CHAIR'S LETTER TO SHAREHOLDERS

Ronnie C. Chan
Chair

Results and Dividend

Owing to the depreciation of the Renminbi and lower contributions from property sales, overall revenue fell slightly by 1% to HK$10,881 million for the year ended December 31, 2023. Rental revenue increased by 2% to HK$10,879 million.

When excluding all the effects of property revaluation, the underlying net profit attributable to shareholders declined by 2% to HK$2,931 million. Underlying earnings per share decreased likewise to HK$2.15.

Net profit attributable to shareholders, after including all the effects of property revaluation, increased by 3% to HK$2,811 million. Earnings per share rose correspondingly to HK$2.06.

The Board recommends a final dividend of HK65 cents per share, payable on June 14, 2024 to shareholders of record on May 10, 2024. If approved by shareholders, total dividends per share for the year ended December 31, 2023 will be HK86 cents.

Looking Back

This is the last time I will write to shareholders, as I will soon relinquish all my executive duties at Hang Lung Group and its subsidiaries, including the publicly listed entity Hang Lung Properties (HLP). This will take effect on April 26, 2024, which is the date of our next Annual General Meeting (AGM). Thereafter, I will take on the title of Honorary Chair. This Board, as well as that of HLP, have appointed Mr. Adriel Chan to succeed me in all my present responsibilities. Since 2020, he has been our Vice Chair.

Because of this transition, I will depart from the usual format of this letter. Detailed operating results can be found elsewhere in this Annual Report. For my analysis of our 2023 performance, I refer readers to my letter to HLP shareholders as an approximation. Instead, I will devote this last letter to bigger issues that affect our industry and our business.

When I assumed the chairmanship of this Company on January 1, 1991, we were almost exclusively focused on Hong Kong. (In the late 1980's, we ventured into Thailand where we operated a small real estate company and owned a Grade A office tower for rental. We also bought assets in Australia and Indonesia. Soon after I took over the reins of Hang Lung, we exited all our non-Hong Kong businesses.) One of the first things I did as Chair, besides making certain necessary personnel changes at the top, was to study mainland China's economy. This resulted in our entering Shanghai in December 1992. Today, the Mainland accounts for 68% of our rental income, and the number is growing. This is why I have written extensively on the Mainland economy and society over the past few years. Those were times of explosive growth, and we greatly benefited therefrom.

During the same period, changes in our home city Hong Kong were no less spectacular after she was returned to the motherland in 1997 from colonial hands. The economy continued to grow, and business carried on as usual. This was why I have not written to shareholders on this city as much as I have on the Mainland market. The latter was new to us and it is where our future lies. Yet, in the past few years, Hong Kong has entered a new phase that has not been seen before. Hence, it is perhaps my last responsibility as Chair to present my views on our home city. To be sure, we have no intention of moving our headquarters anywhere else. There is no other city better suited than Hong Kong to conduct our business.

Let me state at the outset that we have never lost faith in this city — not before 1997, and not today. To be sure, Hong Kong is no longer the same as it was in the past, but that does not mean that "Hong Kong is over", as an American friend of mine recently wrote. Hong Kong is simply different now. We should understand what made the city what it was then, and what made it what it is today.

Let me begin by recalling a personal encounter I had once shared with our shareholders. In June 1995, two years before Hong Kong's return to Chinese rule, a Western business magazine published a cover article suggesting that Hong Kong was "dead". The author was a friend of mine who has unfortunately since passed. After reading the article, I contacted him and flew to the U.S. East Coast to point out why I thought he was wrong. He seemingly accepted my arguments and promised to publish another article to incorporate some of my points. When the article came out in September 1996, 15 months after the original piece, half of it was about me personally, and in the other half, he hardly presented my views. I was disappointed and flew back to see him again in Washington, D.C. This time, he offered to publish my piece if I would write it. I obliged, but when it finally appeared in print in January 1997, 19 months had passed since his original article. The damage to Hong Kong was already done. The title of his first piece was so sensational that it was a simple case of character assassination.

Was it the biased mind of a journalist who wanted personal fame, a publishing house that wanted to boost magazine sales, or was there a political motive? We will never know.

Fortunately, events subsequent to 1997 disproved my friend's writing. Hong Kong continued to thrive. Ten years later, the magazine published an article admitting they were wrong. (That boosted their sales as well!) Given this history, I suppose I, too, have some grounds to now voice my opinion on Hong Kong. After all, before 1997 and soon after, I must have been the local private citizen who visited the West the most to tell the Hong Kong story.

To be sure, the success of Hong Kong before and after 1997 was, until recently, unsustainable in one critical aspect. Our economy was much too reliant on real estate. From what I can tell, the colonial policies that began in the 1970's systematically built up a property bubble. Since the government controls all undeveloped land, which accounted for over 70% of the total, by deliberately releasing it in measured quantities, it was not difficult to manipulate the direction of land price. As a result, for decades, our city had, by far, the most expensive land and residential prices among any major metropolis in the world. Real estate-related income regularly accounted for 30%-40% or even more of total government revenue. This kept corporate profits tax and personal income tax low and brought about many benefits: it attracted foreign businesses to Hong Kong, the high property prices had a wealth effect on our citizens, it gave the appearance of economic vibrancy, and the colonial master could repatriate the maximum amount. It seemed to be a win-win for all.

During the Sino-British negotiations before 1997, the Chinese government feared that London would sell off as much land as possible at high prices and send the proceeds to the United Kingdom. As a result, Beijing insisted on an annual cap of 50 hectares on land sales before 1997. Land prices, in fact, peaked on June 30, 1997, the very last day the British ruled Hong Kong. How odd! After a temporary lull during the Asian Financial Crisis, prices resumed their sharp rise because of limited supply.

On the other hand, mainland China grew economically by leaps and bounds in those years. Double-digit annual increases were not unusual. Hong Kong both contributed to this growth as well as benefited from it. As long as these set of conditions lasted, expensive real estate seemed acceptable. However, it also generated tremendous social problems. Consider the fact that the size of a median home was less than 50 square meters. With an average household of approximately three people, the per capita space was only about 15 square meters. This was one third that on the Mainland, and was one of the lowest in the world given the level of our economy. There was much dissatisfaction in society, which partially fueled subsequent social unrest. At the least, it served as a convenient excuse for social discontent.

Given these conditions, real estate has grown to become the dominant sector of our economy. Other traditional pillars also did well post-1997, such as financial services, trade (including logistics), and tourism. They all benefited from the rise of China. Yet, none can rival our industry in importance — its supply chain is the longest, from construction to home furnishings and sales agencies, etc. But in the long-term, is having the world's most expensive home prices desirable or sustainable?

It seemed that, in those years, nobody bothered to talk about it. With strong economic growth in mainland China on the one hand and Hong Kong land supply constrained on the other, property prices could only keep rising. It was a short-term boon to society but a potential long-term problem. Prices had reached staggering heights.

The increase in home price was perhaps the most troubling because of its impact on society. Apartments became smaller and smaller — our average dwelling size was half that of crowded Tokyo. The inability of young people to own homes became a serious social issue.

Because of Hong Kong's small geography, land for Grade A offices was in short supply, which explained the high rents. Retail space was also expensive because of high population density, a strong economy, and rising salary levels. This lasted for decades.

Earlier, I explained why land supply was kept deliberately low pre-1997. Thereafter, a new reason was added. The land sale mechanism, in the form of a quasi-governmental body instituted by the British not long before 1997, continued by and large. However, the domestic political and social atmosphere have changed. Oversensitivity towards social equity prevented decision makers from selling land. They were fearful of being accused by anti-government politicians of selling cheap to benefit wealthy developers. Consequently, land transactions became unreasonably low, resulting in sky-high prices. It was a disaster in the making.

Ironically, the anti-government politicians, who were supposed to fight for the well-being of the average citizen, had seriously hurt the society by keeping real estate prices super high. The fact is, they only cared for their own political objectives. Hong Kong was not unique in the world in this regard, but the intensity of political infighting before the National Security Law (NSL) was enacted in June 2020 was particularly toxic. In a sense, one may say it was the NSL that finally broke the decades-long curse of exceptionally high property prices. It did so by limiting or removing the selfish and undesirable practices of some of the then legislators.

As in almost everything in life and society, the bad comes with the good. Lowering housing prices is necessary when nearly half the population cannot afford to own homes. It is also good for the city's long-term competitiveness. However, the majority of our citizens who are current homeowners will likely suffer some form of asset depreciation. There will also be a negative wealth effect on this group of more affluent members of society. The transition from an undersupply to an adequate supply of land will gradually alter many of our citizens' belief that investing in property can never go wrong. This is a process our society must sooner or later face.

Besides changes in the real estate sector, another related issue that has fundamentally transformed our society is the role of politics. Before 1997, the colonial master ensured that this subject was strictly forbidden. Democracy was never allowed here until the British realized that they would soon be compelled to relinquish Hong Kong. It was a deliberate effort on their part to make this place ungovernable come 1997, and they succeeded royally. A city formerly driven primarily by economics has become a political jungle.

It is doubtful if Beijing anticipated this when they negotiated the return of Hong Kong or during the drafting of the Basic Law. After 1997, it seems that they were either unaware or chose to do nothing about it. An undisputable fact was that, for many years, Beijing was too lenient in handling Hong Kong's affairs. Remember the mantra those days: the best way to manage Hong Kong was to not manage it at all. They misplaced their trust in most Hong Kong people, and also underestimated the British.

In the early 2000's, at a very small private dinner, I had the opportunity to express my views on Hong Kong to a former ministerial-level friend from Beijing who was on the front line of the Sino-British negotiations. I told him that, while Beijing believed that China had succeeded in ensuring Hong Kong stable and prosperous after the handover, the British had actually loosened the ropes underneath the tent. My friend was so offended that we never saw each other again. A few years later, when some Hong Kong youth waved the Union Jack on the streets of Hong Kong in protest against the government, he could not stand it anymore and publicly condemned those youngsters. Well, he should have known.

Whatever the case, the situation in Hong Kong continued to deteriorate, culminating in the horrific riots that broke out in the second half of 2019. The introduction of the NSL was the only way to restore order and peace. Frankly, Hong Kong was probably the only jurisdiction in the world that had practically operated in the absence of security laws for over two decades. Something had to be done, and hence the introduction of the NSL.

For better or worse, such is what this city lived through. Before the NSL, ours was a politically torn society. History has taught us that it could not end well. Without the NSL, our streets would remain chaotic, and no economy could thrive under such circumstances. It is much better to have the security law. To make things tougher, the riots were immediately followed by three years of the pandemic, which exacerbated the economic woes and delayed the healing process.

Then, something happened, equally serious if not more so. America's attack on China has now been extended to Hong Kong. For the first time, the West wrongly denied the existence and practice of the "One Country, Two Systems" construct. Hong Kong was embroiled in local politics before the NSL of 2020; now, the city is caught in the crossfire of international politics. Under the British rule before 1997, we were at peace with the world. Under the "One Country, Two Systems" construct after 1997, we were acceptable to the West. All that has now changed.

For the past two decades and more, I have advocated that we continue our engagement with the world, while taking advantage of the rise of China. In the past, our citizens knew something of the West, but we lacked a deep understanding of the Mainland mainly due to ideological reasons. But since our motherland was one of the world's fastest growing major economies, failing to forge strong ties with her could only be detrimental to ourselves. Now, the table has somewhat turned. Hong Kong has no choice but to collaborate closely with the rest of China, for it is becoming increasingly difficult to deal with the outside world. In the past, the West welcomed us; now, for political reasons, they shun us. But we have no alternative — being a city economy, we must work with everyone.

So, to summarize, there are three major factors that constituted Hong Kong's change: unfortunate problems around the 1997 return; the consequences of COVID-19, and collateral damage from the escalating China-U.S. tensions. Here are some related issues critical to our future.

To be sure, Hong Kong people do not know how to manage the system left over by the West. This is further complicated by the fact that many of our citizens previously fled here when there were problems on the Mainland, be it in 1949, the famine of the early 1960's, during the Cultural Revolution, or after June 1989. They were not predisposed to support Beijing. As such, it was easy to emotionally alienate them from the motherland. The colonialists were thus able to cultivate a populace who had no national identity whatsoever. This is indeed rare in the world.

Given the propensity against Beijing, the situation after 1997 was ripe for agitations both from within and without. Hong Kong became an anti-Beijing hotbed that led to the most violent 2019 riots. The opposition was calling for a regime change. There were also clear signs of foreign intervention — foreigners were found directing activities on the streets. In hindsight, perhaps one should not be surprised by all the troubles we experienced in the 23 years before the introduction of NSL in 2020.

A critical question here is not just how to resolve the immediate economic problems, but how to foster national identity and who should lead the effort. Few in Hong Kong are thinking about these issues. As we all know, national identity cannot be demanded but must be nurtured over time. Mr. Lee Kuan Yew, the former leader of Singapore, successfully achieved that for his country from the 1960's to the 1980's. If no one proactively and wisely work at it, it will not happen. Such is the critical challenge facing Hong Kong and Beijing today.

Some Hong Kong citizens have complained of late that local officials are today more "left" than Beijing. There is considerable truth to this. But taking into account the history of not having a national identity or emotional attachment for a century, some overshooting is inevitable. No pendulum can suddenly stop at the midpoint.

The three years of the pandemic also severely impacted Hong Kong. Being part of China and increasingly reliant on the Mainland economically, we had no choice but to follow their approach in combating the virus. The outcome was that we became closed off from both the rest of China and the outside world. That was the worst possible scenario for our economy. Many foreign professionals relocated elsewhere, some after having lived here for decades.

As to the full-fledged attack on China by the U.S., troubles had already been brewing for at least three decades, but never have they been more acutely felt than today. Just consider the drastic fall in the stock market transaction volume when most Western capital is forbidden to invest in Hong Kong. I believe that more attacks will come our way, yet most of our citizens seem oblivious to them. That said, this is a national issue, not just a local one.

To forge closer economic ties with the Mainland, we need to improve our knowledge of the country. As a first step, the people of Hong Kong must brush up on our Putonghua. (In Hong Kong, we speak primarily Cantonese, besides English). The huge market up north exerts a strong pull. Now, we also have a push factor — the West is driving us to work more closely with the rest of China.

This is not to replace the outside world. Rather, we must redouble our efforts to better understand and connect with them. Moreover, Hong Kong cannot afford to focus only on the U.S. as we tended to do in the past. Now, we need to venture further afield to collaborate with much of the rest of the world. For those regions in the world with which we place hope for new economic ties, our business people will have to quickly come up to speed in terms of knowing their language, customs, history, and systems. Much learning will be required.

Another thing Hong Kong must do is swiftly enhance our proficiency and adaptability in high technology. The world is advancing in that direction, and our primary economic counterparty, mainland China, is among the most advanced in that regard.

Given the above, it is clear that Hong Kong has transformed significantly from what it was in 1997 and the first two decades that followed. The prosperity we enjoyed back then was based on unsustainable factors like high real estate prices. Major changes were inevitable, although no one could have predicted how they would come about. It turned out that the process was quite unpleasant such as the 2019 riots. It is now time to develop a new model that befits new realities domestically and internationally. After all, change is the only constant in this world. When the external environment evolves, every person, city, or nation must adjust to survive and thrive.

Whilst have already written much about mainland China in previous years, I should nevertheless summarize my views here. Only by adequately understanding the past and the present do we have a chance of more accurately predicting the future.

For about two decades, China was very hot as a destination for investment from around the world. Its seemingly unlimited market was a strong lure to capital and talent alike. The enthusiasm was, for the most part, well-founded. It was based on genuine economic growth. I remember attending, in the mid-1990's, my first board meeting of a then prominent U.S. high tech company that was doing business in mainland China. An item of management reporting was the repatriation of half a billion U.S. dollars to America. The money was transferred without a glitch.

In the past few years under the present U.S. administration, international investment in China has turned cold. Very cold! There is no denying that China is today facing serious economic challenges. Over the past four decades, Beijing has also encountered all kinds of severe problems, both economically and politically. Recall the post-Tiananmen years after 1989, or the banking crisis of the 1990's with the triangular debts.

This time, however, is different in one material respect. Previously, the problem only surrounded economics or domestic politics. This time, there is the addition of a malicious element, namely, international politics. Purely economic issues then and now can usually be resolved. But, for several generations, humankind has not seen a time when the strongest nation in history picks a fight with an enormous, fast-rising number two.

This is Thucydides' Trap par excellence. The last major incident of this sort occurred in the 19th century when the U.S. rose powerfully, thus challenging Great Britain, the dominant power at that time. The enormous amounts of natural resources in North America and a fast-growing population were difficult, if not impossible, for the U.K. to match. Given a less globalized world then, there was sufficient room for the two powers to coexist. They simply divided spheres of influence — the U.S. dominated the New World, while Britain continued to extract wealth from her many colonies, from India and Myanmar to Malaysia and as far east as Hong Kong.

The same cannot be done today. Technology has created a truly globalized world where the top two nations, at odds with each other, will inevitably engage in a comprehensive confrontation, encompassing almost all fields, sparing no geography or industry. This is something that the world has never seen. The U.S. is determined to do all there is within her power to suppress China's rise. It is an all-out war, just short of kinetic actions. The likelihood of a hot war is not high, given the nuclear arsenal and mutual assured destruction, but that does not imply a less brutal conflict. It is a new kind of modern warfare that encompasses cyber, currency, deep-sea, and space, and not just trade, natural resources, or traditional weaponry.

Over the past 30-some years, there were numerous military and economic confrontations, but each time, for their own reasons, both sides kept the problem out of the public eye. During the Trump administration, however, many of them bubbled up to the surface. At that time, trade was what caught the world's attention. Now, the U.S. has made it clear to the world that the contest is comprehensive in nature by raising it to the level of national security. Patriotism became synonymous with anti-China, to the extent that no one in America today dares to speak otherwise. The media chimed in to powerfully propagate the message domestically and internationally. All pro-engagement people dashed for cover. There is an almost unanimous consensus within the country.

One of the most dangerous flashpoints is, of course, the Taiwan Strait. For decades, Washington has all but openly supported the pro-independent political party on the island. In the past, those in America who were against China kept a low profile. There was minimal public awareness, until the last administration.

Now that the China-U.S. conflict is a matter of national security, anti-China sentiments are in the open, rendering the Taiwan Strait even more treacherous than before. During the 1996 Taiwan Strait crisis, two U.S. aircraft carriers were dispatched there but were careful not to enter the Strait at the most sensitive time. Today, U.S. military vessels regularly go through the narrow body of water. Merely five years ago, it was unimaginable that any U.S. congressman could visit Taiwan. A year and a half ago, the Speaker of the House spent two days there on a high-profile visit. America is clearly provoking Beijing.

In response, China understandably feels like she has no choice but to strengthen its arsenal, as only military strength has a chance of guaranteeing peace. Today, Beijing is no longer without the capability to protect herself. Such is the only way to avoid trouble. This, and other reasons, indicate that kinetic action in the Taiwan Strait is unlikely. Moreover, problems in other parts of the world, namely the Middle East and Europe, may divert America's attention. Contrary to widely held opinion, I believe there is a fair chance that the Pacific may be a relatively peaceful part of the world in the next five to 15 years.

This, however, does not mean smooth sailing for China. Besides having to address its present economic woes, keeping the domestic society stable and calm is always of the highest priority to Beijing leaders. The two issues are of course related. Provided the country is able to maintain social cohesion, and I believe she will, her economy will continue to grow.

Some Western commentators often suggest that China would face the middle-income trap like many Latin American countries. Whoever says that is probably unaware of the impressive vibrancy of her tech sector. Possessing the world's largest cohort of engineers will ensure productivity gains. Just as China is already among the world's most advanced countries in terms of digital software applications, the contest initiated by the U.S. is undoubtedly helping China to build her high-tech hardware prowess.

Today, the West loves to say that China is "uninvestable". Such is the political talk propagated by their politicians. It bears little resemblance to the economic and technological realities on the ground. To be sure, China is far stronger in multiple critical dimensions than many Western-approved countries for investment. China is "uninvestable" only because the West says it is.

Such is the external environment we find ourselves in. When I first took over the chairmanship of this Company 33 years ago, China was in its early stage of opening up and economic development. Many people, myself including, were apprehensive, but subsequent years saw tremendous opportunities in the booming market. Hong Kong, on the other hand, also faced uncertainties related to the city's return to Chinese rule. She, too, thrived economically in the years leading up to 1997 and thereafter.

Our challenge back in 1991 was that the Company was financially weak and lacked a clear direction. There was no strategy to speak of. By venturing into the Mainland high-end commercial property rental business, and by strategically timing our property acquisitions in Hong Kong, we gradually re-established our foothold in the market. Today, our finances are healthy, and we have one of the strongest brands in commercial real estate in China.

As I pass on the baton of the Company to the next generation, they now face a set of circumstances very different from what I faced 33 years ago. In fact, the situation is quite the opposite. Today, the Company is in good shape in all critical aspects. However, the external environment is deteriorating. Frankly, I see no end in sight. The only fortunate thing is that our founder started the Company in Hong Kong, right next to what later turned out to be a giant mainland Chinese market. I believe that it will remain a reasonably good place to invest.

If my analyses above are not too far from the realities in the coming years and decades, then the Company should do well.

Looking Ahead

Not wanting to hold back the free hand of my successor and his team, I ought not go into too many specifics. That said, I am gratified to report that whatever strategies we now have were jointly developed by my successor and myself over many years. It is as much his strategy as it is mine. Over time, however, changes may become inevitable as the external environment evolves. I am confident that our management team under the new leader will be able to adapt appropriately.

In the meantime, we can count ourselves fortunate to be in the right market and in the right industry. When surveying the globe, two markets stand out. They are both big and vibrant, namely, the U.S. and China. Since we have operated successfully in Hong Kong (which is part of China) for 63 years, and have been on the Mainland for over 33 years, there is no reason to go anywhere else. After all, what competition advantage do we have elsewhere?! While the U.S. economy may grow annually by 2-3% in the next 10 to 20 years, the number in China may be closer to 4-5%. As such, we are in the right place. And within that market, the luxury retail sector, while small in absolute size, shows steady to rising growth. The industry annual increase may be a few points above the GDP growth rate. If, as expected, we can outperform most peers in our business, then we are aiming at an annual growth rate of about 10% for many years to come. At the least, an average yearly organic rental increase of high single-digits may be achievable. I also expect further expansion of our portfolio.

Such a rise in our business obviously needs an outward environment with which to cooperate. If China is unstable or her economy remains weak, then it will be a different story. As my readers should know by now, I believe that China should be able to remain socially stable and the market should continue to grow. Like everywhere else, there will be bumps along the road, and the Chinese system tends to have bigger bumps, but it also has the ability to learn and adjust. Such was the case for the past 40-some years since the nation's economic reform and opening in 1978. The fact that the ruling party remains unchanged allows the country a better chance of retaining any lessons learned. Her experience in recent decades has been one of constantly adapting and adjusting.

To the West, such a system is an anathema, but to the Chinese, this is how they live by — this has been their practice for several millennia. As Dr. Henry Kissinger repeatedly said, China was at the height of human civilization economically and culturally for much of the past few thousand years, when the Europeans were still living in caves. As such, it is not self-evident that the Chinese need to learn from the West. Learn they will, and learn they should, as they have demonstrated in recent decades. But adopting Western practices in its entirety is another matter. The success of the West and its present system are much shorter in the context of human history, and its longer-term viability is yet to be proven. Moreover, the West is supposed to celebrate diversity (while China values conformity), so why criticize others when they are different. Is it not hubris?

To be sure, because of China's sad history in the past 200 years — also a result of its social and political system — she must learn from the West to catch up. She has done exactly that and is still learning. But what she should learn and what not to is up to her. Every individual, nation, or people must bear the consequences of their own choices. The same system that plunged the country into poverty in the past two centuries also produced millennia of affluence before, and restored prosperity in the past few decades. For example, in no time in history has a country, especially one as populous as China, lifted so many citizens out of poverty, like China did in the last 40 years. It is a human experiment that should be celebrated by all, and not just the Chinese. Much of the world is still poor, so surely there is opportunity to learn something from this enormous and ancient country.

Allow me to present two cases on the Chinese way of doing things that is markedly different from the West. The first is a little philosophical. As I have long written, because of its Judeo-Christian heritage, Western civilization tends to view the world through a zero-sum prism — it's either me or you. This comes from their monotheistic religions, where it is either God or Satan, heaven or hell, and salvation or perdition. As a result, the dominant Christianity is strongly evangelical — to convert all heathens to their way. These philosophical and cultural traditions strongly influence the behavior of Western nations today.

Interestingly, there is hardly any religion in the Chinese civilization. There is not a personal god or gods; they only have what they call "heaven" which is a vague concept and is entirely subject to individual interpretation. Even Buddhism, which China imported from India over a millennium ago, in its pure and original form, does not involve deities. It is more akin to a philosophy.

To the Chinese, everything has two aspects of "Yin" and "Yang". While in opposition to each other, they also strongly complement and supplement each other. Both sides not only should coexist; they must coexist. One cannot exist without the other. This is why the Chinese leadership in recent years has raised the concept of "A Community with a Shared Future", which the West seems hard to grasp. They either ignore or reject it!

Let me cite a second case that is far more pragmatic than philosophical. Having observed the Western financial system that has produced great volatility that can seriously damage the real economy, Beijing came to the conclusion (as many of us did long ago) that finance should be a service and not become an end in itself. Finance is a necessary tool to facilitate the economic activities of producing goods and services for society. Simply put, let finance primarily serve the real economy and not damage it. Financial service is necessary and good, but financial industry not necessarily so.

The question is, of course, where to draw the line. Due to the abundance of wealth accumulated over decades of relative peace after World War II, there is now so much capital in the world. Using money to make more money becomes a very lucrative business, resulting in the rise of the finance industry.

Consider the emergence of two businesses. In recent decades, investment banking (making money with other people's money) and private equity (making money through other people's companies) have risen to the top of the economic hierarchy. Yet, only 30-some years ago, investment banking was regarded as a less respected cousin of commercial banking.
Now, investment bankers have become the elite because they often have much higher compensation levels than the traditional commercial bankers.

Before the 1990's, no one would award private equity (PE) practitioners the same respect usually reserved for the CEOs of major corporations. Today, the best PE managers make a lot more money than those who directly run big businesses. A few of the former add value beyond just investment dollars, but most of them do not.

These are clear signs of the rise of the finance industry, which has overshadowed the financial service industry. Worse still, many investment banks began to run money for their own account rather than only serving the financial needs of their clients. Are there not conflicts of interest? Sure, but there are always ways to mitigate their appearance of self-interest.

I have long observed a phenomenon among young people in mainland China in the past two to three decades. When the country was still rather poor and needed capital, the brightest and the offspring of privileged families flocked to become investment bankers, as they could make a lot of money. Undoubtedly, they serve a real and necessary economic function of channeling foreign money into the capital-hungry and fast-growing economy of China. The danger is that those young people are no longer willing or interested to work in manufacturing, which usually makes significantly less money. Their personal career decisions are understandable, but it is concerning that the smartest would gravitate en masse towards the finance industry over the manufacturing of real products for society. In most cases, the compensation of investment bankers far outstrips those of the company CEOs they serve.

Over the years, I have used investment banking services. They do perform a necessary economic function, especially in capital raising. When I compared the bonuses of those young investment bankers to the value they truly deliver, however, it was altogether out of balance. It is the investment banking network that gets the job done, and I am happy to pay for the benefit derived therefrom. But I shake my head when I learn the amount of money that goes into the pockets of those young bankers who do not create much real value. Some of them are better paid than the CFO of sizable companies, who delivers real value day after day.

In order to earn fees, investment banks with ample money and a bevy of smart brains have created many highly complex financial products. They are so complicated that frankly I doubt if those salespeople even know what they are selling. These activities can unnecessarily create huge volatility in the market that will periodically trigger financial crises. With ever faster computers to help churn money around the globe, the velocity and so transaction volume became so big that can overwhelm sizable economies. That was at the root of the crises we have experienced in recent decades.

Western economies extol market efficiency and believe that such periodic tsunamis are a necessary evil, huge damages to the real economy notwithstanding. The Chinese, on the other hand, value stability above all else, and would like to avoid financial crises if at all possible. Until a few years ago, China was poor and had to play by Western rules, including those in the capital market, in order to receive financing. But as China's economy grows and accumulates wealth within the country, she would prefer stability in the domestic market. This, I believe, is the main reason why Chinese leaders have recently pronounced that, whilst financial services are good and necessary, let us make sure that finance does not become an end in itself. In other words, they are not keen to develop a finance industry. Otherwise, the tail will sooner or later wag the dog.

In this regard, it is helpful that the salary of investment bankers since the 2008 Global Financial Crisis (GFC) has been lowered somewhat. But because success of the West is too far rooted in the supremacy of market efficiency, there is a huge inertia to more fundamental changes. The last GFC almost brought down the global economy, and yet it failed to bring real changes. I fear that it will take a greater disaster to wake them up. A philosophical reorientation of the Western mindset is necessary to reverse the over financialization of their economy, something that Beijing is trying to avoid. I believe that a better system is one which incorporates some elements of the West and the East.

Such is human nature. Unless forced to a corner, we do not want to change. China is now confronting serious economic difficulties that only certain reforms will be able to overcome. Today, the West is perhaps facing even greater challenges that are rooted in more fundamental ethos. Yet, former successes have blinded people to see such problems, and hubris has prevented necessary self-examination and change. As a result, today we are living in dangerous times!

There are no hard-and-fast rules to delineate between the financial service industry and the finance industry. Nevertheless, it is useful to be cognizant of the differences, and not to overindulge finance as a stand-alone industry for its own sake. This way, future crises may become less frequent and less disruptive to the real economy. One should not forget that financial upheavals can render the victim economy less competitive in the longer-term. In some societies, like in Latin America, similar disruptions could even trigger social instability, although their problems were primarily due to economic mismanagement and corruption.

For now, however, there is no denying that the U.S. economy has in recent decades been excessively financialized. Wall Street has grown out of proportion, while the Rust Belt is fading. Lifestyles in these two regimes are vastly different. Young people no longer want to roll up their sleeves and enter manufacturing. Some New Yorkers may even have a sense of superiority over their peers in Detroit or Pittsburg. The same may be true of Chinese investment bankers who look down on others. Well, money has a way to corrupt morals. Unbridled materialization sets in, which has brought down civilizations in the past.

Most Americans have faith in the self-adjusting mechanism of the market economy. True indeed, but the time it takes may be very long, and the pain before adjustment arrives may become unbearable. Let no one underestimate the greed in all of us. A market that swings too wildly can get out of hand. During the GFC of 2008 — to be more accurate, it was primarily a crisis of the capital market led by the West — many countries, including the mighty U.S.A., were on the brink of an economic collapse. We could have easily fallen into the abyss. Will our luck hold next time? I worry!

For the Chinese market, Beijing did not prescribe caution for ideological reasons. They are just being pragmatic. In the face of anticipated dangers, Chinese leaders warn her own people. Such was the trait Mr. Lee Kuan Yew employed to build Singapore, by being pragmatic almost to a fault. Learning therefrom, China is doing the same today. Perhaps more than anyone, the Chinese know the pitfalls of being ideological. Just look back at the country's history before economic opening. Every ideology has some legitimate aspects, but anything elevated to the level of dogma, especially when it neglects practicalities, will likely plunge the country into trouble. It can be extremely difficult to extract oneself from it.

The Western system, rooted in its unique philosophy, has many strengths that have benefited those who have adopted it. But no system is perfect, and none is without an Achillies' heel. It is much safer to be open-minded and always ready to learn and improve. Otherwise, the next financial crisis will arrive sooner than expected.

There is no straight path to progress; there will always be twists and turns. A country that can learn from its mistakes will in the longer run advance faster. For that, pragmatism is essential. In the past 40 years or so of China's economic opening in the Mainland, this was what propelled government policies. We have witnessed how sudden anti-COVID measures were lifted. Many believe that Beijing is today turning ideological again, hence less pragmatic. I am not convinced. There are many critical issues unbeknown to us, and I can only speculate what may be the true situation. What I do know is that, leaders from time to time had to make adjustments to adapt to new realities. I trust that the same holds true today. We should never forget that the legitimacy to rule in any society lies in its ability to improve the lives of its citizens. There are always other competing priorities, but at the end of the day, it is the livelihoods of people that is paramount.

Of late, Beijing seems to be doing more in caring for the rural population, which is necessary and, in the long run, good for the country. For now, city folks may feel neglected, but they were the ones who have benefited the most in recent decades. Ultimately, history everywhere tells us that it is the better educated and more skillful who can take the overall economy to the next level. This cannot have escaped the notice of the leaders.

All that is to say that this vast country is grappling with the headwinds of further advancing her economy and society. For 40-some years, China has had many economic and political challenges, but has overcome each one. There is no reason to believe that the same would not be the case now. This time, the only difference is the added element of hostility from the West, especially from the U.S. As explained earlier, I do not believe that a hot war will break out. Instead, it is likely that the U.S. will one day back off. In fact, America may even retreat to some form of isolationism due to primarily domestic problems but also to international challenges in many parts of the world. This is the main reason why, I believe that China may be a relatively peaceful place in the coming decades. As a result, her economy will continue to grow.

Looking around the world, I see very few places that are attractive for new investments. And if there are such places, they might not be where we can take advantage of. Moreover, I believe in focusing on one business sector and doing it well, as long as it yields promising returns. I believe that world-class commercial real estate rental in mainland China is an exemplary opportunity.

This is my 144th and last letter to shareholders. Over the past 33 years, I had increasingly felt the need to better inform shareholders and potential shareholders. This letter is the only regular platform to communicate not only what has transpired in the Company but also the thinking of management. As a result, this letter became longer over time.

Given the constraints of many managerial duties, these letters were invariably hastily put together. Missing an important point or not presenting a proper argument might be inevitable, but my attitude is: it is better to present something, imperfect or incomplete as it may be, than not presenting at all. For all the shortcomings of this set of letters, I count on your indulgence. Thank you for reading.

Ronnie C. Chan
Chair
Hong Kong, January 30, 2024