

The Bulls are Out Post China's Third Plenum – 13th December 2013

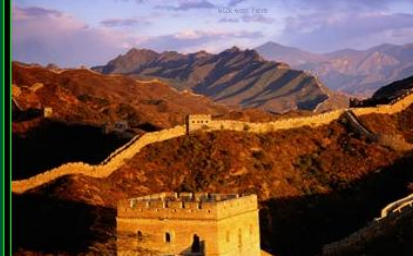
- **China's Third Plenum: An absolute success!**
- **Blueprint to kick-start China's next decade-long secular bull market**
- **China: The only major economy that is going strong with a cheap share market**

This is PCFM's special communiqué post the Chinese Central Government's Third Plenum conference two weeks ago. After what seemed to be disappointing at first, turned out to be relief and great joy within our offices as well as our investment managers in Hong Kong as China's decade-long blueprint has now been activated, which will provide the market with the support it needs to take both equities and the economy to the next level, further cementing the future of China to be the world's largest and most powerful economy.

The Third Plenum is normally held a year after the new leaders of China take office and refers to the third time that they lead a plenary session for the Central Committee, China's highest decision-making body. Not since 1978, with the beginning of "reform and opening up" for China's economy under Deng Xiaoping, has such a large blueprint been laid out for all to see and the key to this is to provide confidence, not only to the global economic community but first and foremost, to the 1.35 billion citizens of China who have longed for market operations to be a key part of the economy's future. One of the key reforms that were released as part of the 20,000 character document entitled "The Decision of Major Issues Concerning Comprehensively Deepening Reforms" was the role of the market. China's leaders have upgraded the market's role from "basic" to "decisive", proving the Government's strong push to allow market forces to make decisions in sectors that were previously protected. These include banking, utilities and healthcare which are planned to open up. As well as this, prices for resources such as water, oil, natural gas and telecommunications will be decided by the market with minimal interference by the government.

One big issue we see in the marketplace is the continued media-bashing of China for matters such as transparency and corruption, which we believe are null and irrelevant arguments in this day and age. These matters, which are continually being brought up, create a large community of China perma-bears which have now become panda bears with black eyes (courtesy of a Tim Farrelly observation). Our learned colleague and good friend Jonathan Pain with his well-known *Pain Report* dated 31st October 2013 (notably before the announcement of measures and reforms post the third plenum) stated very clearly (and rightly so) ***"I believe one of the big surprises over the next 12 months will be the strength in the Chinese equity markets. Valuations are incredibly compelling and an enormous amount of bad news is currently built into prices."*** Jonathan must be commended on this as we have been communicating the same message to the market whereby, given the state of the current world markets, go and find a place to invest which is extremely attractive and where the economy is going strong. China seems to be the only major economy exhibiting this characteristic! Further to this, Deutsche Bank Asia has predicted that for 2014, there will be up to a 25% return in the MSCI China index, with P/E expansion only going from 8.9x to 9.8x and with EPS on average growing 9-13%. UBS and Goldman Sachs also have similar forecasts on the Chinese indices to perform anywhere between 15-25%.

Closer to home, Cheah Cheng Hye the founder and Co-Chief Investment Officer of Value Partners (the fund managers of Premium China's range of fund offerings) has recently called a 15-20% performance on the Hang Seng market for 2014 with a lot of that to come in the first half.



To provide the context of what this incredible value that is presenting itself in the market is, let's refer to the chart to the right, showing where Chinese equities currently sit. We are at levels not much higher than the worst point of the GFC in late 2008, with both the H-Shares index as well as the Chinese head index CSI 300 both trading significantly below their 7-year averages. With a period of depressed P/Es and now the cloud of uncertainty having been lifted with the third plenary, it can be said that this

Forward P/E	Hang Seng China Enterprise Index (H-shares)	CSI 300 Index (A-shares)
Current valuation	8.4x	10.7
7 year average	12.2x	17.7x

7 year H-share & A-share forward P/E



Source: Bloomberg, December 2013

is a turning point for the Chinese markets. It couldn't be better said than by Jonathan Pain once again in his Pain report on 28th November 2013: ***"In the future, we will look back at the deliberations at the meeting as a watershed moment in the modern history of China."*** As we all know, watershed moments are ones that change something forever and the future will not look like anything from the past. As deregulation and market freedom start to move into China's landscape, the course of the economy will change and will shape China with a very strong middle class and, most importantly, a sustainable future.

The banks also provide a wonderful example of how to invest in China at the moment with the Premium China Fund and Premium Asia Fund both acquiring positions in certain Chinese banks, given strong fundamentals with exceptionally cheap valuations. To the right is a table comparing metrics of Chinese and Australian banks. It is clear which one is the superior set to invest from here on in and we are happy to challenge any naysayers regarding these strong metrics. With lower P/Es as well as P/Bs, stronger dividend yields and net profit margins, Chinese banks provide an excellent buying opportunity.

	Bank of China	ICBC	China Construction Bank	CBA	ANZ
P/E	7.04x	6.11x	5.92x	16.48x	14.12x
P/B	0.95x	1.36x	1.31x	2.84x	1.94x
D/Y	6.23%	5.44%	5.41%	4.68%	5.14%
ROA	1.19%	1.45%	1.47%	1.04%	0.93%
ROE	18.01%	22.92%	22.04%	18.16%	14.75%
Net Profit Margin	39.11%	44.02%	41.61%	31.90%	34.01%
Employees	298,621	424,516	344,913	44,969	47,512

Source: Google Finance, December 2013

So here we say bring on 2014 and let the China bull ride!!

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