

China stocks a source of ‘sustainable alpha’, says veteran fund manager

APS All China Alpha Fund has chalked up net returns of 25.7% year to date as at end-July



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[SINGAPORE] Veteran investor Wong Kok Hoi, founder of APS Asset Management, has weathered more than three decades of investment cycles and crises.

But APS’ enviable performance streak, six years since it pivoted to focus only on China stocks, must be the most gratifying yet for Wong.

The APS All China Alpha Fund has chalked up net returns of 25.7 per cent year to date as at end-July, compared to the MSCI China All Shares Index return of 17 per cent. Elsewhere, the S&P 500 returned 7 per cent and the MSCI All Country World Index 10.2 per cent. Over one year, the fund’s return was a stunning 50.5 per cent.

Wong is convinced that China holds the key to the “sustainable alpha” coveted by all active managers. That is why he decided in February 2020 – just a month before Covid was declared a global pandemic – to exit all Asian equity mandates and focus only on China.

“Of course, some clients were upset. We forced them to take back their assets. We felt strongly that the future is in China,” he said. Still, 70 per cent of the current assets under management of US\$2.2 billion were invested prior to the change in focus.

In a letter to investors in February 2020, Wong wrote: “We ... believe our odds of success in investing in (China) are much better if we totally immerse ourselves in understanding the challenges and opportunities in China as it rises.”

Wong believes the China-only focus has helped differentiate it from other Asian managers. “There is no reason for a big investor to invest in you if you are an average manager, or even above average. You have to be outstanding. Then maybe there’s a chance you can make a living.”

As part of succession planning, Wong relinquished his role as APS’ chief investment officer. He is chief strategist, and the CIO is Wang Kangning, who joined in 2004.

Shortly after the pivot towards China, the firm found itself in a proverbial perfect storm. In addition to severe Covid restrictions, China’s property bubble burst in 2021 with China Evergrande’s debt default, sparking debate on whether the country’s stock market was investible. On top of that, there was intense pressure on pension funds in US and Canada to divest from China.

Wong said: “We believe that when China turns convincingly, investors will return. What is needed is for China to outperform the US for, say, two years. Most fund managers are career investors, whether for public pensions or endowments. If performance falters, there is a risk they may be fired.

“Obviously, we must be patient. We can’t change our politics. We just have to continue to do very good work.”

Investing in China has claimed high-profile casualties among Singapore fund managers.

In 2024, Asia Genesis Asset Management wound up its macro fund as wrong bets on China and Japan caused a “significant and unprecedented drawdown”. More recently, New Silk Road Investment shuttered following weak returns and redemptions by institutional clients.

Four alpha hats

APS eschews leverage and manages mainly long-only funds, which surely helps its longevity. But its stock discipline, rooted in what Wong calls “four-alpha hats”, is arguably the key to its performance.

The four hats comprise fundamental analysis (“Benjamin Graham” hat); investigative work into companies (“Sherlock Holmes” hat); business dynamics (“Robert Kuok” hat); and finally, portfolio construction (APS hat).

Investigative work involves more than interviews with company founders. It includes visits to the factory floor and ferreting out feedback from industry sources including competitors and former staff. These efforts build a company profile beyond financial accounts to include elements such as integrity and business practices.

“We know from experience that crooks will sooner or later get their investors into trouble. The people behind the business may be mediocre, and most decisions they make may be bad... Even if a company has been massaging its accounts, (weaknesses) will show up somewhere because you can’t hide all your skeletons.”

The Robert Kuok hat examines companies from a business standpoint. This includes companies’ core competencies and industry dynamics, including barriers of entry and growth rates.

“When you’ve done your investigative research and find problems, obviously you should stay away. I don’t think I’m smart enough to exit before a crash.”

Stocks are grouped into four types of alpha opportunities: structural or growth which is stable and durable; economic alpha or value which is cyclical; dynamic alpha where stock prices are typically unstable; and opportunistic.

Portfolio construction involves decisions on the weightings of each alpha type.

Following the China market downturn in 2021, APS shifted the dominant portfolio weight from growth towards economic alpha or value. “Some stocks were neglected and became very cheap, no matter how you analyse them. But about 18 months ago those stocks began to outperform. Now we have sold (some stocks) in favour of growth stocks.

“We believe the future of China lies in tech industries, not in property or infrastructure but in hard tech. Now we have a much larger exposure to growth stocks or the industries of tomorrow.”

Currently, more than 69 per cent of the portfolio is in structural alpha stocks and around 23 per cent in economic alpha. The top five holdings include SMIC (Semiconductor Manufacturing International Corp) and Tencent.

Rare earths a game changer

Wong believes the trade war has entered a “new chapter” for China in terms of its dealings with the US and the rest of the world. He believes China’s dominance in critical minerals, including rare earth elements (REE) which are used

in tech industries, is a game changer. China dominates supply chains relating to critical minerals, including 70 per cent of REE and 85 per cent of global graphite processing. This gives it leverage in tariff negotiations.

“The Chinese are now more confident coming out of talks in London, partly because of rare earths and a better economy, and partly because of the Tibet dam project,” said Wong.

Following trade talks in London in June, the US and China agreed on a “framework” on trade. China in July announced the start of building works for a mega dam project in Tibet, which is expected to be the world’s largest source of hydroelectric power when completed.

“Confidence among the Chinese has risen; sentiment has changed. Even US investors are asking whether it’s time to invest.”

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