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MARKETS | ASIA STOCKS

Investors Make Their Case for Buying Chinese Stocks Now

Managers look for companies that will benefit from transition to consumer-oriented economy



PHOTO: ILLUSTRATIONS BY CHRIS LYONS

By **JULIE WERNAU**

Updated Sept. 8, 2015 10:27 p.m. ET

A deepening slump in Chinese shares is just what Di Zhou has been waiting for.

Ms. Zhou, who manages \$11 billion at Thornburg International Value Fund, is snatching up shares of Kweichow Moutai Co., whose distilled Chinese liquor has been around since the Qing Dynasty. The shares have dropped 22% since June, but she said the stock looks like a good buy thanks to high profit margins.

She isn't alone. Global investors bought 21.4 billion yuan (\$3.4 billion) worth of Shanghai-listed stocks in August through a trading link with Hong Kong, the largest

monthly sum since December 2014. In July, investors redeemed 31.5 billion yuan of shares.

Despite dour economic reports and volatility rattling Chinese markets in recent weeks, many portfolio managers believe Chinese stocks are worth a look following a 40% decline in the Shanghai Composite Index since its June 12 peak. They are scouring for insurance, health-care, food and technology companies that they think are poised to benefit from China's transition to a more consumer-oriented economy.

They are buying Hong Kong-listed China Mobile Ltd. , the biggest mobile carrier in the country, and China central-government bonds whose returns have outstripped U.S. Treasuries since the end of 2013. They are betting on e-commerce behemoth Alibaba Group Holding Ltd. , Tencent Holdings Ltd., whose instant-messenger service is ubiquitous in China, and on Baidu Inc., a Chinese-language search engine more popular than Google Inc.

The selloff has been "indiscriminate," said Charlie Awdry, who manages about \$1.2 billion in China-focused funds at Henderson Global Investors. Markets across the world have suffered large declines and unusually wide swings since Beijing surprised investors Aug. 11 by devaluing its currency.



People ride a double bicycle past a logo of the Alibaba Group at the company's headquarters on the outskirts of Hangzhou, China. PHOTO: REUTERS

In response, Mr. Awdry has been buying U.S.-listed Chinese shares such as Alibaba, which is down 26% since June 12, losing \$60 billion of market value. Overlooked, Mr. Awdry said, is that the e-commerce firm is "a great cash-flow-generative business." Alibaba's net operating cash flow rose 50% to \$6.79 billion in the year ended in March.

A slowdown in China's economy is widely understood to mean less demand for raw materials, meaning investors should avoid metals and mining stocks, many traders and

analysts said. But other sectors will benefit as the middle class deepens, said Samuel Le Cornu, co-head of Asian equities at Macquarie Investment Management, which manages \$264 billion.

One way to bet on this trend is to buy stocks of Chinese insurers, which got battered in the recent selloff but carry great potential as more people look to protect their families by taking out life-insurance policies, Mr. Le Cornu said.

Among his top picks is Hong Kong-listed China Taiping Insurance Holdings Co. , which fell 35% in the recent crash but has still doubled in value over the past two years. Insurers remain relatively cheap, say investors who are buying the shares: their shares in Hong Kong trade on average at 10 times trailing earnings. Taiping trades at nine times its last year of profits.

Still, few question that the economy in China is facing headwinds or that its regional trading partners will feel the pinch. Imports to China dropped precipitously in July from a year earlier, and more money has left emerging-market equities so far this year than in all of last year. Even those who broadly see China as a rising power are rechecking their holdings.

Alex Muromcew, portfolio manager of TIAA-CREF Emerging Markets Equity Fund, which has \$886.2 million under management, called the market selloff of the last few weeks a “reality check” for investors who believed China could continue to grow at a rate of 7% a year. Mr. Muromcew said when the Chinese government stepped in to prop up the stock market with government funds, preventing companies from selling stock, “they were using an outdated playbook.”

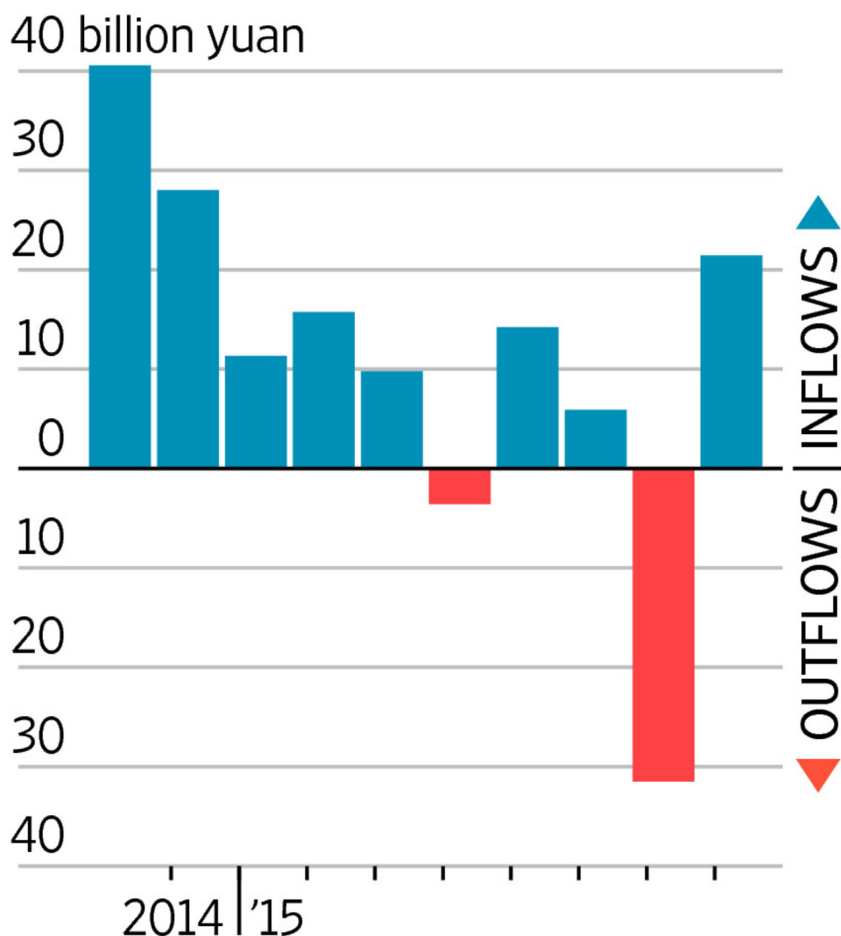
“I think the Chinese government has lost a lot of credibility over the last few weeks,” he said. “I’m going through this difficult process right now trying to figure out what has really changed fundamentally with the companies I own with the slowdown in economic growth there.”

Still, some investors in China say economic-policy decisions in China aim to create the kind of market that global institutional investors will buy into over time. Jan Dehn, head of research at Ashmore Group, which manages about \$59 billion, has been buying up five-year central government bonds in China in the recent slump.

The debt has returned 10.2% in dollar terms since the end of 2013, compared with 5.8% for five-year U.S. Treasuries. He is betting China will soon compete directly with Japan, Britain, the U.S. and Germany’s bond markets and wants to get into China “before the

Rebounding

Investor cash to and from China via the Shanghai-Hong Kong Stock Connect



1 billion yuan=\$157.0 million

Source: Hong Kong Exchanges and Clearing Limited

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herd comes in.”

Policy makers in China are “thinking long term, and I think they’re going to win,” Mr. Dehn said.

—Carolyn Cui, Chao Deng and Juliet Samuel contributed to this article.

Corrections & Amplifications

Samuel Le Cornu is co-head of Asian equities at Macquarie Investment Management, which manages \$264 billion. An earlier version of this article gave an incorrect title for Mr. Le Cornu and an incorrect figure for his firm’s assets under management.

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