

>: Sleeping Giants Cont.: How to Get Rich in China

Tuesday, November 11, 2008 / Chris Rowe

Two weeks ago I wrote an article titled, "[Sleeping Giants: Three Chinese Stocks to Buy](#)," and I said I would be talking for the next several weeks about the Chinese stock market and "very long-term" investments that will benefit enormously from China's growth. I had to write an article related to the elections here in the U.S. last week so I had to put the China series on hold, but now were back on track.

While the stocks I talked about in the article are "very long-term positions" -- I specifically say *very* long-term because just saying "long-term" might indicate a 1- or 2-year hold -- that could increase by several hundred or perhaps several thousand

Stock	Price when mentioned	What happened within 1 week	Today (written Monday Nov 10)
Petro China (PTR)	\$57.00	\$76.00 (34%)	\$80.00 (40%)
China Life Insurance (LFC)	\$33.47	\$40.63 (21%)	\$44.00 (31.46%)
CNOOC (CEO)	\$56.00	\$84.00 (50%)	\$84.00 (50%)

I still think if you bought the stocks above, you have the potential to be up several hundred or several thousand percentage points in 5 or 10 years (almost certainly in 15 or 20). But you might want to wait until the market beats these stocks down again to start nibbling. Don't worry, you haven't missed the boat, and I will be recommending more stocks over the course of this series.

Understanding the Chinese Stock Market

In order to get rich by investing in China, you have to get a better understanding of the lay of the land, so to speak. The way to do this is to understand the events which led up to today's Chinese stock market.

[Two weeks ago](#), I sighted the volatility of the Shanghai Index since the 1990-1991 building of Shanghai's Exchange. There are many reasons Shanghai has had nearly 20 mini-crashes since inception.

China had no laws to govern corporations until 1994 and no laws to regulate securities until 1999! (And you thought it was bad in the States!) Yet the number of individual stock investors exceeded 10 million by 1995. This is obviously a crowd that was dying to get in on the action and take the risk. Through the 1990s, as would be the case in any brand-new market, investors were getting taken advantage of left and right.

In the '90s, with record capital raised through IPOs, money was being funneled into publicly traded companies and out the back door to whatever home it happened to find in that kind of manipulating and maneuvering environment. In fact, that happened in the U.S., too, but it wasn't as easy (some would say).

In the late 1990s, International Trusts and Investment Corporations (ITICs), which are Chinese-backed investment companies, raised billions for Chinese infrastructure. But after borrowing short and lending long (a mistake we, in the U.S. made and are in the middle of paying for today), many went bankrupt or were bailed out.

Let's remember that just as the Chinese stock market was in its earlier years, the U.S. stock market also was incredibly easy to manipulate in the early 1900s with little to no regulation (the NYSE was build in 1903). At the same time, some of the largest fortunes were made by investing in the right very long-term investments.

In China, we're talking about a stock market that is guaranteed to continue to witness high volatility, but with that comes the biggest, very long-term opportunity you'll see in your lifetime.

China Today

You can really get rich if you take advantage of today's market volatility by picking your (stock accumulation) spots carefully. In other words, whenever every financial media outlet is telling you we are in far worse shape than we have ever imagined and it will get worse, that's when these stocks will be cheapest. You might even start nibbling now and piece into these positions little by little.

China's growth has finally slowed to single digits in the third quarter (to 9%). Has China seen the bulk of it's high-paced growth years for the century? ABSOLUTELY NOT! Many economists expect China's economy to surpass America's before 2030.

We're talking about a country that has pulled off a social revolution. We're talking about the world's largest country, the world's largest factory,

one that went through tremendous restructuring already and it's not just going to disappear. The Chinese government has encouraged foreign investment and that's something that's likely to continue. It almost appears that what's bad for the rest of the world is either good for China, or having minimal negative impact (when compared to other countries).

For example: China has a lot of cash on hand, their financial system is largely unharmed by the credit crisis and it's pretty well positioned for a global slowdown. Of course the global slowdown will affect their exports in a big way. But remember that they are huge commodity buyers. So they recently saw record trade surplus mainly because of the steep drop in commodity prices (reducing China's import bill). Of course construction has slowed to a 10-year low (one of the reasons we've seen a sharp decline in commodities).

Late last month at the Asia-Europe Meeting (ASEM), where Asia and Europe works together to meet global challenges, leaders met in Beijing for a summit dominated by the global financial disaster. The Asian countries discussed the creation of an \$80 billion fund to help countries deal with liquidity problems. Representing half of the world's GDP, almost 60% of the world's population and 60% of global trade, ASEM embraces virtually the whole of Asia and Europe. China, who has the biggest foreign exchange reserves (\$1.9 trillion) will no doubt continue to make it's clout. Quoted from the European Commission Website:

You probably heard about the \$586 billion stimulus program China unveiled Sunday. This number dwarfs stimulus programs other countries are moving on as a percentage of GDP (16%). According to The Wall Street Journal, the plan includes spending in housing, infrastructure, agriculture, health care and social welfare, and features a tax deduction for capital spending by companies.

Now I don't want you to make the mistake of thinking I'm saying the worst is over for China. This series is about how to get rich on the very long-term picture for the country. In fact, China's growth has slowed to its weakest pace in five years. GDP expanded "only" 9% in the third quarter from a year earlier after gaining nearly 12% in 2007. (That's still very fast from a global perspective. For perspective, the goal of the U.S., in a ~~Back to the Chinese stock market~~ Emerging markets tend to have much higher GDP.)

At the beginning of this article I said China had no laws to govern corporations until 1994 and no laws to regulate securities until 1999. I drew the comparison to the minimal regulation and enormous opportunities found in the U.S. markets in the early 1900s. But China has been and will be moving a lot faster in terms of regulation, trust and good standing with public shareholders, both foreign and domestic.

Remember, this isn't the early 1900s. Over the last century, the U.S. and other global markets have created a blueprint for China to follow. And guess what - The Shanghai index today is at just about the same level it was at in 1999 when they first started to regulate securities! This is not a "get rich (in China) quick" thing. This is more of an "accumulate long-term wealth" thing that will give you returns that will blow away the S&P 500's long-term return.



China's market has quickly developed from a shady place to invest to one with much more safety. (If you think there aren't schemes on how to swindle you out of your cash in the U.S. markets, you're mistaken.) China's version of the Securities and Exchange commission is the China Securities Regulatory Commission (CSRC). Today you even see China's government stepping in on occasion to support stocks by purchasing shares in them as this global recession unfolds.

I haven't even scratched the surface yet by talking about the fact that a large amount of the Chinese listed equities are government-owned. One of the comments left by a reader after [my China stock market article two weeks ago](#) mentioned the fact that a large percentage of Chinese companies were state-owned. This Tycoon Report reader (Jester) had a very good point that I intended on discussing in this series.

In fact, in 2002, 70% of the value of China's listed companies (publicly traded stocks) were nontradable (compared to 14% of shares worldwide in that category). Only 11% of Chinese listed companies were owned entirely outside of their government. The state owned 78% of the equity shares.

However the Chinese government has a stated goal of floating all nontradable shares. Currently, less than half of equity shares are state-owned. The problem with the market's stability in the past has been the overhang and uncertain disposal plans which would flood the market with new shares.

While that is still a concern today, it has been less of a problem. China is eager to maintain a strong reputation and encourages foreign investment in its public and private markets. So I wouldn't be too worried about it, especially if you have a very long-term outlook.

Next week I will bring you two or three more Chinese stocks to put on your shopping list. I'm watching a few that I think will come down to a better entry level by then. Stay tuned. In the meantime, there is a small energy company trading between \$1.00 and \$2.00 on the American Stock Exchange that I think will be in the double digits within the next 2 years and will at least double within 6 months. But it's a stock I have in the model portfolio at The Trend Rider. If you want, feel free to sign up. There will be a few membership slots opening soon. So you can get on the waiting list by going through [my free education series by clicking here](#).

See ya next week!

?Profit from the Trend?

A handwritten signature in black ink that reads "Chris Rowe". The signature is written in a cursive, slightly slanted style.

Chris Rowe

Chief Investment Officer

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