

# Chapter 1

## Introduction to the China Miracle

**T**here is a six-lane bridge being built in Shanghai that connects Mainland China with the island of Yangshan 20 miles offshore. It will ultimately become the largest sea-span bridge in the world. It will connect Shanghai with a new port in Yangshan, a phenomenally huge facility that will double Shanghai's shipping capability—which is already the third largest in the world. Much of the world's clothes, toys, and electronics will be shipped from this location over the next decade.

Just to the west of Shanghai, the largest construction project in the world, the Three Gorges Dam hydroelectric project, is in full swing. Three Gorges is expected to be five times wider than the Hoover Dam and is the biggest construction undertaking since the Great Wall of China was started in 200 B.C. It will also be the largest source of hydroelectric power on Earth.

The Chinese government is able to pay for these projects thanks to the largest foreign reserve fund, and the largest trade surplus, ever seen. Those reserves and that surplus come by way of China's economy, which is growing faster than that of any other nation in history. In five years, China has sped past Italy, the United Kingdom and France in growth and now trails only the United States, Japan, and Germany. Rest assured, China will not be in fourth place for long. It is already the world's leading manufacturer and exporter of goods. No other nation even comes close.

Welcome to the China Miracle.

China is experiencing the greatest boom in the history of the world, which I believe will provide you with the best investment opportunities of your lifetime. No other economy and no other marketplace has ever come close to offering investors so much potential to make money and build wealth. To be sure, stocks in emerging markets such as China tend to be more volatile than stocks in the United States and other global markets. The potential financial gain from investing in an emerging market with sustained growth, however, can also be much higher.

My purpose in writing this book, quite simply, is to show you how to build your own fortune by investing in the China Miracle.

I've been making money for years by watching China's growth and identifying trends that deliver the greatest return for investors. As one of the leading experts on investing in China's economy, I advise people every single day on how a China strategy will truly take them to a new level of investing. And since you and I are going to be spending a fair amount of time together over the course of this book, I think it's only fair that I tell you a bit about myself and my credentials.

I was born in Taiwan and raised in Southern California. I'm an American citizen, even though I share a heritage with more than a billion ethnic Chinese around the world. I've spoken English my entire life, but I speak, read, and write Mandarin fluently.

Being proficient in Chinese is not the reason that I've been able to successfully invest in the China Miracle—although it hasn't hurt. After all, there are more than a billion other people in the world who can read Chinese and have an ethnic background similar to mine. That's obviously not what makes me unique. What sets me apart from other investors is my history of investment success, along with my understanding of what's happening in China.

I started my career as a trader and analyst for a global macro hedge fund and was then hired by Goldman Sachs, the world's premier investment firm. I learned a great deal about every aspect of international markets while at Goldman, and put that expertise to good use. Like many investors, I made a very nice return from tech stocks in 1999. But unlike most tech stock investors, I continued to do well between 2000 and 2002 even though the NASDAQ declined 70 percent. I was able to do this because I listened to the markets and I changed my strategy when the market changed. I was a millionaire by the time I was 29 years old.

I eventually took my knowledge of international equities, interest rates, currencies, and commodities markets with me to start my own firm, Absolute Return Capital Advisors. I have offices in Century City, situated right next to Beverly Hills and Hollywood, and my team and I use global investment strategies to manage private client money. I also oversee Pearl River Capital Management, a private investment partnership that focuses on China.

In addition, I have two investment newsletters, *China Strategy* and *Asia Edge*. *China Strategy*, in particular, has become one of the largest subscription-based services in the United States since its launch in 2006.

In order to stay on top of investment opportunities in China, I employ a team of analysts on the Mainland to keep me up-to-date with information relevant to my current holdings as well as potential new investments. I also read Chinese newspapers and periodicals while at home in California and travel several times a year to visit the Mainland. I firmly believe that getting firsthand information has been crucial to my success.

What else? I live in Beverly Hills with my wife and two children. Even though I've worked and traveled all over the world, I like Southern California for a number of reasons. I like the weather, I like driving my convertible with the top down all year long, I like the exotic restaurants, and I like the energy and excitement that comes with being in a place that is on the cutting edge of everything from food to fashion.

## **Building True Wealth**

Beyond that, I like building my wealth, and I enjoy the fact that my job makes other people wealthy, too. Several years ago, however, I came

to a realization: Investing in the U.S. economy was no longer the best way for me to accumulate new wealth. For investors, buying and holding a large basket of U.S. stocks no longer produced real annual returns above 5 percent. Eight years after the start of the twenty-first century, the S&P 500 is still around where it was at the end of 1999. I want more than that, and I'm sure you do, too.

The problems I saw weren't limited to the stock market. The U.S. economy since 2006 has moved along so glacially that it has barely kept us ahead of a recession. The decline of the U.S. dollar during that same time has sunk the value of our currency to previously unimaginable lows.

My investment advice is that now, more than ever, investors looking to build their wealth must look outside of the United States for real and sustainable growth. To attain superior absolute returns in the new century, buy-and-hold U.S. stocks are just not going to deliver the profits that I think every investor should expect. And in looking to make the biggest returns, I've found that the single best place to find great returns is China, where the economy continues to grow over 10 percent a year.

Some people have been skeptical—but only for a moment—of my thoughts on the future of U.S. markets. This is because of two assumptions that have long been drummed into our heads. The first is that the U.S. stock market always goes up over time, and the second is that investment gains in U.S. stocks are stable over time. These two assumptions are less reliable than you might think. There have been long periods of time when the U.S. stock market moved down or sideways, seriously damaging investors' ability to make enough money to fund their dreams or retire in comfort.

For instance, following the market peak in 1929, the Dow Jones Industrial Average fell for four years, and it took a full 24 years to get back to pre-1929 levels. There were also long periods when the stock market went up, but was outpaced by inflation. In the 54-year period between 1928 and 1982, the Dow Jones Industrial Average rose by only 1.9 percent per year on average, while the consumer price index (CPI) shot up by over 3 percent per year on average.

As for assumption number two, we all saw the S&P 500 index fall 23 percent in 2002 and then watched it rise 26 percent in 2003. Obviously, returns are actually anything but stable. It's impossible to

predict what any market will do over both long and short periods of time. Thankfully, in this era of globalization, investors have other investment opportunities when the domestic market is weak.

In fact, two things worry me about the U.S. stock market for the next several years: the real estate debacle and aging demographics. The most recent instance of a major stock market being hit with both of these conditions at the same time was Japan in 1990. The Japanese real estate bubble was well documented (at one point, downtown Tokyo was worth more than the entire state of California).

The demographics story is not as well-known, but it had serious ramifications for Japan and its investors. Back in 1990, there were five workers supporting every retiree in the Japanese economy. As the Japanese population got older, there were only three workers supporting every retiree in the system. When Japanese workers retired, the society's economic productivity went down, and retirees took money out of the Japanese stock market to pay for their retirement expenses. Today, the Japanese stock market is still down 60 percent from its peak 17 years ago.

Right now in the United States, there are five workers supporting every retiree. But, as our baby boomers retire, the ratio of workers to retirees will also drop to three workers for every retiree. Does this sound familiar? These ratios do not bode well for the U.S. stock market over the next decade.

This is certainly cause for concern, but the bright side is that there will always be opportunities outside of U.S. stocks to make money, and China's economic emergence is delivering some of the best investment opportunities available. The opportunities have materialized because of two simple economic facts: (1) China has become a mass producer of the world's goods, and (2) China is quickly becoming a mass consumer.

China has an almost unlimited supply of cheap labor, so companies from around the world have been able to produce their goods more cheaply in China. The result is that China has become a leading exporter, with more than half of those goods produced for foreign companies. China's exports soared in 2007 to over \$1.1 trillion, whereas imports came in at over \$865 billion.

Much of this economic growth is being driven by hardworking entrepreneurs, from small shop owners on the roadsides in Beijing to high-tech graduates forming software companies in Shenzhen.

The importance of entrepreneurs to China's economy has taken many China watchers by surprise, especially most Wall Street analysts who rarely, if ever, visit there. They've been missing the boat for years, and all indications are that they're going to continue to miss it.

## **The Real Growth Driver**

A real middle class is now emerging in China, thanks to the burgeoning private sector, and many Chinese aspire to the consumer lifestyle we're accustomed to in the West. With all of this growth, the proverbial talk of China as a land of one billion consumers is finally coming true. More and more Chinese citizens are finding good jobs or starting their own businesses, and they have money to spend.

The energy and excitement that I like in Beverly Hills I've lately found percolating in China's cities. Shanghai, for one, has gone from being a staid industrial port to being one of the world's most glamorous cities. From restaurants to high-end stores and boutiques, theaters, and arts centers, the same cultural drivers that make cities like Los Angeles, New York, London, Tokyo, and Paris so enthralling have taken hold in Shanghai. Throughout China, other cities are following its lead. There is a dynamism, a momentum, that you can feel in the new China.

I like momentum. I'm a momentum investor. I am not a buy-and-hold investor, and I don't get attached to stocks that aren't delivering me a high level of profits. Momentum is all about what my stocks are doing for me right now. When the stocks lose momentum, I lose the stocks. That's why I invest in China—there is incredible momentum and there are huge opportunities to make money.

This is different from buying stocks for the long term, waiting patiently until they deliver you some preordained number that appears to be acceptable. Then when a stock reaches that number you sell it—even if the company is still growing and has momentum—because that's the way Wall Street tells you it's done.

Momentum investing takes its cue from a company's growth and that of its stock price. As long as those go up, you enjoy the ride. Once they stop, the momentum is lost, and it's time to take your profits and move on. This kind of investing takes a lot of discipline, but it keeps your portfolio stocked with winners because the losers are immediately culled out.

It is my belief that you can't sit around and wait for your investments to pay off. To keep them, they always need to be paying off. The U.S. economy is facing some difficult times ahead as it adapts to everything from higher oil prices to providing health care for aging boomers. We need to be building our wealth now, each and every day. In the long run, it will cost more to live comfortably than many investors expect—or have planned for. Thus, wealth needs to be constantly accumulated. Investors need to focus on building wealth so that things like retirement will take care of themselves.

That's why I'm so enthusiastic about the China Miracle. It provides a myriad of ways for us to improve our financial situations. And the entire market has been truly investable only since late 2002. We're just at the beginning, and there's still a lot more money to be made.

You and I will make this money by investing in companies that are smart enough to take advantage of China's economic boom. Companies that are providing the Chinese government with what it needs and the people of China with what they desire, companies that have improved their bottom lines by taking advantage of China's manufacturing capabilities, and companies that have become fantastic international competitors thanks to the innovation of China's new class of entrepreneurs, can be good investments. Over the course of this book, we will look at commodities, telecommunications, tourism, fast food, health care, and a host of other industries that are exploding throughout China.

In short, you and I will make money by identifying and understanding how to stake the best positions in China. The China Miracle is there for everyone who wants a piece of it, but too many people will never understand how to profit from it. By taking the time to read this book, you will become one of the select few who know exactly how to get rich by investing in China.

The momentum is on your side. Let's get started.

