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Participating in China's growth: go direct or indirect?

Access to opportunities a major challenge

By Wensi Zhang, Asia Pacific Asset Management research and investments associate director
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Accessing China via specialist China or Asian funds is a good option for institutional investors, according to Asia Pacific Asset Management.



The rise of the Chinese economy has prompted investors around the world to capitalise on the investment opportunities available in the Greater China markets. Getting access to investment opportunities and the right exposure is a major challenge given the language barrier and the cultural, legal and other differences, which if not properly understood, can expose an investor to unknown or unwanted risks.

The often-recommended strategy for getting investment exposure to China and Asia is through investing in Australian companies that conduct business with or in China, which from time to time makes sense, however, the risk is actually higher in the long term.

First of all, unless they are world-class monopolies such as BHP and Rio Tinto, there is no guarantee Australian companies can readily succeed in Chinese markets. In fact, many local

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Chinese companies, especially in the technology, media and telecom sectors, have now grown to be just as competitive and profitable as their western competitors within the Chinese market.

Secondly, trade frictions and protectionism between governments have become rampant during the current global recession, which means the road for Australian companies into China, or Chinese investments into Australia, is probably not without political oversight and interference. The recent conflict between Rio Tinto and the Chinese steel industry is a good example of this potential risk.

Furthermore, most Australian investors in Australian China plays generally only get Chinese exposure through commodity stocks, which despite impressive performances of late, will continue to be subject to cyclical, boom-bust, outcomes despite apparent Chinese demand. There are a lot more diversification choices available if you invest directly into the Greater China markets. For example, three of the world's top 10 banks are now Chinese, and China's biggest mobile phone company, China Mobile, is five times larger than Telstra and still growing revenue at 15 per cent annually. Another reason why institutional investors, particularly superannuation/pension funds (and their longer-term funding commitments) need to look beyond commodity dependent themes.

Lastly, there have been remarkable improvements in corporate governance in Chinese companies, especially those listed on the Hong Kong Stock Exchange (H shares) where corporate information is disclosed in both English and Chinese. Since the beginning of this decade, the Chinese government has floated many of its state-owned enterprises on the Hong Kong Stock Exchange in order to attract international investors and management expertise. Thus investor confidence in Chinese companies has improved markedly.

Often overlooked and perhaps the best option for investors or their advisers is to look for specialist China or Asian funds, which have the expertise to deal with the challenges faced in stock selection in foreign markets. A fund's track record (especially over the past 20 months) is very important when assessing capability and performance.

The Australian economy is well positioned to benefit from the growth of the Chinese economy, as are Australian investors. Asia is no stranger to volatility and nothing in Asia goes up in a straight line forever. Given the volatility in Asia, investors need to adopt a new mindset that considers a broader range of risks, otherwise overlooked and unseen through the eyes of traditional buy and hold strategies.

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