
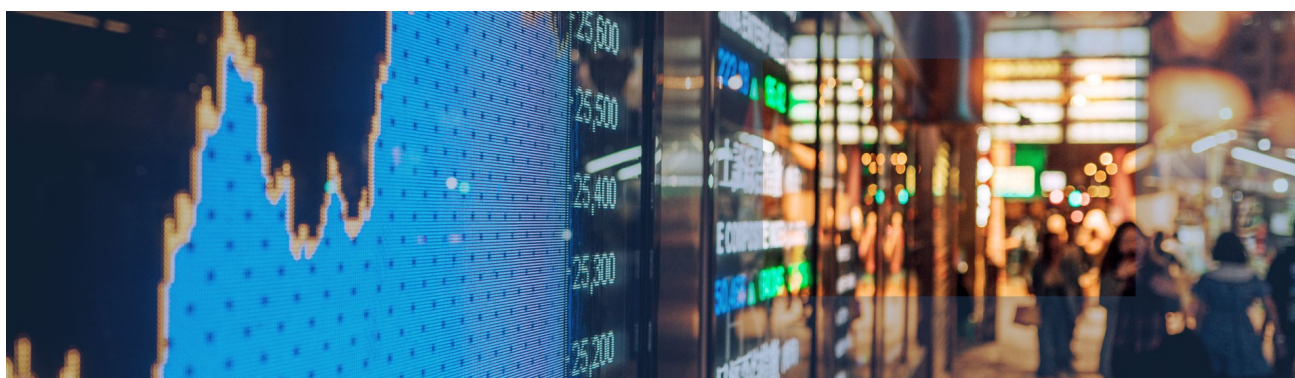



Active is: Seizing the China opportunity

Growth in China set to outlast the pandemic and trade wars

by [Anthony Wong](#) | 17/06/2020  

Summary

Despite the impact of the coronavirus pandemic, and continuing tensions with the US, China remains on course to become the world's largest economy by 2030. This could represent the coming decade's most transformative development in global financial markets – and a major opportunity for investors.

Key takeaways

- While it has been a challenging year so far, we expect China to resume its growth trajectory and become the world's largest economy by 2030
- The previously export-led Chinese economy is shifting its focus to higher-value, tech-driven sectors, with growth fuelled by the country's burgeoning middle class
- Improved accessibility, governance and transparency have increased the appeal of Chinese A-shares to foreign investors
- Many indices underplay China's growth story; a lack of exposure to China could mean benchmark investors miss out

As the world combats the coronavirus and confronts what many believe will be an epic recession, investors need to find new sources of growth potential. We think one answer is to look towards China – in particular, China's A-share equity markets.

Investing in China is not without risks or controversy. China and the US are embroiled in a long-running trade dispute, and the coronavirus has added another dimension to existing tensions. The outbreak also slowed China's growth, just as it has impacted growth in the rest of the world.

But the fact remains that China may be a fundamentally attractive investment opportunity for three key reasons: it has opened its markets to foreign investment, it offers compelling growth stories for investors, and it is executing a strategy to become the world's largest economy by 2030. Over time, this will likely add up to a structural investment trend of steadily growing exposure to China – and proactive investors may want to pre-empt that shift.

China's markets are open for business

China has undertaken a concerted effort to open its markets to international investors. The launch of the Stock Connect programme in 2014 facilitated access to China A-shares listed on the Shanghai and Shenzhen exchanges – representing a total market capitalisation of around USD 8.5 trillion, which is comparable to the eurozone.

In 2018, the inclusion of A-shares in two key MSCI indices – meaning that money that follows those benchmarks must buy Chinese stocks – significantly boosted inflows. The increasing institutionalisation of Chinese markets has also enhanced their appeal.

Listed companies on the A-shares indices are now required to file quarterly reports, and more than half of the largest A-shares companies have embraced global accounting standards and employed international auditors. Greater transparency and improved governance have also helped counter the volatility that has characterised A-shares in the past, although investors should stay cautious.

China offers compelling growth stories

China's economy is changing. Once regarded as the world's factory, it is now focusing more on higher-value goods and services. With its "Made in China 2025" initiative, it has ramped up domestic production in sectors like biotech, automotive and semiconductors, reducing reliance on foreign suppliers.

Meanwhile, other high-value sectors, including tourism, have benefited from wider changes in Chinese society. The emerging middle class that drove the economy's pre-coronavirus growth should help fuel its tentative emergence from the outbreak, continuing China's transformation from an export-driven economy towards one with a greater focus on domestic consumption.

The A-shares market offers investors access to small- and mid-cap companies within those high-value sectors that are set to be the future drivers of China's economic growth.

China is on track to become the world's largest economy

China doubled its GDP in the 12 years to 2020, with an average annual growth rate of 7%. A slowdown seemed inevitable even before the pandemic, largely due to China's rapid accumulation of debt since the global financial crisis and the government's desire to limit future credit growth. The coronavirus exacerbated these challenges, and in April 2020 China reported the first drop in economic output in more than 40 years, with first-quarter GDP 6.8% lower year-on-year.

Amid continuing tensions with the US, China also announced it would not set a GDP target for 2020 – for the first time in 30 years. Although the IMF is forecasting 1.2% GDP growth for China in 2020 – significantly lower than previous expectations – most major economies are expected to shrink due to the coronavirus, including a projected 5.9% GDP drop in the US. Any positive growth in China would vindicate President Xi Jinping's long-term strategy and signify a resumption of the country's growth trajectory.

How to invest in China

For investors considering China, A-shares have historically displayed very low correlation with global markets, suggesting that investing in A-shares could bring additional diversification benefits. While the ongoing institutionalisation of China's A-share markets may result in higher correlations, this change will likely be a gradual process over many years.

Because of domestic revenues and distinct economic and monetary policy, China A-shares have a low correlation with major equity markets

	China A-shares	HK-listed China stocks	Asia Pacific Ex-Japan equities	Global Emerging Markets equities	Japan equities	US equities	European equities	World equities
China A-shares	1.00	0.58	0.46	0.43	0.25	0.14	0.19	0.21
HK-listed China stocks	0.58	1.00	0.86	0.82	0.44	0.27	0.42	0.43
Asia Pacific Ex-Japan equities	0.46	0.86	1.00	0.93	0.54	0.32	0.51	0.55
Global Emerging Markets equities	0.43	0.82	0.93	1.00	0.46	0.47	0.63	0.68
Japan equities	0.25	0.44	0.54	0.46	1.00	0.15	0.29	0.34
US equities	0.14	0.27	0.32	0.47	0.15	1.00	0.62	0.92
European equities	0.19	0.42	0.51	0.63	0.29	0.62	1.00	0.79
World equities	0.21	0.43	0.55	0.68	0.34	0.92	0.79	1.00

As of January 31 2020.

Correlation data is calculated based on historical return of respective MSCI indices for the past 10 years, using weekly USD return. See full names of all specific benchmarks at the end of this paper.

Source: Bloomberg, Allianz Global Investors.

Some investors will access the China growth story through benchmark exposures, now that major indices – such as the MSCI World – include A-shares. In our view, such an approach underplays the opportunity, because China represents only a small percentage of these indices. For instance, A-shares constitute 4.1% of the MSCI EM index – a proxy for global emerging markets – and just 0.5% of the MSCI ACWI ex-US index, representing international equity performance. This is despite China currently accounting for around 15% of total global economic output.

Instead, a deliberate, active allocation may be key to seizing the full scale of the opportunity in China while managing the risks.

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While China may be a controversial topic for some investors, we expect the country to continue its upward path and the world's investors are set to follow gradually. Now could be the time to get ahead of that trend.

List of benchmarks used in graphic

Bloomberg Ticker	Index name	Proxy for:
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MXCN1A Index	MSCI China A Onshore Index	China A-shares
MXCN Index	MSCI China Index	HK-listed China stocks
MXAPJ Index	MSCI AC Asia ex-Japan Index	Asia-Pacific ex-Japan equities
MXEF Index	MSCI Emerging Markets Index	Global Emerging Market equities
TPX Index	TOPIX Index	Japan equities
SPX Index	S&P 500 Index	US equities
MXEU Index	MSCI Europe Index	European equities
MXWO Index	MSCI World Index	World equities

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About the author/s

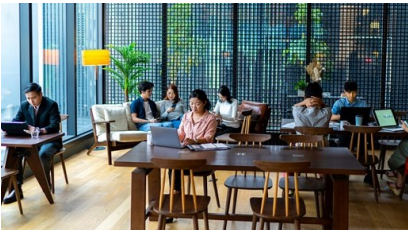


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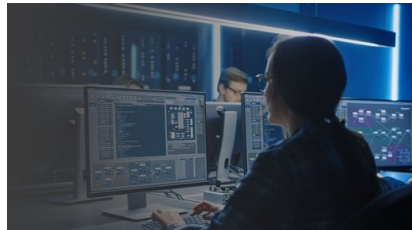


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Will the US risk rally endure – and can cyclicals continue to lead?

by Mona Mahajan | 18/06/2020  



Summary

With equities rallying more than 30% since late March, driven most recently by cyclicals, financial markets were perhaps due for a period of consolidation. New risks could emerge, but we continue to believe in the ongoing economic re-opening story – so cyclical sectors may remain market leaders in the near term. Markets could be supported further as elevated levels of cash are put back to work.

Key takeaways

- Since the lows of this pandemic recession on 23 March, risk assets have rebounded impressively, with US equities and bonds up about 35% and 15%, respectively
- While this year's US equity rally was mostly dominated by the sectors that could be "winners" in the coronavirus crisis (such as technology and healthcare), we have seen a remarkable broadening of leadership since mid-May: cyclical sectors such as industrials, financials and energy have outperformed
- We continue to believe in the re-opening story broadly, and we see a slow march towards normalisation in the US economy – perhaps punctuated by the arrival of a viable vaccine
- Against this backdrop, we believe a "barbell" approach to risk would be prudent: focus on cyclical sectors during the re-opening phase, while considering adding tactical exposure to secular growth themes over time
- Investors should expect natural periods of consolidation in the coming months and be mindful of looming risks – from a second wave of coronavirus infections to the outcome of the US presidential election in November

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