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Fund pioneer quits China bull ring

By Candy Zeng

SHENZHEN, China - Enough is enough, even in China's tearaway stock markets, at least for one pioneering fund manager who has liquidated his firm's mainland assets and claimed ignorance of what is happening in the market there.

Some peers of Zhao Danyang, founder and general manager of Pure Heart Asset Management, have praised his decision; others say the Chinese markets are still in bull mode and there is plenty profit still to be made.

Fund-managed assets in the mainland swelled to more than 3 trillion yuan (US\$416.7 billion) last year as the Shanghai Composite Index soared to its record high of more than 6,000

point in October. A fall to below 5,000 was followed by a year-end rally that ran through to January before the index continued its decline to about 4,383 yesterday.

The average return of open-ended stock investment funds was more than 100% last year, their gains helping to inspire tens of millions of Chinese investors to put their money in various funds.

Many market analysts and fund managers remain optimistic about the outlook of yuan-denominated A-share market this year and confident that fund investment can have another "golden year", despite recent turbulence. Some private funds have become more cautious and conservative, with Zhao leading the way in pulling out of the market in fear of a continued downturn.

Zhao, whose Pure Heart was an influential officially approved "private fund" management firm, announced the termination of business to liquidate five mainland funds under its management on January 2, 2008.

Zhao established a private securities investment fund to invest in the A-share market in 2004; it is believed to have been the first "sunny", or officially approved private fund, in the mainland. He was praised as the "godfather" of China's private funds for his vision and legendary success in fund management when the market at the time was dominated by bears.

So his decision to liquidate all of his firms' five mainland private funds right after the New Year was like a stone thrown into a quiet lake.

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"We would rather miss an opportunity than blindly take a reckless move under whatever [market] circumstances," Zhao wrote in a letter to his clients before the liquidation. "To survive in each investment decision is always our priority."

Zhao predicted in 2005 that the Shanghai Composite would bottom out from 1,000 to a high plateau of 3,000 to 5,000 points in three to five years. He was absolutely right about the trend but wrong on the pace. The index climbed to 5,000 in just about one year.

From April 2004 to June 2005, when the Shanghai index plunged from 1,700 to 1,000, Zhao's Pure Heart Fund I of A shares made an investment return of 25%. In Hong Kong, the Pure Heart Fund that continues there had gains of 500% by mid-January since its inception in 2003.

Zhao was becoming cautious when the Shanghai Composite reached 3,000 in early 2007 although he did set up two new funds at the beginning of last year. Both had achieved relatively mild returns of some 20% at the time of the liquidation. Meanwhile, the Shanghai stock index soared by 93% and most public funds invested heavily in A shares had revenue growth of more than 50%.

"So far, the A-share and H-share markets are beyond our understanding," Zhao wrote in his letter, with H-shares referring to Hong Kong-listed mainland-related stocks. "The bottom and peak of the indexes are always a riddle. Now, we can't find any proper investment targets which meet our investment criteria and have enough margin of safety as well."

He became the first manager to terminate active "sunny private funds" when the market was still considered a bull. In the investment fund circle, in particular in the eyes of his peers in private funds, he was regarded as a moral leader for his early retreat.

Li Chunyu, general secretary of Shenzhen Financial Consultant Association, said the termination of Pure Heart funds of A shares was sudden but not unexpected. "It is normal for a private fund to terminate when opportunities of investment vanishes. It happens almost every day in overseas markets."

Li consoled Chinese investors who were used to witnessing the opening of new funds in the bull market in an article addressing the liquidation of Pure Heart funds.

He praised Zhao for his honesty. "To be faithful is the cornerstone for the survival and growth of private funds. Zhao is honest with his clients about his understanding of the market and returned the money to them. Not every private fund manager has his courage, which is also a challenge to the public funds."

Liu Mingda, manager of Shenzhen Mingda Capital Management, said Zhao is a responsible person because otherwise he could still rein in management fees even if he continued running the funds at a loss.

Though admiring his bravery and accountability, most private fund managers are not as pessimistic as the prudential Zhao. New private fund products were launched one after another from December last year through trust companies. Shenzhen International Trust and Investment Co Ltd (SITIC) helped establish

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13 such private funds in December. In the first week of 2008, a total of seven new private funds were being promoted through trust companies.

"There is a common saying that China will experience Ten Golden Years [of bullish markets]," said Lin Yuan, manager of Lin Yuan Investment Management Company in a private fund promotion meeting sponsored by SITIC on January 27. "I believe we will have 15 golden years. We have cheap labor and growth no country can surpass."

Lin, a doctor-turned private fund manager, is a legendary speculator and investor himself. He is reported to have started with an investment of 8,000 yuan in stocks in 1989, building this to 400 million yuan by the end of 2005. Lin set up his first "sunny private fund" through SITIC in February 2007 and another two in September. By the end of last year, his first fund had a return of investment of 60% and the other two less than 4%.

Various security investment funds in China were big winners in last year's bull market.

Fund-managed assets jumped to 3 trillion yuan from 856 billion yuan at the end of 2006. The number of investors' accounts in security investment funds boomed to 90 million last year from 14 million in 2006.

The sunny private funds were generally out-performed by public stock funds last year. A recent private fund rating showed that 10 out of 53 private funds recorded 100% returns while half of public stock funds doubled their income last year. The average growth of net assets value of private funds was less than 40% in the first half of last year and 20% in the second half, both were only half the growth of public stock funds.

"The high yields [of public funds] are abnormal," Liu Mingda said in defense of his private fund peers in the recent promotion meeting. "Even Warren Buffett couldn't do that. His average rate of return is some 30%. Our core target is to seek value investment in the long run."

He also attributed the comparatively lower yield rate of private funds to their different mechanisms. "Public fund managers care about attracting more investment and winning the race with the stock index; we care about gains from our investment. So that's why we are more conservative."

Generally speaking, private funds mainly live on their 20% share of investment returns while open-ended funds can pretty much survive on management fees given their large pool of investors.

Pan Jiang, a Franklin Templeton Sealand Fund Management analyst, said the termination of Pure Heart served as an education on risk to investors.

"Private funds can liquidate themselves but open-end funds leave the choice [to redeem] open to investors. Maybe soon there will be open-end funds liquidated by the markets," Pan was quoted as saying by a Chinese business newspaper.

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