

Your Money



Conservative investors need to understand risk is part and parcel of the game, writes Philippa Huckle

Rebalancing puts portfolio on an even keel

I am a conservative investor and have a low risk tolerance. How can I get a decent return without taking too much risk?

Risk is part and parcel of investing; it is here to stay. Investment is the lifelong, disciplined process of progressively building wealth by systematically growing your capital at a rate that will achieve your life goals within a predefined and designated time frame.

When formulating your asset allocation strategy, it is important to understand that the calibration of your risk/return profile should be dictated by the time and dollar parameters of your financial plan and not, as is commonly misunderstood, by your personality's instinctive tendency to either take on or avoid risk.

The longer you have before you need to access capital from the

portfolio, the more risk you can afford to take. When pulling capital you need more stability, which is accomplished through depth of diversification.

Modern portfolio theory has proven that diversification across uncorrelated market cycles is the primary defence against risk. It is because economic factors influence asset classes differently.

Uncorrelated cycles shift and grow at different times and rates, offsetting each other to reduce volatility. But if left unchecked, these movements will cause your original allocation to drift, upsetting the tradeoff between risk and return, and means your allocation will deviate at the most critical time.

Buy-and-hold is a dangerous euphemism for abdicating control of your portfolio to this ebb and flow. Your allocation must be systematically managed to capture

market cycles and sustain the level of risk it was designed for.

The solution is rebalancing – re-aligning weightings back to your original allocation target. This is done by slicing capital from recent outperforming cycles, and repositioning into underperforming cycles. The result is that you'll take profit from the maturing cycles, while repositioning into the next cycle that is due to bloom.

A consistent rebalancing policy forces you to buy low and sell high. It protects you from taking either too much or not enough risk.

Rebalancing will lower portfolio volatility and stabilise returns. The average compounded return per year of a rebalanced portfolio (containing low-correlation asset classes) is significantly higher than a buy-and-hold portfolio. An analysis in the October 2001 *Journal of Financial Planning* tested the im-



Impact of rebalancing on several multi-asset class portfolios. The portfolios that had never been rebalanced showed the worst return and the highest risk profile.

My bank is promoting an Asian fund. I think the opportunities for Asia are good over the next few years. How do I know if it is a good fund and how much to put into it?

Choosing an investment is a huge challenge. There are 7,000 listed stocks in the United States alone, and thousands of mutual funds in Hong Kong. People don't have the

time or resources to process the amount of information required to screen all alternatives.

Instead, most investors instinctively "attention-buy", tending to buy investments that catch their attention – whether via an advertisement, article, a tip from a friend, or a fund promotion.

Attention buying distorts the portfolio building process. Studies have proven that asset allocation is the primary investment decision, determining more than 94 per cent of returns. Logically, investors should focus 94 per cent of their time on asset allocation.

Investment selection – the fund or stock you buy – is important, but has far less impact on returns. Prioritising investment selection over asset allocation can inadvertently skew your portfolio.

In properly building a portfolio, it is crucial to begin with asset allo-

cation, carefully and mathematically formulating percentage weightings across uncorrelated cycles; by asset class, geographically and by market capitalisation. This weighting process will identify the dollar value required for investment into each part of the overall allocation. Each section can then be filled with an appropriate fund.

Funds should be selected by elimination. The criteria should include experience, transparency and low fees. Funds that do not fit defined quantitative (standard deviation, low fees, alpha, or beta) and qualitative (independent research ratings, transparency) parameters should be excluded.

Investors usually fall prey to "home bias" or the tendency to overweight the country or region they live in. Many economists project that by 2050, Asian markets will contribute 50 per cent of global

stock market weightings from today's 14.82 per cent.

Dollar cost averaging, or investing a fixed amount into a market on a regular basis, is extremely effective in building Asian exposure and producing above-average long-term returns. It facilitates the systematic capture of larger market cycles, providing a natural framework to consistently accumulate holdings in growing yet volatile Asian markets.

The number of units bought each month will vary inversely to the market price: this means you'll buy more units of an investment when its price is lower, and less during periods of higher prices. Essentially, it automatically facilitates buying low and selling high.

Philippa Huckle is chief executive of the Philippa Huckle Group www.philippahuckle.com

China Green still growing

Andy Mantel

Mainland food producer China Green (Holdings) is the pick this month, with growth prospects intact and its stock undervalued.

It was recommended in November based on its stellar growth prospects and low valuation.

The company specialises in growing and supplying fresh, processed and pickled vegetables and fruits. Fresh produce contributes about two-thirds of total sales.

Aside from core products – including corn, broccoli, radishes, plums, peas, carrots, cucumbers and lettuce – in the past year it has added segments including additional fresh produce, quick-frozen foods, beverages and rice products. In its recent full-year earnings report to April, sales reached 471 million yuan and net profit was 183 million yuan, up 25 per cent and 22 per cent year on year, respectively.

Gross and net profit margins were 54 per cent and 39 per cent, respectively.

About two-thirds of sales have traditionally been for export, mainly to Japan. Last year, domestic sales grew 50 per cent as opposed to a 4 per cent increase in sales to Japan, and now the mainland accounts for about half of total sales. All of its beverage and rice products, and 90 per cent of the fresh produce, are now sold domestically.

China Green operates 28 mainland facilities with a gross cultivation area of 2,267 hectares. Cultivation and processing facilities are in Fujian (福建省), Zhejiang (浙江省), Hebei (河北省), Hubei (湖北省) and Jiangxi (江西省). The Jiangxi cultivation base is developing products such as rice flour for the domestic sector, and new export markets in Europe and Southeast Asia.

Last year, China Green launched corn beverages on trial achieving sales of 6.4 million yuan and 3.2 million yuan in gross profit. After this success, it plans to develop a product line and this division

may contribute up to 10 per cent of total revenue in a few years.

After listing in January last year and a top-up placement in November, China Green has cash and cash equivalents of about 532 million yuan (26 million yuan will be paid out as a dividend). No share placements are expected for 18 months, but debt financing may fund expansion plans.

As a leading domestic agricultural enterprise, China Green will enjoy preferential tax benefits for the next few years. Its key operation Zhonglu (Fujian) Agriculture has tax exemption status and is also exempt from the 24 per cent enterprise income tax.

Its new subsidiaries will also enjoy full tax exemption for the first two profitable years and a further 50 per cent reduction in the next three years. Recent measures to reduce import tariffs on some Taiwanese vegetables should not have

an impact on China Green because transport costs would still make it inefficient compared with mainland produce.

The impact of a further yuan appreciation should be minimal as China Green has been using the cost plus model when selling to exporters. It also has protective clauses in its supply contracts.

Earnings per share is expected to grow 25 per cent annually for the next few years and it is now trading at five times this year's earnings (three times ex-cash). It has a return on equity of 25 per cent and it pays a 4 per cent yield.

China Green, with a market cap of about US\$160 million, remains largely unknown outside the region. But this will change as it continues to post good data.

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MANTEL'S CHOICE		
	Price on recommendation	Friday price
Jan 1		
51job (Nasdaq short)	US\$51.97	US\$13.63
Elong (Nasdaq short)	US\$18.65	US\$12.50
March 18		
The9Ltd (Nasdaq short)	US\$16.86	US\$18.70
May 6		
Petrochina	\$4.75	\$6.20
June 17		
Comba Telecom	\$3.25	\$2.05
September 16		
China Green	\$1.61	\$1.61

WHAT THE BROKER SAYS

Nomura has lifted its fair-value estimate on China Netcom, the smallest of the mainland's four state-controlled telecommunications majors, after it announced a sharp increase in profit for the first half of this year and acquisition of four unlisted networks.

The broker increased its value estimate on the stock to \$16.67 from \$14.40 and reiterated its "buy" recommendation. The counter closed on Friday at \$13.70.

Netcom announced a net profit of 4.93 billion yuan for the half, an increase of 28 per cent year on year, owing to lower costs.

It said its purchase of four networks from its parent, China Network Communications Group Corp – in Heilongjiang, Jilin, Shanxi



and Inner Mongolia – would lift estimated earnings per share by 13.8 per cent. Reflecting the stronger result and increased potential, Nomura says it has increased estimated earnings per share for 2005-07 by 14-17 per cent.

OPENING THE SKIES:

Should Hong Kong speed up the liberalisation of its air services regime?

The Hong Kong government is committed to a gradual liberalisation of Hong Kong's air services. But with passengers in Europe – and many other parts of Asia – benefitting from the cheap tickets of low-cost carriers, should Hong Kong be liberalising faster? Would doing so hit highly profitable Cathay Pacific? Will not doing so threaten Hong Kong's status as the premier air hub serving south China?

- Is the current policy progressive liberalisation working - should it be speeded up?
- Who benefits most from the current regime?
- Do passengers and other users lose out?
- What would be the impact of open skies on Cathay Pacific?
- What are the long-term economic implications of the current policy for Hong Kong?
- Why don't budget airlines operate in and out of Hong Kong?
- Is there a case for throwing Hong Kong's aviation regime open overnight?

Come and join the seminar and you will hear professional opinions on the above subjects from our distinguished speakers.

Confirmed speakers include:

- Andrew Drysdale**, Regional Vice President Asia/Pacific, the International Air Transport Association and Chairman, IATA India Private Ltd
- Tony Tyler**, Chief Operating Officer, Cathay Pacific Airways Limited
- Russell Barling**, Transport and Logistics Correspondent, South China Morning Post

More speakers to follow

Date: Thursday October 6, 2005
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