

Investing in China

“When you visit Goundong or Shenzhen you think anything is possible.”

“We are really worried about intellectual property rights. We are investigating copycat products that are showing up in other markets.”

“It is really hard to get our goods out of China.”

“I no longer want to live in the US. My wife is Chinese, and we plan to stay here. Our prospects are too good to go back.”

“China’s financial system is buoyed with an over inflated stock market and unsecurable debt.”

Which China is true? All of them. I recently attended the Greenwich roundtable session on Investing in China. Here is a synopsis of what the panel talked about by Steve McMenamin of the [Greenwich Roundtable](#).

Panelists:

E. Gerald Corrigan, Goldman, Sachs & Co

Richard Chenevix-Trench, Sloane Robinson Investment Management

Jim Rogers, The Adventure Capitalist



Investing in China—from the Experts

Greetings from the Greenwich Roundtable. Our session titled China: Sleeping Beauty or Waking Giant was held as we wrestle with the looming competitive threat from and the luscious growth prospects in China. We were treated to an eye opening recitation of the many risks that confront foreign investors. We were also given a glimpse of some unusual opportunities. Our speakers are all heavy weights. Jerry Corrigan is the ultimate insider as the

trusted Goldman advisor to China's leadership. Richard Trench is a savvy hedge fund manager who is compounding at 27 percent even through the Asian contagion. Jim Rogers is an old friend of the Roundtable and, after driving around the world twice, has been called the Indiana Jones of investing.

Gerald Corrigan:

My firm has a substantial presence in China. I work as an advisor with their government. The Chinese leaders are focused. They have a clear vision of what they want to do. Once they decide, despite any setbacks, they stick to their vision. The new breed of leadership has a western education and vast experience in a wide variety of specialties. They ask me the toughest questions I encounter from governments anywhere in the world. The next 5 years for China will be tougher than the previous 5 years. The social pressure to keep 7-8 percent growth is a necessity, not a luxury. First, the banking system has a non-performing loan problem that may be worse than Japan. Cleaning it up will cost 25-30 percent of GDP. Fortunately, China can afford it and has created a task force to do it. Second, the transition to the World Trade Organization will be difficult. It will force an enormous restructuring of the public and private sector that will cause several dislocations. Third, the structural reforms in labor, healthcare and education systems will be the most difficult element. Europe has been grappling with structural reforms with limited success. Take Europe to the fifth power and that's the magnitude of China's challenge. Fourth, fiscal reform is needed. In the last decade, fiscal stimulus has been the engine of China's growth. Now the private sector needs to replace the government as the growth engine. Other Asian economies have not successfully converted to private domestic demand as their growth engine yet. Fifth, is the transition into a convertible currency. The transition will be a complex risky undertaking and they will do it with extreme care. Finally, they need to figure out their geopolitical destiny. Based on my interactions, I believe China's leadership has the means and the willpower to cope simultaneously with these difficult challenges.

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Richard Chenevix-Trench:

China's challenges are many. A bubble may be forming. My perspective is in the public equity markets. China built their equity capital market infrastructure in 15 years. A very short time to set policy! Its economy has grown 150 percent but it has not rewarded investors. Having reached speculative highs in 1996 and 2001, Chinese markets are not correlated to the rest of the world. Classes of shares are confusing and valuation methods are different. Each new set of stock listing depresses the old listings. They tend to fatten up state-owned companies for public listing by pumping up their earnings. They practice "signal box" economic policy, which is the risk of a bureaucrat pulling a lever, and profits are diverted to an area of the economy that strikes his fancy. Another risk is where they promise western investors big profits, "inject assets" such as licenses

or provinces for cash. These assets usually deteriorate and fail to return the cash. Experienced investors also call this "moving the goal posts" or a theft of cash. Then there is the "competing with the sons of heaven" risk. For example, we saw fiber optic investors lay cable only to have the progeny of China's leadership quietly lay dark cable alongside which could be lit anytime they wanted. China and Asia lack the fundamental philosophies that are the basis of capitalism. The comprehensions of equity and shareholders' rights do not exist. Seniority of debt and equity is an alien concept. Equity is regarded as free money. Interests are not aligned between managers and investors. Raw competition does not exist. The quest for market share supercedes the quest for profits. China is wedded to a cheap currency policy. Low interest rates and huge surpluses dampen the efficient deployment of investment capital. Sooner or later, inflation will pick up unless their currency rises. Hong Kong is a wonderful place, but its economic importance has peaked. Chinese investment opportunities are fragmented and exist in the smaller companies. Strategic investors often commit capital to gain an understanding of their competition.

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Jim Rogers:

The 19th century was the United Kingdom. The 20th century was the United States. The 21st century will be the century of China. You should teach your children Mandarin Chinese. They are the largest population on earth. Many people, especially in Washington, do not like or understand what's happening there. They are capitalists despite the fact that they call themselves communists. They are growing by leaps and bounds. I was the first person ever to drive across their country 3 times. The changes I've seen are staggering. Their arrogance and hubris rivals ours. They are reserving the best companies for themselves. Investors should have a strong and honest Chinese partner. China's problems are the same as America's problems in the 19th century. Yes, we fleeced all the foreigners then. Rockefeller, Carnegie and Morgan made fortunes off the backs of foreigners. It happens all over the world. Siberia was part of China until Russian squatters took over. It has vast natural resources. Chinese labor and Japanese capital is moving there. Just as Americans moved west, Chinese social and population pressures will be released into Siberia. It will be one of the great frontiers of the 21st century. Figure out a way to sell to China and what they need and you'll get rich. China is becoming one of the biggest importers on the planet. They need lots of things as they build their manufacturing capacity. They need copper and iron ore. One of the biggest opportunities will be the shortage of women there. Women's (lower) status will change as they become scarce. Figure out how to take advantage of their rising status and you can get rich! Shanghai is eclipsing Hong Kong. Investing has never been easy for me. Never has been. Never will be.