

CNBC "Power Lunch" – February 6, 2008

Robert Lawrence Kuhn



SUE HERERA (CO-ANCHOR): It's already Thursday in China, and the country is celebrating the lunar new year. It's Chinese New Year; it is the Year of the Rat. The question is, will it be a prosperous one, and what are the best investment plays, given the economic slowdown here in the U.S.?



Here to help you get an edge in China, we have **Robert Lawrence Kuhn**. He is Senior Advisor at Citigroup and has been an advisor to the Chinese Government for some years now. He is also the author of *The Man Who Changed China: The Life and Legacy of Jiang Zemin*. Edmund Harriss also joins us. He's investment director at Guinness Atkinson Asset Management. And Herb Greenberg is here as well.

Gentlemen, welcome.

Mister Kuhn, I'll start with you, if I could. China has had phenomenal growth, but the snowstorms that have paralyzed a large portion of that country have also brought up some key infrastructure issues. Overall, do you still remain bullish on China's economic future?



ROBERT LAWRENCE KUHN: To understand China, one needs to look very carefully at the totality of China. Westerners sometimes have a naïve approach. Last year, China's growth was 11.5 percent; projections this year put it at about 10 percent. China is like a Ferrari race engine; it's very highly tuned, goes very fast; but a little piece of dirt -- like the snowstorm, as the analogy would go -- can be disruptive.

Politically, China is probably more stable than it's ever been in our lifetimes. Recently, they appointed two new senior leaders for the next generation, effectively giving China political stability for some 15 years. One individual has a Ph.D. in law, the other in economics. You have waves of close to 400 million people who will be brought from the rural economies into the urban economies over the next ten to 20 years, and this additionally fuels the domestic economy.



HERERA:
Okay.

KUHN:
So, there is a great amount of future growth, but as for stock market valuations, they high right now, so it's a complex story.



HERERA:

Which brings me, Edmund, to you, and how you invest in this particular environment. You put together some picks for us. You do have to be careful with the U.S. growth slowing, and one of the stocks you like is Lenovo. How do you decide what to add to the portfolio?

EDMUND HARRISS (Investment Director, Guinness Atkinson Asset Management):
Well, I think you have to be very careful in how you approach Chinese investments because of the rigidities in the economy and the fact that some parts of it are purely driven by market forces; other parts are regulated. I know a lot of manufacturing businesses, at the moment, are struggling with the rising costs of materials and rising costs of labor, and are unable to pass on those costs to a domestic market because China's a highly competitive market.



Now, a company like Lenovo, that acquired IBM's PC division, has been going through a period of restructuring and has managed very successfully to build its brand, to put the IBM brand to one side and to develop the Lenovo brand, both in the U.S. and in Europe, and also in China. So, it's a very specialized sort of restructuring turnaround story, I think.

Herb?



HERB GREENBERG (CNBC Contributor):

Edmund, that was very interesting. Morgan Stanley put out a report a number of months ago, and buried down on page five, they mentioned that their concern was that a lot of non-operating income and investment income was actually driving the earnings for such key sectors as industrials and financials. This seems unsustainable income. Have you seen this?

HARRISS:

Absolutely. What you're talking about there is very much on the mainland-listed companies and those that have invested a portion in the shares traded on the Shanghai and Shenzhen exchanges. You are quite right that that has boosted earnings growth, and I think in the coming year, you may see that headline-earning growth is flat, because you won't get those returns from the investment gains, but the operating income is still growing. So, it is a little bit more complex than that; the headline is not looking so exciting. But what you want to see is an improvement in the operating earnings, and those are still coming through.



HERERA:

Robert, I'll give you the last word; we have about a minute left. One of the issues for China, as its growth continues, even with the politically stable environment that you describe, is the prospect of social unrest. Because the gap is growing between those that have in Shanghai and Beijing – and that's a booming part of China – and those who do not have, and who are starting to pay a lot more for coal, if they can even get it. Is there a worry about social unrest?



KUHN:

The economic imbalance between regions -- west/east, rural/urban -- is the most significant problem in China. Senior leaders are extremely focused on it. President Hu Jintao talks about being "close to the people," listening to the people. Income inequality is a serious problem. You know, 30 years ago, everyone was poor, but they were all equally poor so there were no major imbalances. But today, although everyone's standard of living is much higher than it was, some segments are still higher -- which everyone can see through the media -- so that social comparisons are inevitable and many social problems are based upon that. It's China's biggest concern. But leaders are paying close attention to the problem. It's difficult to rebalance rapidly because the growth that China still needs nationally -- China needs to drive its economy at eight, nine percent minimum -- is still coming largely from the wealthier areas (coastal, urban). So, income imbalance and social fairness is a continuing problem, but it has the attention of the senior leadership.



HERERA:

Well, we will continue to follow it. Thank you, everyone; we appreciate it very much.