APS ASSET MANAGEMENT

China specialist leverages on-the-ground research

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THE RELENTLESS PURSUIT OF STRONG ALPHA

By Elizabeth Dooley

James Liu

Since its inception in 1995, APS Asset Management, winner of the *Asia Asset Management 2012* award for China A-share Equity, has employed a stock selection process that begins by sourcing ideas from structural and business trends, new companies and products, out-of-favour stocks and company-specific leads. Stocks are then classified in a preliminary review into alpha groupings and clusters before being thoroughly researched and evaluated prior to any final investment decision being made.

"The final phase is the construction and investment in stocks that ultimately produce an alpha diversified portfolio," explains James Liu, portfolio manager for the firm's China A-share Equity fund and Co-CIO of APS.

The fund has successfully outperformed the A-share market since its launch in July 2004, weathering a string of highly uncertain periods that have included non-tradable share reform in the second half of 2005; the heyday of 2007 when the market was trading at more than 40 times forwards PE; the 65% crash amid the financial turmoil of 2008; and the de-rating of China A-shares from 2010 to 2012 that resulted in China's slowdown and marked the start of economic rebalancing. It is a feat that Mr. Liu attributes to a disciplined investment philosophy and process that is always sensitive to valuation and does not overpay.

"For us, overpaying for a stock is a genuine investment risk rather than being related to market volatility or tracking error," notes Mr. Liu. "We adopt an in-depth fundamental research driven approach and stick to our investment philosophy and process. We believe that the company's fundamentals will prevail eventually," he adds.

For Mr. Liu, one of the most important differentiating factors of the APS China A-share product that has resulted in its outstanding track record of outperforming returns is the fact that each and every member of the established and experienced investment team holds intimate knowledge of each and every one of the portfolio's holdings through fundamental research defined by robust analysis, company visits, field investigations and continual validation of the original investment thesis.

"We believe that leveraging our on-the-ground research is a key differentiator. Also, our senior portfolio management team has a significant amount of our own investible net-worth and the firm's capital invested in the fund," explains Mr. Liu, noting an 'investor-to-investor' approach that ensures that the company and its clients have an alignment of interests.

On the apparent regained momentum of exports, industrial production and retail sales growth in recent months, Mr. Liu appears cautiously optimistic. Indeed, the economic data has certainly been more positive recently, reinforcing his view that China's economy has stabilised and started to recover from its 3Q12 trough. Not taking into account new economic measures that are expected to be unveiled over the next few months under the new cabinet in Beijing, momentum does seem to be continuing and is likely to translate into higher earnings growth, especially for non-financial corporations in 2013, he observes. That said, there are a number of policies that Mr. Liu and his team believe will have a significant bearing on the economy and firms in specific sectors.

"Chief among these is 'urbanisation', which we believe will entail monetisation of the farm and *hukou* reform and possible relaxation of the one-child policy". These issues, he adds, are expected to translate to higher infrastructure spending – particularly on transport linkages that will connect cities, towns and villages; healthcare spending – as more farmers settle into cities to gain access to social welfare benefits; and agriculture spending, as farm productivity increases to offset the decrease in farmland and workers. The real estate and consumer goods and services sectors should also broadly benefit according to Mr. Liu, with other areas of reform set to include greater emphasis on distribution and social justice, likely to provide greater scope for private sector development. Addressing issues such as corruption, as well as greater investment in environment protection and pricing reforms of oil, gas, coal, electricity and water, he adds, will help to establish a more transparent development environment and release sustainable growth potential from the grassroots level.

On the effect these measures are likely to have on APS' portfolio strategies over the medium-to long-term, Mr. Liu remains philosophical: "Given these economic and business trends during the economic rebalancing period, we will continue to identify companies that will be able to ride on these trends, particularly in mass market consumption plays, entertainment, power plants and petrochemical names. Given that our approach is fundamental and bottom-up driven, we cannot simply stay abreast of current policies and trends to achieve higher returns. Rather, we need to stay one step ahead of the market by identifying attractively valued companies within sectors with a two to three year investment horizon." ■

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