

# Growth. The China Way.

## Investors can pounce on equity market opportunities in the Year of the Tiger

February 2022

**After a year in which China's equity markets were held back by concerns over rate rises and increased regulation, the government has shifted decisively towards pro-growth policies. This creates a brighter outlook for equities in 2022.**

China has entered a period of easier financial conditions – including rate cuts and higher government spending – that may provide a more favourable backdrop for equity markets through 2022, the Year of the Tiger.

This is a welcome change from 2021, when growth slowed and China's government tightened regulation in some sectors – notably e-commerce, financial technology and private tutoring. But today, China's fiscal and monetary policy has shifted back towards supporting the economy, according to Anthony Wong, Senior Portfolio Manager at AllianzGI and lead manager for China A-share equity portfolios.

"We have already seen interest rate cuts and increased fiscal spending, and top officials in China have repeatedly emphasised the importance of stability this year," Mr Wong told investors during AllianzGI's China equities webcast on 9 February.

China's objective historically has been to balance growth, stability and reform, explained Tessa Wong,

### Key takeaways:

- China's government has moved to a more pro-growth stance, potentially creating more favourable conditions for equity markets in 2022.
- Investors may want to consider shifting their China equity allocations to capture the potential benefits of easier monetary spending and higher government spending.
- Long-term trends, including high levels of business spending on new technologies, aspirations for a healthier lifestyle and ongoing financial market reforms can deliver opportunities.

**This article is a summary of insights from our Q1 2022 webcast on China equities.**

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Product Specialist for Chinese equities at AllianzGI. This played out in the government's shifting approach during 2021. In the first half of last year, China's country's rapid recovery from the first wave of Covid-19 brought robust economic growth, which allowed the authorities to



accelerate reforms and address structural problems such as weaknesses in the property market. But in the second half, this phase came to an end as the economy slowed sharply and the government's attention turned to more pro-growth measures.

### Onshore-offshore divergence

Yet despite a well-publicized market downturn in autumn of 2021, China equities didn't all march in lockstep. Performance was markedly different between domestically-listed A-shares, which are traded in "onshore" exchanges in Shanghai and Shenzhen; and the stocks traded in "offshore" markets, primarily Hong Kong and the US. Despite weak market sentiment, the A-shares market ended 2021 up 4%<sup>1</sup> and attracted net monthly inflows of foreign capital throughout the year, as global investors used a period of weakness to build their long-term allocations to China.

However, the government's tightening of regulation on internet-related sectors last year had a major impact on offshore markets, where many internet companies are listed. Offshore equities fell more than 20% during 2021<sup>2</sup>. This drop was caused by a rapid derating of valuations as the Chinese government's regulatory changes caused sentiment to weaken, rather than a collapse in earnings expectations.

By the end of 2021, both the onshore MSCI China A index and the offshore MSCI China index were trading close to their long-run average valuations, in contrast to some developed markets where valuations remain stretched by historical standards. To many investors, China equities today seem more reasonably priced than their developed market counterparts.

### Long-term trends are supportive, though risk factors remain

Even though the policy backdrop is becoming more supportive for equity markets, important risk factors remain. China is maintaining tough public health restrictions to prevent the spread of the Omicron variant. If the virus escapes these controls, efforts to contain it could seriously disrupt the economy. China's huge property market has also been causing concern. Several highly indebted property developers ran into liquidity

problems last year as limits on leverage were introduced and the market slowed. However, Mr Wong believes the government will find a way to engineer a "managed decline" in property prices rather than a crash.

"If there are signs that the Chinese economy is decelerating further, we believe more aggressive rate cuts and fiscal policy actions will be taken by the government to cushion that downside risk," Mr Wong said.

To capture the benefits of easier monetary spending and higher government spending, investors may want to consider shifting their China equity allocations to the exchanges and sectors that may be poised to benefit.

- Within the A-shares market, there are opportunities from domestic wealth managers, potential beneficiaries from rising household wealth and appetite to invest in financial markets
- Opportunities also exist in the long-term trends of healthy living and new technologies. The latter covers augmented and virtual reality, and the semi-conductor supply chain
- But investors may want to be more cautious about areas linked to the property sector, such as materials companies. The oft-cited mantra that housing is 'for living in, not speculation' suggests there is unlikely to be a quick rebound

Mr Wong added that the much discussed "common prosperity" policy, a central objective of the Chinese government, was not intended to involve state-sponsored redistribution of wealth, as often assumed in the West. Instead, it aimed to address more systemic long-term issues for China – including high levels of leverage, wealth disparity and slowing growth. He believes that the common prosperity policy would not deflect China from its journey towards financial and economic liberalisation. Access to foreign capital and a vibrant private sector would remain central priorities for the Chinese government.

For investors, China's shift towards easier financial conditions, coupled with undemanding valuations, creates a more supportive backdrop for the country's equity markets in the Year of the Tiger.

1 Bloomberg data as at 31, December, 2021

2 Bloomberg data as at 31, December, 2021

\*Excludes Allianz Capital Partners

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Data as at 30 September 2021

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