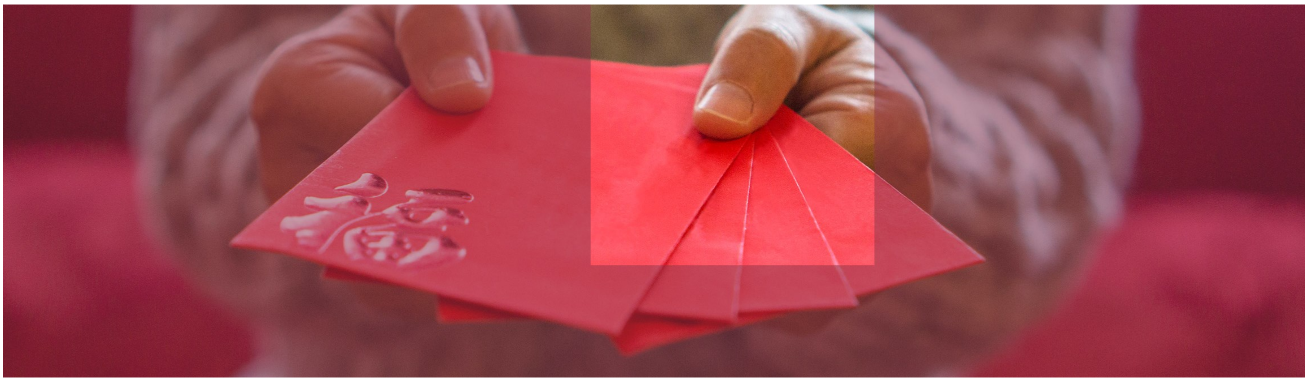
Active is: Sharing insights

Will the "Year of the Pig" be a prosperous one for China?

by Neil Dwane | 31/01/2019



Summary

In the "Year of the Pig", China will likely continue grappling with slower growth, a mountain of debt and a trade war with the US. But according to Chinese legend, the pig is a sign of good fortune – which is consistent with our long-term view of China's economic potential.

Key takeaways

- China is set to usher in the Lunar New Year – and the "Year of the Pig" – on 5 February
- China's high debt levels and slower growth will likely last well beyond the New Year celebrations, but we believe China's government has the right tools to solve them
- With China's economy on track to become the largest in the world, we believe investors must think about China as an asset class

Fattened up on debt and penned in by trade?

We expect China may deliver slower growth in the near term because of its high debt levels – estimated at as much as 300% of GDP – and because of concerns about the trade war with the United States. But more important than trade headlines is the potential for a US-China "tech cold war" that could result in two competing high-tech ecosystems and force the rest of the world to choose sides. As trade tensions drag on, investors should watch for companies around the world – but particularly in the US and China – that are grappling with threats to their manufacturing supply chains. It's also important to be mindful of export-driven companies that could see weaker earnings growth prospects due to trade-related issues. On the positive side, some companies seem set to benefit from these tensions – particularly in countries such as Vietnam, which is picking up new manufacturing business as the trade war drags on.

"Made in China 2025": a highly intelligent strategy

High debt levels, slower growth and trade wars are long-term issues that can't be solved overnight, but we believe China's government has the right tools to solve them. President Xi Jinping has spelled out clear strategies to create more demand inside China and to move up the value chain of many industries. This is at the heart of the "Made in China 2025" programme for advanced manufacturing. By shifting China's industrial capabilities into high-tech areas such as aerospace and robotics – and away from apparel, consumer electronics and other lower-value products – China hopes to avoid the "middle-income trap" to which so many emerging economies have succumbed.

Look beyond the New Year: think long term

In terms of sheer economic growth, China is no longer the force it was for the last 20 years. As it lowers its debt levels and rebalances towards a consumer-driven economy, it will become a different type of investment opportunity. But in the very long term, China is almost certain to become the largest economy in the world – and a global leader with a seat at the table in Asia and elsewhere. So we believe investors must think about how to allocate to China – just as they think about how to allocate to the US.

This is a far cry from today, where most investors' global equity portfolios allocate a fraction to China versus the US. But if you think about the sheer scale of China's economy, we believe this points to a significant mismatch. As a result, we believe we are at the beginning of a long journey that will see investors consistently increase their allocations to China over time.

Of course, this is a new theme to many investors, in large part because China's financial markets have essentially been closed to foreign investors for years. Only recently have we seen an opening up of the access to China's equity and bond markets to foreign investors through the "bond connect" and "stock connect" programmes.

But with greater access comes new risks and opportunities that investors need to navigate. With that in mind, here are some of our top investment ideas for the year ahead:

- Identify the winners and losers in China's A-share market. The losers may be companies dependent on imports from the US as part of their manufacturing process. But the winners could come from the "new economy" sectors such as consumption, technology, the environment and health care.
- Hunt for income. Income can provide a host of benefits to portfolios, but it isn't easy to find in today's low-yield world. However, Chinese bonds still offer healthy yields and attractive real return potential inside a global bond portfolio.
- Take an active, bottom up approach to investing in China. It helps to understand local business practices, accounting methods and company structures. In-depth, proprietary research may be able to provide an advantage.
- Keep an eye on the "G" in "ESG". In recent years, environmental, social and governance (ESG) factors have become increasingly important indicators of a company's health and prospects. Governance can be a particular issue in China, which is why it is important to for asset managers to have experts on the ground who can conduct in-depth analysis, speak to management teams and truly understand how companies are approaching ESG factors.

We know China has its challenges, but we believe its leadership is well-placed to handle them – which helps make China an asset class that clients should consider actively participating in. In the end, it's not really a question of whether investors should buy China – in our view, the better question is rather how much they should buy.

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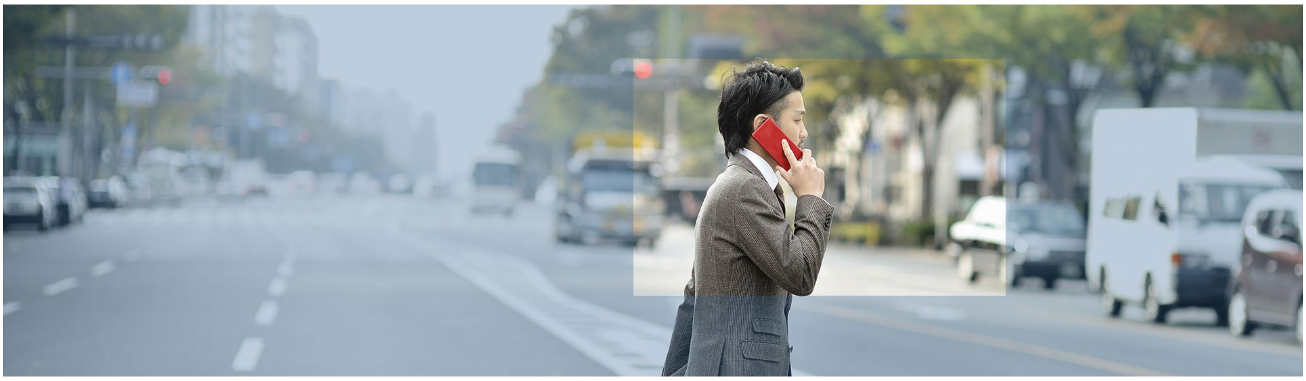
Neil Dwane is a portfolio manager and the Global Strategist with Allianz Global Investors, which he joined in 2001. He coordinates and chairs the Global Policy Committee, which formulates the firm's house view, leads the firm's bi-annual Investment Forums and communicates the firm's investment outlook through articles and press appearances. Neil is a member of AllianzGI's Equity Investment Management Group. He previously worked at JP Morgan Investment Management as a UK and European specialist portfolio manager; at Fleming Investment Management; and at Kleinwort Benson Investment Management as an analyst and a fund manager. He has a B.A. in classics from Durham University and is a member of the Institute of Chartered Accountants.

→ VIEW DETAILS

Active is: Finding new sources of income

To fight inflation, hunt for income

by Neil Dwane | 30/04/2019



Summary

Investment income provides many benefits – including guarding against inflation – but today's "safe" bonds may offer no or ultra-low returns. We suggest investors hunt for income among "riskier" income generators like corporate bonds, emerging-market debt and dividend-paying stocks.

Key takeaways

- Inflation is an overlooked risk that can feel higher than official inflation numbers – but even 2% annual inflation can reduce purchasing power by almost 20% over 10 years
- Slow economic growth and low interest rates mean market returns – beta – may also be low; this underscores the importance of taking enough risk to earn a sufficient return
- Many "safe" bonds offer zero or ultra-low returns – and now that most central banks have stopped raising rates, easy and attractive cash returns are hard to find
- Investors who "hunt for income" using riskier asset classes may be able to fight off inflation, stabilise returns and reduce overall portfolio volatility
- An active approach to income investing can help investors search for opportunities and manage a broad range of risks