FUNDAMENTAL FLASH

Navigating China's Crackdown

24 AUGUST 2021

Prepared by Affin Hwang Asset Management

Regulatory Headwinds

China had recently released a five-year blueprint outlining tighter regulation in critical parts of its economy such as technology, national security and monopolies.

As investors reel from a wide regulatory dragnet that has already targeted the technology and education sector so far, what's next for China?

John Lau, Portfolio Manager of Affin Hwang AM shares his thoughts in our latest Fundamental Flash.

1. Following the release of the five-year regulatory blueprint, what are your initial thoughts and the policy intentions of Beijing?

What we can infer from China's recent actions as well as the resulting market correction is that Beijing is increasingly prioritising its socialist ideology and agendas.

The welfare of its citizens, shared prosperity and quality of life are seen as cornerstones of the country's social and development goals.

Flashpoints

- China's stock market have been unnerved by Beijing's socialist aims and 'Common Prosperity' vision.
- Though, a slew of announcements will provide some clarity to investors in communicating its policy intentions and timeline.
- Investment opportunities are emerging owing to the broad-based sell-down. Key is to be selective through a bottom-up approach.

#GrowWithUs

In turn, enterprises are not supposed to be seen as maximising profits by taking advantage of these aims. In Chinese characters, it is called 图暴利 which roughly translates to “figure profiteering.”

In broad summary, the government’s stated agenda are as follows:

- Domestic consumption upgrades also known as the “dual circulation” strategy to reorient its economy by placing greater focus in its domestic market, whilst remaining open to international trade.
- Expanding its technological capabilities to escape the “chokehold” of western powers
- To achieve carbon neutrality and further its sustainable agenda
- Handling demographic issues in the country including an ageing population and falling birth rates.

2. What do you think are some of the main concerns by investors right now including foreign ones?

The fact that the government was able to turn an entire industry (i.e. after-school tutoring services) into not-for-profit without considering the impact to capital markets is telling.

Foreign investors’ confidence are likely to be scarred, and we might see continuous outflow from the Chinese market (both A and H-market). Companies that were heavily owned by foreigners bore the brunt of the sell-off this year. Northbound outflows surged to over RMB 13billion which is close to the highest outflow in a day so far this year.

That said, some interesting opportunities seem to be emerging, looking beyond the current weak sentiment into a longer investment time horizon. Since its peak in the Lunar New Year, the MSCI China index has sold-off by over 33% this year.

Whilst we should expect further volatility in markets, the slew of announcements and plans that have been released by Beijing will at least provide some clarity to markets in communicating its policy intentions and timeline.

3. How are we positioning for China?

Underweighting China seems like a logical thing to do now. But, there are also interesting opportunities emerging on a bottom-up individual stock basis.

Retail banks such as China Merchants Bank (CMB) have come down to attractive levels and could attract strong retail interest from local investors.

Strong Chinese brands that are less cyclical in nature also provide shelter from the current market maelstrom. One such example is Li Ning which not only has stable growth, but also seen to be in the good books of government by having a clean image and not making “excessive” profits.

We are also relooking into investment opportunities within the solar energy supply chain especially as China doubles down on its sustainability agenda. However, company-specific execution track record and operation fundamentals are issues for the sector and warrants broader and deeper research.

There is also value emerging in the Contract Research Organisation (CRO) sector which is involved in clinical drug trials and development. As a non-disposable link of the biotech supply chain, CRO stocks could see strong demand from increased healthcare needs in the country.
