Five trends shaping investments in China: 2021 and beyond

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Given its size and influence, China remains a key investment destination despite ongoing trade disputes and diplomatic tensions with the US and Australia. With a GDP equivalent to around 70% of the United States, many global portfolios continue to feature Chinese equities.

Against this background, Martin Lau, Managing Partner at FSSA Investment Managers, provides five insights into the current and future trends shaping the Chinese economy.

2021 will see a strengthening economy in China

This year will provide an opportunity for more balanced market growth, perhaps including cyclical stocks and shares whose value took a hit last year. As the economy recovers, shares in a wider range of sectors will become more attractive. Last year, just a handful of companies accounted for the majority of the returns. We have already started to see signs of change, hence why we expect this year to be different from the last.

2020 was slightly unusual in that investors were very confident in the market despite the high valuations. As companies whose prices have increased 80- to 100-fold release their earnings, it will be interesting to see if they are able to meet expectations. We do not necessarily expect share prices to fall, but believe returns may be lower than last year. As such, we will be conservative when deciding which stocks to purchase.

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Equities are more attractively priced than bonds

Despite the expected economic recovery this year, no one is predicting higher interest rates, unlike in previous recoveries. This is because the economy is still in a precarious situation. Compared to bonds, we believe equities still offer better value for money. For example, the yield from a CK Hutchison Holdings bond (a global conglomerate) is around 1.6%-1.7%, but the dividend yield is more than 5%.

Chinese manufacturing and technology is more competitive than ever

The days of China being a cheap source of labour are gone – but at the same time, the salary of a well-qualified Chinese engineer may be just one-half or two-thirds of the salary of a US-based engineer.

As a result, some sectors of the Chinese economy have started to grow quite rapidly, such as pharmaceuticals, software, semiconductors, and the automotive industry. China has been upgrading its manufacturing industry – a key aim of President Xi's latest and previous Five-Year Plans – which has benefited companies like telecoms equipment manufacturer Huawei.

On a similar note, almost 600,000 Chinese graduates return from overseas universities each year, boosting China's technological capacity. The R&D expenditure of Chinese tech companies has increased and it will be interesting to see the growth opportunities that result.

Our China tech investments are not restricted to internet companies. We expect to see new technologies in other sectors, such as retail and food, to cut costs and increase efficiency. In the future, the tech sector will become much broader as a result.

Trade sanctions may actually boost China's economy

There are historical precedents for the current political climate: in the 1980s the US levied high tariffs on Japanese car imports in a bid to protect its own home-grown car manufacturers.

The US is again in a political and economic wrestling match with its biggest rival – which was once Japan and is now China. As a result, we expect to see more policies from the US designed to limit China's economic rise.

However, the impact of trade sanctions on the Japanese economy were positive in some respects. Toyota, for example, remains the world's largest car manufacturer and even produces cars in the US. Toyota used local resources to support its global expansion and maintained its status as an industry leader.

We believe that in the short term, the Chinese government will support the economy through measures such as personal income tax cuts and private enterprise financing support. In the medium-to-long term, Chinese companies will be forced to strengthen their core competencies – those that are able to adapt to the new norm should emerge stronger over time, despite trade sanctions.

Chinese consumers will increasingly look for home-grown products

In China's latest Five-Year Plan, the government announced plans to reduce the country's vulnerability to, and dependence on, the global economy; achieve self-sufficiency; and boost domestic consumption. The government has also introduced subsidies to boost purchases of home appliances and cars.

We see these trends continuing over the next 5 to 10 years. As the Chinese economy develops and incomes rise, people will start to think about how they can improve their quality of life. We believe consumer spending, education and tourism are all poised for significant growth.

Related to this is the increasing popularity of domestic brands. As the younger generations see their living standards and incomes improve, they will start to become more confident about Chinese brands. You can see this in the success of domestic sportswear brands such as Li-Ning and Anta, or cosmetic brands such as Marubi and Pechoin. We predict this trend will continue – and there will be more home-grown brands such as Huawei or Xiaomi to help underpin a local consumer economy.

Conclusion

As President Xi rolls out the latest Five-Year Plan, we expect to see a number of secular trends take hold, which should help the Chinese economy maintain its growth. With an attractive base and a competitive, well-educated workforce, China's manufacturing champions should continue to advance its technology prowess and gain global market share. At the same time, China's population is looking inwards for local products and services, helping the country become more self-sufficient. Companies that can tap into these trends will be well-placed to ride the China wave into the next decade.

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