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THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

A Bottom-Up Approach to Investing in China

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PING ZHOU, CFA, is a Senior Vice President and Managing Director – Greater China with GE Asset Management Incorporated (GEAM). He is also Portfolio Manager for GEAM's Emerging Markets, China H Share, and China A Share Equity strategies. Mr. Zhou is based in Shanghai, China, where the firm has a research operation. He has 16 years of investment experience. Mr. Zhou joined GEAM in 1997, and prior to that worked at GE Capital. Before he came to the U.S. in 1991, he completed 10 years of management experience in China, including four years as a senior manager running a shopping center in Shanghai. Mr. Zhou has a BS from Northeastern University and an MBA from Fairfield University. He is a graduate of GE's Financial Management Program and is a holder of the Chartered Financial Analyst designation.

TWST: Please begin with a brief introduction to the China H Share Equity strategy and the investment philosophy you employ.

Mr. Zhou: We started the GE China H Share Equity strategy in 2002 to invest in securities of financially strong Chinese companies. We are fundamental, bottom-up investors looking to identify investable growth companies, but with attractive valuations. Our approach involves a heavy emphasis on company and industry fundamentals, and we also talk to management of all the companies that we invest in, as well as performing site visits to virtually all the companies in the strategy.

TWST: Would you actually walk us through your stock selection process for the portfolio?

Mr. Zhou: Our initial screening process begins with the universe of names within our market, which includes Hong Kong-listed H shares and U.S. listed ADRs. Our process is used to identify names that are possibly misunderstood by the market. This misunderstanding can go both ways. When a company's price is below its value, it could be attractive to us, but when it's above its value and held in our strategy, we will review it and may exit the holding. As the Portfolio Manager, I work closely with three dedicated analysts based with me in Shanghai. We seek to identify those companies that are attractive or very competitive in their industries. We also look to identify long-term economic and industrial themes, and pay special attention to those companies that will benefit from those themes. Once we've narrowed our list to those that are highly attractive from a valuation standpoint, we'll talk to the management and the next step will be on-site company visits. Last year alone, we did on-site visits of more than 100 companies.

Our investment decision is based both on quantitative and qualitative analysis. For the quantitative part, we build a financial model to analyze how the company did financially in the past, their profitability, cash flow and how strong the balance sheet is. We'll construct our forecast based on our own research and discussions with the management on the potential of the company and their products over the next three to five years. At the same time, we'll do a qualitative analysis, which includes how competitive the company is in the industry, the transparency of that business, the capability and credibility of the management, and the attractiveness of the industry. If we determine that a company is attractive and the valuation is cheap, we'll invest in that stock.

TWST: What are the key upsides to putting money into China, which is technically classified as an emerging market, but obviously is unique compared to other emerging markets?

Mr. Zhou: First, emerging markets are currently still enjoying higher growth relative to developed markets. With China, you have a country that has experienced the highest economic growth of the past 10 to 15 years in the world. China is reforming economically and has benefitted most from globalization and outsourcing. Today we see many companies there that have matured in terms of their products and technologies, and also their management. As a result, you have broader-based investable companies, and many more names compared to the past have emerged as investment opportunities. I believe this will continue going forward.

The China stock market has become very, very large. The equity market size of all the companies that are listed in the local and international market is now second to the U.S. So the market is expanding and the quality of companies is improving. You can see many high-quality companies in China, some of which have already become globally competitive.

TWST: Tell us about the sectors you're invested in.

Mr. Zhou: Yes, a few sectors emerging with globally competitive companies are telecom equipment, where you see two, three companies have already become very big globally. Infrastructure-related companies, capital goods companies, they're getting very competitive as well. You see power equipment has been exporting. Railway equipment has started to export. Compared to the past, you see many high-value-added companies emerging in China. If you're not familiar with China, you may still think of it as a low-end product provider making things like shoes and clothing. But China is not that today. If you look at the export component, capital goods machinery is becoming a bigger component of the total amount, as a percentage of exports, which means that China is moving up on the value chain with their export products. So these are providing opportunities for investors as well. And also we see many value-added local consumer companies in China. Internet-related companies, for example, they have local advantages, they understand the local culture and they're becoming very successful now. You can see many companies emerge in a local market competing with the global companies.

Highlights

Ping Zhou is Portfolio Manager for GE Asset Management's Emerging Markets, China H Share, and China A Share Equity strategies. He discusses his strategy for investing in China and what themes they are playing at the moment. He also shares his insights on how developed markets' troubles have impacted the emerging markets, effects from headwinds investors should keep an eye on in 2011 and how potential investors can better understand investing in China.

TWST: As we go into 2011, what headwinds should investors keep an eye on when investing in China?

Mr. Zhou: At this moment, inflation is a big concern, because China's financial system is not as flexible as those in the developed countries. The challenge is how to manage that inflation with a relatively controlled interest rate. You have a mismatch that can cause economic problems. How to provide the right liquidity into the system is another concern. We should give the government credit for being able to really control economic growth and inflation in the past. But we need to closely watch how it progresses, how tight they will control the growth by taking away liquidity, and also how they manage the interest rate increases, as well as the currency. On the currency side, we see pressure from developed countries to appreciate the renminbi, but this is a complicated issue. How it's managed is something we will be closely watching as well this year.

TWST: How have the troubles in the established markets impacted the emerging markets like China, both positively and negatively?

Mr. Zhou: On the positive side, we definitely see from an emerging point of view, particularly in Asia, that it has helped the competitiveness of the local companies. The financial crisis really impacted developed market companies. Many manufacturing companies in these countries had trouble because of their balance sheets, which they were busy consolidating during the financial crisis and right after it. I believe some of them are still consolidating. Once you've consolidated your balance sheet, you're not able to grow and spend on developing your product in the market. They have less money needed for investment and brand marketing. This gives an opportunity for a local emerging market company to emerge if they were less impacted in this crisis, particularly in China. They have a relatively much stronger balance sheet, so they are able to spend money for marketing and developing products to increase their market share. This is very positive for these companies. Also, you see evidence that because of the financial weakness by developed country global companies, there are real merger and acquisition opportunities for local emerging market companies. You already see Chinese companies or other developing country companies that are making acquisitions into developed countries to buy their products or their technology.

On the other hand, one clearly negative outcome of the crisis is the export sector, because consumer demand in the developed countries has slowed down a lot. That impacted very particularly those low-end products from China because of reduction of consumption.

TWST: What concepts related to investing in the Chinese market do you believe are most commonly misunderstood by U.S. or global investors?

Mr. Zhou: While there are many investors who understand China now and are investing there, there's still a pretty large group of people who are still skeptical. I think one of the main reasons behind that is that they are not traveling enough to China. Going there to see how the country is changing is very important to understand the opportunities. The country is still misunderstood when it comes to things like the legal system and accounting policies. China has really reformed economically, and I think not understanding this is the biggest mistake investors make. Many people still have an old perception of the country. The legal system and the accounting system are far from perfect, but the thing we look at is the trend in these areas. The trend has been very positive, and I believe the change will continue.

TWST: Thank you. (MES)

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