good for the market in the long term. Better to do it now, and in small measures, than to allow things to get too overheated and out of hand before coming down hard on the market. So from that longer-term perspective, the current sell-off represents a buying opportunity, I think.

A lot of views or noises are out there now as investors try to decipher how the global economy is actually doing and the implications of the unprecedented initiatives implemented by the various governments last year.

China, as one of the fastest-growing major economies of the world today, is of course attracting a lot of attention. And the views on the Middle Kingdom are as divided as ever. On the one hand, there is James Chanos, who foresaw the collapse of Enron. He recently described China as 'Dubai times 1,000'. On the other hand, there are still a lot of steadfast China bulls out there.

One of them is Tan Teng Boo, the founder of Capital Dynamics, which manages, among others, the i-Capital Global Fund. That fund has chalked up one of the best performances for long-only equities fund in the world since its inception in July 2007 until now.

Here's how it has done: From July 31, 2007 until Dec 31, 2009, i-Capital Global Fund has gained by 28.8 per cent. That's an annual compounded return of 11 per cent a year for a period which is arguably the most atrocious one in our generation.

In that period, it beat the MSCI All Countries World Index - which slumped by 23.9 per cent - by a staggering 52.7 percentage points.

In his recent newsletter, which is available for subscription, Mr Tan presented some of the more lucid views on China.

He disagrees that the Chinese economy is a bubble and is about to crash. What is happening in China is an event that happens only once in a millennium, claims Mr Tan. 'Surely, 30 years in a millennium is just like a second.'

Despite the high level of investment, China still needs vast amounts of all kinds of basic infrastructure. Despite being the largest mobile-phone market in the world, the number of mobile-phone subscriptions per 100 people in China is still below that of Brazil. The number of Internet users per 100 people is also lower than that of Brazil. Even the number of TV sets per 1,000 people in China is below that of Russia. 'The high level of investment seen in China can persist for many years to come,' says Mr Tan. Comparing it with the experience of South Korea or Taiwan or even Japan during their fast growth era is misleading.

'As a country, China is geographically huge. Its population is vast and it is starting from a low base in all areas. Catching up with Japan on an aggregate basis took more than 30 years. Catching up with Japan on a per capita basis will take no less. Overtaking Japan on a per capita basis will take an even longer time.'

Mr Tan describes Japan as a nation of innovators while China is a nation of inventors, with a whole long list of fundamental inventions such as paper, gunpowder, compass and the rudder.

Mr Tan's main thesis is that China is about to enter the consumption boom phase. This boom will be even more massive and spectacular than the investment and export boom that China saw in the last 30 years.

'China's current per capita income is around the magical threshold level of US\$4,000. In short, consumer spending in China is at the stage where it is about to really take off,' says Mr Tan.

Indeed, that view was lent credence when China's Vice-Premier Li Keqiang said this week at the World Economic Forum in Davos, Switzerland, that China will seek to boost domestic consumption to drive forward its booming economy, acknowledging that export growth alone was unsustainable for development.

Mr Li added that China would look to increasing employment and income levels of its poorer people, hoping to unleash the huge potential of the Chinese consumer.

He also said the government would break monopolies and encourage competition while integrating more deeply into the global economy.

The i-Capital Long Boom

Mr Tan formulated the i-Capital Long Boom Theory as far back as 2002-2003. The theory centred on the transformation of China. A major component of the theory is that the benefits of China's transformation will be felt by the rest of the world and not just in emerging markets. Australia, Africa, Indonesia, Vietnam, Korea, Canada, the United States and others will gain substantially from China's transformation. 'It is an unprecedented event. As China moves into a more balanced development phase, with consumer spending playing a greater role, the rest of the world will benefit even more.'

Addressing the issue of the wide wealth gap between the rural and urban dwellers, Mr Tan says that is a grave concern if China is governed by leaders who are naive, short term-focused and have only their self-interests to serve. 'Fortunately for the Chinese people, and all the others in the emerging economies, China is capitalist in economics but socialist in politics.'

It is this unique combination that makes the leaders in China so acutely aware of the income and wealth gaps, he says. They have been implementing endless measures to move rapid economic development away from the coastal areas, away from the major urban areas to inland China.

Overall, one could argue with good reasons that the property and stockmarket boom in China is still in the early stages. says Mr Tan. 'For sure there will be cyclical ups and downs in China's property and stock markets but the factors driving a secular property and stockmarket boom in China are still in place.'

In comparing China now with Japan in the 1980s, Mr Tan notes that the crash that the Shanghai stock market suffered in 2008 was very severe, acting as a crucial catharsis. It provided a base for the market to start a new bull phase from. In contrast, Tokyo didn't have such a cathartic experience until the 1990s. The stock market in Tokyo did not have a crash from the end of World War II until the end of 1989.

In the 1990s, Japan faced a bursting of three asset bubbles nationwide: residential and commercial properties, and stock prices. China, at worst, may be facing a restricted property 'bubble' in some major cities. Prices of properties outside the tier-one cities in China did not surge in recent years and are holding up well as the economic growth spreads beyond Beijing, Shanghai and Guangzhou. By the 1980s, there was nowhere domestically for Japan's economic growth to spread to. Development was focused only around Tokyo and Osaka. Growth for Japan had to be shifted to cheaper countries overseas.

The worries in the market now are very much centred on shorter-term, cyclical types of factors, notes Mr Tan. Beyond that, China's economy would become more balanced and its economic growth will be robust and sustainable. Time to short James Chanos, he asks?

- **The writer is a CFA charterholder**

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