10 questions on China equities

Bin Shi, Head of China Equities, answers ten key questions on China equity strategy including market outlook, prospects for US-China relations and de-listings of Chinese companies from US financial markets.

How has the Chinese government acted to control the COVID-19 outbreak and what steps has it taken to support the economy?

China took very serious measures early, such as enforcing working from home, social distancing, closure of bars/restaurants and public meeting spaces, and strict controls on flights arrivals.

On the economic side, we have seen a whole range of targeted policies to support the economy, such as support for small businesses and easier monetary policy.

How did China use technology to tackle COVID-19?

A wide range of smartphone apps helped track user's movements and gauge whether the user had been put at risk by being close to areas with high rates of infection.

The most widely used app, operated by Tencent and with 800 million users, would assign a user a QR code in either red, yellow, and green depending on their level of exposure to the COVID-19 virus.

The red colour would mean a two-week quarantine, the yellow colour may ask the user to stay home for seven days, and a green colour code would mean the user may move about unrestricted.

Such apps and programs helped identify areas of risk and, crucially, which individuals had been in close proximity to them. This kind of contact tracing and monitoring played a major role in controlling the spread of COVID-19, which ultimately helped China recover.

Is China back to normal now?

China's economy is certainly improving, but we have yet to return to pre-crisis levels.

Proxy indicators like traffic congestion levels may suggest a recovery since they are higher than last year. However, these levels are higher because people are social distancing and avoiding public transport.

So it is important to remain cautious about the outlook but we feel confident that the economy is on the right track to recovery, although it may take some time to get there.

Are you concerned about a second wave of COVID-19?

The first wave of COVID-19 was an out-of-the-blue event, much like an earthquake and the world wasn't either prepared or clear about what to do to handle the situation.

Now I believe both people and government authorities are much better prepared than they were before and will have a more effective way of handling any outbreaks in the future. As such, I believe a second wave of similar magnitude to the first is highly unlikely.

China's GDP growth dropped in the first quarter this year and China has not set an explicit GDP target, are you concerned about this?

Not really.

In many ways the decision to not set an explicit target is a prudent response. Giving targets to local governments runs the risk of local officials rushing to enact policies to beat the target, which may not be good for the economy in the long run.

> “ We don't really focus too much on GDP numbers; we are more focused on long-term fundamental trends.”

For us, we don't really focus too much on GDP numbers, we are more focused on long-term fundamental trends, like urbanization, premiumization, R&D and innovation, and China's aging population, and we believe these remain intact, despite the disruption caused by the COVID-19 pandemic.

What's the outlook for the US-China relationship?

US-China tensions are likely going to be around for a long time and these have moved beyond trade to technology, capital markets and more. In addition, it is not unusual to expect the current US administration to be tough towards China in the run-up to the US elections in November.

Current tensions are also related to the COVID-19 outbreak and we are seeing some of the blame for COVID-19 being put on China, and that is creating a lot of bad sentiment.

We expect tensions to continue at least up to the elections, and that will likely create more volatility in the market.

De-listings - just how serious an issue is this?

De-listing has been discussed a few times previously and the Equitable Act was a subject of debate last year too. We think this is a manageable risk as, even if it were to go ahead, it would take a few years to be implemented, and companies have time to react.

In a bad case scenario, Chinese companies will get de-listed after three years of non-compliance. By then, most of the ADRs should be able to list in Hong Kong. Hong Kong would benefit from increased flows. Alibaba has already listed in Hong Kong last year, in addition to their ADR in the US, and other companies are preparing similar plans.

While this might mean that a subset of US investors might no longer be able to buy these stocks – southbound investors from China would now have access to them through the Stock Connect programs.

In a good case scenario, de-listing is more of a national security and disclosure issue and an agreement can be reached between the US' SEC and China's CSRC on audit procedures.

What will the future relationship between China and Hong Kong look like? Will the US reaction to China's approval of the Hong Kong national security law impact Stock Connect?

We believe that Hong Kong will remain an important financial centre for China, perhaps even more so with the recent newsflow around potential de-listing of Chinese companies in the US.

Hence we continue to see more Chinese companies with ADRs exploring plans to list in Hong Kong.

The Stock Connect programs too are an important component of China's financial liberalization, and route to access foreign capital, and we do not foresee these market access mechanisms being impacted.

Does the China standalone thesis still hold after COVID-19 disruption?

The COVID-19 crisis has been a very good test of the standalone China thesis. China's equity market remains under-represented in global equity indices. Also, the correlation between domestic China and other equity markets remains low and this was again proven during this crisis.

What is your strategy currently?

Our cash levels are a little higher than normal, but we feel that is prudent given current market conditions. We will put more cash to work when we feel the time is right.

Our focus remains on identifying quality companies that can withstand difficult times and outperform the market and their peers over the long term.

Given the inefficiencies and alpha opportunities present in China, we believe that such an approach should produce strong returns for investors over the long-term, as it has done in the past.

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