GEORGIAN
CAPITAL PARTNERS

‘China, China, China’ – An expert’s observations, with mega implications. Enjoy!

David Knight
Georgian Capital Partners
Scotia Plaza
40 King Street West, Suite 3405
Toronto, ON M5H 3Y2

Toronto: (416) 640-4100
Victoria: (250) 595-7955
www.georgiancapital.ca

June 18, 2015

LLOYD GEORGE
ADVISORY

June 2015

Investment Outlook

Where Will Chinese Wealth Go?

Today it was announced by the Boston Consulting Group that there are now four million millionaires in China (up from three million in 2014) compared to seven million in the USA. This was mainly attributed to the rise in the Chinese stock market last year, as it only includes cash, shares, and financial investments not real estate, art or businesses. In the Asia-Pacific region as a whole, private wealth rose nearly 30% last year to US$47 trillion, out of a global total of US$164 trillion.

The question that comes to mind, as the Renminbi becomes convertible by the end of 2015, and China liberalises both its financial system and its capital account, is – where will all this wealth flow? In our view, real estate has always been the primary destination of Chinese family savings, but this hunger has already been assuaged in cities such as Beijing, Shanghai, and Hong Kong, which now has the highest values per square foot in the world (HK$32,500 per sq. ft. or US$8.3 million for a 2,000 sq. ft. flat).

The new wealth will, in our view, be directed to liquid securities, such as shares, bonds, and mutual funds. With the "Shanghai-Hong Kong Connect" being swiftly followed by a parallel Shenzhen-HK capital link, the money will be flowing mainly one way, into Hong Kong, where there are over 600 listed Chinese securities, and the average multiple is 11x compared to 25x on the Shanghai market and almost a 74x compared on Shenzhen. We expect that the greater China market will harmonise into a single capital market like Europe did after 1992, with Hong Kong being the centre as London became the financial centre of

LLOYD GEORGE ADVISORY (HK) LIMITED
SUITE 4004, TWO EXCHANGE SQUARE, CENTRAL, HONG KONG
TELEPHONE (852) 3468 7278 FACSIMILE (852) 3468 7163
EMAIL: BETTY@LLOYDGEORGEADVISORY.COM

the EU. We are therefore very much focused on the liberalisation of the Chinese financial sector, banking, insurance and broking as it adapts rapidly to the imminent possibility of full convertibility for the Renminbi. We have received confirmation that the IMF will officially accept the Renminbi as an international reserve currency by September, and China may move to open its capital account by the end of 2015.

China is moving rapidly from heavy industry and infrastructure development to the service and consumer sector. It is also moving from energy intensive GNP growth to a lighter model where alternative energy sources (nuclear, solar, wind and electric vehicles) assume a much greater importance. By 2030, China has pledged to reduce its carbon emissions, which is a major undertaking considering that China depends for 70% of its energy on coal, and is now the largest importer on oil in the world at 6 million barrels a day. The pressure of public opinion on the Communist Party leaders has increased in recent months, since over 20 million people viewed the video “under the dome” about the worsening problem of pollution in Beijing and its health consequences. Nothing will be more significant to the world energy balance and to the oil price than if China reduces its use of fossil fuels (this also effects geopolitics, as China moves to build base in the South China Sea and to protect its sea lanes, especially for oil tankers coming from the Middle East.

All this rapid change in China is having consequences on other countries, especially on the emerging markets in South East Asia, Africa and Latin America. We do not expect there to be a recovery in commodity prices. If Islamic State invades Saudi Arabia, the oil price would certainly jump in the short term, but there is no visible bounce in gold or other mineral prices. The world is awash with oversupply for most of these products, which Chinese demand has driven for the last decade or more.

LLOYD GEORGE ADVISORY

We are still in a deflationary world, which is beneficial for consumers especially in Asia. As retail activity moves more and more onto the internet, this is also going to effect the demand for commercial space and we see a significant downturn in property values coming over the next few years. We are currently researching all of the Chinese internet stocks to find the new winners in e-commerce and other high growth sectors.

In conclusion, although the market is expecting a summer correction, because of Greece or rising US interest rates, we are looking beyond these factors, to see that China is still moving ahead fast, and liberalising. China has learnt a valuable lesson from the USA in paper wealth creation, which is now coming from stock market more quickly than from trade and manufacturing. Over 4,000 new Chinese hedge and private equity funds have started up in the past three months and assets under management rose by US$75 billion to US$433 billion. In our view the Shanghai boom is just beginning and we will be going to Shanghai next month to try to assess the foundations, and the sustainability of this important development, of the financial sector, of the world's largest second economy.

R. Lloyd George

Robert Lloyd George
June 2015