Musings from our global friend, Robert Lloyd George – China on the inevitable march. Enjoy!

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# Investment Outlook

## Discontinuities

Oil has rallied 25% from the bottom and, according to Fibonacci, needs to retrace 38% of its decline to break the cycle, i.e., $67 a barrel. This is now quite probable and would imply (given the extent of monetary easing and reflation in past 6 years) that from January's deflation scare, we are now moving towards slightly higher inflation and higher interest rates. The relatively sharp upward move in bond yields (from their 30-year low) is also signalling this change.

We do not believe that this indicates an upward move in commodities generally, (thermal coal, for example, is nearly 60% below its 2011 price). Oil is a separate and special situation, still driven by Middle East political tensions. If Iran gains control of Iraq, they control almost 50% of oil supplies in the "Persian" Gulf; if they can block Saudi oil tankers (i.e., by controlling the port of Aden), this rises to about 70%. In the words of one astute European investor aged 80, this is "the most dangerous geopolitical situation since 1939," including Russia's revanchism, again on display during the May 9th Moscow commemoration of victory over the Nazis.

Another potential "discontinuity" is if the cost of solar power falls and the advance of electric battery technology proceeds rapidly enough, then the use of gasoline and diesel in the world's vehicle population (around 1 billion cars and trucks) will rapidly decline; and the oil age will end within 20 years. Supply will, in any case, be plentiful (as the Arctic and other areas are opened for exploration), and the oil price would be nearer $20 than $100. All of this is good news for energy consumers such as China, Japan, Korea and the Philippines.

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In the short term, we continue to be optimistic on stocks and, more specifically, on China/Hong Kong, Japan, and India, also South Korea. Earnings growth this year will be better than expected in the region, and there is generally political and currency stability; and average GDP growth in the Asia-Pacific region is expected to average 6.3%.

How do we reconcile our bearish view on Chinese real estate values with our bullish stance in Chinese equities? Kenneth Rogoff in his notable 2009 book, *This Time is Different*, noted that the peak in US real estate prices occurred in 1925; but the stock market did not peak until October 1929, four years later. Although we may have actually seen the peak of Chinese property (both residential and commercial), it is a slow-moving cycle; and the massive shift of savings from 'hard assets' into shares (evidenced by millions of new share trading accounts opened in Shanghai and Shenzhen) will propel the share market up for several more years. A parallel was made in the Financial Times two weeks ago between the growth in GDP in Japan from 10% from 1950 up to 1970, when it slowed down to 4% in 1970s, and at that point, the Tokyo stock market began its 20 times move up, until 1989. So far, Shanghai has only doubled and is still on a reasonable P.E. ratio of 22. We expect both Shanghai and, more especially, Hong Kong, on a P.E. of 13 and 40% discount to Shanghai, will make a much more significant move in the next 2 or 3 years.

The Bamboo Fund is currently invested 40% in Hong Kong, 10% in China, 10% in India, 10% in Japan, and the balance in Singapore, South East Asia and cash. We continue to screen vigorously our potential investee companies for valuation, management quality, and product and price sustainability as well as E.S.G. We are rigorous in our research because a public listing does not certify long-term honesty or respectability. Despite our enthusiasm for solar power, we are proud not to have invested in Hanergy, a former market darling (up 400% in seven months). We did not trust management, and when their Chairman did not turn up to a meeting, their stock fell by 47% in a morning. We earn our living by finding value-for-money companies that are managed to the highest standards. Our major themes and sectors continue to be financials (banks and insurance stocks with high consumer penetration potential, for example, HDFC in India), Internet and mobile applications (especially in China, gaming and on-line shopping), power and water utilities, and healthcare. We have recently made company

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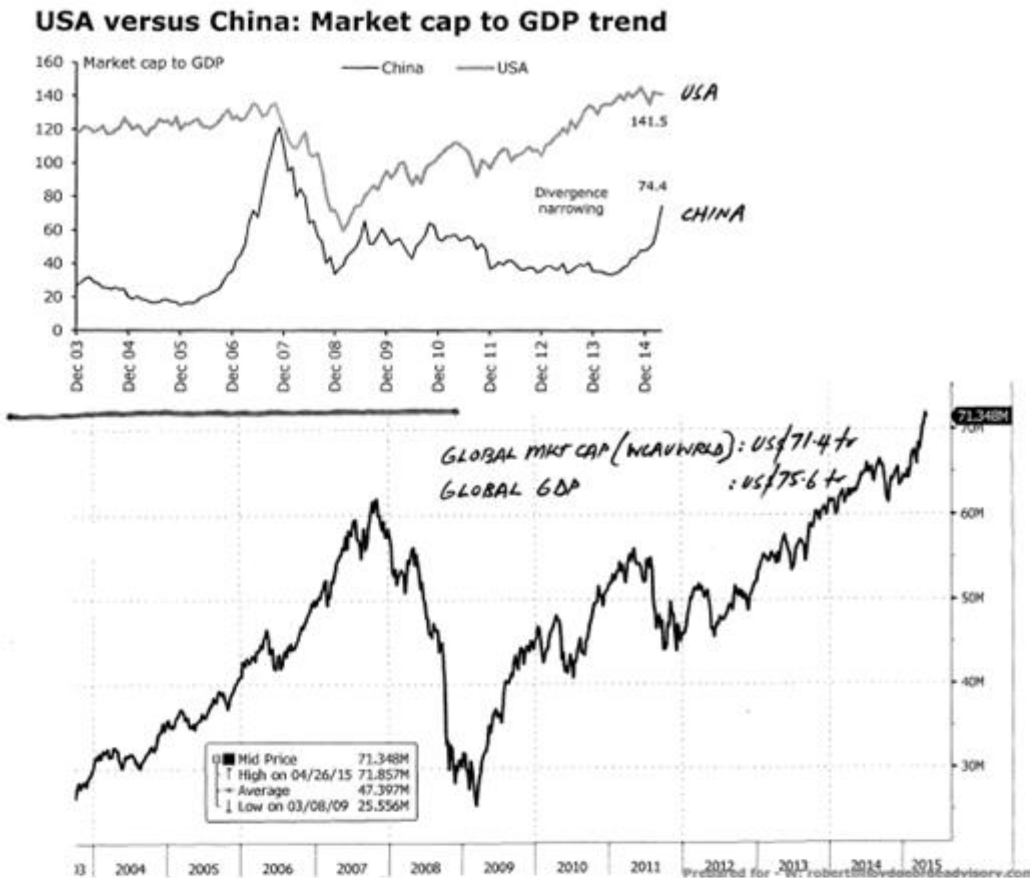
visits in Taiwan, confirming the pre-eminence of our major holding, TSMC. The Taiwan market still trades 22% below 1989 levels. In India, where we have been analyzing the durability of the IT sector as reflected in space demands (Ascendas REIT, listed in Singapore) and in Japan, where we are focused on earnings growth among hi-tech exporters (Fanuc, Omron).

In conclusion, we are convinced that we are in the early stages of a long Chinese bull market in Shanghai, Shenzhen and Hong Kong shares (like New York 1925 or Tokyo 1985). There are now more than 81 million private trading accounts in China: up 12% since the start of 2015. Many people have more than one account, so this means that despite a stampede of growth, equities ownership among 1.4 billion Chinese remains very low and with plenty of room to grow.




Source: CLSA

My vision of Asia in the next few years is that, as China's economy matures and liberalises (especially in the financial sector and the international use of the Renminbi), a single capital market will emerge, as it did in the European Union after 1992. Hong Kong will likely perform the role of central financial hub, as London did for Europe. The Hong Kong dollar may be repegged to the RMB instead of the US dollar. This is a positive for Hong Kong, because the internationalisation of the mainland Chinese currency is good for China and what is good for China is good for Hong Kong, her shop window. Both the Hong Kong and Taipei share markets will be revalued as they continue to become more visibly linked to China.

Robert Lloyd George
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