Stepping into the future

How China is transforming its economy and creating opportunities
China is stepping into the future and creating opportunities by proactively applying reforms and policies that are opening the financial sector, boosting new industries, upgrading its manufacturing base, building on its new hi-tech labor advantage, and reshaping world trade.
Table of contents

4  Delivering the plan: Accelerating reforms, transforming the economy

6  China’s financial sector: Increasing access, expanding opportunities

10 The services-led economy: New economy sectors take the lead

13 Manufacturing 2025: Creating the future through upgrading and automation

16 China’s new labor advantage: STEM Graduates

20 Going global through Belt & Road

24 UBS Asset Management: Your first call for China

26 Glossary
As China steps into the future, we are expecting it to go through a significant transformation that will reshape the economy, cement China’s position in the world, and create a wealth of opportunities for investors.

That transformation has to meet a series of challenges, many of which have been facing policymakers for some time.

The most pressing of these challenges include rebalancing the economy from investment to consumer-led growth, addressing the build-up of debt in the financial system, managing a rapidly ageing society and a shallower labor pool, and creating a cleaner environment.

The goals of the 13th Five Year Plan have been set with these challenges in mind, and will have to be met by 2020.

The goals are based on the following fundamental strategies:

- **Services and consumer-led growth**: where services account for 56% of total GDP and consumer demand overtakes investment as the principal driver of the economy.

- **Financial sector reforms**: Renminbi (RMB) internationalization, focus on deleveraging, and the continued opening of China’s financial markets to overseas investors.

- **Innovation-led development**: expanding internet services, improving internet infrastructure, increasing R&D expenditure, supporting hi-tech education, boosting the quality and value of patents.

- **Industrial upgrading**: following the Made in China 2025 strategy, China will boost productivity, occupy new economy sectors and maintain a dominant share of world manufacturing.

- **Environmentally-friendly growth**: developing renewable energy and new energy vehicles, protecting land resources, reducing energy and water consumption.

- **Increasing urbanization**: boosting urbanization to 60% of the population, loosening barriers to rural-urban migration, creating 50 million urban jobs.

As China steps into the future, we are expecting it to go through a significant transformation that will reshape the economy, cement China’s position in the world, and create a wealth of opportunities for investors.

That transformation has to meet a series of challenges, many of which have been facing policymakers for some time.

The most pressing of these challenges include rebalancing the economy from investment to consumer-led growth, addressing the build-up of debt in the financial system, managing a rapidly ageing society and a shallower labor pool, and creating a cleaner environment.

The goals of the 13th Five Year Plan have been set with these challenges in mind, and will have to be met by 2020.

The goals are based on the following fundamental strategies:

- **Services and consumer-led growth**: where services account for 56% of total GDP and consumer demand overtakes investment as the principal driver of the economy.

- **Financial sector reforms**: Renminbi (RMB) internationalization, focus on deleveraging, and the continued opening of China’s financial markets to overseas investors.

- **Innovation-led development**: expanding internet services, improving internet infrastructure, increasing R&D expenditure, supporting hi-tech education, boosting the quality and value of patents.

- **Industrial upgrading**: following the Made in China 2025 strategy, China will boost productivity, occupy new economy sectors and maintain a dominant share of world manufacturing.

- **Environmentally-friendly growth**: developing renewable energy and new energy vehicles, protecting land resources, reducing energy and water consumption.

- **Increasing urbanization**: boosting urbanization to 60% of the population, loosening barriers to rural-urban migration, creating 50 million urban jobs.
Against the backdrop of the 13th Five Year Plan, we are expecting to see a series of reforms being rolled out which will mean that the drive to restructure the economy will accelerate in the coming years.

Notable reforms in recent months include removing controls on overseas investment in the domestic banking sector, issuance of private land rights to rural citizens, further restructuring of the SOE sector, and more stringent enforcement of environmental standards on China’s industrial sector.

The goals of the Five Year Plan and the above policy changes are to meet the challenges mentioned and also promote closer integration with the global economy, improve industrial productivity, and expand consumer-led economic growth.

Reform packages and policy changes will create a range of opportunities for investors across many different sectors. With these in mind, and the prospect of China emerging as a dominant player in the world economy, China is now, more than ever, too big to ignore.
China’s financial sector

Increasing access, expanding opportunities

- China remains intent on reforming its financial system
- Deleveraging is an essential part of that process and will continue into 2018
- Debt levels are high but concentrated in the state-owned sector, private companies have little or no debt
- Stock & Bond Connect programs have made China’s financial markets more accessible
- China is making a concerted effort to promote RMB internationalization, which we think is increasingly likely in the coming years

Aside from addressing debt levels, opening up to foreign investors marks a key element of China’s financial reforms, and China has made a number of landmark reforms that mean investors have greater access than ever before to China’s equity and fixed income markets.

Deleveraging: an essential part of the reform process

Tackling China’s debt pile is an essential part of reforming the financial system because China’s debt, estimated by the Institute of International Finance at 259% of GDP in 2016, will weigh on future growth and balance sheets if left unaddressed.

While we see the debt build-up as a long-term issue, it’s important to note that most of the debt is concentrated in the state-owned enterprise sector and owed to the state, rather than international institutions. In contrast, companies in the private sector, particularly those that are in the consumer-led sectors that are powering the new economy, have comparatively low debt levels.

Since mid-2016 regulators have employed a variety of tools to limit credit growth, including curbs on lending, controls on wealth management products, and increased oversight of local government debt issues.

We are expecting this campaign to continue into 2018.

While this will likely impact near-term economic growth prospects, the deleveraging campaign will improve China’s long-term growth potential by forcing the closure of excess capacity, imposing greater discipline on lending practices, and addressing the rate of debt accumulation.
1. Shanghai & Shenzhen Stock Connect
The Shanghai and Shenzhen Stock Connect programs, launched in November 2014 and December 2016, respectively, have opened up over 70% of the market value of China A-shares for offshore investors and about 85% of H-shares to onshore investors.

Investors can now quickly and effectively deploy capital and are no longer subject to the lock-up and repatriation restrictions imposed by the QFII program.

Unsurprisingly, the programs have been a great success, with overseas investors’ A-share holdings reaching a record RMB 1.021 trillion in September 2017, up 55% from September 2016, according to the People’s Bank of China.

The Stock Connect programs have given overseas investors the opportunity to invest in companies that are more closely aligned with China’s new economy, the majority of which are not listed overseas.

That’s been one of the main benefits of the Shenzhen system, because almost half of that market consists of China’s new economy sectors, including information technology, consumer discretionary, and healthcare, which are comparatively more profitable than the state-owned enterprise (SOE) sector.

Looking ahead, overseas investors will soon be increasing their allocations to China’s A-share market. The success of the Shanghai and Shenzhen Stock Connect programs were a key factor behind the June 2016 decision to include 222 China A-shares into the MSCI global benchmark equity index.

As China imposes stricter international standards of disclosure and corporate governance on the A-share market, it’s expected that the MSCI index will increase the number of A-shares in its measurements and that could trigger a reallocation of up to USD 210 billion into Chinese equities during the next five years.

Global investors will bring a different investment practice (long term oriented, more fundamentally-driven) to the A-share market, which will change the market structure significantly, since retail investors largely dominate the current market.

2. Bond Connect
After a series of reforms in 2016 and 2017, international investors now have direct access to China’s onshore bond markets.

Reforms have imposed international standards of governance and disclosure and have also brought in necessary changes such as allowing foreign ratings companies to issue ratings and bring onshore markets into line with global standards.

And overseas investors have significantly upped their onshore holdings. At the end of September 2017, overseas investors held a total of RMB 1.06 trillion of onshore bonds according to the People’s Bank of China, with inflows increasing markedly following the start of the Bond Connect system.

As global indices begin to factor in China’s bond markets into their benchmarks, demand for onshore bonds looks set to increase.

As China becomes more integrated globally, the onshore market will grow rapidly in size. That’s why we expect the onshore bond market to grow to USD 18 trillion by 2020, and overtake Japan as the world’s second largest.

Fig. 1: 10-year government nominal bond yield, 2007-2017

Source: Bloomberg
3. RMB Internationalization

The inclusion of the RMB in the IMF’s special drawing rights basket in October 2016 marked a milestone in China’s drive to establish the RMB as a global reserve currency, and also provided recognition of China’s progress in opening its financial markets and moving towards international standards.

Since that time, the RMB’s use in overall international trade transactions has remained stable, but China has been laying the groundwork for the RMB’s future role as a reserve currency. Notable changes include:

- **Money market reforms**: the People’s Bank of China has introduced a new range of monetary policy tools to more closely manage liquidity flows in domestic markets and bring them more into line with international standards.

- **RMB-denominated payment systems**: introduced in 2015, the Cross-Border International Payments System (CIPS) enables cross-border RMB clearing, uses international reporting standards, handles payments in 17 time zones, and offers an alternative payment system SWIFT.

- **Offshore clearing centers and currency swap deals**: the PBoC has set up 23 clearing centers globally for RMB trade, and has signed RMB 3.3 trillion worth of bilateral currency swap deals with 35 central banks across the world.

- **Free Trade Zones to test RMB convertibility**: China now has 11 free trade zones that are pilot zones for testing convertibility of RMB, wholly foreign-owned fund management companies, interest rate liberalization, and liberalization of foreign currency limits and offshore financing.

Fig. 3: China’s sustained drive to open its financial sector

- China introduces deposit insurance
- RMB exchange rate liberalization
- Mutual recognition of Funds launches
- China opens domestic bond market to investors
- SAFE liberalizes QFII rules
- PBoC starts daily OMO system

- PBoC launches CIPS system
- Interest rate liberalization
Aside from these policy initiatives, the China’s overarching strategy is to push RMB internationalization to mitigate China’s exposure to macroeconomic currency risks in the long term, help the its national firms trade in RMB, and to force domestic reforms, such as the freeing up of its capital account.

Put together, China’s efforts to deleverage, promote RMB internationalization and open up its stock and fixed income markets amount to a concerted effort to reform its financial sector.

As China moves to bring its financial markets in line with international standards, and global indices move to include China’s market, we can expect China’s markets to become a much more significant part of the global economy, and that’s why investors can no longer ignore the opportunities China presents as it steps into the future.
The services-led economy

New economy sectors take the lead

- Reforms and growing consumer demand are supporting the emergence of the services sector
- China’s services sector still has much more room for growth compared with other countries
- New industry leaders are emerging, particularly in the private sector, and our China equity funds favor healthcare, IT, education, and consumer sectors

China’s economy passed a watershed moment in 2012 when the services sector took a dominant share of GDP and eclipsed manufacturing as the economy’s main driver and confirmed that the process of economic rebalancing was well underway.

Fig. 4: China GDP: Sectoral breakdown (%), 2003-H1 2017

Fig. 5: Services sectors compared globally, 2015 (% of GDP)

Though China is on track to meet its goal of making services 56% of the economy by 2020, there is still ample room for China’s services sector to catch up as a share of the economy with more developed nations.
And that’s why the government is aggressively supporting the development of new industries within the services sector, with three industries standing out in particular:

1. Healthcare

China faces the challenge of boosting healthcare coverage whilst also managing increased demand for health services from its rapidly ageing population which will see an extra 110.7 million residents aged over 65 by 2030, according to United Nations’ forecasts1.

With this in mind, China is boosting spending on public healthcare services, passing reforms to promote private investment in healthcare services and medical products, reducing waiting times for drug approvals, and strengthening intellectual property protection laws.

These reforms, plus increasing private expenditure on healthcare services – which is far outstripping growth in developed nations are creating a new breed of leading industry companies in the health sector, supplying a range of services and goods including medical devices, pharmaceuticals, and healthcare services.

And prospects for growth look so strong that Bain & Company predict that China’s healthcare sector will generate USD 113 billion in profits between 2010 and 2020, and grow at a CAGR of 17.6% p.a.

---

1 UN: World Population Prospects: The 2017 Revision.
2. Internet services
China’s rapidly expanding internet user base represents a high-potential market for IT services companies. Mobile users account for an increasingly large share of China’s online population, and it’s via widespread mobile usage that we are seeing drastic changes in consumer behavior.

Chief among them is the growth of online retail. China is the world’s largest online retail market, accounting for an estimated USD 752 billion in 2016 according to Euromonitor, compared with USD 395 billion in the US, and USD 100.3 billion in Japan.

Online retail now accounts for an estimated 15.5% of total retail sales in China according to the People’s Bank of China, compared with 11.7% in the US, 14.6% in the UK, and 7.5% in Japan.

But China’s internet sector has much more room for growth.

Though its internet user base is the largest in the world, penetration rates (53.2% in 2016) lag behind developed markets such as the UK (92.6%), Japan (91.1%), and the US (88.5%)2, this factor, combined with government efforts to improve telecoms coverage as laid out in the 13th Five Year Plan, means this user base will likely grow considerably in the future.

3. Education
As rapid urbanization raises competition for places in China’s best schools and universities, Chinese parents are spending increasing amounts on their children’s education, and this is fueling demand for private education and after-school tuition services.

Adults, especially graduates, are also increasingly looking for additional tuition services amid fierce competition for jobs in local markets and employers’ increasingly high-end demands for labor as they shift up the value chain. Recent reforms to open the education sector to private investment are presenting great opportunities to private firms to benefit from this trend.

Private companies increasingly lead services sector growth
China’s structural economic transformation to services and consumer-led growth is largely being led by companies in the private sector.

Recent statistics show that private companies are much more dynamic and they are leading the charge, accounting for over 80% of all jobs3, and 90% of new urban job creation in China4.

Indeed, within MSCI’s China index, new economy sectors, such as healthcare, IT and consumer staples, are dominated by private companies, whose earnings consistently outperform those of both SOEs and old economy sectors.

Source: CNNIC: 39th Survey Report, 8th June 2017

Source: Factset, Macquarie Research

2 Internet Live Stats: Internet Users by Country (2016)
3 China Daily: China’s private sector regains strength on optimistic economic outlook
4 Reuters: China needs the private sector to step up
Manufacturing 2025
Creating the future through upgrading and automation

- China has a long-term plan to upgrade its industrial sector
- Closures and tighter monetary policy are impacting low value-added sectors
- Consumers are becoming more sophisticated and manufacturers are adapting to this trend
- Chinese companies are becoming increasingly innovative and automation is more widespread
- China is leading the world in installed robotics, particularly in the auto and electrical manufacturing sector

Since China’s labor pool is shrinking as demographic trends play out, companies are facing the challenge of doing more but with fewer workers, and that means they have to invest in technology.

Fig. 10: Output per employed person (USD), 2017

Source: The Conference Board: International Labor Comparisons
China: Global AI leader by 2030
While the Made in China 2025 includes many different initiatives, none encapsulate China’s ambitions better in the industrial upgrading process than the government’s plan for artificial intelligence.

China plans to build a domestic artificial intelligence industry worth USD 150 billion by 2030, and is supporting this goal by offering funding for AI-related companies, special grants for start-up companies in the field and increased support for AI-related academic research.

China already leading in robotics
The most obvious, or well-known application of AI to manufacturing is in the form of developing robotic production systems, and with China’s push to apply AI to manufacturing, Chinese manufacturers are responding by automating their manufacturing processes and replacing humans with robots.

Indeed, the increase in installed robotic machinery in China has been dramatic. In 2016, China overtook the US and Japan, the previous leaders in installed robotics systems, with an estimated 340,000 industrial robots installed across the country, and that has grown significantly from the 17,000 installed robotics units estimated by the International Federation of Robotics in 2006, implying a CAGR of 90%.

As well as installing the largest base of robotics systems in the world, Chinese companies are rapidly acquiring the knowhow to create robots of their own. For example, Midea, a Chinese electricals manufacturer, spent USD 4.7 billion in acquiring the German robot specialist Kuka, which has been regarded as one of the world’s leading robotics manufacturers.

And China is expected to dominate the global robotics industry by 2020, supplying 40% of all robots produced globally, according to IFR projections.

---

Fig. 11: Installed robotics systems: China, Japan & United States compared, 2015-2020 (f)
Robotics supporting China's auto industry
China’s auto sector accounted for approximately 48% of all of China's installed robotics systems in 2014, according to the China Robot Industry Alliance5.

This commitment to upgrading is consolidating China’s position as the world’s leading car market, producing an estimated 30% of all cars sold globally6.

And that’s why leading global auto names such as BMW and Mercedes Benz continue to invest in China, and see China’s upgrading production capability as creating the world’s largest production base for new energy vehicles.

Automation is an all-encompassing trend
And these are just some of the industries where China’s application of AI, robotics, automation, plus its development of high-tech knowhow and intellectual property is transforming its industrial base. Other industries include:

- **Logistics**: With competition for customers growing ever fiercer in China’s e-commerce market, online platforms like Alibaba and JD.com7 are automating their warehouses to handle shipments more efficiently. Tests at Amazon’s US bases showed that robotic order sorting systems reduced click-to-dispatch times from 60-75 minutes to 15 minutes8.

- **Shipbuilding**: Long considered to be an excess capacity sector, Chinese shipbuilders are upgrading and rationalizing their production capacity by introducing automated welding capacity into their production processes to cut down on costs and manpower9.

- **Electrical goods**: With profits and worker supply tightening, major electronics manufacturers are shifting to automation, with Foxconn, the iPhone manufacturer, announcing plans to gradually replace its workforce and achieve 30% automation by 202010.

Fig. 12: Share of global robotics supply (%), 2020 (f)

![Figure 12: Share of global robotics supply (%), 2020 (f)](image)

Source: International Federation of Robotics, 2017

---

5 HKDTC: China’s 13th Five-Year Plan: Smart Solutions Required to Upgrade Chinese Robots
6 MMTA: The Chinese Automotive Market – Much more than just large
7 Tech in Asia: Chinese ecommerce giant shows off its first ever ‘robot warehouse’
8 Quartz: Amazon is just beginning to use robots in its warehouses and they’re already making a huge difference
9 Engineering at Sea: Automated shipyards: The growing prevalence of robotics in shipbuilding
10 SCMP: Foxconn’s Foxbot army close to hitting the Chinese market, on track to meet 30 per cent automation target
China’s new labor advantage

STEM Graduates

- China’s labor advantage is shifting
- By 2030, China will have produced 48 million graduates in science, technology, engineering and mathematics (STEM) fields
- China’s new labor advantage is already driving an increase in AI and computer studies-related research
- China’s expanding knowledge base supports our positive view on China’s tech and pharmaceutical sectors

China’s earlier growth was propelled by low-cost, low-skilled labor, but that advantage has shifted because it now has a large and growing workforce capable of propelling the innovation-led economic development path that the government is promoting.

China leads in STEM Education

Education spending has ramped up with a total of RMB 2.8 trillion invested in 2016, compared with RMB 478 billion in 2006 according to China’s National Bureau of Statistics, in line with its plans to drastically improve the skills and education levels of the population, with recent emphasis being squarely placed on technical subjects.

This has created a huge population of students graduating in the Science, Technology, Engineering, and Mathematics (STEM) subjects, with 4.7 million Chinese students graduating in the field in 2016\(^1\), far in excess of India (2.6 million), the USA (568,000) and Japan (195,000), according to data compiled by the World Economic Forum.

And this talent pool is being augmented by a flow of returning students from overseas, with 432,500 (80% of the 544,500 going abroad in 2016)\(^2\) coming back to China in 2016, up from 272,900 in 2012\(^3\).

---

12 The Pie News: 80% of Chinese students return home – MoE
The knowledge base for innovation-led development

Looking ahead, the OECD estimates that China’s superiority in producing STEM graduates is only going to increase.

Between 2015 and 2030, China will produce approximately 48 million STEM graduates, compared with an estimated 10 million in the USA, and 2.5 million in Japan14, meaning that it will take the majority of STEM graduates globally.

And it’s this expanding knowledge base that will be at the heart of China’s drive for innovation-led development. And the trends are already lining up, with China’s output of cutting-edge research, particularly in subjects like artificial intelligence and computer studies, growing significantly in recent years.

Chinese educational institutions account for two of the top institutions in the world, and 15 of the top 100, for citations for artificial intelligence papers.

“China has around 43% of trained AI scientists globally” – Kai Fu Lee

Fig. 14: % Share of STEM graduates globally, 2030

<table>
<thead>
<tr>
<th>Country</th>
<th>Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>1.4%</td>
</tr>
<tr>
<td>UK</td>
<td>1.5%</td>
</tr>
<tr>
<td>Turkey</td>
<td>1.6%</td>
</tr>
<tr>
<td>Korea</td>
<td>1.9%</td>
</tr>
<tr>
<td>Japan</td>
<td>2.0%</td>
</tr>
<tr>
<td>Brazil</td>
<td>2.2%</td>
</tr>
<tr>
<td>Mexico</td>
<td>3.0%</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>3.7%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>4.2%</td>
</tr>
<tr>
<td>USA</td>
<td>4.5%</td>
</tr>
<tr>
<td>Others</td>
<td>8.9%</td>
</tr>
<tr>
<td>China</td>
<td>26.7%</td>
</tr>
</tbody>
</table>

Source: OECD

Fig. 15: AI Citations

<table>
<thead>
<tr>
<th>Institute</th>
<th>Country</th>
<th>No. of AI Citations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microsoft</td>
<td>US</td>
<td>6,528</td>
</tr>
<tr>
<td>Nanyang Tech</td>
<td>Singapore</td>
<td>6,015</td>
</tr>
<tr>
<td>Chinese Academy of Sciences</td>
<td>China</td>
<td>4,999</td>
</tr>
<tr>
<td>CNRS</td>
<td>France</td>
<td>4,492</td>
</tr>
<tr>
<td>Carnegie Mellon</td>
<td>US</td>
<td>4,389</td>
</tr>
<tr>
<td>University of Toronto</td>
<td>Canada</td>
<td>4,315</td>
</tr>
<tr>
<td>MIT</td>
<td>US</td>
<td>4,283</td>
</tr>
<tr>
<td>Google</td>
<td>US</td>
<td>4,113</td>
</tr>
<tr>
<td>Tsinghua University</td>
<td>China</td>
<td>3,851</td>
</tr>
<tr>
<td>New York University</td>
<td>US</td>
<td>3,506</td>
</tr>
</tbody>
</table>

Source: FT: China’s AI ambitions revealed by most cited research papers, November 6, 2017.

14 Economist Intelligence Unit: Education to 2030
Businesses are Investing in China’s STEM Workforce

China’s rapidly growing knowledge base is a key attractor for both domestic and overseas businesses.

In a 2017 McKinsey survey\(^\text{15}\), 37% of respondents cited the improved capabilities of Chinese workers, particularly engineers, as a key reason why they were investing in product and business development in China, and this explains why R&D spending in China has been growing rapidly, and is projected to have grown 8x between 2007 and 2020.

China’s expanding knowledge base, fed by steady growth in university graduates and an increase in knowledge workers coming from overseas, is at the base of China’s growing superiority in hi-tech sectors, and here are two examples:

China’s pharmaceutical sector

China’s huge base of R&D researchers, estimated by McKinsey at 3.8 million at the end of 2015, are the basis for China’s fast-growing pharmaceutical sector.

And this huge talent base lies at the core of China’s massive increase in patent/research output in recent years, which has seen Chinese companies surpass others.

And it’s this ability to create cutting-edge output for the pharmaceutical sector that explains why total sales of pharmaceuticals have grown rapidly in recent years, with sector revenues reaching RMB 1.7 trillion in 2016, and increasing at a CAGR of 12.8% per year between 2012 and 2016 according to DBS estimates.

---

15 McKinsey: How semiconductor companies can win in China’s new product-development landscape
### Internet services

Companies like Baidu, Tencent and Alibaba have grown to become giants of China’s internet sector in part because of the rapid growth in internet users, but also because of their ability to digest the huge volumes of data created by their millions of users and create appealing services that are targeted at consumer behavior.

That’s the story behind Alibaba’s development of fintech services for small businesses, which uses financial data from online businesses’ transactions and investments to gauge whether or not that party can qualify for a loan. Alternatively, Tencent uses data on how users operate on WeChat to gauge how firms should allocate their marketing spending.

Having a strong supply of graduates and STEM professionals helps China’s leading internet services firms build the services that create their leadership advantage, and all indicators show that these firms are investing in developing their local talent pools, with Alibaba and Huawei recently announcing new R&D and training facilities in China.

### Having a strong supply of graduates and STEM professionals helps China’s leading internet services firms build the services that create their leadership advantage.
Going global through Belt & Road
• Belt & Road will restructure the global trade system
• Major infrastructure investments are being commissioned that will create demand for Chinese companies in sectors such as construction services and equipment

China’s ‘new era’ also means a more active role in world affairs, and the principal channel for this approach will be through its Belt & Road strategy.

The project has been left open-ended, with various estimates of total investment ranging from USD 800 billion to USD 1 trillion on the total amount of investment implied by the plan.

Essentially, the Belt & Road strategy is about establishing closer trade links between China and the outside world. The primary component of this concept is the development of real assets to support greater connectivity and interaction among international businesses.

Similar programs (albeit at smaller scale) have been implemented in various locations across the globe. As this development strategy unfolds, real assets will play a vital role in the region's productivity and investment opportunity.

To this end, a review of Infrastructure and Real Estate investments around the world can help investors take advantage of the opportunities and minimize the risks associated with a global development program.

Developing infrastructure lies at the core of this strategy, and various projects around the world will create demand for the project expertise that Chinese companies have, which explains why state-owned infrastructure development firms have been so active since the strategy was announced in 2013. Notable projects include:

• **Kunming-to-Singapore Rail Link**: Connecting Kunming, an emerging industrial hub in South China, with Laos, Thailand, Malaysia and Singapore, the rail link is intended to boost trade and investment flows, and has seen financial commitments of an estimated USD 5.2 billion from Thailand\(^\text{16}\), plus an estimated USD 6 billion from China\(^\text{17}\), to fund separate parts of the project.

• **Yiwu-to-Rotterdam 'New Silk Road'**: Yiwu and Rotterdam mark two ends of an extensive network of train lines connecting trade hubs throughout China, Central Asia, Eurasia, and Europe such as Chongqing, Urumqi, Tehran, Istanbul, and Moscow. Train services on the route began in 2016 and are expected to increase as infrastructure develops, cutting the estimated time of shipping a container from Yiwu in China to Rotterdam in Holland to 23 to 25 days by rail, compared with 50 to 55 days by rail\(^\text{18}\).

---

16 Channel News Asia: Thailand Approves USD 5.2 billion for delayed China rail project
17 Wikipedia: Kunming-Singapore Railway
18 JOC: China-Europe rail routes continue to add services
Massive Port Investments: China is pumping huge investments into developing new ports across the world to manage and take control of key strategic trade hubs along its main trade routes. China’s investment in new port facilities in Malacca, Malaysia, is a case in point. By opening up an alternative to Singapore, China can reduce potential trade slowdowns and can prevent Singapore being used as a choke-point for oil imports.

Real estate investment will begin when the prospect of revenue becomes apparent. The timing of delivery is important to the success of the overall development. Thus, control and incentives are key features leading to successful real estate development. It is important to establish critical mass and understand interrelationships, when considering investment into projects of this scale. In the near-term, the new initiatives will create demand for infrastructure, construction services, and equipment, as well as steel, aluminium and cement.

New trade bases
Reshaping the global trading system also means opportunities for Chinese manufacturing companies through the creation of new production bases, and access points into overseas markets, from the development of the Belt & Road strategy.

One sector example includes the auto industry, where Chinese companies are setting up manufacturing capacity in countries, like Sri Lanka and Czech Republic, which have signed trade and investment deals in line with China’s Belt & Road strategy.

So there’s lots for investors to consider as infrastructure projects ramp up and Chinese companies align themselves with the strategy. In the near-term, the new initiatives will push Chinese firms’ global expansion and create opportunities for infrastructure investment and will create demand for construction services and equipment, as well as steel, aluminium and cement.
So, as China steps into the future, we expect a sustained drive to both reform and support the economy, so as to provide access to the financial sector, boost its new industries, upgrade its manufacturing base, build on its new hi-tech labor advantage, and reshape world trade through the Belt and Road initiative.
UBS Asset Management, your first call for China

And as China steps into the future, UBS Asset Management is ideally placed to help you capitalize on what we expect will be a wealth of opportunities.

UBS Asset Management has been investing in China since 1997. Over the years, we have developed extensive local expertise. Being the first international manager with both Qualified Domestic Limited Partner (QDLP) and Private Fund Management (PFM) licenses, we continue to grow our presence in China.

Together with our in-depth knowledge of China, we have built an outstanding team of experienced investment managers for traditional and alternative assets. Our dedicated China team benefits from the support of our regional and global specialists, with access to a global network of proprietary research databases.

Portfolio management is supported by the regional team, covering both execution and investment communication. As a truly global firm, UBS provides investment solutions which include a risk system incorporating both proprietary and industry standard risk analytics.

The depth and breadth of our capabilities allow us to offer global and domestic investors a broad range of traditional China strategies and alternative solutions including real estate, private equity and hedge fund solutions. Investors can access China’s onshore and offshore market through our wide spectrum of equity, fixed income and multi-asset class strategies with varying risk and return attributes to fit their specific needs and goals.

For offshore investors

UBS Asset Management has been offering equity, fixed income and multi-asset solutions since 1997

<table>
<thead>
<tr>
<th>Year</th>
<th>Greater China Equities</th>
<th>China A Opportunity Equities</th>
<th>Renminbi Diversified</th>
<th>Renminbi Fixed Income</th>
<th>Mainland China Fixed Income</th>
<th>China Income</th>
<th>China Allocation Opportunity</th>
<th>China High Yield</th>
<th>QDLP Fund of Hedge Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: UBS Asset Management

24 | Stepping into the future
## For onshore investors

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Description</th>
<th>Equity</th>
<th>Bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>China Equity Private Fund Series 1</td>
<td>A-share fund focused on investment opportunities in China's new economy.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CSI 300 Financials</td>
<td>Passive index investment. Closely tracking the CSI 300 Financials and Property index.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CSI 300 Financials and Real Estate</td>
<td>Invests mainly in the target ETF fund.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>RUIHE CSI 300 Multi-Class</td>
<td>Focuses on effectively tracking the CSI 300 Index.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stable Income Bond</td>
<td>Focuses on having higher investment income than the benchmark.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Core Bond</td>
<td>Provides investors with low volatility and stable returns.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporate Bond</td>
<td>Based on the effective control of risk and steady long-term increase in value of the fund’s assets.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mid/High Grade Bond</td>
<td>Focuses on the non-domestic credit bonds in mid and high grade.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Enhanced Bond</td>
<td>Based on the effective control of risk; steady long-term increase in value of the fund’s assets and maintaining liquidity.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Healthcare Balanced</td>
<td>Invests in high quality companies from health care and related industries.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Opportunity Balanced</td>
<td>Optimizes the allocation of different assets and portfolio selection in order to achieve a steady long-term increase in value of the fund’s assets.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ronghua Balanced</td>
<td>Pursues low risk and stable income. Focuses on bonds and invest steadily.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stable Growth Balanced</td>
<td>Through the rational allocation of assets such as stocks and bonds, balance income and risk for a steady long-term increase in value of the fund’s assets.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jingqi Balanced</td>
<td>Balanced investment strategy and seize the investment opportunities of booming industries.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Select Strategy Balanced</td>
<td>Based on the effective control of risk and organic combination of various investment strategies. The objective is to increase steadily the value of the fund’s asset in the long term.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Core Companies Balanced</td>
<td>Invests mainly in companies with core competitive advantage, good corporate governance structure and sustainable profitability.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dynamic Innovation Balanced</td>
<td>Invests mainly in high quality companies that are innovative and share the excess return of business growth.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Key Selection Growth Balanced</td>
<td>Aims to achieve steady long-term increase in value of the fund’s assets by investing in companies that have good prospects and rapid growth opportunities.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: UBS Asset Management, UBS SDIC.
Glossary

‘A’ shares: Shares in mainland China-based companies that trade on Chinese stock exchanges.

Belt & Road: A China-led strategy that includes a ‘belt’ – a land-based infrastructure network connecting China with Southeast Asia, the Middle East, Central Asia, Russia, and Europe, and a ‘road’ – a sea-based infrastructure network connecting China with Southeast Asia, Oceania, North Africa, and Europe.

Bond Connect: A mutual market access scheme allowing mainland China and overseas investors to trade in each other’s bond markets via brokers in China and Hong Kong. Launched in July 2017, the system currently allows for northbound (Hong Kong to China) trading, southbound trading will be brought in at a later date.

CIPS: A payment system which offers clearing and settlement services in RMB. The first phase began in October 2015.

‘H’ shares: Shares of companies incorporated in mainland China that are traded on the Hong Kong Stock Exchange.

Made in China 2025: An initiative to upgrade China’s industrial sector that is similar in form to Germany’s “Industry 4.0” plan introduced in 2013. The plan stresses innovation-driven industrial development and the importance of quality over quantity.

MRF: Mutual Recognition of Funds gives mainland China and Hong Kong fund products cross-border mobility. Starting on July 1, 2015, onshore asset managers can offer fund products registered in mainland China to Hong Kong investors, while Hong Kong fund products will also be made available to mainland China investors.

NPC: Officially titled the National Congress of the Communist Party of China, the NPC meeting occurs every five years in either October or November, and usually sees top-level leadership changes in China’s ruling Communist Party.

OMO: Open market operations undertaken by the People’s Bank of China to adjust the supply of money in financial markets.

QFII: Introduced in 2002, the Qualified Foreign Institutional Investor scheme allows qualified offshore institutional investors to invest in onshore products in China.

QDII: A scheme through which domestic investors in China can invest in offshore markets.

RQFII: Introduced in late 2011, the RMB Qualified Institutional Investor scheme lets Hong Kong-based institutions raise RMB and then invest the proceeds in onshore securities markets.

SAFE: State Administration of Foreign Exchange – China’s foreign exchange regulatory agency and part of the People’s Bank of China. SAFE manages China’s foreign exchange reserves and implements RMB policy.

Shanghai-Hong Kong Stock Connect: An investment channel linking the Shanghai Stock Exchange and the Hong Kong Stock Exchange. Investors in each market are able to trade shares on the other market using local brokers and clearing houses. Launched in November 2014.

Shenzhen-Hong Kong Stock Connect: Similar to the Shanghai-Hong Kong Stock Connect but linking Hong Kong with Shenzhen. Launched in December 2016.

SOE: State-owned enterprises

Follow us on WeChat and LinkedIn for more insights

Visit www.ubs.com/am

For more information, contact your local UBS Asset Management representative.