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Highlights

- Important catalysts to realize value are missing in China
- Value in emerging markets should be assessed differently
- Find out about [JOHCM Emerging Markets Opportunities](#)

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Emerging markets: Is it time to buy Chinese stocks?

Some Chinese stocks may appear attractive from a valuations perspectives – but you need to think differently about value investing in emerging markets.

ARE Chinese stocks good value? “It’s a question we’re getting asked by a lot of clients,” says JOHCM’s Paul Wimborne.

The MSCI China index has halved since its peak in February 2021. Falls of that magnitude in developed markets soon attract bargain hunting buyers that sow the seeds of the next bull market.

But does the same thesis hold for China? “The answer to that question at the moment is no,” says Wimborne, co-manager of JOHCM Emerging Markets Opportunities Fund. “The reason for that is we think value in emerging markets should be assessed very differently than in the developed world.”

A value stock is one that trades at an attractive price relative to fundamentals like its earnings, dividends or assets. Many Chinese stocks appear to fit the bill, including internet leader Alibaba and telecommunications giant China Mobile. Both are trading at single-digit price earnings ratios with strong balance sheets and good quality earnings. But the appearance of value is only part of the investment story, says Wimborne. Investors also need to be able to realize that value.

Three catalysts for realizing value

“In the developed world, you have three strong catalysts for the realization of shareholder value:

- Strong corporate governance,
- Minority shareholder rights, and,
- Entrenched culture of merger and acquisition activity.

“These catalysts ensure the realization of value when a company’s shares are not doing well. In the emerging world, we think these catalysts are often lacking.” Alibaba — once a popular and strongly performing stock for western investors — is a prime example of how value can be illusive, says Wimborne.

“For starters, foreign entities are not allowed to own Chinese internet businesses, so Alibaba has to have this strange ownership structure — a variable interest entity, where shareholders have economic but not legal control.

“Management can decide what they want to do with the business and minority shareholders have no way of exerting any control or influence over what management does with free cash flow. The business throws off a lot of free cash flow, but we struggle to see how minorities will actually get hold of any of it.”

This is exacerbated by China's closed capital account that stops money moving freely in and out of the country.

"Alibaba would need the permission of the Chinese government to be able to send that money offshore to foreign shareholders. We think it's extremely unlikely that the Chinese government would approve significant dividend payments that would catalyze value for Alibaba." Wimborne says these concerns hold true for other emerging markets as well.

Take care in South Korea

"South Korea is another example where value has not worked well. Corporate governance is not well entrenched in South Korea. In the past, the family-run chaebol industrial conglomerates have been allowed to abuse the wider society including minority shareholders in order to develop the economy for the past 60 or 70 years.

It's starting to improve at the margin, but minorities do not get treated as well as they should, relative to developed markets. As a result Korea trades at big discount to other emerging markets."

Investors in emerging markets need to be aware of these kinds of local specifics and not simply apply western ideas to developing countries.

"The way we run our portfolios is very top-down, country-specific — looking at the country's history, its economic outlook and its equity culture to determine where we think the potential returns will come from. Part of that is assessing each country's corporate governance, its treatment of minority shareholders in general, and the culture of rewarding equity holders."

Source for all data JOHCM/Bloomberg (unless otherwise stated)

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