

How to *Safely* Play China's Growth

By Fitzroy McLean

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In our constant travels for [Without Borders](#), we look for progressive, undervalued international investment opportunities in booming economies with governments that treat capital well. To even begin to make the cut, the countries also have to possess multiple economic growth engines, open trade and business freedom.

Finding these opportunities is just half the mission. The more important, and often more difficult task, is finding safe ways to play them.

Consider China. Unless you've been cooped up in Guantanamo for the last few years, you're already familiar with the miracle of China, Inc.: 11.4% GDP growth, the world's "go to" manufacturing center, a 1 billion strong local consumer market, and some of the greatest business opportunities in the history of the world.

So far, so good. But when you drill down another level, the level where you hope to find undervalued investment opportunities, things quickly get more complicated. Thanks to that country's emerging middle class, flush with exponential growth in purchasing power and investable funds, the Shanghai stock exchange has become one of the hottest capital markets in the world. And one of the most dangerous.

Over the last 7-years, the Shanghai Composite Index has returned approximately 80% to investors with some serious roller coaster rides along the way, including days of such catastrophic meltdown that even the most seasoned investors make a bee-line for the nearest emergency exit.

The Price/Value Disconnect

The most disturbing thing about the Shanghai market is the often complete disconnect between the price of a given stock and the value of the underlying company. In China, soothsayers in the local newspapers predict what numbers will endow great luck... just like a fortune cookie at your favorite Chinese buffet; and as you are undoubtedly aware, stock symbols in Shanghai are numbers, not letters. So when the great sage says 0, 4, 7, and 9 are today's lucky numbers, that spells good news for Shanghai Zenhua Port Machinery Co., symbol: 900947, and *poof*, the stock jumps—irrational exuberance at its most irrational. This and similar actions of an inexperienced, first generation investor class, coupled with a general overconfidence among the Chinese on the outlook for their stock market, periodically drive the Shanghai exchange to bubble territory, that is subsequently corrected in stomach churning down moves.

So, the sort of booming economy and big upside we like, but with an unpredictable and wildly irrational stock market.

What's an investor to do?

Because we're looking to buy into the growth, and to do it safely, stepping up to the crap table in Shanghai along with all the other speculators and soothsayers isn't going to cut it.

Instead, we invest in undervalued Chinese companies listed on more established exchanges. Simple, but effective.

Some examples...

We are currently following a Jersey-domiciled, London-traded cement company based in the western China province of Shaanxi (not to be confused with the neighboring Shanxi province...). Shaanxi is one of the fastest growing provinces in China, and this cement company is ideally positioned to capitalize on this growth. Currently trading on London's Alternative Investment Market (AIM) at only 6.4 times earnings and 4.6 times current assets, this stock is as undervalued as it gets, especially considering the growth prospects.

While it has already provided us with solid profits, we see it as a relatively near-term double from today's levels. But we digress from the central point here... which is, because it trades on the London AIM, and not Shanghai, your shares have nowhere near the volatility.

Confirming that point, we looked at twelve worst performing days of the Shanghai Composite Index since January 1 2007, with single day losses ranging from 5% to over 10%. On average, during those steep drops, our Chinese cement play outperformed the index by an average of 6.85%. Viewed from another angle, on the 12 worst performing days of the Shanghai Composite Index since January 2007, our AIM-listed Chinese cement company actually posted a daily gain on eight of those twelve days, and posted a far better return than the index on all twelve.

For us as investor this means we are able to capitalize on one of the fastest growing industries in one of the world's fastest growing economies with one of the industry's most seasoned management teams, and doing it all safely, with far less volatility than in Shanghai.

We believe in the Asia growth story, and we believe in companies like our China cement story (the name of which we can't share here because it wouldn't be fair to our subscribers). But we are only willing to risk our hard earned capital in a way that makes sense to us. So in China, we look for solid, undervalued companies on established exchanges – and there are a number of these gems if you dig for them - and save the gambling for the casinos in Macau.

Fitzroy McLean is the co-editor of Without Borders from Casey Research, a monthly service dedicated to searching the world for undervalued, lower risk investments. A three month, no-risk subscription offer is available that will bring you current with all of the Without Borders recommendations... [learn more now](#).