Global Matters Weekly

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Yet another update on China

by Lorenzo La Posta, CFA Portfolio Manager

For some reason, any time it's my turn to write our weekly Global Matters blog, there is something happening in China worth writing about. Or perhaps, it is just my colleagues deliberately leaving me with the honour of updating our readers on the latest developments within the Chinese walls (pun intended). Luckily, these days we are not short of significant news and while the west is struggling with rising rates and elevated inflation, China is facing a different set of issues that still have global consequences.

On 22 October, the country witnessed the closing of the 20th Chinese Communist Party Congress, where president Xi Jinping consolidated his power for another five years, becoming effectively the second most powerful person in modern Chinese history, after Mao Zedong. Financial markets were disappointed, with Chinese stocks experiencing the deepest daily fall since 2008.

While the re-election itself was widely expected, what markets didn't like was that Xi's politburo is now composed of his supporters only, with his predecessor Hu Jintao having even been escorted out of the congress. What they liked even less, is that during the congress the word "security" was mentioned more frequently than the last congress five years ago, while the word "reform" significantly less, raising fears that this new regime in China might actually follow the recent past: zero-Covid policy, common prosperity and the (mostly grim) economic consequences of the two.

We expect the public sector to continue strengthening over the private sector and that the Party's social reforms should support growing the middle class. Whilst the former may not necessarily be a positive from the perspective of an international investor, the latter should benefit the country and ultimately the growth of a broader investible universe. Moreover, technological growth is still heavily incentivised, and we expect economic growth to come back to being a priority in the coming months, as that is a key element to common prosperity and social stability.

Markets have been revising down their expectation around the country's economic growth over the past 18 months and today Chinese equities are down about 50-60%[1] from their peak in February last year. However, it is seemingly obvious that investors are eager to put money to work and hungry for a pivot in narrative around the zero-COVID-19 policy. The stock market valuation has rarely been as attractive in recent years and the catalyst it needs is simply a small step in favour of global and local investors, a hint of easier conditions. Last week, for instance, markets cheered the continued rumours of zero-COVID-19 rules being relaxed in order to prioritise the economy and rallied on the back of a picture that circulated on social media, unveiling the existence of a "reopening committee".

We don't spend much time on Chinese social media, nor do we invest based on rumours and hopes. However, despite the depressed market sentiment, high volatility, and weaker economic data, we believe the investment opportunity within Chinese equities remains strong. Active management is key, and to take full advantage of the available universe we advocate the use of experienced stock selectors as the best solution, from a risk and return perspective, to navigate current risks and select outstanding businesses that will prosper and grow.

Source
1 Bloomberg Finance L.P. data as of 4 November 2022

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