



May 23, 2007 Edition > Section: [Business](#) > Printer-Friendly Version

On the Fast, Risky Boat to China

BY Dan Dorfman

May 23, 2007

URL: <http://www2.nysun.com/article/55019>

China may have the world's swiftest growing economy, but with the average mainland Chinese stock selling at an astronomical 50 times last year's earnings, its market seems about as appetizing as a bowl of cold wonton soup.

"A bubble waiting to burst" is how numerous Wall Street pros and some Chinese officials view the Shanghai Composite Index, which more than doubled last year and is up roughly another 45% this year. Some, in fact, are warning of a crash similar to the one that occurred February 27, when in-the-stratosphere Chinese stock valuations sent the SCI skidding 9%, in turn knocking down the Dow a wicked 416 points.

Some China bulls, though, are urging investors not to be faked out of what Asian markets tracker Tony Sagami calls "only the third or fourth inning of the most profitable game we will see in our lifetime." Editor of the Asian Stock Alert, a monthly newsletter out of Bigfork, Mont., Mr. Sagami concedes the multiples are indeed rich and that clearly there's risk. Likewise, he says, it's guaranteed there will be corrections along the way.

However, he argues, there are many reasons to expect any such damage to be limited, and he reiterated the one that he stressed to his subscribers after the hefty February downturn, namely that the market action doesn't do a single thing to change China's juggernaut economic growth. He adds that anybody who heeded his advice at the time has made out like a bandit, as the Chinese market subsequently recovered all of its 9% loss in less than a month and has been on a roll ever since.

In arguing his bullish case, Mr. Sagami, currently on a three-week Asian trip, takes note of a significant regulatory change that took place last week in the Hong Kong stock market. Ultimately, he says, "It is going to send mainland China stocks listed on the HK exchange to the moon."

The change is the easing of restrictions for qualified domestic institutional investors to invest larger portions of their portfolios in the Hong Kong market. This will do three things, he says: (1) Transfer some of the Shanghai market's enormous amount of liquidity to the Hong Kong market, which will cool down speculation mania, (2) inject billions into the Hong Kong market, and (3) close the valuation gap between the same stock listed on both the Hong Kong and Shanghai exchanges.

Mr. Sagami figures the Hong Kong exchange-traded fund IShares MSCI Index, listed on the Big Board under the symbol EWH, is a great way to play this development, but the best investment of all, he says, would be the shares of the Hong Kong stock exchange itself (symbol HKXCF) listed on the pink sheets

While such Chinese luminaries as the head of the People's Bank of China have expressed concern about the giant amount of capital flowing into the Chinese market, Chinese citizens are paying little attention to their worries. In April, for example, the Chinese public opened 4.79 million new brokerage accounts, about 90,000 a day, raising the overall number of China's individual accounts to 91 million. Putting that in perspective, only 3.08 million accounts were opened in all of last year. Apparently, the Chinese are not only opening accounts, they're buying stocks big time. In one recent week, for example, trading volume spiked to a record 307 billion yuan (\$40 billion).

As one trader put it: "The bears on China are saying beware of another big selloff. Someday they'll be right, but don't hold your breath."

Meanwhile, to bring stability to China, which is running close to a \$20 billion-a-month trade surplus, the central bank has initiated a series of rate hikes over the past year, while the People's Bank of China has done the same with bank reserve requirements.

The failure of these tactics to slow China's economy or its stock market, plus efforts by Beijing officials to jawbone the markets down, suggests to Mr. Sagami "the bull market in Asian stocks has a lot of room to run."

Another China booster, San Francisco money manager Lou Gerken, says, "You've got to be careful because of the high valuations. So we're being much more selective." Instead of chasing richly priced large companies, he's focusing on the more reasonably valued Chinese mid-caps and those markets in countries especially impacted by China's economic boom, such as America, Britain, and Singapore.

Pointing to expectations of continuing above-average economic growth this year of 8% to 9% and certain liberalizations of the Chinese market, Mr. Gerken, skipper of the GCA Greater China Hedge Fund, with nearly \$50 million of assets, is emphatic in his view, saying: "China is definitely a place to be."

dandordan@aol.com

May 23, 2007 Edition > Section: [Business](#) > Printer-Friendly Version