COMGEST

The Quality Growth Investor

PRESS RELEASE – 18 January 2023

THE YEAR OF THE RABBIT: CHINA POISED FOR A REBOUND

As China prepares to celebrate the start of the Year of the Rabbit on 22 January 2023, Jimmy Chen, Portfolio Manager of the Comgest Growth China fund, believes some positivity lies ahead for China with a recovery from a year of economic stress and poor investor sentiment:

"For Chinese equity, 2022 was the second tough year in a row due to China's stringent zero-Covid strategy and regulatory crackdown on businesses as well as an escalation of geopolitical tensions. The end of the year saw a vast change as the Chinese government lifted most of their Covid controls, industrial policies turned more business-friendly and progress was made to control geopolitical tensions. Meanwhile, their inflation rate is expected to stay moderate, allowing macroeconomic policies to remain loose."

"In our view, the outlook for 2023 should be one of growth reacceleration and investor sentiment recovery. The P/E valuation for Chinese equity remains cheap by historical standards. As a result, we believe that China equity is poised for strong performance in the Year of the Rabbit."

CHINA CLIMBS OUT OF THE RABBIT HOLE

"During 2022, the Chinese government's zero-COVID controls were the major drag on consumers and business confidence. As of 8 January 2023, however, all final Covid restrictions were lifted. The bad news is this enabled the pace of Covid infections to become fast and furious, stretching the health system.[1] On the positive side, China is anticipated to reach peak infection earlier[2] and economic activity should rebound faster than expected."

"In addition, industrial policies have become more pro-business. This can be seen as the nearly two-year crackdown on tech platforms seems to be winding down, exemplified by the recent completion of Ant Financial's recapitalisation.[3] Similarly, gaming license issuance resumed in April after an eight-month freeze, with Tencent and Netease receiving approvals starting September[4]. The government is also easing policies on property developers, after efforts to deleverage created liquidity crisis for the industry. On a macroeconomic front, because the domestic supply chain has remained resilient and there was no 'helicopter cash', inflation is tame, allowing fiscal and monetary policy to remain loose.[5]"

"Geopolitical tensions between China and the US have stabilised. In November, Chinese President Xi Jinping and US President Joe Biden met face-to-face for the first time as leaders in an effort to re-establish a working relationship.[6] Similarly, auditors from the U.S. Public Company Accounting Oversight Board (PCAOB) were finally permitted by the Chinese regulator to audit ADR documents in September in Hong Kong and noted that they were satisfied with their initial reviews, significantly alleviating the risk of Chinese companies being forced to delist from US stock market."

"All of these developments suggest that President Xi Jinping, like other Chinese leaders since Deng, is taking a pragmatic approach to balancing social stability versus economic growth. While there was severe market panic in October after Xi was re-elected for an unprecedent third term at the Communist Party Congress, so far that fear seems misplaced."

[1] Cao, Ella and Ryan Woo. China's healthcare system put to the test as COVID curbs fade, *Reuters,* 12-Dec-22.
[2] End of Covid Zero Threatens to Overwhelm China with Infections, *Bloomberg,* 9-Dec-22.
[3] Ant gets approval to expand its consumer finance business, *CNBC.* 4-Dec-22.
[4] Tencent and NetEase secure major game approvals at the end of 2022, *technode,* 29-Dec-22.
[5] China Hints at Pro-Business Policies, Smaller Fiscal Boost, *Bloomberg,* 19-Dec-22.
[6] Bose, Nandita and Stanley Widianto. Biden and Xi clash over Taiwan in Bali but Cold War fears cool, *Reuters,* 15-Nov-22.

COMPANIES HOPPING INTO RECOVERY

"Based on our research, those companies benefitting from China's reopening and long-term quality growth compounders could be a winning combination for Chinese equity investors in 2023. Anta Sports, Suofeiya, and Focus Media all have these credentials, with leadership in areas such as sportwear, customised furniture, and advertising as a result of their constant innovation and ever increasing footprints."

"Tencent, China's economic bellwether, combines the country's domination of video games, payment and social media platforms. Growth and sentiment have been held back for two years by a tough regulatory environment, a weak consumer and the tech rout. We believe the normalisation of gaming license approvals, an improving consumer sentiment and a sanguine outlook for Chinese tech investments should contribute to a positive 2023 as well as a long-term outlook. The monetisation of its short-video platform will add an extra boost."

"Another global growth trend that Chinese companies are seizing is the outsourcing of biopharmaceutical production and development. Wuxi Biologics is one of the strongest challengers to global market leader Lonza with their competitiveness coming from the combination of a unique business model, innovation and access to a bigger talent pool. The stock underperformed in 2022 after two of its subsidiaries were added to the US Unverified List[7], creating fear that the Chinese-US tech conflict is spilling into the biopharma outsourcing industry.[8] By the end of 2022, Wuxi Biologics' subsidiaries were all removed from the Unverified List[9], seemingly lifting the geopolitical cloud."

[7] Ahern, Brendan. US Commerce Department's Unverified List Tanks Wuxi And Investor Sentiment, *Forbes,* 8-Feb-22.
[8] Bhattacharji, Aditya. US-China Tensions Heating Up in the Life Sciences, *Pharma Boardroom,* 7-Sep-2019.
[9] U.S. Commerce removes Wuxi Biologics from unverified list, *Reuters,* 15-Dec-22.

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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 £25.3 (€29.4) billion (unaudited data as of 30 June 2022).