Chinese Regulators Create Opportunities For Wealth

29 January 2016
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The seemingly endless bumbling of regulators has sent the Chinese market back to the 2015 low, providing new opportunities for wealth creation.

A Guiding Hand For Trouble Investors

There is a yin and a yang when it comes to investing in China and it doesn't take enlightenment to understand. The country is vast, has the largest population on Earth and the fastest growing economy of the developed world but is ruled by a communist government that tightly controls the spread of information, business, capitalism and investment ... and not necessarily with the good of the global financial markets in mind. There is money to be made in China, but it's not that easy to make it.

One of the biggest hurdles for the average investor is access to the Chinese markets and the diverse nature of Chinese equities. To put it in perspective; Chinese companies can be based in China, Hong Kong or elsewhere and do business inside or outside of China, creating a minimum of 8 different asset classes for equities alone. Add to this the fact that foreigners are only allowed to access certain markets, through specific channels with limits on ownership and the task of choosing where and how to invest in China only gets more complex.

One avenue for investors are funds and the guiding hand of fund management. The JP Morgan China Region Fund is an actively managed closed end fund benchmarked to the CSI 300 and the MSCI Golden Dragon Index. It has exposure to Chinese A, B and H shares, Red Chips, P Chips, Hong Kong, Macau and Taiwan shares... the entire Chinese economic arena, not an isolated segment of it.

Manager Ernest Liu and his team focus on only the top companies in each index, those with the strongest balance sheets in the top sectors in order to capture the best and safest returns in the region.

Chinese Regulators Scare The Market Into January Correction

The mainland Chinese regional indices fell to new lows during the first month of 2016. These lows are driven by an ongoing slow down in economic output, plunging oil prices, the continued bumbling of Chinese regulators and their bungling of financial markets. Local indices like the small cap Shenzen and large cap Shang Hai both lost more than -24% over the the period, led by the Shenzen's -27.5%, and are now trading at extreme lows valued more on emotions and fear than they are on China's prospects for the future.

The actions of the PBOC and other regulators over the past month and past year has proven them to be more reactionary and experimental with fiscal policy than one might hope to see from the worlds 3rd largest economy. The latest events revolve around trading circuit breakers installed to prevent wild swings in market value.

The irony is that the very action of initiating the safety measures caused, or at least amplified, a wild market sell-off that resulted in a full closure of Chinese markets. The circuit breakers were later removed, but not after a lot of technical damage had been done to the market. Since then Xiao Gang, creator of the circuit breaker and heavily criticized market regulator, has resigned. Xiao and his mismanagement is held largely responsible for a loss of over $5 trillion yuan of Chinese market value over the last year.

Adding to fears created by financial instability are a slowing economy and plunging oil prices. 4th quarter GDP, although meeting expectations, showed another dip in output and leaves full year 2015 GDP below the 7% government target. Oil prices, well oil prices dipped to near 14 year lows and dragged the entire global market down with it, not just China.

To help alleviate market fears and fears of a slowing economy the PBOC stepped in once again, injecting close to 1.5 billion yuan into the economy during the month of January. This move, intended to shore up the economy and market sentiment, have only fueled outflows from regional markets and new lows for the regions stock market indices. Now, regulators are trying to curb outflows by blocking the repatriation of profits by companies based outside of mainland China as well as investment in foreign markets by yuan based funds.

Returns And Performance In Troubled Markets

One sign of the JP Morgan China Region Fund's success is its dividend distribution. The fund has paid a regular dividend since 2009 and distribution has been rising since 2011. This year, regular distribution jumped nearly 100% from 2014's $0.127, not counting spillback and other special dividends which bring total 2015 distributions to $0.9734 per share or greater than 7% at today's share prices.

Up until very recently the fund had been trading at more than double its average discount to NAV. The discount has shrunk to more normal levels but still provides value for long term investors. There is also value without the discount,share prices are near long term lows with positive outlook for growth into the coming years.

In a price based comparison of JFC to the greater China region 1 month, 3 month, 3 year and 5 year performances all exceed the benchmark. In the nearer term, according to Morningstar, 3 month price based total returns for JFC are near 14%, nearly double the 8.25% attributed to the region. return on the region as a whole.

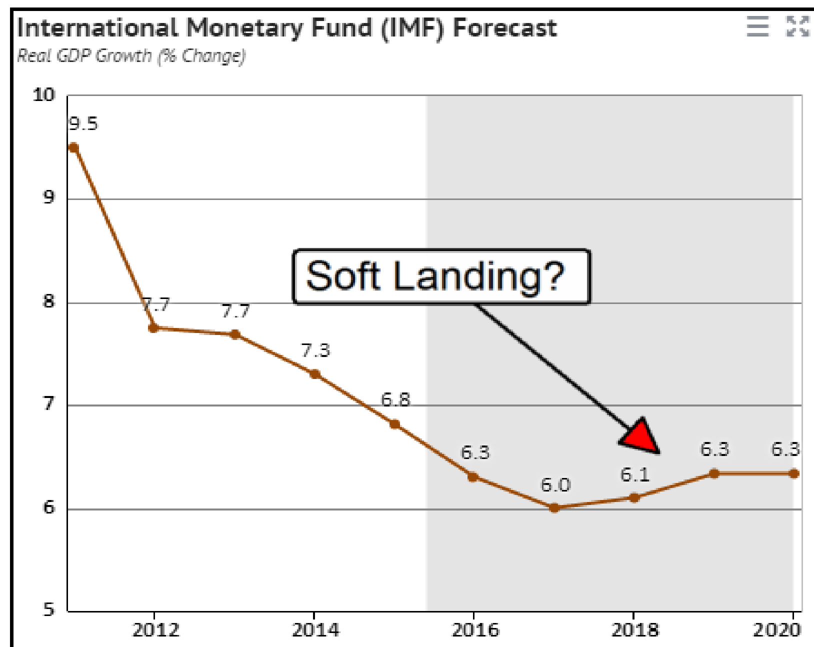
Over the longer term, 3 year performance for JFC is 5.76%, more than double the 2.66% return on the region as a whole.

Risky But Still Growing

It goes without saying that investing in China is risky. It also goes without saying that it is still the worlds 3rd largest economy (2n largest if you don't count the EU as one unit) and growing at a faster pace than the rest of the developed world. December GDP data showed slowing growth, granted, but not a surprising amount of slowing not to mention that growth is still nearly 7% for the quarter and for the year. Seven percent is more than three times that of the US and, even assuming the numbers are inflated, robust compared to the rest of the global economy.

One factor driving the slowdown is the ongoing shift from an industrial based to a consumer based economy. This shift can be seen in the data, industrial production is in decline and retail sales are on the rise. Industrial production is still growing but at a much slower rate than in previous years, only 5.9% in December 2015, while retail spending is up more than 11.1%. Based on the data,

Looking forward Chinese GDP is expected to continue to decline but remain strong relative to the rest of the world. Depending on which forecast you look at economic growth is expected to run in the range of 6.5% in 2016 and decline to near 4.5% by 2020, and hold steady between 3% and 2% going out from there. It's not that growth and profits are disappearing, it's that the amount of growth and sectors where growth is found are changing.



Where China Is Headed

Regardless of what happens to China today, tomorrow or next week the country is on a path to continued, long term, steady growth. If you think otherwise there is no reason to invest in China but if you agree with me and growth predictions of the World Bank, The IMF and other international agencies then times such as these are opportune for making longer term investments. The trick is knowing where to invest and that's when the value of a well managed fund like JP Morgan China Region Fund really stands out.