Beyond the noise: Why long-term capital will capitalise on China's future

Global investors must avoid allowing any short-term misperceptions about recent Chinese regulatory reforms to derail their big-picture perspective of the vast opportunity set in the world's second-largest economy.

The intention behind the government's vision is, in fact, to continue along the path towards long-term economic and social stability that will foster measured and sustainable growth for decades to come.

"This round of regulations is intended to create a favourable environment for China's sustainable high-quality growth, which needs innovation and social equality," said Xiaoyu Zhang, Chief Macro Research Analyst at E Fund Management (E Fund), China's largest fund manager with over RMB2.49trn ($385bn) in AUM as of June 30th 2021.

More specifically, the recent legal and policy actions are top-down implementation measures of the mid-term goals of the 14th Five-Year Plan (FYP), which build on the success of the 13th FYP towards achieving China's long-term goals of 2035.

"In the 14th FYP, the Chinese government has emphasised its priority of technology, consumption and efficiency, and the importance of developing the digital economy. The regulatory clarity will lead to a fall in risk premium," added Xiaoyu.

In short, this is why long-term investing prevails in China – and is the root of success for an asset manager which understands the development goals to offer investors access to the right opportunities.

A roadmap to "common prosperity"

The latest FYP offers a refreshed blueprint to reinforce the importance of the domestic economy to play a bigger role in driving future growth in China.

It focuses on "socialist modernization". This reflects China's move from being a low-income to a medium-income country, to becoming a moderately developed one that also maintains public well-being. It wants to be in a position to capitalise on an already-large domestic base that will grow stronger and hungrier as far as consumer demand goes.

Achieving these goals is part of a pragmatic approach to paving the way for a socio-economic environment in China that can provide consistently attractive risk-adjusted returns across key sectors going forward.

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In line with this, the focus is on concepts such as innovation, coordination, green development, opening-up and sharing.

New opportunities emerging

As a result, global investors with a longer time horizon – such as pension funds – have a lot to gain from their allocation to China.

Forecasted numbers in key growth areas tell a compelling story:

- Aggregate sales of retail goods in China in 2020 was equivalent to nearly $5.7trn – at only $0.5bn behind the US, this shows an ever-narrowing consumption gap that is also expected to disappear within the next couple of years.
- By 2025, the growth rate of Research & Development (R&D) spending within technology is expected to reach 7%, while the ratio of

expected R&D spending to GDP will increase from 2.4% last year to 2.7% in 2025.
- The digital economy, already valued at RMB35.6trn ($5.5trn) in 2019, or 36.2% of GDP, is expected to become even more dominant during the 14th FYP period

Taking a sector-specific focus

Based on China's projected growth story – and the core focus of economic development, innovation, public well-being, green ecology and social protection – four key investment themes will shine between now and at least 2025: technology, carbon neutrality, consumption and intelligent manufacturing.

These are represented by investment opportunities in a wide variety of sectors and industries – from cutting-edge technologies like artificial intelligence, integrated circuits and aerospace systems, to clean energy, infrastructure for water, electric power, transportation and communication, to food-related production and consumption.

As part of the "greening" of China's economy, for example, non-fossil fuels, which accounted for 16.4% in 2020, are expected to reach 26% by 2030 – and will eventually become the main energy source in 30 years. "Clean energy is required to replace fossil energy and thermal power," said Zhan Zhang, portfolio manager at E Fund, which was one of the first Chinese fund houses to become a UNPRI signatory, with the firm joining Climate Action 100+ last year. "Based on current technology, photovoltaics and wind power have the largest potential, followed by hydrogen power."

Analysing the technology space, meanwhile, the semiconductor industry chain offers tangible investment potential as China evolves from its current low self-sufficiency rate.

Notably, some of the strongest investment themes will benefit from a combination of both green revolution and tech-led advancements. Electric vehicles (EVs) are among these; fuelled by top-down policy support over the past decade, sales volume reached 1.32 million units in 2020, representing over 30% CAGR from 2015.

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At the same time, China's consumption trend will provide a strong boost to investment opportunities in the coming years. Based on the pace of digital adoption in e-commerce, streaming and more, the 14th FYP has a target for the proportion of GDP to come from core industries in the digital economy to increase from 7.8% in 2020 to 10% by 2025.

Chinese domestic brands will also become more prominent over the coming years. Notably, social networks at the hands of Generation Z will spur demand for new products such as personal care and cosmetics as female consumption flourishes.

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The so-called "silver economy" will also contribute towards this broad consumption story. Beneficiaries from China's ageing population in the next few years will likely include healthcare via innovative medicine, ophthalmology and rehabilitation therapy.

Staying invested in China's future

Such breadth and depth of potential across the domestic economy well beyond the latest FYP underscores the need for global investors to ensure they have access to deep local knowledge to understand local trends and changes – and within the context of China's development path.

As they do so, global investors will need to look carefully at the quality of each company in terms of its business model, plus with a view of how government policy will foster much-needed socio-economic changes.

"In fact, with portfolios generally underweight China in fund allocations, it seems to be a good time for investors to benefit from attractive valuations," explained Dongmei Yang, Executive Vice President of E Fund Management, which has over 200 investment and research professionals to support market analysis.

Ultimately in their favour are the policies embracing global capital. Continued efforts to open up China's capital market and proven effective pathways to access the domestic equity and bond markets have achieved remarkable results.