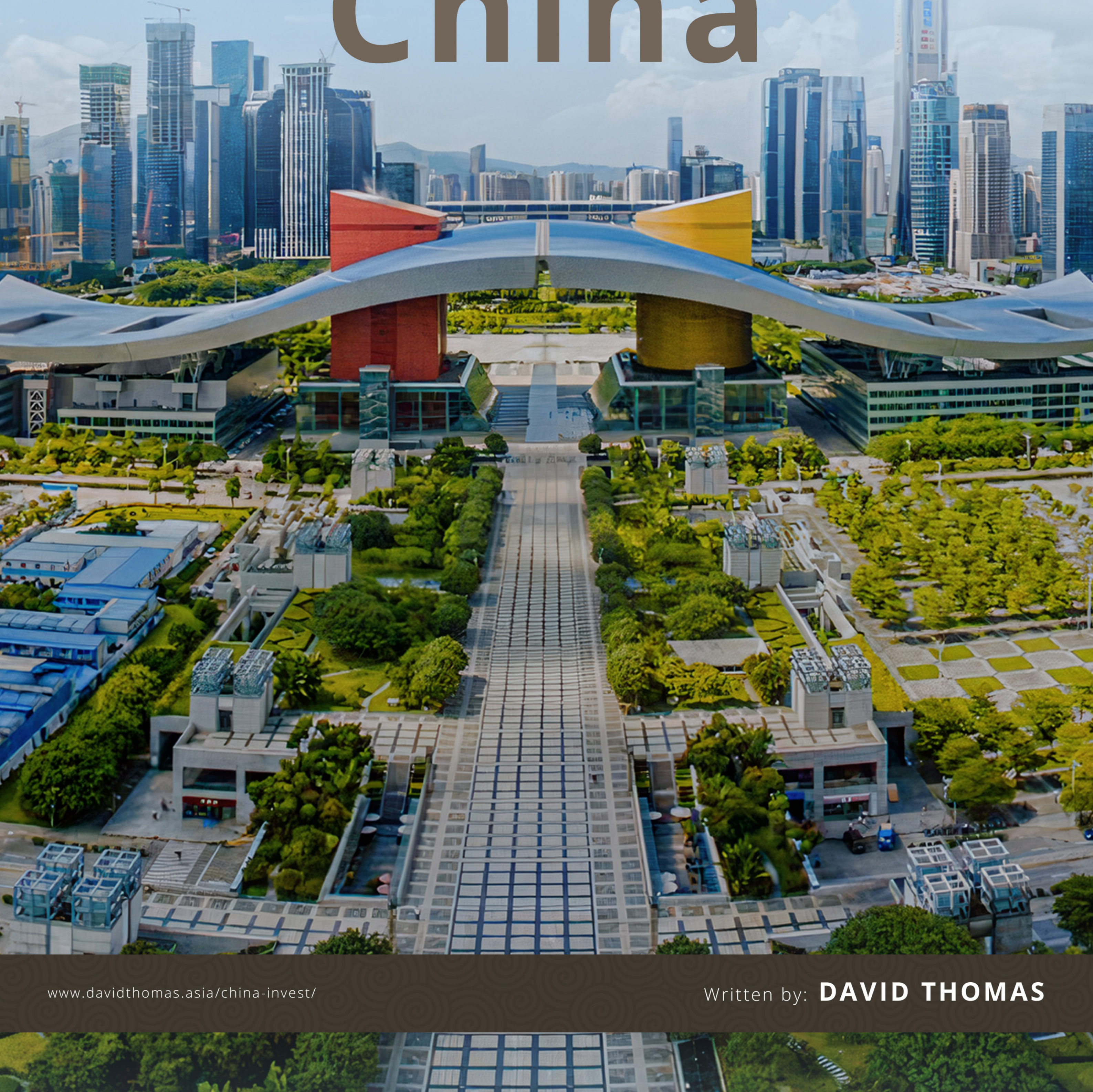
CHINA INVEST

July 2022

Eight Reasons to Invest in China



www.davidthomas.asia/china-invest/

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Introduction

China Invest is a platform designed to provide clients, investors, readers and followers with the insights, knowledge and confidence that will empower them and/or their organisations to invest in China over the course of 2022, and beyond.

China's economy today is driven by domestic consumption. Similar to America in the 1960s, China is following a long term path to building a nation and an economy that, before the end of this decade, will become the largest economy in the world. Foreign investors have a unique opportunity to participate in China's future economic and market growth which is under-pinned by some unqiue fundamentals.

In the pages that follow, I have set out the **Eight Reasons to Invest in China** which offers a compelling case for investors to pay close attention to what's happening in China, and to start researching and assessing the investment opportunities that fit their risk profile. Future updates, news and opportunities can be accessed from the China Invest web site: www.davidthomas.asia/china-invest

We work with local Chinese based institutions, fund managers (specialising in China A shares, PE, VC, property, alternatives etc.), family offices and high net worth investors to bring information and opportunities to our clients around the world who have an interest in investing in China.

Please contact us via support@apacfinancialservices.com or visit the China Invest website to express interest in our activities or ideas. If you find this information relevant and interesting, please pass it on to others.

Best wishes

David Thomas

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July 2022

The information that follows is for general information only. It should not be taken as constituting professional advice. You should consider seeking independent legal, financial, taxation or other advice to check how the information relates to your unique personal circumstances.

1. China is the Second Largest Economy in the World

Considering the size, scale and growth of China's economy, it's amazing to find that the participation of foreign investors in China is so low. Consider the following:

- China's economy is the second largest in the world in nominal terms, with a GDP of nearly $17 trillion, approximately 18% of the world's total GDP (see chart below from Visual Capitalist). China is the largest manufacturer in the world with extensive production of steel, electronics and robotics and a significant commitment to innovation, particulary in retail, healthcare, technology and renewable energy.

- China has the world's largest economy on a PPP (purchasing power parity) basis and accounts for 33% of global economic growth, four times more than the United States, Europe, Middle East, Africa, Latin America and Japan combined.

- With a population of over 1.4 billion people, China's middle class has increased from less than 8% in 2010 to over 50% of total households today.

- Chinese consumer discretionary spending has doubled since 2010, and the combined services plus consumption sectors contribute 75% to China's GDP growth.

- China's Government remains committed to economic growth through the expansion of domestic consumption, innovation and opening its economy to foreign investment. Unlike in the past, when China's economy was vulnerable to external factors and shocks, China's future economic growth will be predominantly driven by its domestic market.

Yet, despite the above:

- Foreign investors generally have very little exposure to Mainland China in their portfolios - a total of only 4.1% of China's domestic A share market

- Australia as a country invests only 2.1% of a total foreign direct investment (FDI) in China, compared to 28.4% in USA and 20.2% in UK (source: DFAT)

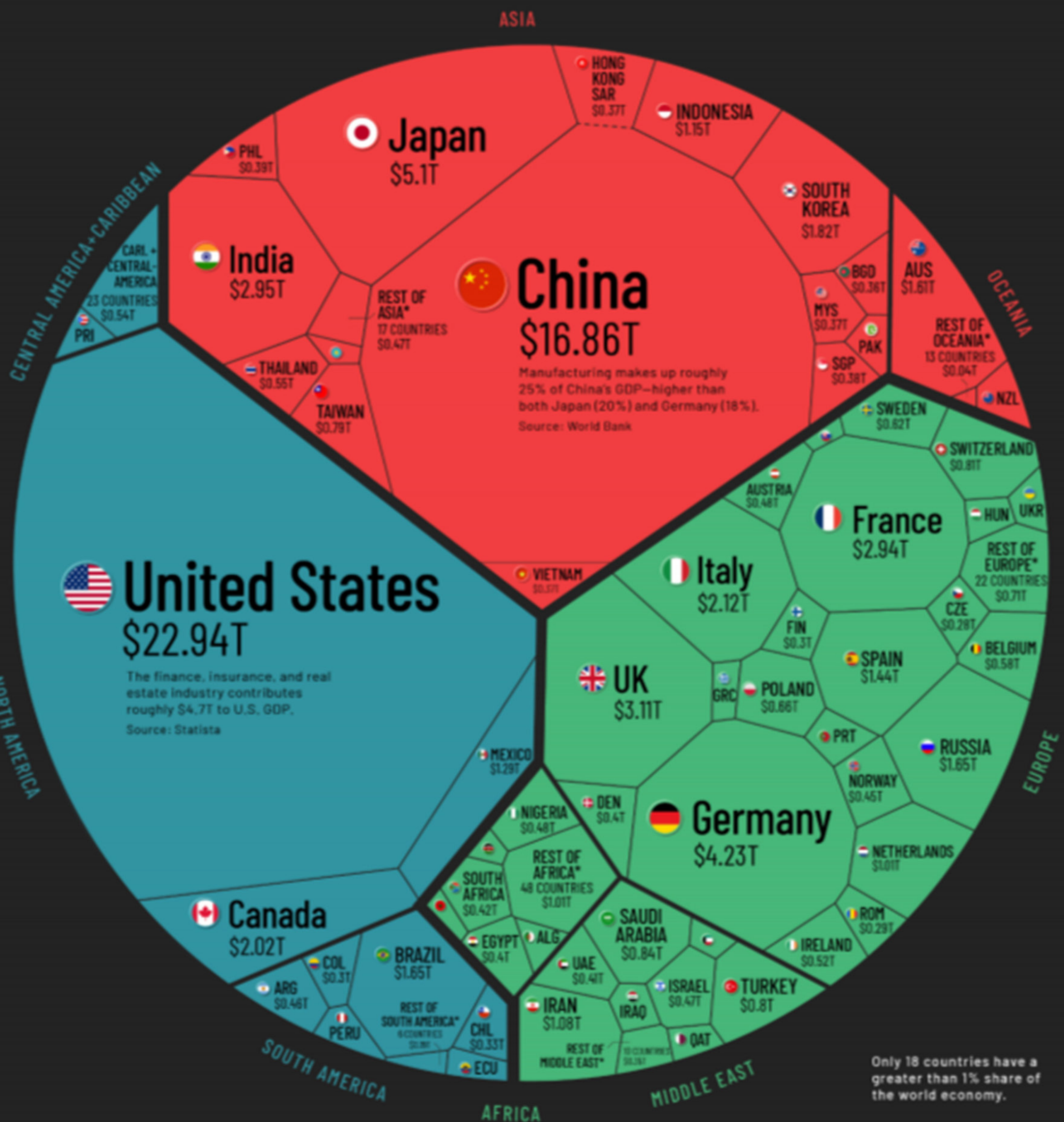
- A review of Australia's largest industry superannuation funds suggest that very few investors have any direct and/or targeted exposure to China's A share market (other than via a broad exposure to Asian or Global Emerging Markets)

There is plenty of evidence to suggest that foreign participation in China's A share market will increase substantially in the years ahead. How much exposure to China do you have in your investment portfolio?

GLOBAL GDP 2021

Gross domestic product (GDP) serves as a barometer for a country's economic health. It measures the total market value of final goods and services produced in a country during a given year.

Together, the U.S. and China account for 42% of global GDP. Here is GDP by country according to IMF estimates.



2. China’s Domestic A Share Market is Broad, Deep, Liquid and Strong

China’s ‘A Share’ market is the world’s 2nd largest stock market, with a market capitalisation of US$ 14.1 trillion (compared to Wall Street US$26.2 trillion, London US$3.8 trillion and Australia US$1.6 trillion) and over 4,500 listed companies (4,000 in the US). Shares worth more than 1 trillion yuan (US$154.6 billion) are regularly traded each day on the Shanghai and Shenzhen exchanges (retail trading accounts for 60-70% of daily turnover, mutual funds 20% and pensions/insurance 10%) making it one of the most liquid and actively traded markets in the world.

Investors in China’s A share market are offered opportunities to invest in a diverse selection of local companies from a wide range of sectors, including from the ‘old economy’ (financials, property, utilities, mining and energy) and the ‘new economy’ (consumer, healthcare, technology and renewable energy sectors). This includes some large household names (e.g Haier, Midea, Moutai) and also smaller emerging companies who benefit from the Government’s emphasis on increasing competition, innovation, ESG (environmental, social and corporate governance) and greater transparency and regulation. Most A share listed companies generae over 90% of their revenues locally or domestically which makes them less vulnerable to economic downturns overseas and allows them to invest in innovation, growth and creating local employment.

Most economic commentators agree that China’s economy plays a prominent role in propelling the growth of the global economy and this offers enormous potential for local companies to continue the amazing domestic success story of the past 30 years. Over 85% of Chinese healthcare, consumer and information technology stocks are listed only on the A share market, meaning that foreign investors will have to increase their China exposure to access some of the world’s most innovative companies.

Skilled, active and local fund managers (particularly whilst borders are closed due to Covid) with a focus on fundamentals, industry and individual company research can exploit the inefficiencies in a retail-driven domestic market and deliver above average returns to foreign investors who otherwise find it hard to research and understand the market from overseas.

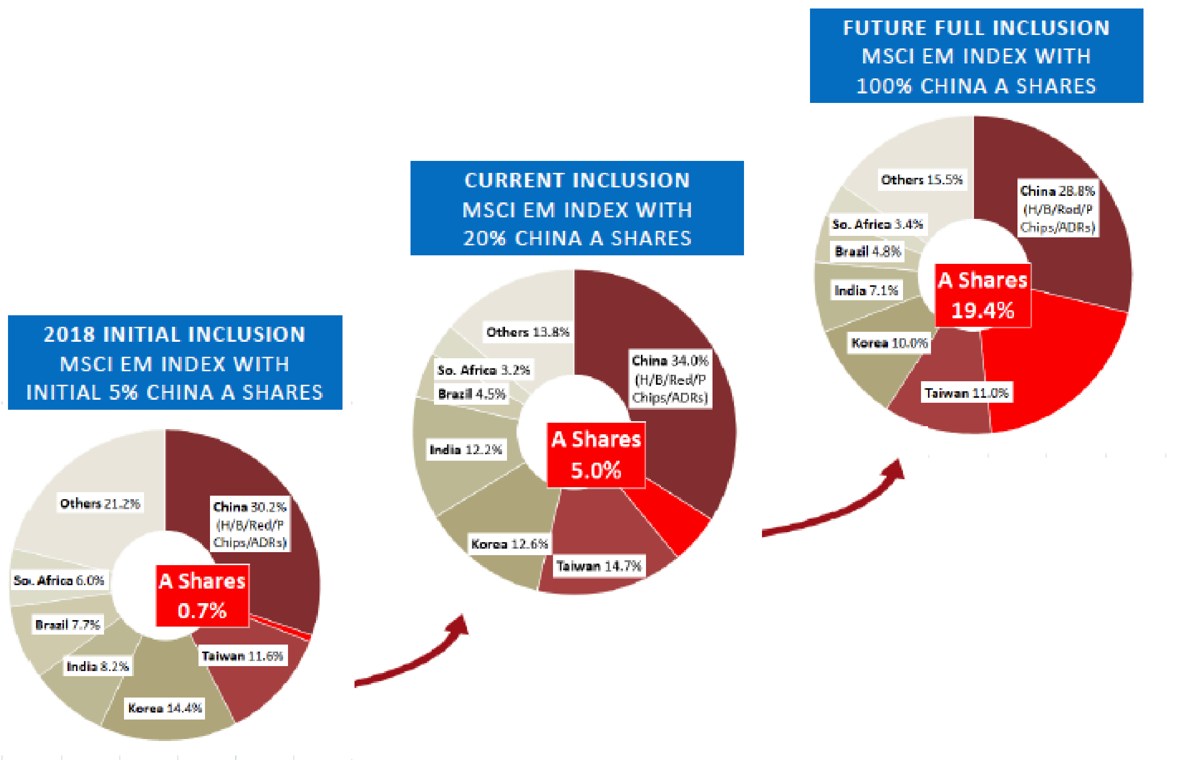
3. MSCI will Significantly Increase its Weighting towards China A Shares

For many years, investment commentators have predicted that MSCI, the globally accepted benchmark by which active fund managers measure their performance against underlying equity market(s), will increase their weighting towards China A shares to reflect the growing influence and contribution of Chinese companies within the global economy.

Over the past 2 years, the 'inclusion factor' for China A shares in the MSCI Emerging Markets Index has increased from 0.7% to 5% which has forced foreign managers to significantly increase their China A share exposure to at least match the MSCI Benchmark. Whilst these relatively minor adjustments may not have attracted wide scale media and industry attention, the amounts involved stretch to many billions, if not trillions, of institutional fund flows, and this is one of the reasons for the strong performance of the China A share market in recent times.

As a result of the ongoing liberalisation of the A Share market by the Chinese Authorities, a trend that has accelerated in recent years and is expected to continue into the future, it is widely expected that China will become a separate asset class within the next 5 years, and the weighting of China A shares within the MSCI Emerging Markets Index will be increased to 20% (see chart below) before their inclusion in other MSCI benchmarks.

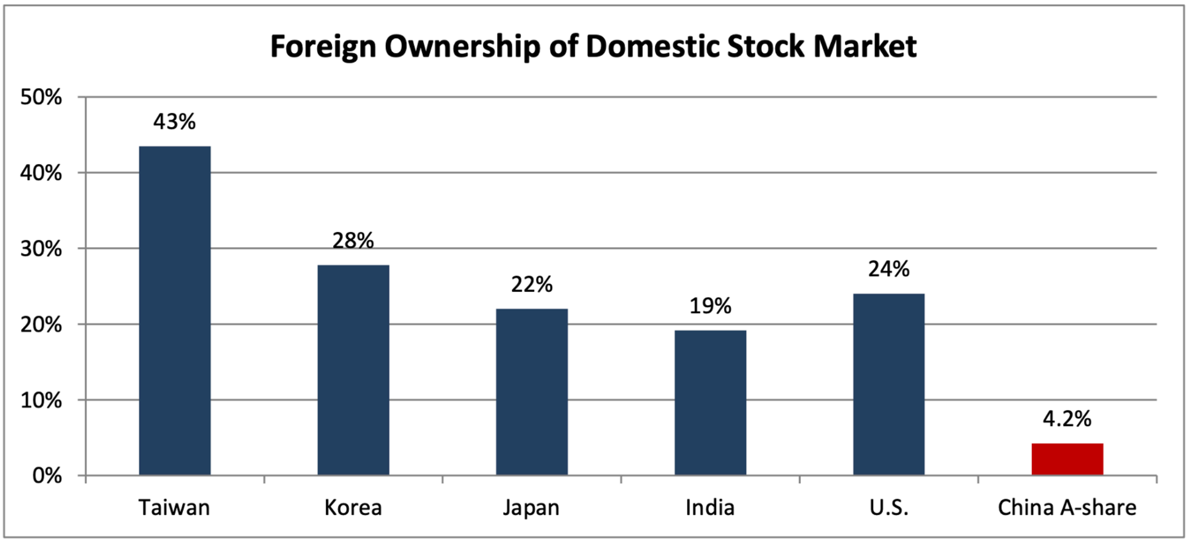
Foreign portfolio investment in Greater China is still very low relative to the benchmark (foreign investors own just 4.1% of the domestic A-share market) which suggests that a lot more foreign institutional investment will flow into China in the near future. Foward thinking long term investors will want to get ahead of this wave.



[1,2,3] Source: MSCI; Nov 2019 Index Review; MSCI, "China A Shares, What Have We Learned" (October 2020); Wind, People's Bank of China, "Domestic Financial Assets Held by Overseas Entities" (November 2021).

4. Foreign Investors are Significantly Underweight China

The Following chart from MegaTrust illustrates the massive under-representation of foreign investors in China's domestic A share market when compared with other markets:



Source: Various stock exchanges and MegaTrust estimates. As of December 2021.

As covered in this book and elsewhere, there are many reasons to believe that China's A share market, the second largest stockmarket in the world (by virtually all measures, including size, volume and daily turnover) is likely to see a significant rise in foreign ownership in the years ahead.

This will result in the inflow of many billions of dollars from foreign institutions, a trend that will lead to rising share prices and positive returns, especially for the ealry movers.

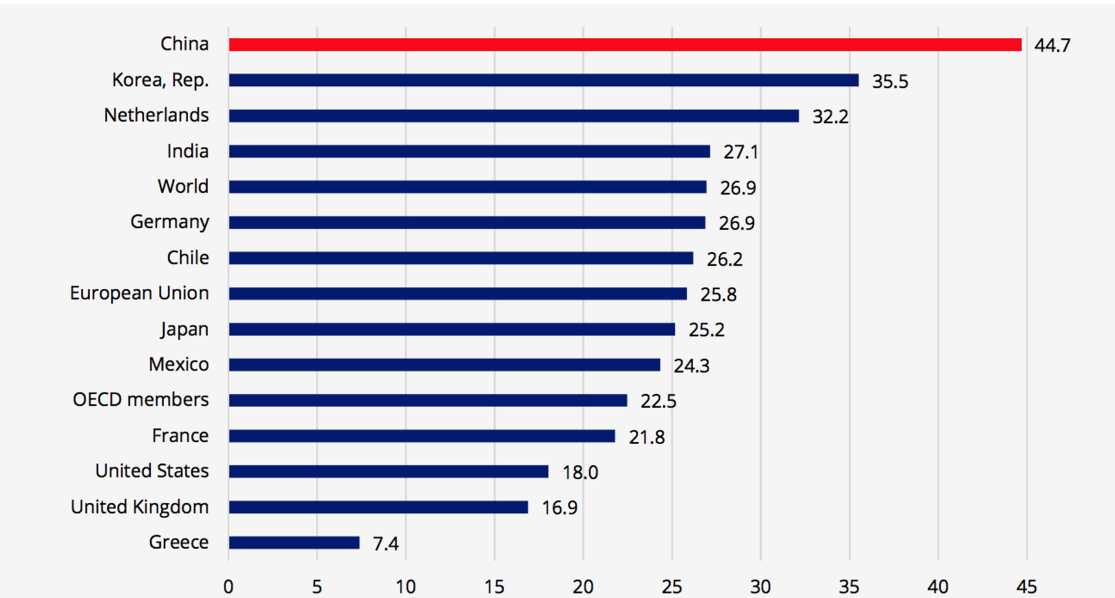
5. China is Introducing Long Term 'Patient' Capital

Anyone working in the financial services markets of the US, UK and Australia will be well aware of the importanc of a strong and tax efficient private pensions systems to boost equity markets and drive long term 'patient' capital. Many jobs, careers and fortunes have been built on this, and equity markets in developed markets have benefited from consistent inflows and the participation of professional institutional investment managers rather than the more skittish and emotional behaviour of individual retail 'mum and dad' investors. Introduced in 1992, Australia's mandatory superannuation system has now accumulated a total pool of A$3.4 trillion (more than 125% of the nation's GDP and over double the total market cap of the local ASX) and, with projected inflows and future capital gains, this number is expected to treble by 2050 (according to KMPG).

With its ageing demographics and underfunded pensions system, it's not surprising to find that China is now striving to reform and expand its pensions sector, an urgent national priority highlighted in the 14th Five Year Plan (2021-2025), and a strong signal to investors around the world that Chinese equities will become an attractive asset class in the future. With the imminent launch of a new individual retirement savings system, it is estimated that private pensions will grow almost six-fold from US$300 billion today to US$1.7 trillion by only 2025.

According to Van Eck Investments "the growth of private pensions in China will support further development of the country's capital markets by raising the quality of the assets invested in the country's stocks and bonds since retirement savings are a source of long-term, patient capital. Additionally, as international managers participate in the development of China's private pension market, corporate governance among public companies will improve to match global standards across mature pension systems. Long-term international investors in Chinese equities would do well to stay the course with the country's stock markets and reap the benefits of this potential windfall".

Gross Savings (% of GDP) for Select Countries, 2020



Sources: World Bank national accounts data, and OECD National Accounts data file

6. China's Massive Investment into Energy Transition

It is generally accepted that "Energy Transition Investment", a market that requires US$125 trillion by 2050 to enable the largest and most developed countries in the world to achieve their promise of net zero emissions by 2050, is the most attractive and lucrative investment opportunity for global investors in the coming decade. Annual global investment in this sector reached a record high of US$755 billion in 2021 (up 27% over the past year) and we're already seeing significant flows into projects offering exposure to the growth in (amongst others) new sources of renewable energy, electric vehicles, batteries, nuclear, hydrogen and sustainable materials.

As you can see from the infographic, China is already investing more than one-third of the world's total investment into this sector (more than the USA, Germany, UK, France, Japan and India combined) making it a market that is certain to attract the attention of global investors seeking opportunities to invest in some of the most innovative and fast-growing companies of the future. Many of these Chinese companies will only be accessible to investors who participate in China's domestice sharemarkets.

ENERGY TRANSITION INVESTMENT

Top 10 Countries in 2021

Global investment in energy transition hit a record high of $755B in 2021, up 27% relative to 2020.

Non-renewable energy transition investment

Includes: hydrogen, nuclear, carbon capture, electrified transport, electrified heat, energy storage, sustainable materials

Renewable energy investment

The top 10 countries accounted for 74% of global energy transition investment.

China added 48 gigawatts (GW) of wind and 53GW of solar capacity in 2021, increasing its total wind and solar capacity by 19%.

European countries collectively invested $219B in the energy transition.

Source: BloombergNEF

7. China is Modernising and Nation-Building

Similar to America in the 1960s, China is following a long term path to building an economy which, before the end of this decade, is expected to become the largest economy in the world. Foreign investors have a unique opportunity to participate in China's future growth which is under-pinned by some unique fundamentals, including the following:

Domestic Consumption

China's economy today is driven by domestic consumption. China is the world's largest market for online retail and now represents more than 30% of the global market in luxury goods, automotive, consumer appliances, mobile phones, and spirits. In 2021, local consumption contributed over 90% of GDP growth. Chinese consumer discretionary spending has doubled since 2010 and is set to double again in the next 10 years to reach US$12.7 trillion, approximately the same as American consumers spend today. In addition, with household savings rates increasing during the Covid pandemic, there is increasing pent-up domestic demand which is likely to have an impact in 2022. Retail sales are already predicted to grow by at least 6% this year.

Innovation and R&D

China invests more money in innovation (USD60 billion) than any other country in the world and is already becoming a global leader in high value manufacturing, healthcare, environmental protection, e-commerce and technology. China's spending on R&D increased 10.3% in 2020 to USD378 billion, accounting for 2.4% of GDP, and is set to increase by more than 7% per year between now and 2025.

Urbanisation and Infastructure

Over the last 30 years, half a billion people have moved from the countryside to an urban centre, a rural-to-urban migration story which has no parallel in modern history. China's long term plan is to be nearly 80% urbanised which means that the future demand for commodities (cement, aluminium, coal etc.) seems assured, and new 'mega-cities' with a population of 10 million or more will emerge, currently standing at six (Shangai, Guangzhou, Beijing, Shenzhen, Tianjin, Chengdu). The nine cities that make up the Pearl River Delta in southern China are already being integrated with Hong Kong and Macau via new roads, sea bridges, high speed rail and 5G connectivity to make up the new 'Greater Bay Area', predicted to become 'the largest unified urban area in human history'.

7. China is Modernising and Nation-Building

Privatisation and Entrepreneurship

Whilst less than 30% of Chinese companies are privately owned, the private sector will be the dominant driver of China's future economic growth, contributing 60% of China's GDP, 70% of innovation and 80% of employment in urban areas.

China is 'modernising'. It's not 'westernising'. Investors must take a fresh, proactive and open-minded approach to investing in China, and resist the temptation to make decisions based on knowledge and experience gained in more developed markets.

8. China is Proactively Tackling its Major Challenges

Whatever you think of China's Government, or read in the media about its political system or international reputation, you cannot ignore its economic potential, its robust and stable Government, its commitment to long term 'top down' planning, and its ability to tackle its challenges head on. As a potential investor in China's future growth story, it's therefore important to maintain an objective view and cuirosity about what's actually happening on the ground in China and to access commentary, views and information from a wide range of independent and/or local sources.

Whilst China's economic success over the past 40 years has been dramatic and unprecedented, it has also created huge problems, challenges and disparities. Not just for the environment but for society aswell and, having initially been embraced by western markets for the economic benefits delivered from China's admission to the WTO in 2001, China now faces geo-political challenges that were unimaginable five years ago.

As a result, the Chinese Government's economic policy priorities have recently shifted to social equality, national security and self-sufficiency:

- The ultimate goal of social equality is to achieve common prosperity by narrowing disparities between the rich and poor.

- Recent regulatory scrutiny on e-commerce platforms, tech companies, online gaming and big data operators is deemed to be an effective way to ensure national security aswell as creating equal opportunities for all.

- Sanctions and bans by the US are accelerating the development of domestic supply chains to mitigate against future geo-political challenges.

All of these priorities present significant opportunities for investors who look beyond the headlines and follow the trends, particularly in sectors like retail, healthcare, technology and renewable energy, which also represent major Government priorities.

8. China is Proactively Tackling its Major Challenges

China is a planned economy. It publishes its challenges, priorities and targets every 5 years in its Five Year Plan. There are very few surprises. As has been the case for over 40 years, successful investors and entrepreneurs make decisions and take positions designed to capitalise on sectors, companies and opportunities that will benefit from Beijing's policy priorities.

Why wouldn't you be one of them?

About the Author

David Thomas

David Thomas is well known in the Asia Pacific region for his experience, credibility and passion for identifying, building and facilitating business and investment relationships between developed and emerging countries. Over the past 20 years, David has inspired, motivated and educated global business leaders, entrepeneurs and investors to pay attention to the massive growth potential offered by modern China as the financial engine of Asia and taken them on a journey to identify and build long-term business and investment relationships.

David lived in Hong Kong in the 1980s and 90s with his father, Michael Thomas QC, who was the Attorney General for Hong Kong (1983-88) and intimately involved in the negotiations between Britain and China to design and implement the new Basic Law of Hong Kong to take effect from 1997. In addition, his step-mother, Baroness Lydia Dunn, was a senior political leader in Hong Kong and worked with Deng Xiaoping and Margaret Thatcher to negotiate the future of Hong Kong under Chinese sovereignty post 1997. These unique insights and high level family connections provided David with a fascinating perspective on China's ambitions for the future which prompted his first visit to Beijing in 1989 and a life-long interest in China's role on the global stage.

David ran his own successful wealth management firm in Hong Kong from 1988 to 1995 before moving to Australia and working with leading financial planning firm, Godfrey Pembroke (1996-8) before joining the Commonwealth Bank of Australia (1999-2001). Over the past 20 years, David has led and organised many missions, study tours and business delegations to China and the other "BRIC countries" which in addition to enhancing his reputation, influence and networks within the Asia Pacific region, has provided him with unique opportunities to stay ahead of the trends that are impacting the wealth management sector in China, Australia and the Asia Pacific region.

Based in Sydney, David is a Keynote Speaker and Thought Leader on Australia's role in the Asian Century, and the author of two books and over 500 blogs on the topic of doing business in China. More at **www.apacfinancialservices.com**

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