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Newsletter

SPEKTRA MAKELAARS

Signals from the East

One gets the impression these days that every time a newspaper is opened or the latest headline is read we are introduced to the newest set of regulatory crackdowns emanating from China. These regulations have been widespread and have underscored President Xi's drive to control all forms of business as well as the general public.

Peering Through the Regulatory Lookingglass

The vast majority of these regulations have formed the basis of Chinese president Xi Jinping's drive toward "Common Prosperity". The overarching goal of common prosperity, or at least the underlying theory, is one we are well familiar with here in South Africa; that is to bridge the excessive gap between the nation's rich elite and the impoverished general population. As such, many of the regulations of common prosperity stemming from Beijing seek to reign in some of the billionaire owners of China's biggest companies and instead offer equal opportunity in healthcare and education, as well as better opportunities and social welfare. One would do well to remember, however, that this idea of Common Prosperity, and indeed the phrase itself, is in no way new to China. The phrase was first used in the 1950's by none other than Mao Zedong, the founding leader of the People's Republic of China. It is therefore no surprise that President Xi has been labelled as having Maoist leanings as he extends the party's dominance over civil society.

The increase in rhetoric in the recent months has seen action taken against a multitude of Chinese businesses. These crackdowns have extended from insurance agents to private tutoring firms, along with real estate developers. Any firm taking an interest in the Western World has come under intense scrutiny, particularly those wishing to sell shares in America. Probably the largest and most heavily affected industry is that of Chinese Tech, which has seen a myriad of regulatory action taken against it from all angles. In September China embarked on a nationwide cleansing of social media platforms and financial blogs which were suspected of generating and distributing misinformation. The clampdown targeted general market sceptics as well as financial news and social media accounts reporting negative views on China's economy. While this may seem in good faith (and in China it has certainly been marketed as such), it has the ancillary effect of offering the Chinese government yet another means of controlling the media and an even greater potential for misinformation stemming from the Communist authority. The Chinese government is nothing if not efficient, and already 8 000 accounts have been shut down and over 17 000 pieces of 'harmful information' have been removed. Essentially this move targets, and has the potential to arrest, any Chinese citizen who disagrees with Beijing's data. This severe crackdown on the spreading and sharing of information was made no more evident than earlier this year with the introduction of China's new anti-fraud app. The app, which currently has around 200 million users, serves to identify and question any local who makes use of overseas financial news websites as opposed to local Chinese websites. After its launch in March this year numerous government agencies and businesses have made it mandatory for their employees and customers to download. The measures used within the app are nothing short of draconian, as users are contacted by police if any of their devices are found to be making use of overseas news sites which have been labelled as "highly dangerous", of which Bloomberg has been listed. There has been a strong clap-back from the Chinese public over the use of the app and the constant surveillance by the Chinese authorities. Once installed, the app requires a total of 29 permissions, including live call monitoring as well as location tracking. There have been thousands of complaints of privacy invasion and many citizens have threatened to delete the app altogether. However, the Chinese authorities have remained undeterred and have made it exceedingly difficult for the Chinese public to live without the app. In some cases, proof of the anti-fraud app is required in order to rent an apartment, or even enrol your child in school.

A further regulation which has garnered more of a mixed reception is that relating to gaming. The new gaming regulation limits gamers under 18 years old to 3 hours of online gaming per week. The move restricts all gaming during the week and allows only 1 hour of gaming on Friday, Saturday, and Sunday. The move has caused an outcry from the international e-sports community, where competitive players can train up to 70hrs every week.

Depending on one's view, however, this latest move can be seen as a positive social intervention. China has been heavily criticised in the past for the number of hours children spend online and has named the gaming addiction amongst the youth a "Spiritual Opium". Readers would do well to remember that the current headlines and regulations are in no way new, and have been a mainstay in Chinese-related news articles for several years. Below are some news headlines from the London Financial Times from the first half of 2020, all of which could just have easily been published in the last week:

FINANCIAL TIMES

Chinese business & finance ✓ Added

Chinese state seizes control of 9 insurers, trusts and brokers

US tech groups resist Hong Kong's customer data access plan

Google, Amazon and Microsoft on collision course with regulator over financial data held in cloud platforms

China imposes Great Firewall on Hong Kong

#techAsia, your guide to the billions made and lost in Asia tech

FINANCIAL TIMES myFT

Trade Secrets Global trade + Add to myFT

The power battle between Beijing and Washington over global regulation

From an analytical point of view, it is important not to get too caught up in the latest sensationalist headline, but to endeavour to look through the noise and try determine what signals we are being given from an investment point of view.

The Investment Case for China

When assessing global markets as a whole, there has been a clear trend of increasing levels of concentration at both the regional and sectoral level. Global Tech stocks, led by the FAANGM's, have enjoyed a truly herculean rise and have become the dominating force behind the majority of portfolio returns (and often portfolio declines) over the last decade. From a country perspective, the US continues to boast the largest global economy by a long way, however China's rapid economic growth has done a great deal to boost the importance of emerging markets. Currently, the US accounts for about 60% of Global Equity Market Capitalisation, with the entire Emerging Market Basket (of which China is party) accounting for a mere 13%, less than a quarter of that of America. This outsized weight of the US clearly skews an investor's regional and sectoral allocation decisions.

Today, China accounts for over 40% of Global Emerging Markets, more than double its weight a mere decade ago. As such, any decision to invest in EM's should naturally begin with determining one's desired exposure to China. Due to increased levels of globalisation investors are now able to access non-domestic equities with relative ease. As such, the link between domestic economies and equities has declined as investors have sought opportunities offshore. In order to measure the relative size of equities versus their home economies, the MSCI measures the market capitalisation relative to GDP for each of its composite countries. It shouldn't come as a surprise that the US is significantly outsized according to this measure, with a Market Cap to GDP of around 170%. China, on the other hand, has an investable market capitalisation in the MSCI Index of only 20% of its GDP. Essentially, this means that China is significantly under-represented and has the potential to substantially rise as the equity market opens further. It is important, however, to approach investing in China with a healthy level of caution. The opportunity set within China is very wide, boasting the largest number of companies in the global benchmark, however we would argue that investing in China remains a selective stock-picking call.

That is, of course, notwithstanding the growing debt issue starting to take material effect in global markets. One can hardly consider an investment in China without mentioning the word "Evergrande" …

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