State of Play

27 May 2021

Our Investment Specialist, Simon Durling, shares his thoughts on China in our latest update.

Investing in China

Without a doubt, COVID-19 has been the biggest risk to worldwide economic growth since the pandemic began in the first quarter of 2020. A year on and a number of Asian countries appear to be in a better position than those in the west. China in particular has made significant progress in containing the virus, which has helped lay the foundation for a strong rebound and longer-term growth.

China was a late joiner to investment markets when the Shenzhen Stock Exchange came into operation on 1 December 1990, with the Shanghai Stock Exchange following 18 days later. A large driver was the need for a mechanism to convert abundant household savings into cheaper capital, often for cash-strapped state-owned factories on the verge of bankruptcy. The speed of change since is simply staggering: as at the end of April there are 1,784 listed companies in Shanghai and 2,341 in Shenzhen[1], with a combined market value of ¥69.4tn (Chinese yuan)/$10.6tn[1] (US dollar), surpassing the previous peak which was recorded in 2015, versus ¥2.94tn in 2002.[1]

Western democracies like the UK, US and Europe have in the past evolved through various stages, including the industrial revolution, transportation advancement and now digital and technological progression, taking more than 150 years to reach today's economic make-up and structure. China has achieved all of this and more in just 30 years - crafting out a more influential role in world trade, politics and investment markets in the process.

China's economic journey has included massive infrastructure projects using vast quantities of commodities produced by South American countries like Brazil and other places like Australia. They have also developed their own sites to mine commodities and raw materials, helping to support the speed of development and building of cities, roads, bridges, and tunnels. The advantage of being able to employ much cheaper labour costs enabled them to undercut most other global producers in virtually all commodities, especially the manufacturing of steel.

Today, China is home to three of the world's 20 most valuable companies: Tencent Holdings, Alibaba Group Holding and Kweichow Moutai. MSCI, an index compiler, included Chinese onshore stocks for the first time in 2018 by giving them a 4.1% weighting in its Emerging Markets Index. At FTSE Russell, Chinese stocks accounted for 5.2% of its All World Index, the largest after those from the US and Japan.

China's economic transformation has also altered the industry make-up to reflect its new economic structure. Technology and biotechnology companies account for 7.3% of the market capitalisation in the Shanghai Stock Exchange since the STAR market (short for Shanghai Stock Exchange Science and Technology Innovation Board) was created in 2019. In the Shenzhen Stock Exchange, the proportion has increased to 10% from 6.4% in 2013. The Shanghai Stock Exchange is now the world's third largest stock market by market capitalisation at $6.92tn as at 27 May.[2]

Current state of play

The US-China rivalry over the last decade has created volatility for investors and uncertainty as their respective governments have used trade, currency, and stock markets to leverage favourable outcomes. More than 20 Chinese companies will be removed from their global stock and bond indices from this month by FTSE Russell, S&P Dow Jones Indices and MSCI, following a ban on trading and investing by Americans from next year. These decisions create uncertainty and highlight the risks associated with investing in a market influenced by government-controlled regulators and not independent institutions. Recently, the decision by China to ban the investment into cryptocurrency is said to have triggered this month's (May 2021) sell-off.

With global commodities rising to record highs, Chinese Government officials are trying to temper prices and reduce some of the speculation that has driven markets. Wary of inflating asset bubbles, the People's Bank of China has also been restricting the flow of money to the economy since last year, albeit gradually to avoid derailing growth. At the same time, funding for infrastructure projects has shown signs of slowing. Economic data for April suggest that both China's economic expansion and its credit impulse - new credit as a percentage of gross domestic product - may already have reached a tipping point.

The most obvious impact of China's deleveraging (the reduction of debt) would fall on those metals key to real estate and infrastructure spending, from copper and aluminium, to steel and its main ingredient, iron ore.

Learn more

You can learn more about managing risk in our About Investing article, **Defining diversification.**

Despite the additional risks created by government influence, lack of transparency and global political back stories, China has become the second largest economy in a little over 30 years and continues to target growth – at a rate which is double the growth forecast for the rest of the world, developing the largest middle class in the world in the process.

Market update

Markets experienced a largely benign week with most major indices seeing movement of less than 1%, this was largely driven by the easing of inflation fears as oil and commodity prices eased slightly and central banks reinforced their view that inflation will be transitory, indicating that interest rate rises are not imminent and when they do arrive they will be slow and steady. According to BlackRock its Geopolitical Risk Dashboard has fallen to a four year low as investors increasingly focus on the economic restart and inflation. Interestingly, yesterday (26 May) China overtook Germany as the UK's single biggest import market since records began in 1997. Brexit disruption coupled with lockdown disruption, especially to the automotive industry as new car sales slumped, alongside a surge in demand for China's textiles for face masks and personal protective equipment accelerated a developed trend.

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Note: Data as at 26 May 2021.

[1] Bloomberg, 26/5/21
[2] Tradinghours.com - Shanghai Stock Exchange, 27/5/21

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