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UOB Investment Insights
Quick Note

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Chinese Equities – Riding Through Short-Term Risks, Towards Long-Term Gains

- Concerns over policy tightening, increase in regulations on Chinese technology companies and delistings by US exchanges have led to a recent sell-off in Chinese equities.
- The first two are indications of a prudent Chinese government moving in a direction that is sustainable and longer-term. China also has alternate listing venues for delisted companies, such as Hong Kong and Shanghai.
- We remain optimistic on China's structural growth story. Investors should remain invested to reap the full rewards from China's multi-year initiatives.

Speed bumps ahead for Chinese companies?

- Chinese equities seem to be facing wave after wave of headwinds in recent months. These can be summarised into three key risks some Chinese companies are facing at the moment.
- First of all, China has been imposing regulations and fines on its technology companies, starting with Alibaba and recently expanding to Tencent, Baidu and ByteDance, among others. This has gotten markets worried about the future growth potential of these companies, and whether the government is potentially crippling these companies to favour state-owned enterprises (SOEs).
- Secondly, the People's Bank of China (PBoC) has been gradually removing liquidity from the financial system through open-market operations (OMOs), although it has kept broad interest rates, like its 1-year and 5-year Loan Prime Rates (LPRs) stable. This still raises concerns that the strong 2020 gains by Chinese equities could reverse sharply if a deleveraging cycle is triggered, similar to what we have seen in 2016.
- Lastly, the US has also begun to enforce a Trump-era action requiring Chinese companies to delist from US markets if they cannot follow US audit requirements. As Chinese law prohibits Chinese companies from meeting certain requirements, delisting becomes necessary for these companies. Concerned investors worry about how these delistings will impact their holdings, and the ability of these companies to raise future capital for growth. (See Quick Note: Potential De-Listing of Chinese Companies in the US, 22 March 2020)
- These risks have caused short-term uncertainty, but we think that long-term gains are still in the pipeline for these companies and investors.

Prudent policies to maintain long-term structural growth

- China is the first major economy to emerge from the COVID-19 global recession, growing by 2.3%[1] in 2020, even as most other economies contracted. We forecast a strong 8.5%[1] economic growth for 2021.
- Amid a booming economy, the PBoC has to begin withdrawing liquidity to prevent inflation spikes and asset bubbles from forming. These can eventually threaten financial and economic stability. With 2021 being the 100th

[1] Source: UOB Global Economics & Markets Research

anniversary of the founding of the Chinese Communist Party, as well as the start of the 14th Five-Year Plan, the PBoC will be **extremely cautious and sensitive** in policymaking to avoid upsetting the economy.

- Chinese technology companies have not been regulated as tightly as their non-technology counterparts. An example is Ant Financial, which was able to offer loans to borrowers, but was not required to set aside as much capital as required of Chinese banks for each loan granted. This has allowed Chinese technology companies to undercut their “offline” competitors. Beijing has since tightened their regulation of companies to level the playing field between online and offline platforms.

- We do not think Beijing will over-regulate these companies – that are important pillars in the domestic economy and have created millions of jobs for the people – as they are key to widening the middle-class and driving consumption growth in China.

- Many of these companies are also global leaders in their own right, and requiring these companies to compete fairly will improve their standing amongst investors. As long as these companies align with Beijing’s interests over time, they will continue to thrive.

- This alignment is even more important as the US takes steps to curtail China’s rising influence, such as denying Chinese companies’ access to US capital markets through forced delisting. Fortunately, these companies can easily find another home in Hong Kong or to a lesser extent, Shanghai. Alibaba and Baidu have relisted in Hong Kong, and more companies are expected to follow suit.

- Hong Kong remains an important global financial centre despite its political issues, and will attract more fund inflows as international investors continue to tap on the growth potential of these companies for their portfolios.

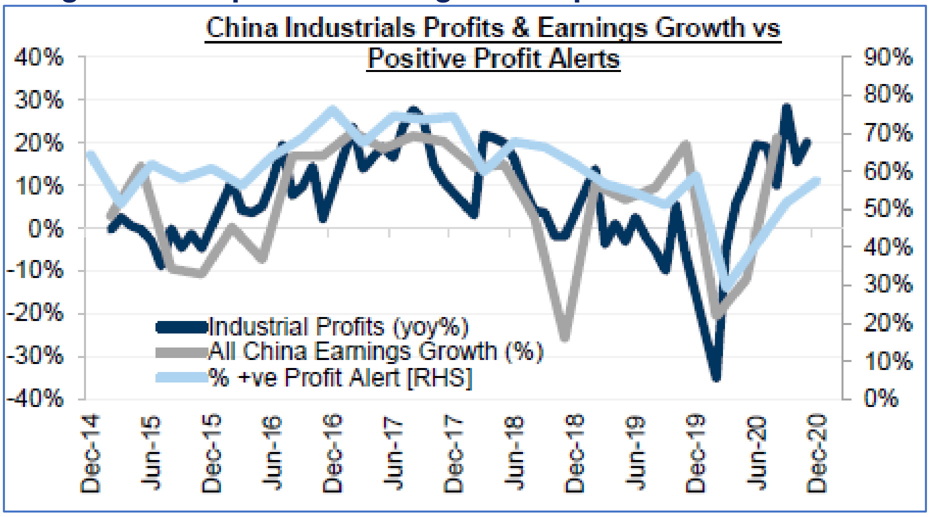
Structural growth drives multi-year benefits

- Being the quickest to bounce back from the pandemic slowdown, Chinese equities have experienced a strong rally, but this will be accompanied by volatility in the near-term as policy safety measures kick in. However, China’s strong growth performance in 2020 after the COVID-19 outbreak has enabled Beijing to focus on policy goals that will improve the quality of economic growth, supporting its “internal circulation” supply chain and innovation drive.

- As such, we remain optimistic towards China’s structural growth story, that is supported by a strong post-pandemic recovery and a focus on technology and innovation as cited in China’s 14th Five-Year Plan. China’s corporate earnings are expected to rise in 2021 (Figure 1), which will also drive equity returns.

- Investors should remain invested in the China Megatrend to reap the full rewards from China’s multi-year initiatives.

Figure 1: Corporate earnings are expected to rise in 2021



Source: Wind, FactSet, Goldman Sachs Global Investment Research, 20 March 2021.

What should investors do?

- Invest in line with your **risk tolerance,** and maintain **adequate diversification** across asset classes, regions and market segments to manage potential bouts of unforeseen volatility. Our proprietary Risk-First approach can help ensure that you take the appropriate amount of risks in accordance to your risk profile.

- **Stay invested in China –** The recent sell-off has brought valuations down to more attractive levels. While some volatility may persist in the shorter-term, the long term prospects of the Chinese market remains bright given its huge economic ambitions. **Adopt a long-term perspective when investing in the Chinese market.**

- Consider **investing in tranches** and **buying on market dips** to build up your positions in the **China Megatrend** at cheaper valuations.

- Please speak to your UOB Advisor to determine the appropriate courses of action for you in light of these latest developments.

All data are sourced from Bloomberg unless otherwise stated.

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