

The Long Road: a focus on China

ADVANCE

Advance Asset Management together with Dr. Jonathan Pollack, an expert on Chinese political and military strategy and Felix Stephen, Head of Strategy & Research at Advance Asset Management met with Advance's key advisers in August 2013.



Dr Pollack is the Director of the John L. Thornton China Centre and a Senior Fellow in the Foreign Policy program at the Brookings Institution (an American think tank based in Washington, D.C).

He is widely published on Chinese political-military strategy, US China relations, political dynamics of the Korean Peninsula and US strategy in Asia and the Pacific.



Felix Stephen has over 40 years of experience in international banking, treasury, fixed income, foreign exchange and portfolio management and has served on asset allocation and investment strategy committees at funds management institutions in Australia and overseas. Felix has also been a consultant to institutions in Australia and overseas on strategic developments in funds management and financial markets.

Advance advisers were invited to an exclusive event with Dr. Pollack, in order to give them some interesting and useful insights to use when making investment decisions on behalf of their clients.

The focus was a macro-economic view of China, and guests heard Dr Pollack's views on China's long march towards possible global and regional economic dominance and the impact on Australia.

WHY IS IT SO IMPORTANT TO UNDERSTAND WHAT IS HAPPENING IN ASIA, AND IN PARTICULAR CHINA?

JP China's transition from a historically insular, rural society to a major global and regional economic influencer is intrinsically important to Australia. Since the early 1970s China's freedoms have grown – the natural entrepreneurship of the Chinese people has been encouraged. The rural class had been encouraged to grow its own crops and not depend on the state, and in the process become more prosperous. It is an agricultural led economic revolution. Deng Xiao Ping (a politician and reformist leader of the Communist Party of China who, after Mao's death led China towards a market economy) understood that you need to enable Chinese to be Chinese. People have to feed themselves, the revolution had to begin in the country and it was an economic revolution. He understood that China had to transition to be more like the "tiger" economies of Singapore, Hong Kong, Taiwan and South Korea.

FS The adjustment taking place in China is one of the most crucial and significant things that can happen for Australia. Whilst this transitory phase in China could be painful; the end result has the potential to be beneficial. The Chinese want high protein food, wheat and our industrial resources (although not as strong as before) - we can give them exactly what they need ... and also added to that there is a financial market that is crying out for help, and our financial market is one of the most sophisticated, developed markets in the world. So not only can we give the Chinese what they want in terms of the daily consumption with the emerging middle class, we can also help them out with our financial expertise.

HOW DEPENDENT IS AUSTRALIA ON CHINA? IS THERE A FOLLOW-ON EFFECT FROM CHINA TO OTHER COUNTRIES AND REGIONS?

JP Australia is co-dependent on China. We have Chinese companies choosing to invest in Australia, not as a favour, but out of need and self-interest. That binds us together. The question is if this is sustainable over the long-term? As China becomes less interested in resources we have to see if we continue to accommodate their other needs and see them as great opportunities.

FS There is great opportunity for the Chinese investor to pursue investments in Australia that may not be available in China. Also, we should be able to bi-laterally share our expertise and knowledge in banking and financial services given the sophistication, depth and expertise found in the Australian financial service sector. We should be prepared to share this expertise with China.

WHEN WE TALK OF CHINA'S GROWTH SLOWING – WHAT DO THE NUMBERS MEAN AND HOW DO THEY COMPARE TO THE GROWTH NUMBERS FOR AUSTRALIA AND OTHER WESTERN NATIONS?

JP The rate of economic growth is definitely slowing in China. However, if you listen to the senior leaders they're saying that they're not fearful for it. They say that they need at least eight percent growth now, but it can't be just based on growth for growth's sake. It needs to be qualitative growth. It has to be growth that is based, not just on the assembly of goods for export but on value-adding growth. Without value adding, there is not a basis on which there are enough opportunities for Chinese to make the transition to a real sustainable economy.

I (Dr Pollack) wouldn't place blind faith on the numbers the Chinese provide us. They are collected from the local grassroots level and passed up the system. Sometimes the numbers just don't add up. More telling are the messages from the leaders themselves. All have acknowledged that growth has slowed to perhaps 7-7.5%. Some people say that the real rate is much lower, but there is no way of obtaining more reliable data.

FS In spite of this fatigue, Australia is in the unique position to export our financial expertise and knowledge services. In particular, the services sector could play a key role in mitigating the downside risks associated with the current dependence on the resources sector.

PRESIDENT NIXON FIRST VISITED CHINA IN 1972 AS IT BEGAN TO OPEN UP TO THE WEST. SINCE THEN ENORMOUS CHANGE HAS OCCURRED. WHAT ARE SOME OF THE MOST SIGNIFICANT CHANGES YOU SEE IN CHINA AND/OR THE WEST'S RELATIONSHIP WITH CHINA?

JP When President Nixon visited China in 1972, the nation was yet to fully embrace modernity. Chairman Mao was the leader and not familiar with the world outside China. When President Nixon walked off the plane in 1972 it was televised and it was reported comparatively to stepping onto the moon. There was nothing there. Fast forward to present time and Beijing Airport is the largest enclosed building in the world. Some information worth noting;

- In 1972, Japan and Australia normalised their relationships with China.
- In 1978, the US, under President Carter, agreed that from 1979 onwards the US would recognise The People's Republic of China as the constitutional government of all China, including Taiwan. Deng Xiao Ping ratified the promise to open China to the outside world. From there began a series of reforms in the rural sector which resulted in changes to industry which were inflationary and caused upheaval throughout the country. This culminated in the protests in Tiananmen Square in 1989 where untold numbers of Chinese protesters were killed by the military. This protest was much more about economic factors but coincided with Mikhail Gorbachev's (President of the Soviet Union from 1990 to 1991) visit to China. Deng took punitive measures because he saw the possibility of things spiralling out of control.
- In 1997, the world watched as Hong Kong was returned to Chinese rule.
- In 2008, the Olympics showed a global audience, the manifestations of greatness to an enormous extent despite the reality of not yet being an advanced society.

WHAT ARE SOME BASIC DIFFERENCES TO CHINA AND THE WAY THE CHINESE BEHAVE WHICH PEOPLE SHOULD OVERLAY IN THEIR INTERPRETATIONS WHEN THEY HEAR NEWS FROM CHINA?

JP Remember that the official China is dominated by the power of the elites, propaganda and political influencers. Even under the surface there are

enormous vested interests. The Chinese people have more autonomy and ability to voice their opinions. The Chinese government understands they are leading an increasingly prosperous, better-informed country. The citizens are focused on the issues of clean water, clean air and safe food. The leaders need to deal with the reality of grievous damage, which is the reality of China in the failings of institutions, leadership and growth for growth's sake.

ARE THERE ANY PARTICULAR TENSION POINTS YOU WOULD BE WATCHING REGARDING CHINA RIGHT NOW?

JP The top leadership is very fearful about how the middle income class will express individualism or more collective and organised in promoting their own views. There are outlets for individual opinions but the leaders don't want it to lead to explicit political consequences and challenge the control at the top.

Another issue is that as people become more empowered they develop a patriotic and nationalistic voice which says "don't push us around anymore". Individuals have the potential to make statements which may lead to potential tensions in the region if unchecked. Leaders can be more circumspect and politic in these issues. Finally, the disclosure of corruption is something that the Chinese people want to see. The sense of ill-gotten gains offends the Chinese.

Conclusion

The new leadership in China recognise the urgent need for their economic model to be changed and the need for social, political and financial market change. They are also fully cognisant of the risks associated with initiating crucial changes in a country as large and diverse as China.

However, having recognised that doing nothing is far more risky, they have, in their wisdom embarked upon steering the country towards a more balanced, equitable and domestically focussed nation where the short term pain resulting from change will eventually be rewarded with long term gains. Ultimately, change is taking place in China – and whilst it should be considered to be positive for Australia in the long term, it increases uncertainty and volatility in the short term.

Who we are

Advance is a specialist asset management business within the Westpac Group. Our focus is on asset allocation and risk management, implemented through a multi-manager process, providing investment opportunities across a range of asset classes, including shares, property, fixed interest and cash.

Why Advance?

- We offer investors a wide choice of quality investments and the security of ongoing monitoring and analysis.
- Our investment team provides in-depth analysis of investment funds and the managers behind them, with the aim of offering broad diversification, quality risk management and access to some of the world's best investment managers – without having to do it all the investigation yourself.
- Our multi-manager approach is based on the belief that different styles, when combined, can produce a more consistent outcome for investors by minimising style and portfolio risk.
- Our blended multi-manager funds offer greater diversification, while benefiting from active investment management and the potential to achieve sustainable outperformance over the longer term.

With a dedicated team of skilled and experienced professionals performing an ongoing investigation into the funds, investors can spend less time worrying about market and manager fluctuations and more time enjoying the more important things in life.

Award winning

Our investment process is tried and tested, and acknowledged by our peers as best practice.

Advance is *Money* magazine's **Best Fund Manager** for 2012 and 2013.

Advance is the 2011 *Financial Review Smart Investor* **Fund Manager of the Year**.

Advance won '**Multi-Manager of the Year**' at the 2009 Money Management Fund Manager of the Year awards, judged by research house Lonsec.

In January 2010, Lonsec also gave the Advance Multi-Blend Funds its highest rating, **Highly Recommended***. In its overall assessment, *"Lonsec has upgraded the Advance Multi-Manager Funds to 'Highly Recommended' reflecting the manager's well established and thorough manager research process, solid portfolio construction techniques, strong SAA culture and well resourced team."*

Advance's manager of managers expertise is available across investments, superannuation and retirement fund structures.

Advance Asset Management

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