Hedge Funds Prosper on China Tech But Bubble Fears Emerge

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Commercial buildings stand in the Central district of Hong Kong in May. Hedge funds betting on China have chalked up some of the biggest profits of 2017 so far, fueled by concentrated bets on the technology sector. PHOTO: BILLY H.C. KWOK/BLOOMBERG NEWS

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0 COMMENTS

Hedge funds betting on China have chalked up some of the biggest profits of 2017 so far, fueled by concentrated bets on the technology sector.

But echoing concerns voiced in the U.S. about the relentless upward surge of the Nasdaq Stock Market , some fund managers are expressing worries about the Chinese tech sector's potential for overheating.

Among the hedge fund industry's top performers globally this year is Pinpoint Asset Management, which runs $1.9 billion and which gained 23% in its China fund through August. Greenwoods Asset Management's $1.6 billion Golden China Fund gained 30.4% this year to date. Zeal Asset Management, which runs $1.1 billion, has gained 23% in its China fund through Sept. 8. Hong Kong-based Oceanwide Asset Management, which runs $100 million, has gained around 35% in its Quam China Focus fund through August.

The gains stand out in a hedge fund industry where strong returns have been hard to come by. Hedge funds globally are on average up just 3.9% this year through Sept. 8, according to data group HFR. Returns have been lackluster in recent years. Many blame this on massive central bank stimulus, which has pushed up stocks across the board and can make it hard for managers to pick between strong and weak companies.

"Our largest exposure is in technology," said Chris Choy, Oceanwide's chief investment officer. Its Quam fund has a big position in the smartphone components sector, where it owns stocks such as lens maker Sunny Optical and Qtech, which makes camera parts for phones. It also has a large exposure to internet platforms stocks, with positions in Tencent, the fund's biggest holding, Alibaba, and JD.com .

"In three or four years' time 5G will be launched. People will be upgrading their phones, which is good news for components makers," Mr. Choy said. "Some [stocks] have gone up twofold, but their value will continue to go up."

The huge returns mirror some of the gains seen on the other side of the Pacific in the U.S., where the Nasdaq is up 19.5% this year and has doubled since early 2013. The tech-heavy Bank of New York Mellon China index has surged 45.7% this year, compared with a more modest 8.9% rise in the broader Shanghai A-Share index.

As in the U.S., tech's gains in China have raised concerns among some commentators over whether the sector is a bubble.

Chinese tech stocks such as Baidu, Alibaba, Tencent and NetEase are consensus investments that "everyone, Chinese or not, owns," said Joel Werner, founder of Hong Kong-based Solitude Capital Management. His fund is up 57% this year, though he doesn't own such stocks.

He drew a parallel with U.S. stocks Facebook , Amazon, Apple, Netflixand Google. "They're consensus trades and driving the market globally," he said. He said that such stocks are expensive and could be vulnerable to a macroeconomic shock.

However, Oceanwide's Mr. Choy, whose fund increased exposure to tech in the final quarter of last year, said the internet platform sector is "very solid and sustainable."

He added: "Some of our peers are concerned about valuations. We do very in-depth analysis, and we think there is still a huge space they [the companies] can develop their business." He is instead concerned about sectors such as domestic banks and property developers, which he believes could be hurt if problems develop in China's shadow banking system.

Technology stocks have also helped drive gains at Pinpoint, which said it has been building a position in Alibaba, and Zeal.

A tough operating climate for industries including technology has meant that "some clear leaders have emerged while others have left the business," said a Zeal spokesman. These survivors "have grown in market share through industry consolidation. Further need to vastly invest in capital expenditure [has] decreased and so the companies are enjoying much stronger cash flow."

He added that Zeal doesn't believe that a "major bubble" has formed, but said "there is a risk that some of the largest cap stocks are overheating."