FSSA Investment Managers



Reflections on China's market evolution over the last 30 years

February 2023



Martin Lau
Managing Partner

Martin joined the team in 2002 and he is the portfolio manager of a number of strategies, including the FSSA Greater China Growth and Asian Equity Plus strategies.

In the first part of this three-part series, Martin Lau, managing partner and lead portfolio manager of the FSSA China Growth strategy, shares his reflections on the past three decades of investing in China markets as the strategy celebrates its 30th anniversary this year.

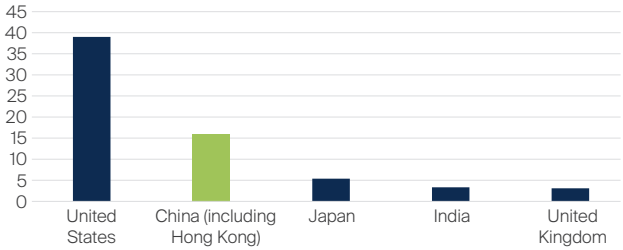
When I joined the firm in 2002, FSSA Investment Managers, known as First State Investments back then, managed USD 2bn of assets and I was the only employee in Hong Kong. Having worked at a larger asset management firm, I joined a smaller company so that I could have room to develop my own investment beliefs and build a team. I shared a similar philosophy with the founding partner Angus Tulloch — we were both focused on being long-term, bottom-up, and seeking quality companies. At the time, this was unique in Asia's asset management industry.

From humble beginnings, today FSSA has a team of over 30 people and USD 30bn under management (as at the end of December 2022). The FSSA China Growth strategy has gone from USD 3m in assets when I first joined, to USD 3bn today, a thousand-fold increase in 20 years. While hard work certainly played a role, we were also in the right place at the right time — in the midst of China's accelerating economic development, its opening up to the rest of the world and the move toward market reforms.

The evolution of China's stock market

The first Chinese stocks were listed in Hong Kong as H-shares during the early 1990s. We did not expect that 30 years later, China would become the world's second-largest stock market.

Biggest stock markets globally (USD trillions)

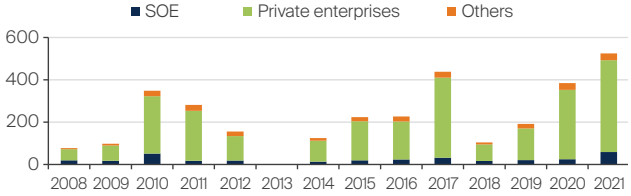


Source: World Federation of Exchanges, data as of December 2022.

I witnessed up close the gradual privatisation and listing of China's economy, which was comprised of mostly state-owned enterprises (SOEs). China Mobile was listed in 1997 and was the first Chinese initial public offering (IPO) to make global headlines. This was followed by other sectors like energy and financials, and more recently internet and biotech. While the government retained significant ownership and control in these listed SOEs, most industries now have large public shareholdings and are run more commercially. As the economy liberalised and moved from being state-controlled and centrally planned, privately-owned companies were also able to develop and play a bigger role.

Large number of private enterprises

More than 2,500 private A-share companies listed since 2008



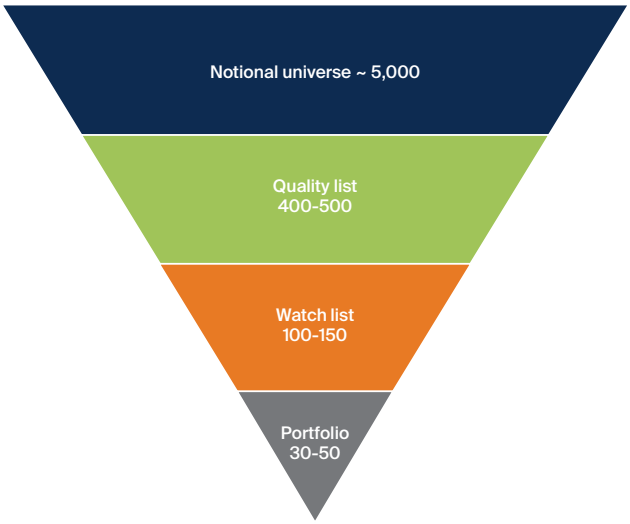
Source: Wind, CICC, CLSA as of June 2022.

In the 1990s, China's stock market was rather primitive, with most of the shares being non-tradable or over-the-counter. It was difficult to create a China portfolio as an offshore investor, as A-shares were not accessible and a handful of B-shares and H-shares were the only securities available. Some of our early portfolio holdings included Goldlion, a popular menswear brand owned by a Hong Kong entrepreneur. Another company was First Sign, which owned Montague, a French silkware brand. We sometimes had to argue about whether something could be categorised as a "China stock" to include it in our China portfolio.

Besides having fairly obscure companies, the market felt like a black box. Analyst coverage was practically non-existent, and our internal research was rather rudimentary. We did not have the internet or other digital tools like we have today. Instead, we would read the newspapers and as companies announced results, we would enter the numbers into a spreadsheet before conducting our analysis.

Now we have channels like the Qualified Foreign Institutional Investor (QFII) licensing program and Stock Connect, and can access a universe of more than 4,000 A-shares and 1,000 offshore listings. Our watch-list has around 250 Chinese stocks which we consider to be decent quality with good management, and we own around 100 of them. But some things from back then remain unchanged today, like our frequent meetings with company management and the lively team debates where we challenge each other's views.

Around 5,000 listed companies in the All China universe



Source: FSSA Investment Managers.

The nature of Chinese businesses has also evolved over time, from being somewhat basic to now being much more sophisticated. Some of the earlier stocks that were listed included a pencil-making company, First Pencil, and a motorbike company, Jinan Motorbike, both of which have gone bankrupt. Now there are large, technologically-advanced companies like Tencent, Meituan and Shenzhen Mindray, which are arguably global leaders or on their way there. This shows that we need to not only think about the medium-to-long term, as in 3 to 5 years, but also the very long term, like 10 years and beyond.

Company management were also less sophisticated in those early days. When we travelled around China, we would bring a pack of cigarettes and I had to pretend to smoke to get along with the management. Today managers are more professional in their interactions, and the reporting, disclosures and presentations to investors have become more in-depth. They also have better credentials — it is not uncommon to see management teams full of PhDs or MBAs. As they have become more polished, we as investors need to be more sceptical and look for subtle red flags such as appearing uninterested during meetings.

Despite these changes, our process for assessing managers has mostly stayed the same. We still look for leaders who are honest, capable and risk-aware — there needs to be a balance, as being too capable or successful can sometimes lead to arrogance or excessive risk-taking. And we still regard alignment with investors as being critical.

Companies became more market-driven and aligned with investors

Charlie Munger famously said, "Show me the incentive and I'll show you the outcome."

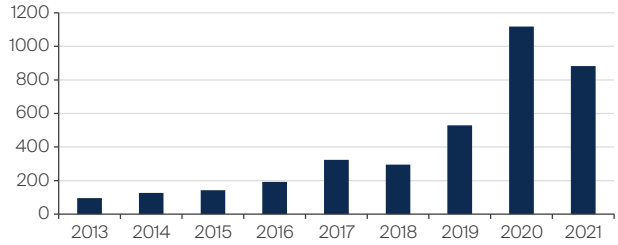
A major frustration in the early days was that 90% of Chinese companies were state-owned and their incentives were not aligned with investors. For many SOE managers, their priorities revolved around revenue growth, raising the employment level and growing China's GDP — in other words, they were expanding for the sake of building an empire, or earning a promotion in the government. We typically try to avoid such companies.

One example is Aluminum Corporation of China (CHALCO). When we looked at the company's capex in the past and the returns on those investments, it was hard to make sense of it. In another memorable meeting with a local copper mining company, when I suggested cutting costs, the government-appointed chairman became indignant and complained about his low pay.

Over time, companies (particularly SOEs) have become more market-driven and aligned with investors, as seen in the increasing use of share/option incentives based on performance targets.

Share incentives have been increasing

More than 3,700 cases of share/option incentives



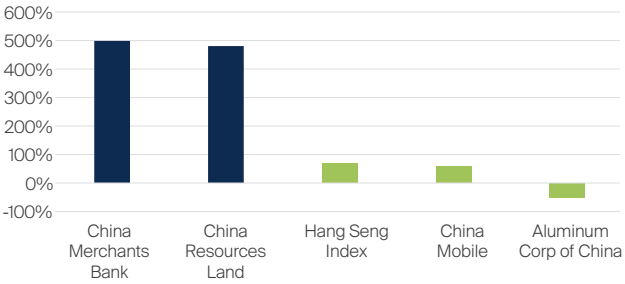
Source: Wind, CICC, CLSA as of June 2022.

For the state-owned companies we own, such as China Resources Land and China Merchants Bank, the incentive structures are more market-driven than their SOE peers, and so are their company cultures overall. This is partly due to their original DNA, which forced them to be both hungry and resourceful.

China Resources Group was founded in Hong Kong in the 1930s to help the People's Liberation Army procure supplies and equipment during its civil war against the Nationalist Army. Being headquartered in Hong Kong made the company more market-driven as mainland China underwent various revolutions. China Merchants Group was founded during the Qing dynasty in the 1870s, to take part in the international trading business, which was monopolised by foreign companies at the time. And CNOOC Group (which we no longer own for environmental, social, and corporate governance (ESG) and geopolitical reasons) was founded without any capital from the Chinese government. Being capital-starved, it had to form joint ventures with multinational oil companies, which helped them acquire international best practices and technical knowhow. This put them ahead of domestic peers when it came to shareholder returns and operating efficiency.

There are still inefficient SOEs, of course, as it is a broad and diverse group. But we only invest in SOEs that act like private companies, and they have performed much better over time relative to their more complacent peers. This is especially important as China's heady growth days are mostly over, and companies are shifting their focus to enhancing returns and winning market share with better brands, products and strategies.

Total returns from Jan. 2007 through Dec. 2022



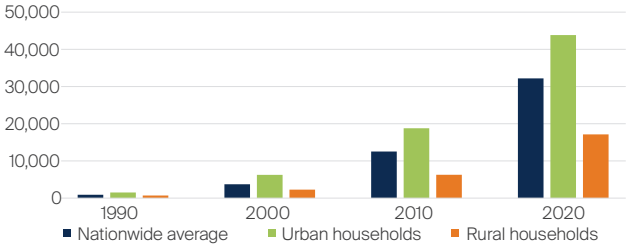
Source: Bloomberg, FSSA Investment Managers, October 2022.

Shifting focus to quality growth over quantity

China's transformation gradually pivoted after Xi Jinping became president in 2013. The country was no longer poor, with a growing number of billionaires and a widening wealth gap, and it turned from a strictly communist system to perhaps being too capitalist. Once China reached a certain level of development, the policy focus shifted from growth-at-any-cost to quality and balanced growth. This meant companies had to take better care of workers and the environment.

While the 'common prosperity' campaign has added some challenges and concerns among investors, our view is that it may be good for China to become less market-driven and more socialist, with wealth being more evenly distributed.

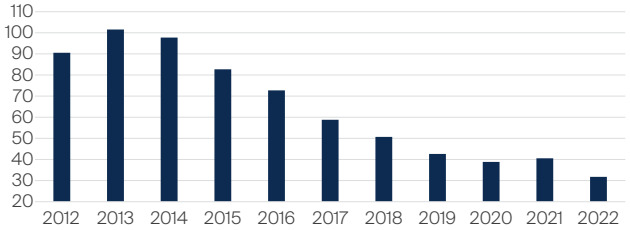
Per capita disposable income (CNY)



Source: JP Morgan, China State Council, National Bureau of Statistics, as of October 2022.

Meanwhile, China seems to be using ESG as an opportunity to leapfrog other countries, such as phasing out gasoline and diesel while leading the world in the electric vehicles push. Chinese companies are ramping up their ESG efforts, and these efforts are starting to bear fruit. A decade ago, when we visited companies in large Chinese cities like Beijing and Chengdu, grey smog cover was a common feature, whereas now there are blue skies generally visible across China.

Average annual PM2.5 air pollution levels in Beijing (Micrograms per cubic meter of air)



Source: US Department of State. PM2.5 refers to particles that are 2.5 micrometres or less in diameter, known as fine inhalable particles. The average human hair is about 70 micrometres in diameter.

The social side has also improved, such as companies' treatment of workers. There was a time when local governments would roll out the red carpet and give entrepreneurs various incentives to set up local factories,

with few restrictions on wages or social security. Now there are strict conditions like minimum wages and environmental requirements before projects are approved.

The governance aspect is where we see the most room for improvement. We typically want to see strong, independent boards with deep experience to contribute to the quality of their discussions. Many Chinese companies are still learning these concepts, as their boards tend to agree with the senior management by default. And many are still owned by the government so some misalignment of interests remains.

ESG has always been at our core

At FSSA, ESG has always been at the core of our investment philosophy and process. We engage regularly with companies to help enact positive changes. Thanks to our longstanding relationships and our reputation as long-term shareholders, companies are more likely to be receptive to our feedback and treat us as partners.

The largest holdings in the FSSA China Growth strategy today, like Midea, Tencent and China Mengniu Dairy, have all been owned for more than 10 years. Over time, we found that that companies which are more open-minded and think about constant improvements are more willing to engage.

ENN Energy, a leading gas distributor, is a good example of an ongoing and productive engagement. Having been an investor in the company for over 15 years, we have engaged with the management throughout on governance and environmental factors.

A few years ago, we asked a third-party consultant to assess the company's major risks and opportunities related to the long-term energy transition, and then shared the research with the management at ENN Energy. We also offered to introduce the consultant to ENN directly, as we thought ENN could learn more from them and benefit from their recommendations for independent director candidates. Covid hit shortly afterwards, which put these plans on hold; but ENN's management were willing to listen, and showed that they cared about our views.

In recent years ENN has increased exposure to alternative energy, helping its customers do the same with its nascent Integrated Energy Solutions segment. Meanwhile, its core gas distribution volume continues to outperform the industry and GDP growth. We believe the company is well positioned, as natural gas — which is cleaner than coal and crude oil — can play a key role in bridging the transition from fossil fuels to renewables.

On the negative side, a chemical company in Guangdong was accused by Greenpeace of polluting the local waterways and farms with toxic waste. We wrote to the company in 2010, then met with a director, but he was dismissive about Greenpeace's concerns. He said, "Our job is to make sure our plant is being run properly," which suggested that the company was less worried about the externalities beyond being legally compliant.

In a follow-up meeting, the company's tone was unchanged — there was no need to pay attention to Greenpeace as long as relations with local governments were maintained. When we asked if the company had ever been fined by the government, the management replied that fines were common because every local government had a budget to meet!

Overall, this interaction showed us that the company did not care about the environment or minority shareholders like ourselves. Although the business had performed well, we exited our position shortly after this experience.

Happily, such attitudes are becoming less prevalent among Chinese corporates as more of them make positive strides in ESG, such as publishing ESG reports, conducting share buybacks and reducing pollution.

The future of China's stock market and FSSA Investment Managers

As we celebrate the FSSA China Growth strategy's 30-year milestone, I am proud that we have remained true to our investment philosophy and have generated decent returns over the long term. Our goal was (and still is) to become a trusted and respected asset manager, in an industry that is often associated with greed, short-termism and occasional blow-ups.

As a team, our experience and understanding of the market has grown. Ageing has played a role in my own investment style and mindset. Today I am less easily excited by hot markets or depressed by prolonged corrections. It helps to have younger people on the team, because as an investor you need to be excited about new things. Meanwhile, curiosity is crucial and needs to persist. After 20-plus years of managing money, I still feel energised conducting research and meeting companies.

Looking ahead, my hope is for FSSA to be remembered as a good steward of our clients' capital. To achieve this we need to continue to evolve and learn, while still being focused on higher quality companies and on the long term. We also need to maintain valuation discipline and not be carried away during the ups and downs.

I also hope for FSSA to be remembered for doing what is right. I am proud to have never invested in a casino company or a tobacco company. While there are some grey areas up for debate (like alcohol and fast food), we believe it is fine to miss out on profits that we consider morally objectionable. Related to this goal is

our charity arm, Manan Trust, which focuses on helping disadvantaged communities across Asia and is funded by a portion of our profits. We rarely promote it because that is not the goal, but I firmly believe we should give back to society as we have benefited enormously from the region's growth and development.

Although investor sentiment towards China has been rather negative during the last two years, I prefer to take a contrarian view and focus on the positives: the China market will continue to broaden and develop, and choices and accessibility will improve for investors. Foreign participation in the A-share market is only around 5% and this should continue to increase. Many of the companies or sectors today were not around 20 or even 10 years ago. We will see more tech-savvy manufacturing like robotics and medical devices, and home-grown brands in areas like sportswear and luxury products. As our opportunity set grows, there is a greater need to focus on the companies which are high quality in terms of their franchise and management teams.

In conclusion, we are grateful that our clients have been supportive throughout the ups and downs of investing with us over the past 30 years. For long-term investors such as ourselves, the journey has been very rewarding.

References to specific securities should not be construed as investment advice or a recommendation to buy or sell the same.

Source: Company data retrieved from company annual reports or other such investor reports. Financial metrics and valuations are from FactSet and Bloomberg. As at February 2023 or otherwise noted.

Important Information
This document is not a financial promotion and has been prepared for general information purposes only and the views expressed are those of the writer and may change over time. Unless otherwise stated, the source of information contained in this document is First Sentier Investors and is believed to be reliable and accurate.

References to "we" or "us" are references to First Sentier Investors.

First Sentier Investors recommends that investors seek independent financial and professional advice prior to making investment decisions.

In the United Kingdom, this document is issued by First Sentier Investors (UK) Funds Limited which is authorised and regulated in the UK by the Financial Conduct Authority (registration number 143359). Registered office: Finsbury Circus House, 15 Finsbury Circus, London, EC2M 7EB, number 2294743. In the EEA, issued by First Sentier Investors (Ireland) Limited which is authorised and regulated in Ireland by the Central Bank of Ireland (registered number C182306) in connection with the activity of receiving and transmitting orders. Registered office: 70 Sir John Rogerson's Quay, Dublin 2, Ireland number 629188. Outside the UK and EEA, issued by First Sentier Investors International IM Limited which is authorised and regulated in the UK by the Financial Conduct Authority (registration number 122512). Registered office 23 St. Andrew Square, Edinburgh, EH2 1BB number SC079063.

Copyright © (2023) First Sentier Investors

All rights reserved.