# China multi-asset: 10 Questions on Strategy

Gian Plebani, Portfolio Manager for China Allocation Opportunity, discusses why he puts more emphasis on onshore China assets now and answers ten key questions on the strategies as well as market outlook.

**How have you adjusted the China multi-asset strategy given the events of recent months?**

Generally speaking, we haven't made any major directional changes because of recent market uncertainty.

However, we have made some relative changes, mainly by putting more emphasis on onshore China assets. This breaks down in two ways.

Firstly, on the risk side we have kept a preference for China A shares, despite slightly reducing our overall equity allocation compared with the end of 1Q20.

That's because we have seen strong policy support from the Chinese government. This support has bolstered both onshore investor sentiment and A-share market performance.

The sentiment factor is important here. Sentiment feeds the A-share market because it is driven by retail investors, and that's different to offshore markets for China stocks, which are more driven by longer-term more fundamentally-driven institutional investors. For this main reason we see differentiation between the offshore and onshore markets.

As the Chinese government has made clear its ongoing support for the economy, we believe positive market sentiment will continue in the coming months, and will particularly benefit the A-share space, so we have maintained our allocations accordingly.

Secondly, we have raised our allocation to onshore China fixed income - to China government and policy bank bonds in particular. That's because we see them as a relative safe haven asset.

Put together, these changes amount to maintaining risk on the one hand and taking safer bets on the other, which we feel is consistent with the 'risk-aware' approach that we take to asset allocation.

**How are your cash levels currently and how have they evolved over the past 3 months?**

At the end of June 2020, our cash levels were moderate at about 7% of the total strategy allocation.

In April, we raised our cash levels to around 10% given the strong and quick rebound in risky assets over the past month. Since then we have reduced our cash holdings to where they are now at around 5%.

For us, cash is a risk-off asset and the balance between cash and risky assets is an important part of our process. However, we also see onshore China fixed income as a risk-off asset, and we have raised our allocation to this asset class also over the past couple of months.

**What is your top-down view on the outlook for China's economy this year and into 2021?**

Recent data show that China's economy is rebounding. For example, Purchasing Manager's Indices (PMIs) for both the manufacturing and services sector have shown expansion recently, with manufacturing expanding for three straight months between April and June.

Looking ahead, we believe China's economy will remain resilient. The Chinese government has committed to prioritizing employment and relaxing the deleveraging campaign.

We believe these factors, as well as China's remaining capacity to respond to shocks and its first-in, first-out status on the global pandemic, have allowed its domestic equities to hold up better in 2020 compared to most other equity markets globally.

> “ Looking ahead, we believe China's economy will remain resilient.”

**What are the key risks you see in the next 3-6 months and how does this influence your multi-asset strategy?**

Two key risks: the impact of COVID-19 and potential volatility ahead of the US election in November.

There's still uncertainty about the shock to global demand and the precise negative impact on China's economy from the COVID-19 outbreak.

This is a key risk; however we believe that China is better positioned than other countries if a second wave of COVID-19 happens. That's because firstly, the recent experience in Beijing demonstrates how effective the Chinese authorities can be in suppressing an outbreak and, secondly, that Chinese more strictly observe precautionary measures, like facemasks and social distancing, compared to other outbreak hotspots.

As for the second risk, we see potential instability in the US/China relationship ahead of the November US Presidential election. We expect a lot of finger-pointing at China from the presidential candidates in the coming months, which may introduce some tension to the relationship and volatility to the markets. We doubt, however, that the phase 1 trade deal is in jeopardy for reasons we will explain later.

**You have steadily raised your allocation to onshore China fixed income over the past year, why is that?**

We see onshore China fixed income, and particularly government and policy bank bonds, as a safe haven asset which brings important diversification benefits to our multi-asset strategy since the asset class is negatively correlated to Chinese equity and Chinese credit and has low correlation to overseas markets.

**China A-shares also form a larger part of your multi-asset allocation now than they did say two years ago; can you explain your thinking here?**

We mentioned before that from a structural perspective the structural make of the China A-share market has different characteristics compared to offshore markets for China equities, which allows us a diversification opportunity and adds a different component to the strategy.

Also, the index inclusion process means that A-shares are becoming a more prominent factor in global asset allocation portfolio, so there should be structural support from global flows

Finally, from a long-term perspective, the opening up of onshore markets and related access channels - like Stock Connect – create new possibilities for us as it internationalizes and institutionalizes the market.

China A-shares offer a different opportunity set than say H-shares and ADRs, so we look to exploit these opportunities as we evolve our strategy.

**You have a large allocation to high-yield offshore bonds, what's happening in the China real estate sector?**

Market wise, we are seeing demand return to normal after the market disruptions caused by the Covid-19 outbreak. Recent data show a pick-up in price growth, which tells us that demand remains healthy.

We continue to like the sector from a structural perspective. The sector continues to rationalize with smaller players either leaving the space, or being taken over by larger players.

We remain selective and favor larger, higher quality names in the sector, particularly those who have grown market share and a diverse range of funding options.

**What's your current strategy regarding the RMB?**

We hedge part of our RMB exposure. In the unlikely case of a major escalation of the US-China conflict, China may potentially depreciate the RMB, so we are protecting ourselves by hedging about 10% of our onshore exposure.

**Are there any risks to the first-round US-China trade deal?**

We mentioned before that there is a risk of higher volatility within the US/China relationship prior to the election. We believe a rollback on the phase 1 deal is possible, but not likely.

Our base case is that both sides keep the phase 1 deal as it is. Looking particularly at the US side, we feel the existing deal is a positive one for the US agriculture sector, which is a key constituency in US politics.

The Chinese government has committed to substantial purchases of US farm products, like soybeans, and we doubt the US side would want to jeopardize this in the lead up to the election.

**What differentiates your China multi-asset strategy from competitors?**

Two aspects stand out:

Firstly, our strategy is not run as a fund-of-funds. The strategy is managed actively by our Investment Solutions team with dedicated resources assigned to hand pick direct securities.

Our multi-asset investing approach is to have a maximum 10% limit in funds, whereas some key competitors have fund allocations ranging from 30% to more than 90%.

Secondly, we have a longer track history in this space than most of our competitors and, by many measures, have delivered stronger performance over a three- and five-year time horizon.

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