



# China: Past its peak? Or starting a new growth phase?

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June 2021



Schroders

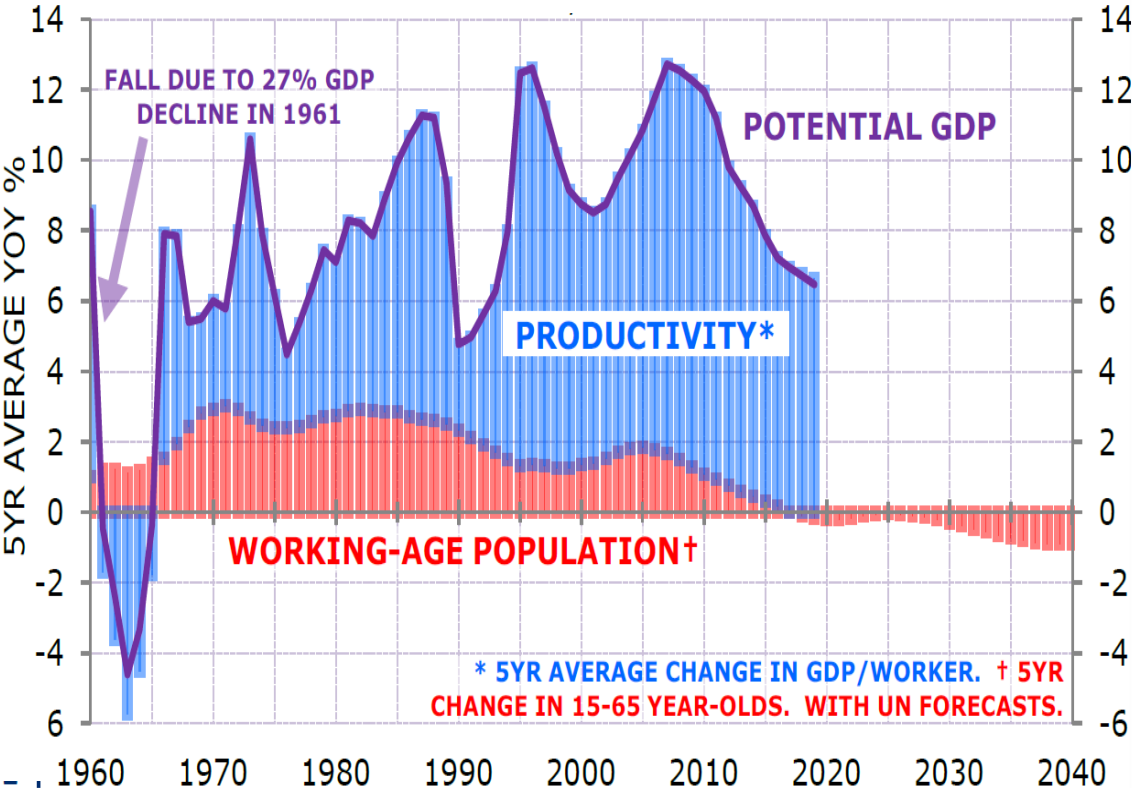


**China – the bigger picture**

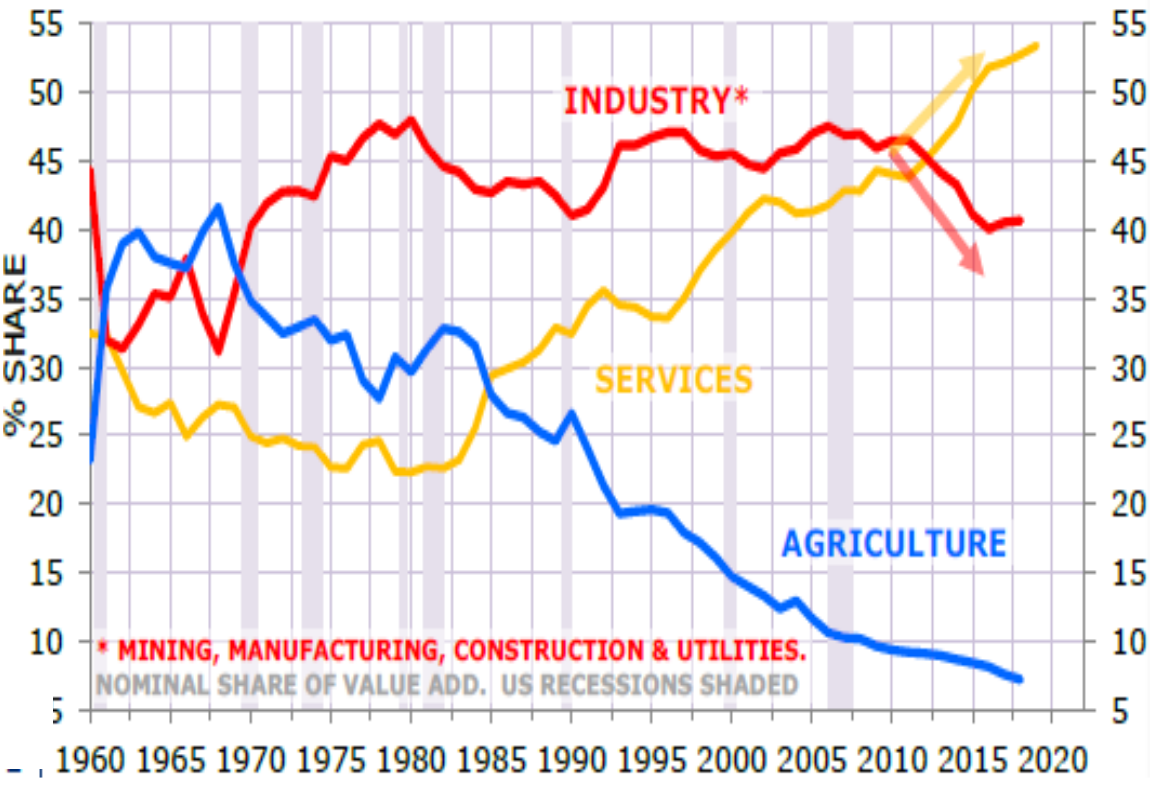
# China's old growth model has largely run its course

Future growth relies on productivity and services

China: Potential growth, productivity & population<sup>1</sup>



China share of GDP<sup>2</sup>



Source: NBS, UN, Minack Advisor's April 2020  
 Source: NBS, OECE, NBER, Minack Advisors, April 2020



# How do we see China today?

Implementing new, efficient technologies fast



## Digital innovation

With no legacy systems to hold them back, world leaders in e-commerce volumes, mobile payments and 5G technology

# How do we see China today?

Productivity driven by automation, robotics and IT



**No longer just a low value manufacturer**

Made in China 2025 plan calls for Chinese industrial robots to make up half of the domestic market by 2020 and 70% by 2025

Source: Schroders, Reuters as at August 2019



# How do we see China today?

Urbanisation continues to drive growth and development



Focusing on economic collaboration

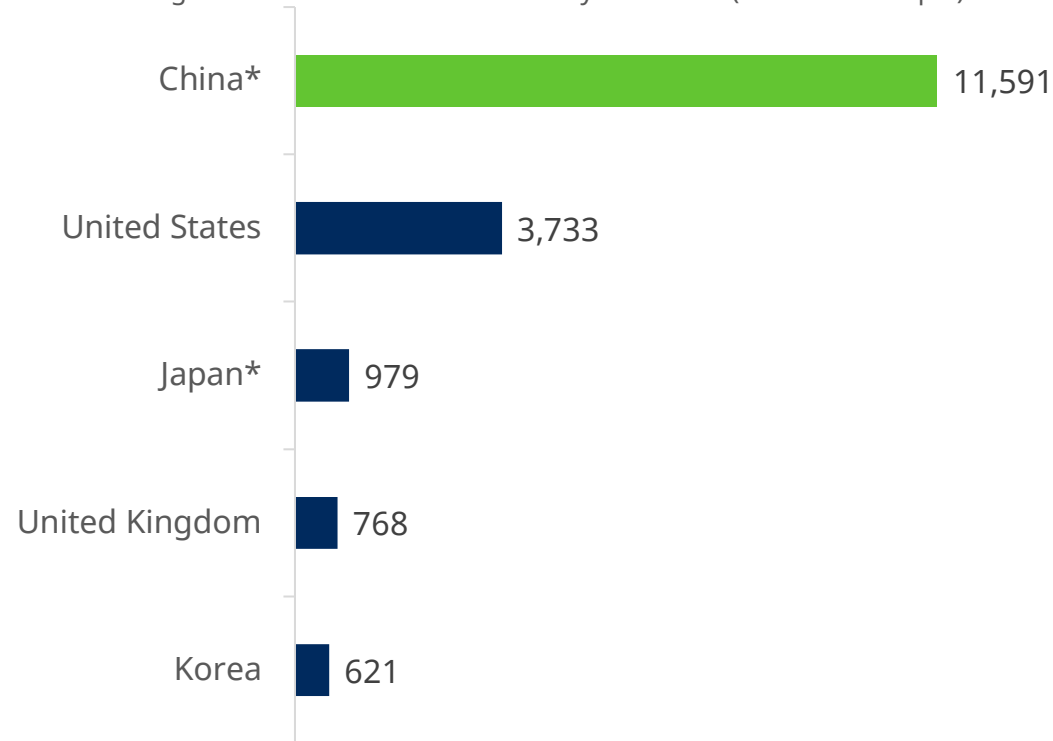
Infrastructure investment into development of city clusters and smart cities to boost productivity and incomes.

# Why China works (versus other emerging markets)

Well educated work force forms a strong base for development

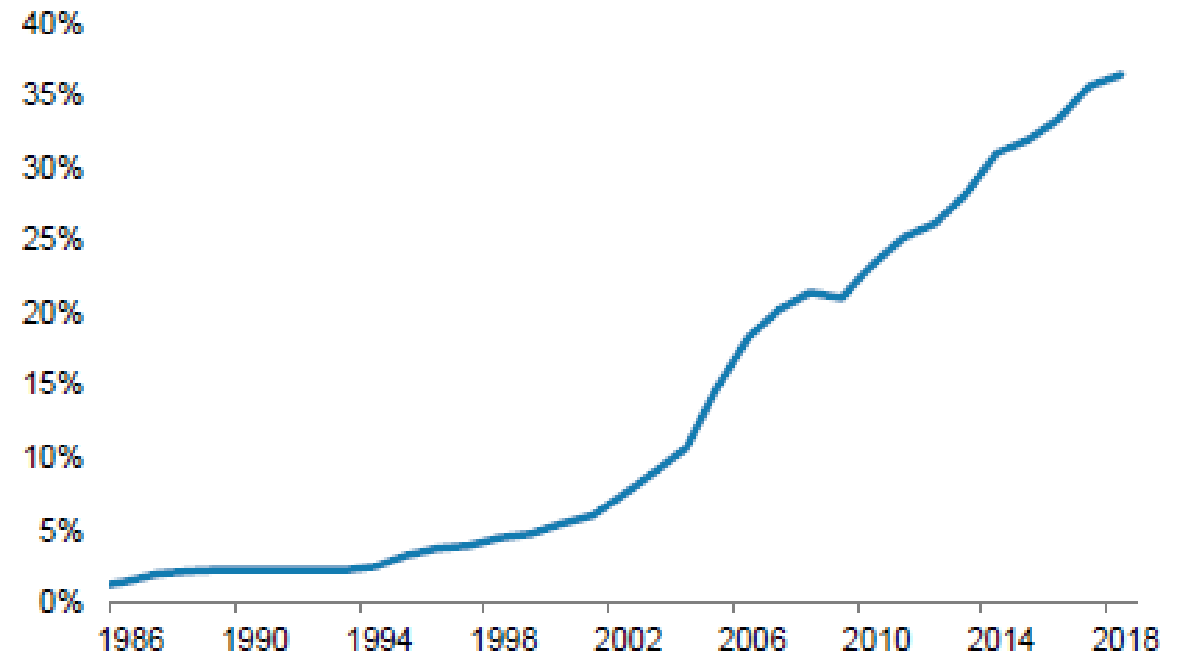
## China's number of new graduates per year far exceeds that of key developed countries<sup>1</sup>

Annual Average No. of Graduates from Tertiary Education (Thousand People)



## More and more young people are graduating from college<sup>2</sup>

Tertiary Graduates / Births 22 Years Ago



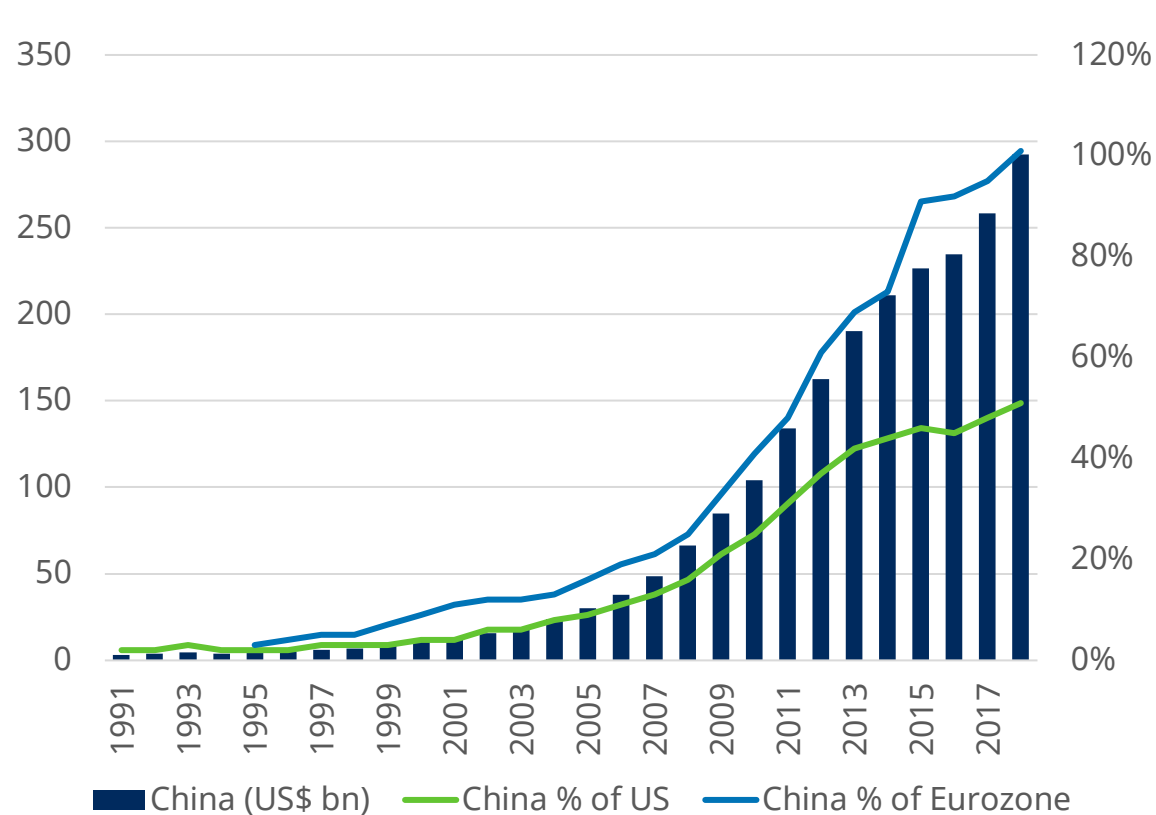
<sup>1</sup>Source: World Bank, Morgan Stanley Research. Note: 2013-2017 data for China and 2012-2016 data for the other countries. 2013-2016 average data for Japan because of missing data for 2012, October 2019

<sup>2</sup>Source: Ministry of Education, NBS, Morgan Stanley Research, October 2019. For illustrative purposes only and should not be viewed as a recommendation to buy or sell.

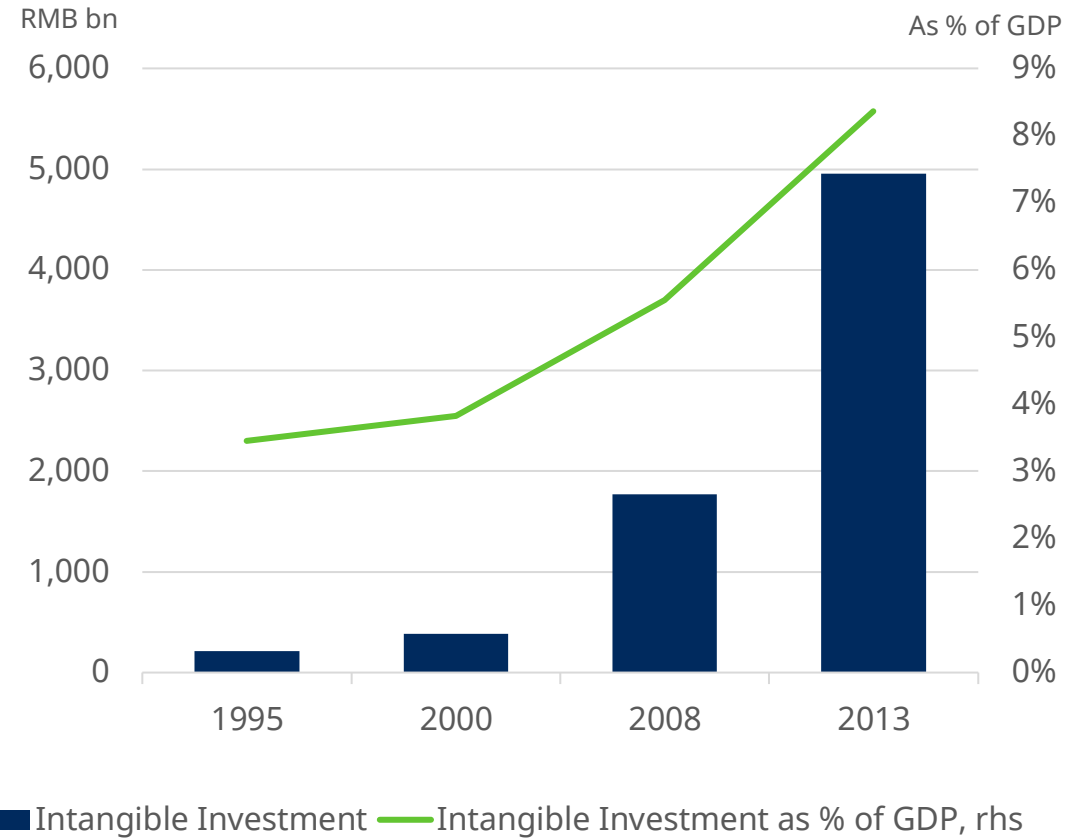
# Why China works (versus other emerging markets)

## Continued investment into R&D

China - R&D Spending (US\$ bn) (% of US & Euro)<sup>1</sup>



China - Intangible asset (Rmb m) (% GDP)<sup>2</sup>



<sup>1</sup>Source: OECD, Macquarie Research, September 2019

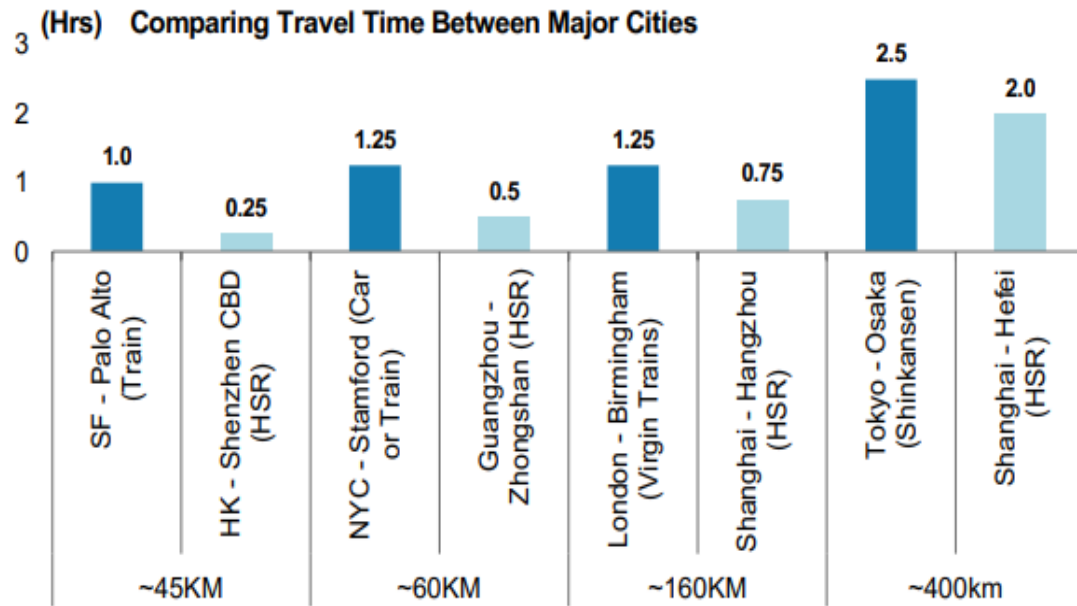
<sup>2</sup>Source: Wu, Hao (2018) Intangible Investment by Industry in China, CEIC, Macquarie Research, October 2020



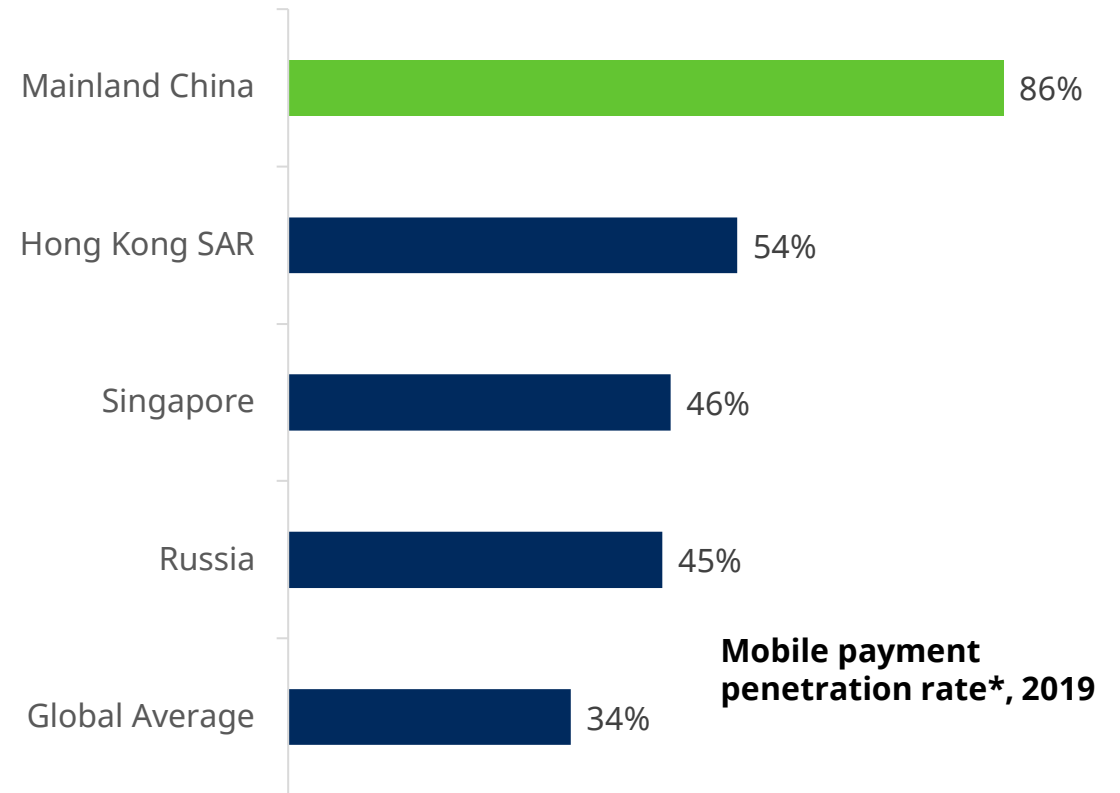
# Why China works (versus other emerging markets)

Efficiency and connectivity provide the ingredients

Significantly shorter travel times in China's key city clusters than other developed countries<sup>1</sup>



....and mobile payment<sup>2</sup>



<sup>1</sup>Source: Morgan Stanley Research, Sep 2020

<sup>2</sup>Source: PWC Global Consumer Insight Survey 2019. \*Share of mobile payment in total purchase, October 2019



# Key risks for China

- ① **US-China tensions** – not purely just trade conflicts, but ideological confrontation
- ② **High debt situation** – repairing China's balance sheet will take time
- ③ **Structural reforms** – more resources allocating to private instead of public, liberalization of industries, SOE reforms
- ④ **Demographics** – can productivity gains offset deteriorating demographics?
- ⑤ **Managing stable currencies** – balancing the impossible trinity

Source: Schroders

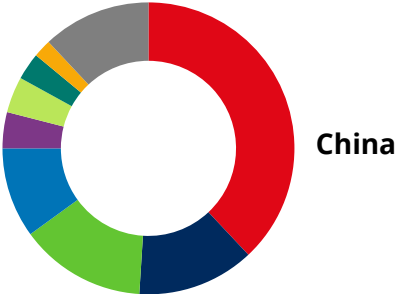




## The opportunity in Chinese equities

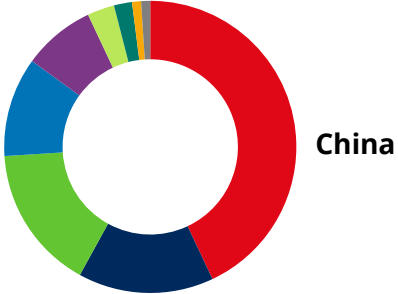
# China under-represented in global portfolios

MSCI EM index country weights<sup>1</sup>



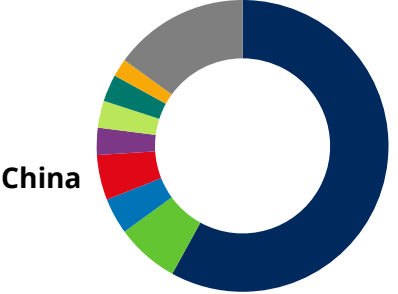
- China, 38%
- India, 10%
- Russia, 3%
- Korea, 13%
- Brazil, 4%
- Mexico, 2%
- Taiwan, 14%
- South Africa, 4%
- Others, 12%

MSCI AC Asia x Japan index country weights<sup>1</sup>



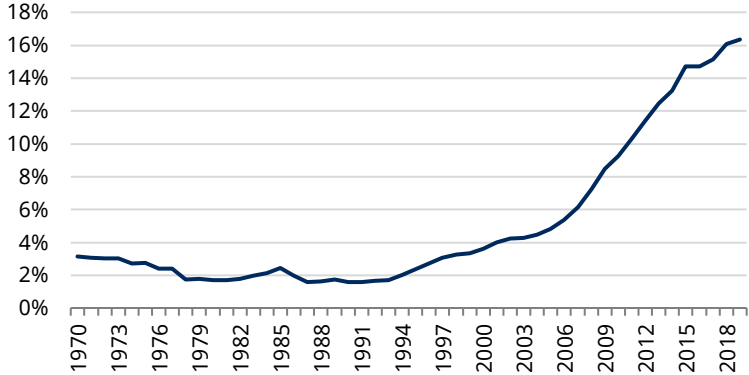
- China, 43%
- India, 11%
- Thailand, 2%
- Korea, 15%
- Hong Kong, 8%
- Indonesia, 1%
- Taiwan, 16%
- Singapore, 3%
- Others, 1%

MSCI AC World index country weights<sup>1</sup>

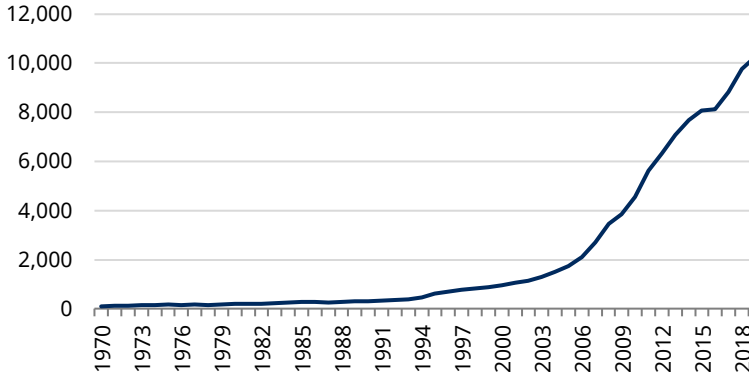


- USA, 58%
- China, 5%
- Germany, 3%
- Japan, 7%
- France, 3%
- Switzerland, 2%
- UK, 4%
- Canada, 3%
- Others, 15%

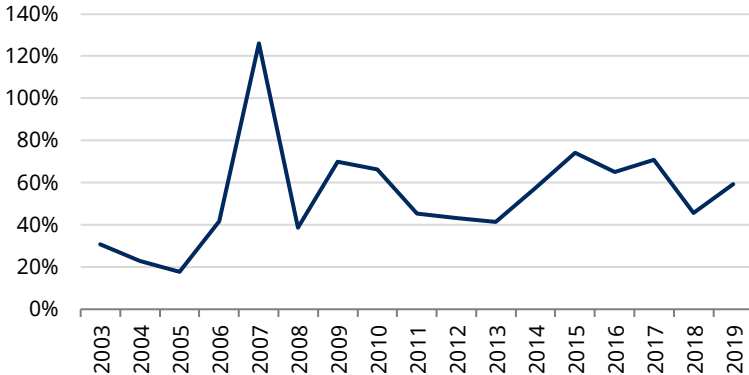
China GDP (% world)<sup>2</sup>



China GDP per Capita<sup>2</sup>



China Market Cap (% GDP)<sup>2</sup>



<sup>1</sup>Source: MSCI. Percentage weightings as at 31 March 2021. <sup>2</sup>Refinitiv, World Bank WDI, as at December 2019.

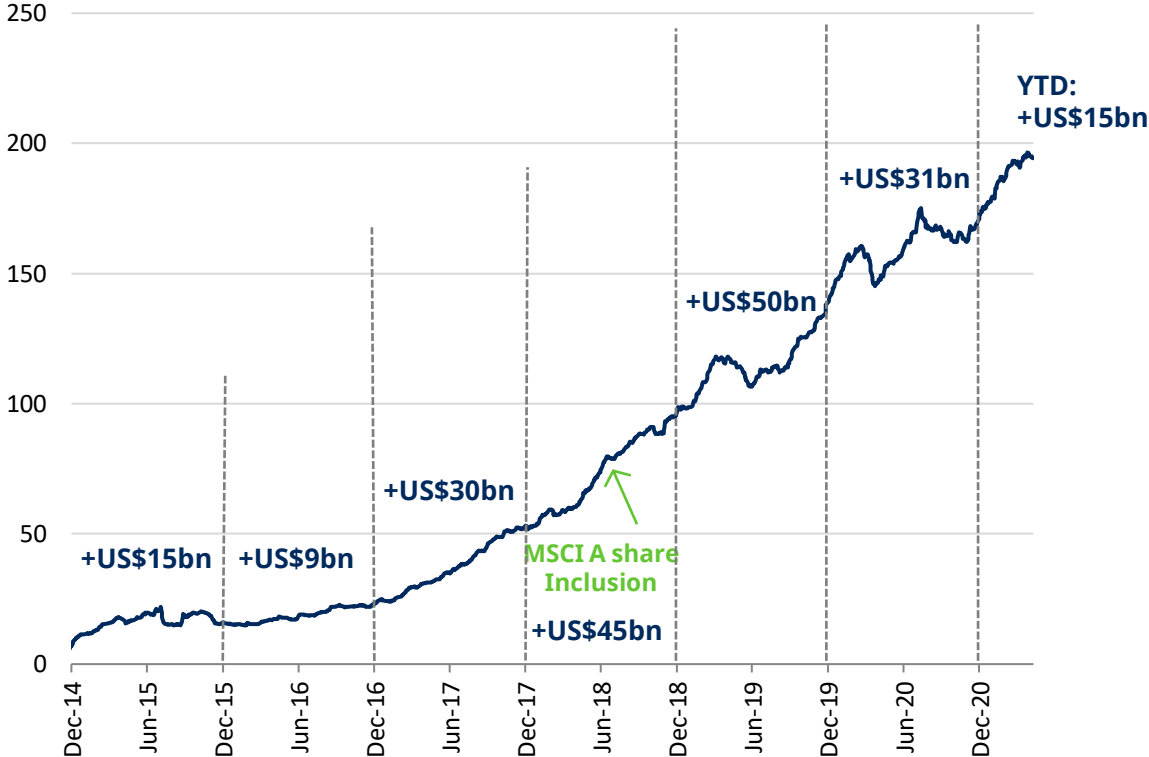


# China weight set to increase in global indices

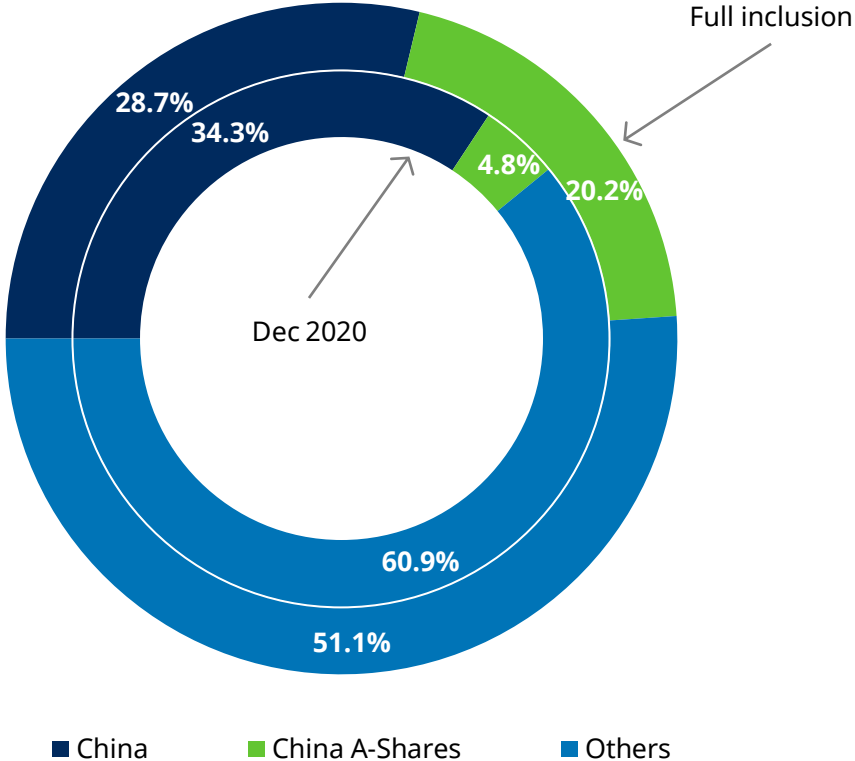
Continued interest in A-share market from international investors

## Northbound flow into China A shares<sup>1</sup>

Cumulative Northbound buying (US\$bn)



## MSCI Global Emerging Markets Index<sup>2</sup>



Source: <sup>1</sup>Bloomberg, Goldman Sachs, April 2021. <sup>2</sup>MSCI, Factset, data as of December 2020.

# The China equity universe

Combined market cap of over US\$10tn, over 4,500 listed companies

## Shanghai, Shenzhen (onshore)



- A-shares, B-shares
- US\$8.7tn market cap
- US\$67.3bn daily turnover (A-shares)

## Hong Kong (offshore)



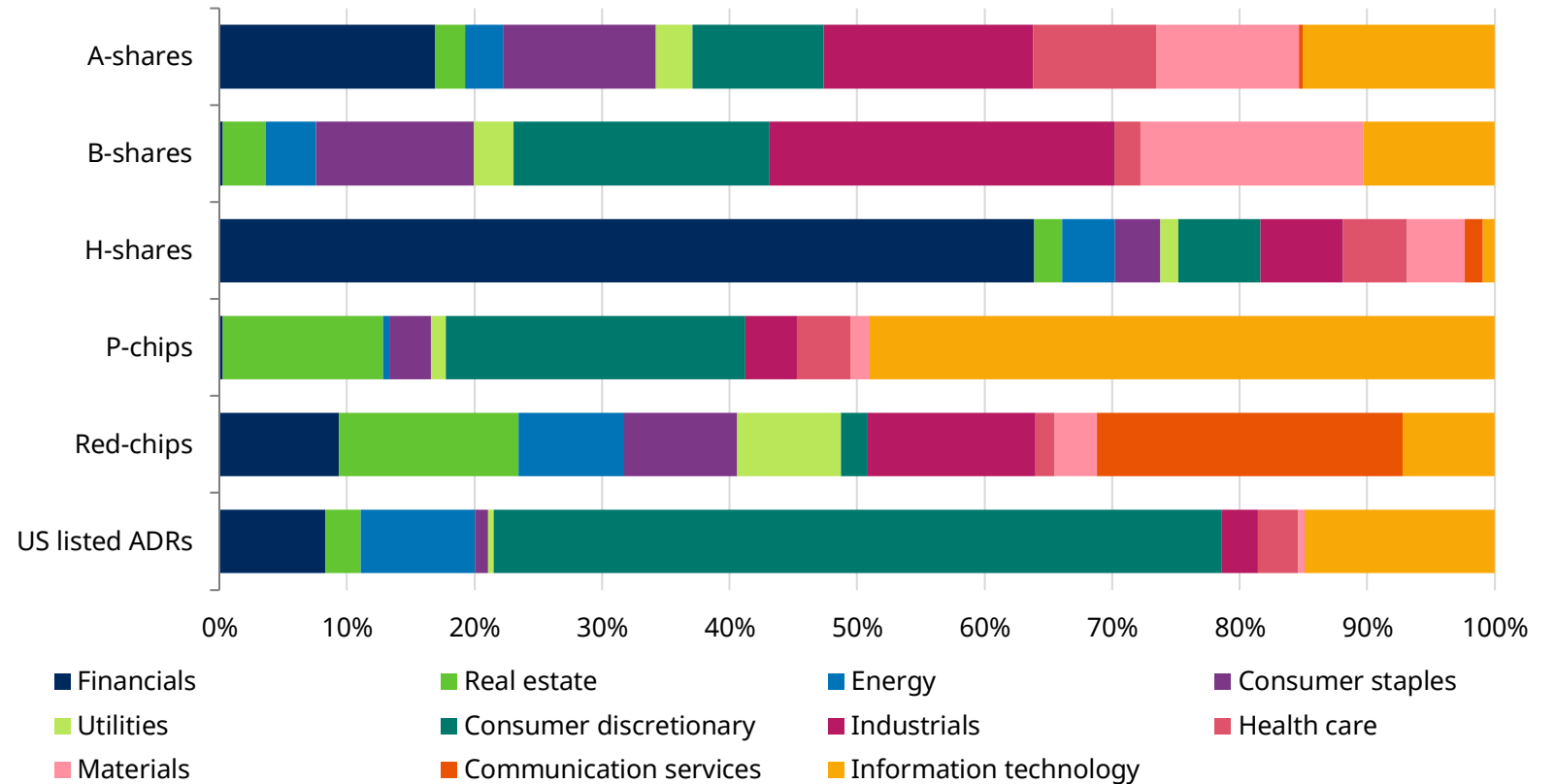
- H-shares, Red-chips, P-chips, HK shares
- US\$3.9tn market cap
- US\$6.7bn daily turnover

## US (offshore)



- ADRs
- US\$1.0tn market cap
- US\$6.0bn daily turnover

## Market cap breakdown by sector

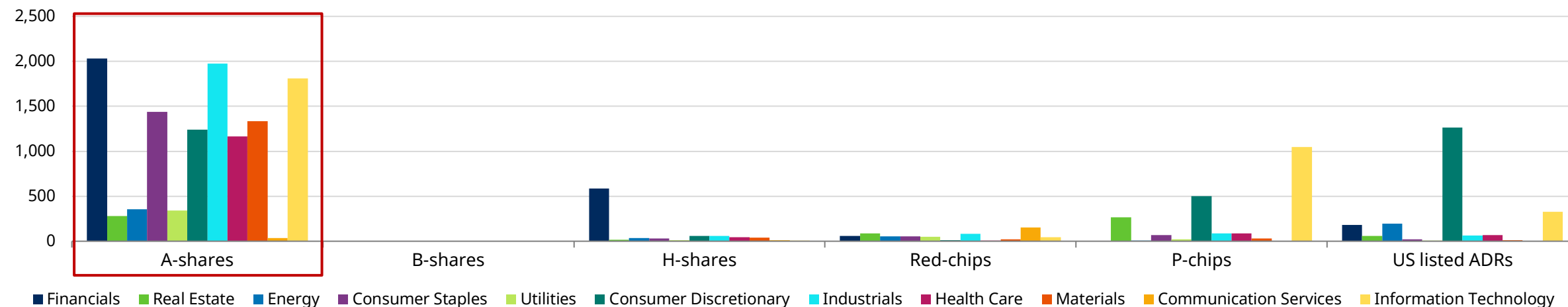


Source: (LHS) Wind, FactSet, GS research. Data as of January 2020. (RHS) Wind, CICC Strategy Research. Data as of March 2021.



# A-shares represent the bulk of China's market cap

The 'dim sum' basket of different Chinese equities

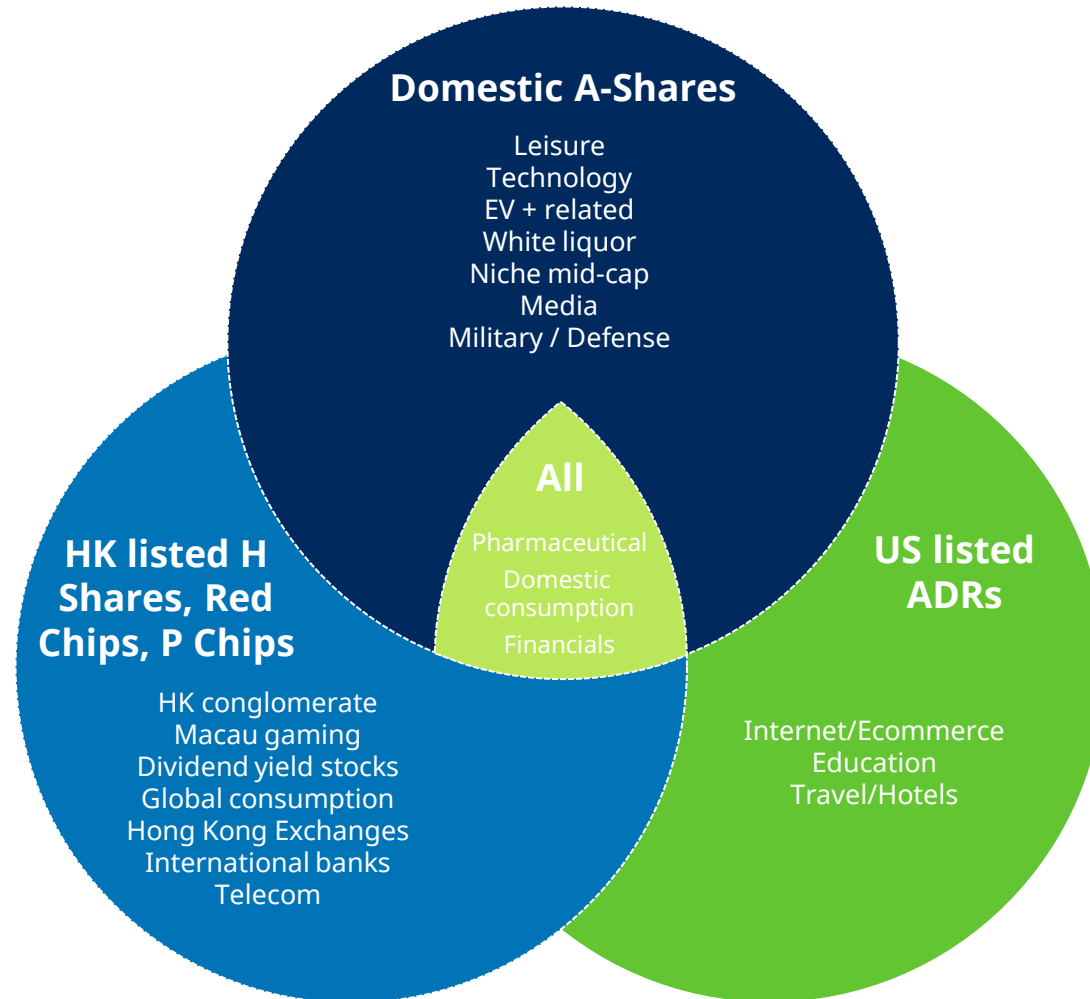


	A-shares	B-shares	H-shares	Red-chips	P-chips	US listed ADRs
Definition	Chinese securities incorporated in Mainland China, listed in China	Chinese securities incorporated in Mainland China, listed in China	Chinese securities incorporated in Mainland China, listed in Hong Kong	Chinese companies incorporated in Hong Kong, but whose primary business interests are in mainland China	Shares of companies that are controlled by mainland Chinese individuals, with a majority of their revenue or assets derived from mainland China	Shares of Chinese companies that are listed in US
Stock Exchange (currency)	Shanghai (RMB) Shenzhen (RMB)	Shanghai (USD) Shenzhen (HKD)	Hong Kong (HKD)	Hong Kong (HKD)	Hong Kong (HKD)	NYSE/NASDAQ (USD)
Market Capitalisation (USDbn)	12,010	19	917	644	2,140	2,214
Number of Stocks	4,263	93	291	173	731	274

Source: Wind, CICC Strategy Research. Data as of March 2021.

# China A provides unique opportunities

Access to opportunities not available in offshore market



Source: MSCI, Schroders.

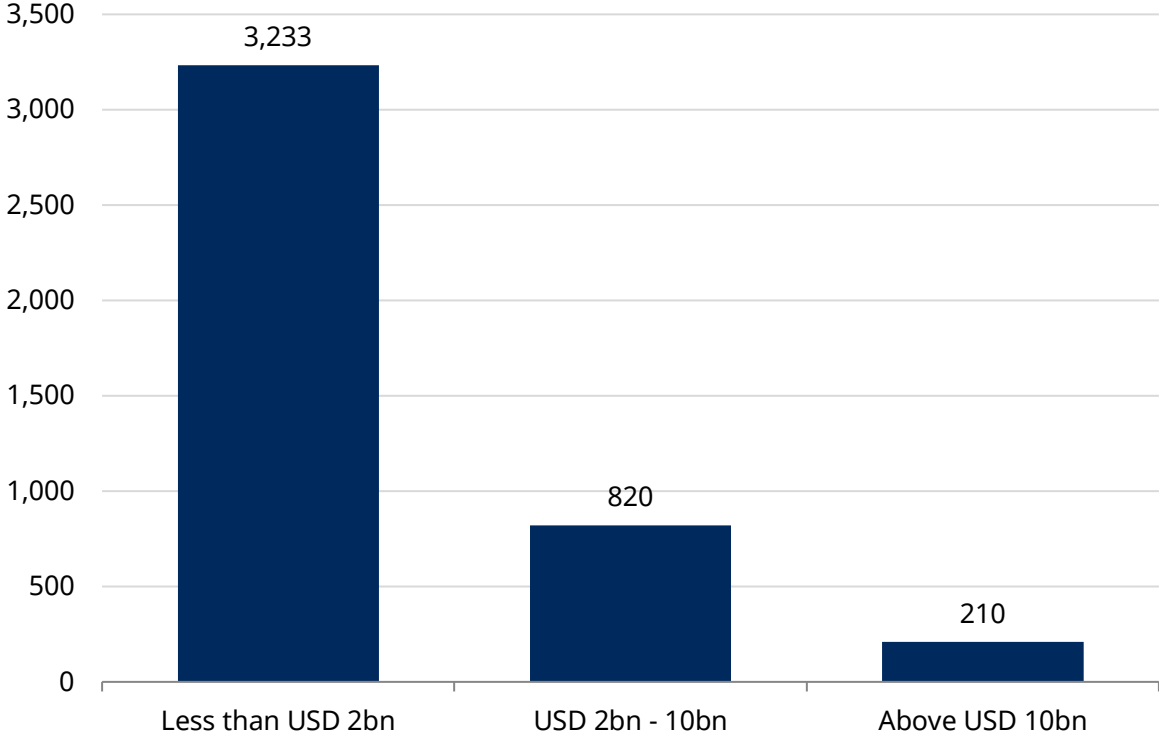


# China A – A highly inefficient market

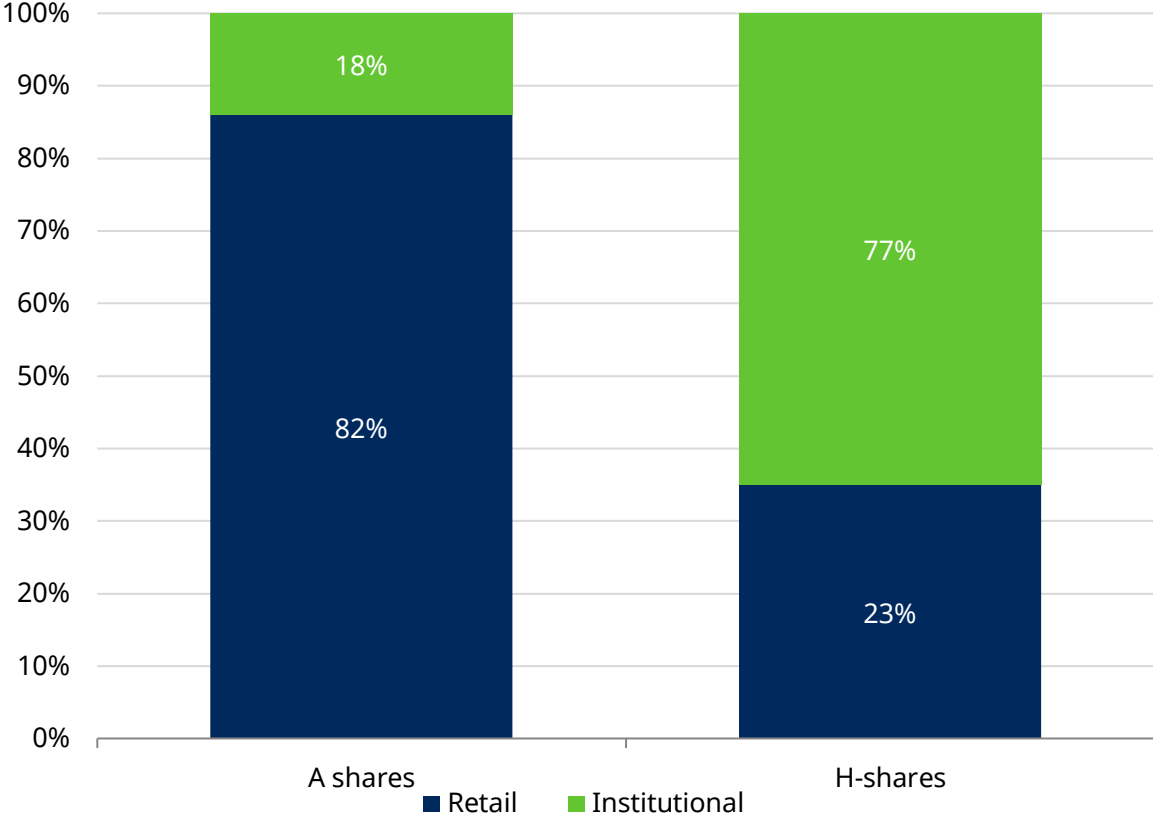
More mid-sized companies, highly inefficient given retail participation

## More mid and small cap companies<sup>1</sup>

No. of companies



## High retail investor participation = inefficient market<sup>2</sup>



Source: <sup>1</sup>Wind, as at 19 April 2021. <sup>2</sup>Wind, HK Exchanges and CICC, September 2019.

# China A – Diversification benefits

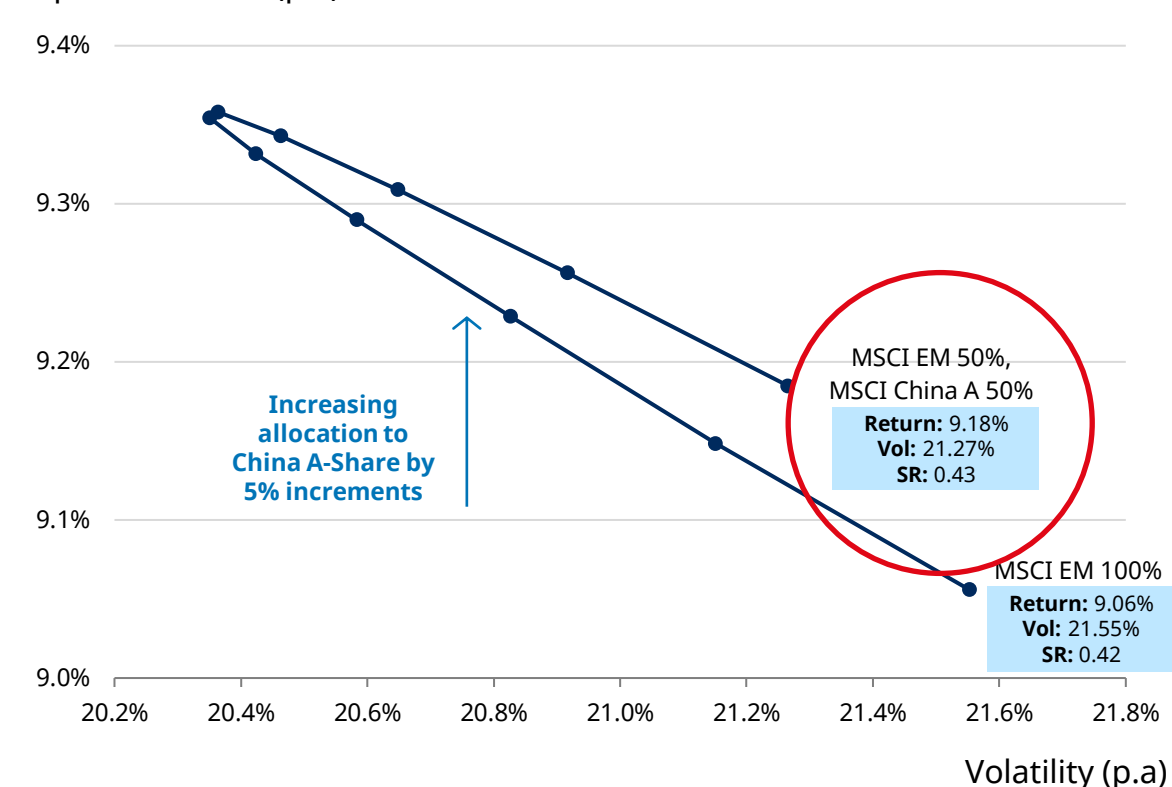
A stand-alone allocation can result in a more efficient EM portfolio

## Monthly correlations: Jan 2001 – Jan 2021

	MSCI World	MSCI EM	MSCI ACWI	MSCI Emerging Asia	MSCI AC Asia ex-Japan	MSCI ACWI ex-China	MSCI China	MSCI China A-Share
MSCI World	1.00							
MSCI EM	0.87	1.00						
MSCI ACWI	1.00	0.90	1.00					
MSCI EM Asia	0.82	0.97	0.85	1.00				
MSCI AC Asia ex-Jp	0.83	0.97	0.86	0.99	1.00			
MSCI ACWI ex-China	1.00	0.89	1.00	0.84	0.85	1.00		
MSCI China	0.69	0.82	0.72	0.83	0.84	0.71	1.00	
MSCI China A-Share	0.33	0.41	0.35	0.44	0.45	0.34	0.55	1.00

## Risk/return impact of including China A-Share

Expected Return (p.a)



EM = Emerging markets, ER = Expected return, Vol = Volatility, SR = Sharpe Ratio.

**Past Performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested.**

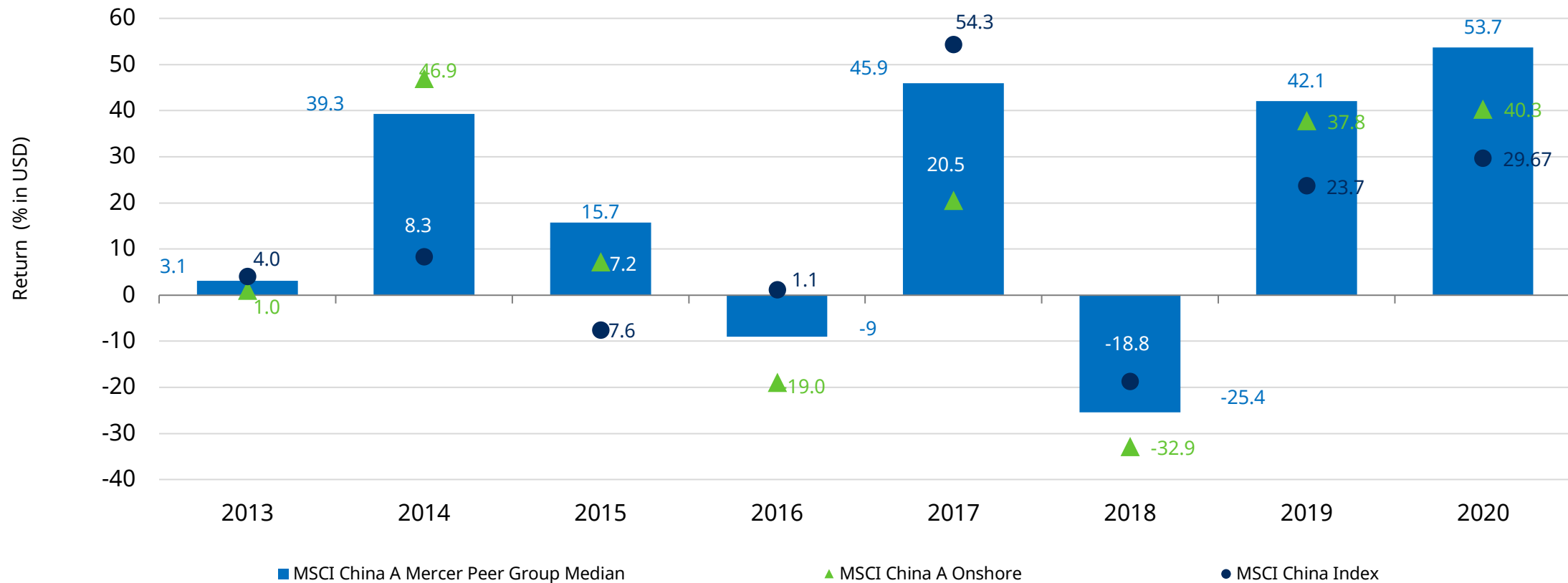
Source: Bloomberg, Schroders. Based on returns for an unhedged USD investor. Volatility and correlations expressed using monthly returns from 31 January 2001 – 31 January 2021. Start date limited to inception of the MSCI China A-Share index (31 December 2000).



# Why China A?

Ripe for active managers – even the median manager has been able to add alpha

## Return by Calendar Year<sup>1</sup>



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Source: Schroders, Mercer, as at April 2021. Morningstar, as at May 2021.

# Investment Strategy

## How are we positioned?

Portfolio themes	Rationale
Consumer discretionary	Companies benefiting from rising wealth and increasing demand for leisure services
NEV & components	Policy support to NEV and auto-electronic applications brings more upside to the supply chain.
Industrial cyclicals & automation	Industrial automation and import substitution trends continue. Selected industrial players to gain market share.
Technology hardware	Prefer suppliers that benefit from China's focus on self sufficiency amidst the Sino-US trade tension.
Materials	Upstream material companies supplying to technology space; exposure to gold miners.
Internet/e-commerce	Positive on long term growth prospects but cautious on valuations and near term gov policy headwinds
Financials	Prefer insurers over banks & brokers. Cautious of bank 's asset quality risk and NIM pressure

Source: Schroders, at June 2021

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