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China – too big to ignore?

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China …too big to ignore?

TAM Europe Asset Management thinks so.

Globally, markets have been in a precarious place, where opportunities have been scarce and we have watched economies walk the tight rope to recovery. Unfortunately, in 2022 China slipped. Weighed down by its stringent zero-Covid policy, distressed real estate sector, crackdown on tech firms, and geopolitical tensions with Taiwan. It's no doubt, that investors fuelled with pessimism after an onslaught of jumbo rate hikes, and the anticipation of a global recession has also delivered another blow to Chinese equities. However, the rhetoric is changing, and some optimism is resurfacing. China's policy of zero tolerance toward COVID-19 ending and the government's renewed priority for growth give us reasons to be optimistic. As with every well-crafted boomerang, we expect the Chinese economy to return, and in full force.

Zero-Covid policy

It's not so long ago we were all bound by nationwide lockdowns where bedrooms became our new offices, pyjamas were the choice of attire, and the desire to interact with people outside a zoom meeting grew. The consequence; we saved more! China has been in lockdown for almost twice as long as the western world. But now that zero-Covid policies have been abandoned, pent up savings should re-energise the economy, with consumption expected to drive growth.

China's sudden reopening should be the catalyst for a recovery in domestic consumption with the services sector to be the biggest beneficiary from the loosening of Covid restrictions. Demand for air travel, hotels, and restaurants will all be supercharged as the Chinese indulge in recreational activities once again.

Inbound tourism has also spiked since they have opened their borders to quarantine-free tourism, with tourist numbers 23% higher than in 2022. These areas of increased domestic activity help tee up the economy for a growth rebound.

Macro-economy

A major headwind for developed markets has been inflation which remains an issue. This is not a China problem, and in fact there seems to be no inflationary risks for China in the near term. The People's Bank of China reiterated its accommodative monetary policy stance which will be targeted and "forceful" to expand domestic demand, stabilise growth, and help improve the overall economy. A reversal in U.S. dollar strength should also be supportive of China's dollar denominated debt, providing more fiscal agility to support China's growth focused objectives.

Historically, Chinese production and manufacturing have helped them gain double-digit paced growth. However, as their economy evolves, China is also moving further up the value chain and this is allowing them to capture more growth from services and technology.

Political landscape

Posturing for the next five years, Xi Jinping's 2022 Work Report released in December was less ideological than people were expecting, with a more expansive embrace of reform highlighting the need for improving market confidence, and economic policy which prioritises national self-sufficiency over global economic integration. China's heavy-handed crackdown on tech firms has also eased. China has forged a path to reign in monopolistic behaviour in the technology sector which involved levying fines on giants Alibaba and Tencent etc and increasing government monitoring. Many of these regulatory overhangs have been removed to alleviate investor concerns.

Investment opportunities

So far, we have articulated the current state of China's economy, but what does this all mean from an investment perspective? Well, "Like a bull in a China shop," China is too big to ignore.

Chinese equity markets have already reacted favourably to the abandonment of zero-Covid policies, which has unleashed an onset of consumer activity in previously dormant sectors. China's task-focused agenda to restore economic growth and their easing of the regulatory crackdown has also helped reignite investor confidence and release the shackles which had shunned investors from pouring inflows into Chinese assets.

On a longer-term view, the increasingly consumer-led economy offers a deep and diverse pool of investment opportunities. China cradles an abundance of idiosyncratic and structural opportunities that focus on digitalisation, electrical vehicles, 5G infrastructure, and artificial intelligence where companies are leading the charge in innovation and piercing global competition. Self-sufficiency is also on the Beijing government's agenda, especially within the software industry as it favours home-grown software companies and encourages Chinese companies to use domestically produced chips. This domestic bias over foreign peers creates an international moat where sectors that run alongside policy priorities should perform well.

Headwinds

With optimism building and long-term believers already enjoying the spoils of China's market recovery, we still prescribe an air of caution. Although medium-term headwinds do not impair our conviction to China, it may mean a bumpy, stop-start trajectory to recovery. In a manoeuvre to consolidate its power and control the home of the computer chip industry, China has vowed to bring Taiwan back under its control. Relations between the two nations have since deteriorated. However, we believe there are no immediate risks of tensions with Taiwan curtailing our investment case for China and see this narrative playing its course over the longer-term.

Conclusion

In our view, much of the pessimism around China is subsiding and we are beginning to see a sentiment change as the nation emerges from its zero-Covid policy and becomes more growth conscious. However, it's important that investors choose an investment partner with local knowledge to uncover China's idiosyncratic and structural opportunities.

For further information contact **Tom Worthington – tom.worthington@tameurope.com** or tel: **+34 688 988 686**.