TRANSCRIPT: EPISODE 23
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[INTRODUCTION]
**Darius McDermott (DM):** Hello and welcome to the Investing on the go podcast brought to you by FundCalibre. I'm Darius McDermott and today we're joined today by Martin Lau, Elite Rated manager of the First State Greater China Growth fund. Martin thank you for your time.

**Martin Lau (ML):** Thank you Darius.

[INTERVIEW]
[0:16]

**DM:** You've been manager on the fund since 2003 and you will have learned I'm sure a lot, there would have been a lot of changes in the market place in China. Can you give us a brief summary of some the major things that have changed at a market conditions level since you began running this fund?

**ML**: Yep, that's a very good question Darius and thanks a lot for having me. I've been managing this Greater China fund since 2003, so it's been 16 years and I've been running China funds for 25 years. I think one of the major things that has been quite rewarding over the years is that we've seen a significant increase in depth for the China stock market and that was actually before the China A-share market even opened up.

If we think about some of the top Chinese companies that we're talking about today like Alibaba, Tencent are some of the really leading technology companies, these companies were actually just founded 20 years ago and listed give or take 5 or 10 years ago - expect Tencent. So for the last 15 years we've seen a significant increase in the market depth - the number of companies - that investors like us can choose from. As bottom-up investors like us at First State this is such a very important thing.

The second thing along side that is actually the opening up of this A-share market. The A-share market as you probably know is actually the second largest stock market globally with 8 trillion US dollars…

**DM**: Yeah, it's huge isn't it.

**ML**: And nearly 4,000 listed on the market. So again, these days on average, once every two or three weeks, we'll be visiting different parts of China seeing a number of different A-share companies. In our view that is going to be extremely important in generating performance over the next 10 years. We believe among this nearly 4,000 companies there are some really good ones that we believe we can be long term shareholders of.

[2:25]

**DM**: Excellent. With your style which investors have enjoyed for a long time, good corporate governance has always been something which you and your team have looked at - how easy is it to find good corporate governance and has that actually changed and improved over the last 10+ years?

**ML**: Yes. Corporate governance is an area that we focus on a lot and I will say that corporate governance has definitely improved over the last 10 years. In terms of the absolute corporate governance you still can not compare against the Western standard of like corporate governance 1, 2, 3 type of standard. One major difficulty when it comes to corporate governance in China is the state ownership: 70-80% or more of the companies are still owned by the government.

Just like in Britain, where maybe in the past British Telecom, BP, etc, whenever a government owns a stake in a company there's a natural misalignment of interest between the government and you as a minority shareholder.

**DM**: Of course.

**ML**: So we do have that. What we've learned over the years is that even first of all, even state-owned companies - there's some good corporate governance, well-managed, they own companies with a strong franchise. So state ownership is not necessarily ideal, but even among state ownership in the companies we can still find some good ones.

The opposite of the spectrum is of course people talk about VIE [Variable Interest Entity]* structure for the Internet companies. You may not have the actual ownership of the underlying business for those internet companies, but again, something which we've learned over the years, is the VIE structure is one structure, but even among the different VIE structures there's different arrangements so it's a bit simplistic to say that they're all bad. So it's a learning experience for all of us and our intention, or plan, is actually to identify those companies with good quality management which we can travel with, as in they will continue to improve their corporate governance, they may not be ideal as of today, but they're making improvements.

[4:23]

**DM**: One of the key things in the Greater China Growth fund, which I've always really liked, was your ability to invest in Taiwan and Hong Kong. There was always times in markets where you're just likely as a manager to be less cautious and I think you've always pointed it to Taiwan and Hong Kong as more defensive markets. Is that actually true and how much do you use those markets?

**ML**: Yes that's actually very true. The way that we look at it is China in the bigger form is actually, I mean Taiwan wouldn't like this comment, but with Taiwan and Hong Kong included, that is if we want the Greater China economy.

What actually happened within those three markets is because they are under slightly different liquidity cycles, so at times, for example the China A-shares market last year, where they were the worst performing, and this year A-shares were actually the best performing. Where as Hong Kong markets sometimes might perform better when interest rate expectation was that interest rates would fall and Taiwan is an export orientated economy, so whenever people are positive about external demand it might perform better.

By combining the three together we manage to manoeuvre around the different kind of extremes in different markets and diversify out the risk for the portfolio. Also, if you take a long term view, which we certainty need to, the three markets are actually very different.

The China market is known for its big domestic market: there's lots of emerging technologies within China like internet companies, so that's very unique for China and also the large number of companies on the A-shares.

In Taiwan we do have quite a number of leading technology companies like TSMC [Taiwan Semiconductor]. We are shareholders of Advantech and Delta Electronics, these are good quality companies: they tend to export, so again, Taiwan is quite unique in that it exports instead of domestic consumption on the A-shares.

Hong Kong again it's different, it's slightly more established companies, like AIA Group, like ChuKong etc. In terms of the business practices and also some companies in Hong Kong they manage to replicate their successful business model from Hong Kong to China like Hong Kong and China Gas, which we've been a shareholder for many years, and Vitasoy, which is the soya milk company in Hong Kong which managed to expand into China and now China accounts of two-thirds of the profit. So we like this kind of successful business model proven in Hong Kong and trying to replicate that into China.

[6:43]

**DM**: We touched briefly on China A-shares and corporate governance, but the A-shares have been included more in the MSCI Global Indices, is that making a difference and how much of your Greater China fund do you commit to the A-share market?

**ML**: Yes, that's a good question. In terms of the amount of time that we have committed to the A-shares is actually very very significant so of our team members, myself included, we actually spend more than half of our time looking at and discussing A-share companies. We may not have that amount of money invested into the A-shares because normally it takes some time for us to convince ourselves on the corporate governance, on the quality etc. So if you look at the Greater China Growth fund as of today it's about 13% of the fund is invested into the A-share market. In total, as a team, we have about 2 billion US dollars invested into the A-share market and that's out of 25 billion [US dollars] asset that we are managing as of today.

Again it's a growing market, it's an important market, we're probably devoting more than half our time within China onto A-shares but it will take time for us to get the confidence. It is a market that is rewarding, I mean the number of companies that are available on the A-shares is just amazing. The amount of excitement can be more if we identify say an entrepreneur that is really captive that we can be really believe in and they have a sound business plan and you can see a lot of potential in 10 years time, that is really really exciting.

[8:28]

**DM**: It would be remiss to have somebody of your experience and local knowledge with us today and not raise the subject of the US/China trade tensions - trade wars - however we like to call them. How are you seeing that impact actually on the ground with either companies that you're invested in or companies that you might invest in? Or is that just more a noise we see on the news or is it actually impacting on the ground?

**ML**: Yes actually the trade war we believe is a huge subject and we also believe it's going to be something which will last for many many years. It depends on Trump and Xi Jinping. Some times it can be better some times it can be worse, but our view is that this relates to two big economies with different kind of systems having a conflict. It may be harbour today, it may be technology, maybe trade, maybe import tariffs, it may be something else tomorrow, so we believe that the conflict is not going to go away any time soon.

[9:35]

**DM**: That's quite interesting because you know when Trump meets the President [Xi Jinping] they walk out smiling, markets all rally and the other times when headlines run out and he [President Trump] tweets something and then markets can be quite violent across the globe. So you think this is a multi-year story?

**ML**: Yes, I think this is a multi-year risk that we need to accept. We actually look back to Japan and what happened in Japan in the Heisei era in 1989 - the same thing that happened in Japan was a very strong economy then and there were a lot of conflicts between the Japanese and also the Americans at that time.

The way that we look at it is first of all it's creating negativity for the economy, so when you have the two largest economies of the world trying to fight against each other it's bad for the global economy and we've seen that with global growth and we've seen that with bond yields worried that the economy's going to weaken further. It's also important for companies if you operate out from China, and I do have a lot of friends who run factories etc. The amount of uncertainty that is introduced and you don't even know if the tariff is going to be introduced any time soon and you just defer.

**DM**: So sorry, it's holding back capital spending whilst that uncertainty remains?

**ML**: Yeah and also especially bad for capital investments and also very bad for smaller companies because you tend to have one or two customers and if that one or two customers are not sure whether they want to place the orders it's going to effect your whole business. Therefore you may have seen the second quarter GDP was the weakest in like 27 years, 6.2%, we're seeing the same thing with automobile sales, with retail sales, with truck sales and a lot of those are heavily regulated. I think our underlying case for China - even though we've been saying this for like the last 15-20 years - is that China's growth slow down is structural and I think the trade war is going to make that happen even sooner.

**DM**: Martin, thank you very much for your time and your comments. Thank you very much for listening, I'm Darius McDermott and if you'd like more information on the Investing on the go podcast please subscribe to FundCalibre.

*for more information on Variable Interest Entity visit **investopedia.com**