Asia

FUND MANAGEMENT

The sleuth of Shenzhen

Turning a profit by investing in China's dysfunctional domestic securities markets has proved a perilous occupation for most fund managers. Recent share reforms have helped to improve an appalling investment climate but there is some way to go before China's domestic asset management industry begins to resemble anything like those of more developed markets.

This is what makes Pure Heart Asset Management stand out among many local fund management companies. Founded in 2003 and now with just $150 million under management in four funds, Pure Heart, a hedge fund of sorts based in Shenzhen in southern China, is one of the country's first pure privately owned asset managers.

Factory owner

Founder and chief investment officer Zhao Danyang cuts a refreshingly frank and down-to-earth figure in an industry still dominated by overseas-educated princelings and the politically connected elite. A former factory owner, Zhao says he decided to turn his hand to fund management after realizing that making consumer electronics in China's cut-throat manufacturing sector was fast becoming a game of diminishing returns.

Studying investment theory at night after work, Zhao soon turned his back on his old career, but took some valuable lessons with him.

"Owning a factory, I know how hard it is to make money," he says. "I believe in caveat emptor, I never trust anyone. The market's always full of stories."

Zhao says that he learnt this lesson the hard way when he began investing personally in the stock market based on tips and rumours – with disastrous results in 1998.

"When this happened, I thought very hard about what a stock really is," he says, "and how best to invest in it."

Now Zhao relies on extensive investment research before he will contemplate investing in a stock. Not all of that research is conventional. Zhao says he has sneaked into factories to talk directly to workers of a manufacturer, checked sell-by dates on bottles of pills to ascertain stock turn levels for a Chinese medicine company and even resorted to counting cars on the highways of a toll road operator.

While he also reviews the financial statements of the companies he invests in, he accepts that ascertaining the true numbers in China is not always possible, hence the need for his additional sleuthing.

"I base my investment decision on logic," he says. "Can this company make money? Is management honest and has the company been around a long time? If a person has been honest for 10 years, chances are he'll be honest in the 11th year too."

Zhao's approach naturally lends itself to larger and more concentrated investments. Pure Heart holds between eight and 15 stocks in a single fund at any one time and is never in a hurry to invest.

"Most of the time, I keep cash and do nothing. Survival is the key to this game," says Zhao. "Before I invest, I must know the maximum loss: if that's OK, I go ahead. I don't care so much how much I make, I worry about the downside."

Despite China's strong IPO market, particularly in Hong Kong, Zhao has generally avoided investing in new listings and warns of the dangers of chasing this market.

"If fund managers get too used to investing in IPOs, they get lazy," he says. "They'll end up relying on IPOs for their performance and I don't like this."

Although unorthodox, Zhao's investment strategy appears to have paid off thus far. Pure Heart's funds have performed strongly. Its first fund, Pure Heart China Growth Investment Fund, a Hong Kong fund investing in China concept stocks, started in January 2003, has an accumulated return of almost 370%. Its second fund, SZITIC Pure Heart China Investment Trust, which invests in China's A-share market, has returned 144% since February 2004. Two further domestic China funds have been launched over the past two years. Both have performed strongly.

While they are structured as open-ended funds, Pure Heart's products behave more like hedge funds for high-net-worth individuals in China, the source of most of Zhao's money to date. The funds operate a fee structure of 1.5% management and 20% of retained profit with minimum subscriptions of around $50,000 equivalent. Investors are also locked in for a year following subscription and can sell with a month's notice, says Zhao.

The structure clearly helps with liquidity management issues. Even so, Zhao says he is looking for more committed capital.

"Our funds have grown very fast from $10 million to around $150 million," says Zhao. "Now I know more about the markets, I think I can manage more money, perhaps up to $500 million. China's story hasn't finished yet. I want long-term money. It can come from individuals or institutions."

Based on its performance to date, Pure Heart deserves more capital.

CHINA

ICBC listing: a tale of two cities

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partitioning of a market trading essentially the same financial instrument with the same shareholders' rights undermines the efficiency of the market."

Yam proposed that this partition could be removed without undermining China's foreign exchange controls. "The two classes of shares can be made directly fungible, or indirectly fungible by trading depository certificates evidencing the holding of shares in the other market." He suggested an arbitrage arrangement could be established to allow price equalization, possible involving China's State Administration of Foreign Exchange and conducted on a non-profit basis by a newly established public organization "conducting arbitrage whenever a significant exchange-rate-adjusted price differential appears."

As a general rule among dual-listed companies, big-name heavyweights such as Bank of China tend to trade at a premium in Hong Kong, while smaller companies trade at a premium on the mainland.

Chris Wright