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The Quality Growth Investor

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CHINA: MUCH ADO ABOUT NOTHING?

A BOTTOM-UP VIEW OF THE CHINESE COMMUNIST PARTY'S 20TH CONGRESS

On 16 October, the governing Chinese Communist Party (CCP) will convene for its 20th party congress with President Xi Jinping expected to secure an unprecedented third term. After numerous regulatory changes upended portions of the Chinese market over the past year, many international investors have questioned whether China is even investable anymore. The congress is further a reminder to investors that the Chinese market is heavily influenced by their politics.

Jasmine Kang, portfolio manager of Comgest's China Equity strategy notes that China remains an attractive market for those stock pickers who avoid the political noise and pitfalls.

As the countdown to the 20th Party Congress draws near, China has been contending with numerous crises including a "zero-covid" policy that has slowed their economy and a wave of new regulations. The list of questions for investors is lengthy: What impact would a technology or trade war have on Chinese companies? How will the regulatory landscape further evolve? What political direction could President Xi Jinping take in the future? All of this uncertainty has contributed to the high volatility of the country's stock market.

Investing in China: Taking advantage of secular trends

Since the circles of power in Beijing can be more opaque than in other countries, it tends be difficult to predict the direction of Chinese politics. At Comgest, we aim to factor in government targets and regulatory risks when picking stocks by asking ourselves if our portfolio companies are – or aren't – compatible with the Chinese government's long-term goals. We then focus on companies that benefit from the various Chinese secular growth trends that we've seen in our research and which align well with government targets.

Some of these trends stem from President Jinping's "common prosperity" policy which the government claims is aimed at narrowing the widening wealth gap.[1] Although certain investors may view this policy as unilaterally negative with the view that mass consumer goods may benefit the most, we believe that it could offer many local opportunities. Emerging domestic brands are benefitting as the country's growing middle class increase their consumption, particularly among companies seen as "guochao", i.e., the "China-chic" trend driven by younger Chinese.[2] Anta Sports, the third-largest company in the Chinese sportswear market illustrates a home-grown company that has been steadily gaining market share.[3] The traditional high-end baijiu spirits manufacturer, Kweichow Moutai, now features in middle-class households in China.[4] Inner Mongolia Yili, China's largest dairy products company has also gained market share over foreign brands, such as in instant baby food, where – following a 2012 scandal[5] – the company has re-earned the trust of young couples thanks to secure sourcing, innovation and brand strength.[6] As a result of the "common prosperity" policy aiming to give the middle class a larger piece of the consumption pie, the effect has been positive for domestic consumer-driven companies with strong brands and high levels of innovation.

Invest in market leaders and technological pioneers

In terms of clean energy, China's policy direction has been clear and positive, with many domestic incentives for the government to reduce carbon emissions and pollution.[7] With government support and the goal of becoming a high-tech manufacturing hub, Chinese companies have developed technological know-how in growth markets such as electric vehicles (EVs). Bafang Electric, founded in 2003, is one of the largest manufacturers of electric motors for e-bikes in the world and competes with well-established

[1] https://www.bbc.com/news/business-58784315
[2] https://www.ft.com/content/ee881d38-b497-4c6a-a672-73c30723a510
[3] https://global.chinadaily.com.cn/a/202203/25/WS623d15eea310fd2b29e53322.html
[4] https://www.caixinglobal.com/2017-03-01/baijiu-makers-benefit-from-rising-middle-class-reform-in-sector-101060899.html
[5] https://www.wsj.com/articles/BL-CJB-15964
[6] https://www.just-food.com/news/yili-opens-hub-for-milk-cheese-and-infant-formula-in-china/
[7] https://www.csis.org/east-green-chinas-global-leadership-renewable-energy

companies such as Shimano and Bosch. Another example is Xinyi Solar, the world's largest manufacturer of solar glass.

Chinese companies are increasingly becoming technological pioneers: they invest more in research and development to boost the quality of their products and services. This trend is visible in all sectors, especially in the country's rapidly growing health care market. Shenzhen Mindray Bio-Medical is a Chinese market leader in medical technology, and although 50% of their turnover is generated in China, they are also strong internationally – ranking fifth worldwide in haematology.

While companies with advanced technological know-how are widely promoted in China, there are serious investment risks stemming from ongoing geopolitical tensions, particularly with the US. A technology war between China and the US could severely limit the growth opportunities of the country's semiconductor and biotech companies.[8]

Important Information:

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About Comgest:

Comgest is an independent, global asset management group with headquarters in Paris and offices in Amsterdam, Boston, Dublin, Düsseldorf, Hong Kong, Singapore, Sydney, Tokyo, two branch offices in Milan and Brussels and a representative office in London. Since inception in 1985, Comgest has pursued a long-term 'Quality Growth' and responsible investment style with the objective of selecting quality companies with solid prospects for sustainable growth. With more than 200 employees of 30 different nationalities, Comgest serves a diverse global client base and manages assets of over €29.4 billion (unaudited data as of 30 June 2022).

[8] https://www.bloomberg.com/news/newsletters/2022-08-13/us-goes-on-offense-in-china-tech-war-new-economy-saturday