Lilian Co

✻ Chief investment officer ✻ LBN Advisors

Lilian Co left her job at Baring Asset Management as its China and Hong Kong equities manager to establish LBN in September 2007, a Greater China equity hedge shop. During her tenure at Barings, its Hong Kong China Fund, a long-only vehicle, saw AUM rise from $100 million to $6 billion. She also had some experience managing a long/short equity fund, which whetted her appetite to move to a hedge-fund environment.

When did you launch LBN?
I started this firm and launched LBN China+ Opportunity Fund in November 20007, exactly at the peak of the market. So it made for a pretty rough start.

However, we ultimately survived the downturn and made a positive return in 2008. We are now approaching the beginning of our third year of operations, and total firm assets under management are over $200 million. We started the hedge fund with just $12 million.

What lay behind that increase to assets?
It is attributable to both our performance and new investors coming in. Risk appetite has come back in the second quarter of this year, and that has been when most of the asset growth has taken place.

What is the fund's strategy?
The hedge-fund strategy being used is long/short China-focused, listed across exchanges but mainly those listed in Hong Kong. We can do China-listed A shares but we don't have any at the moment. I think the best way to play the China story is via H shares in Hong Kong, which are less volatile and less retail-driven.

Why launch during a market peak?
We didn't know when we started that the market was at its peak. Had I known that, I would have shorted. The first two months went along all right, but it became critical in January 2008. We took a short-term view that the market was due for a rebound and increased the net-long position from 50% to 80% right before the market collapse.

So, we ended up capturing most of the downside and were down -18% for that month. It was a bad month for our China peers in general, which were down in the range of 7-10%. Obviously, we were among the underperformers in that single month.

What happened next?
I revisited the strategy to see what went wrong and concluded that we were already at the early stage of a bear market. So I shifted from net long to neutral in the following month. That was the turning point for the fund, because we stayed market-neutral thereafter until late November, when we reverted to net long. The neutral strategy saved us from suffering in the down market, especially during the autumn months of September and October.

And then came your rebound.
By the end of the year we were up 11%, so from the low point, we had returned almost 35% in total during the rest of the year. A neutral book was being run, so it was really all down to alpha from stock selection. I was defensive in the long book and was shorting high-beta and high-p/e ratio names on the other side. Consumer discretionary stocks were trading at more than 30x multiples at the peak. All of those high price/earnings ratio stocks underwent a de-rating and that was where I was positioned on the short side of my neutral book.

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What was the main contributor to performance?
If you look at our performance attribution in 2008, single stock shorts were the major contributor.

In November 2008, we changed from market neutral to a 40% net exposure. It wasn't so much a macro driven call, as it was a bottom-up call, because by then assets were very depressed and even good assets were priced as if they would go bust. It was a clear mis-pricing opportunity.

What convinced you to pull the trigger?
The catalyst to increase longs was the government's stimulus package, which set the floor and at that point you knew that downside risk was very limited. You knew that if those assets weren't going bankrupt, they shouldn't be trading at that kind of level and should start to normalize. It turned out to be a good call. In late November I went into property and shipping stocks, which were trading at 0.2x to 0.3x book value, and I'd never seen those levels of pricing before. I also moved into bonds and convertible bonds for this once-in-a-lifetime opportunity.

PERSONAL CV

CAREER
September 2007-to date LBN Advisers, CIO, 1997-August 2007 Baring Asset Management, head of Hong Kong/China equities

EDUCATION
Bachelor of commerce degree from University of Alberta
MBA from University of Nottingham

How has the fund performed this year?
Year to date we are up almost 40%. We've underperformed the index, but I am still happy because we had not gotten stuck in the bearish camp. The challenge for a hedge-fund manager is the ability to change view from one extreme to another in a very short period of time. You need to be flexible and to be able to adjust to a market. Otherwise you can get trapped in the overly bearish mentality and fail to capture the upturn.

What is your outlook?
Today we are approximately 80% net long and we're bullish. We are expecting a fourth quarter rally. Valuations are not bubbling yet. If you look at the MSCI China forward price/earnings ratio it is 13-14x. Historically, China p/e tends to trade in the range of high single digits to about 20x, so I see no bubble of valuations so far in this cycle. Also the real economy is recovering so valuations are well supported by fundamentals. There isn't any inflation risk and there is abundant liquidity. With the low interest rates, investors are keen to put money to work.

We're in a sweet spot, so I think the rally will continue. However, its probably too late if you're thinking about leveraging into it. The market has already doubled and I'm not expecting it to double again.

What sectors do you now like and dislike?
Domestic consumption is the major theme as I don't expect exports to have a V-shaped recovery. The government has done what it can to increase consumption, and I think it will remain the focus over exports.

As I expect a fourth-quarter rally I don't have many specific shorting ideas at present. Sectors that are sizzling hot this year are potential shorting candidates for 2010.

How do you balance the need to be a bottom up stockpicker and a top down policy watcher?
There is no such thing as being one or the other. All I can say is that at different stage of a cycle, they carry different weights. Last year, macro was the dominating factor. This year macro is still important, but if you get the idea right, your return can be much higher than you can get from the index, 300% compared to just a 50% return from the index. So, stock selection definitely adds value this year. ■