



# China: Steady As She Goes

October 2016





# Agenda

- Understanding the Marketplace
- Waiting in Transit...*In a Wind of Change*
- Investment Themes

# Understanding the Marketplace





# Characteristics

- Highly volatile, with government policy being a key source of influence
- Dominated by short-term trends
- Dominated by retail investors
- Institutional investors remain dormant
- Other parameters such as issuance approvals, corporate governance, information disclosure are key areas for improvement



# Key Drivers

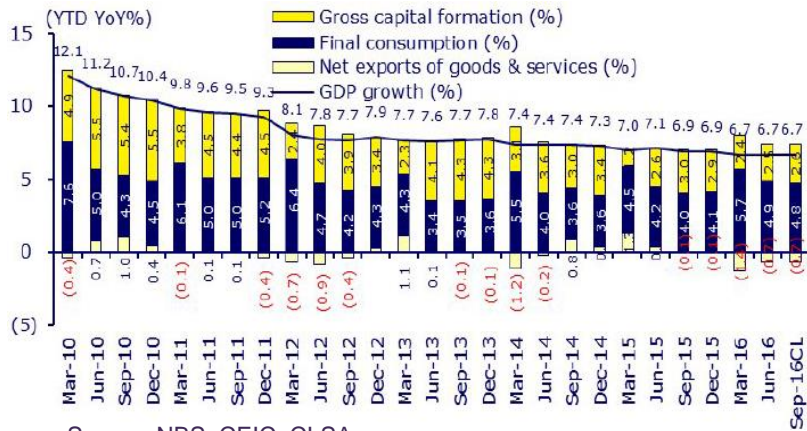
- Structural trends
  - Macroeconomic
  - Industrial and corporate development
- Short-term
  - Market liquidity
  - Investor driven
- Government policies
  - Affect both short-term liquidity changes and long-term fundamentals
  - Have become a dominant force influencing market trends

# Waiting in Transit...*In a Wind of Change*



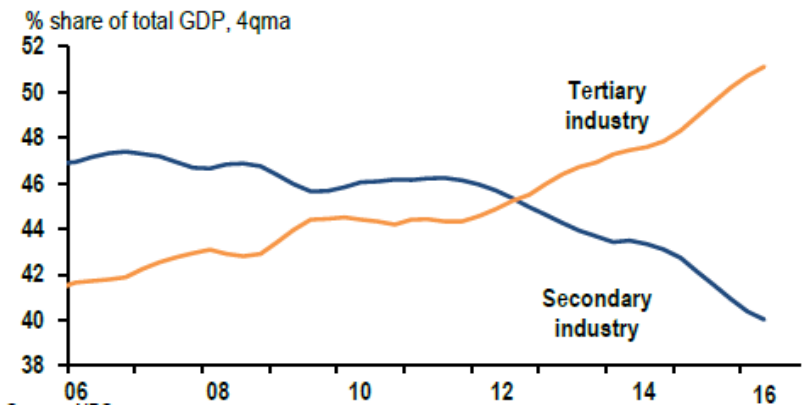
# Economic Transformation

## China's Growth Engines



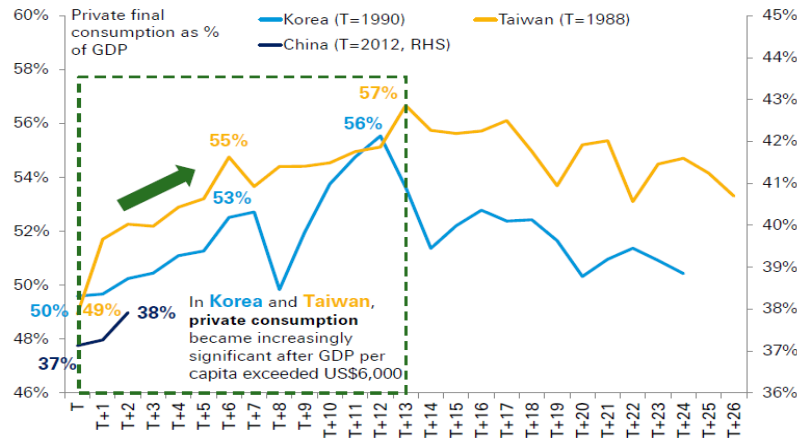
Source: NBS, CEIC, CLSA

## From Manufacturing to Service



Source: NBS, JPMorgan

## Consumption to Contribute More – in Time



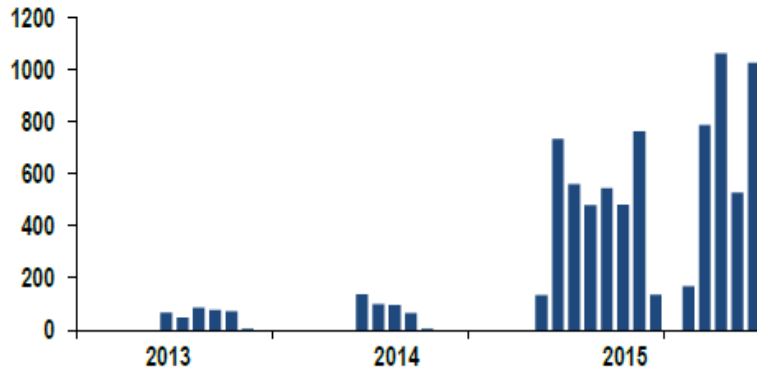
Source: Haver Analytics, Deutsche Bank Strategy Research

# Fixed Asset Investment

## Accelerating Local Government Debt Swaps

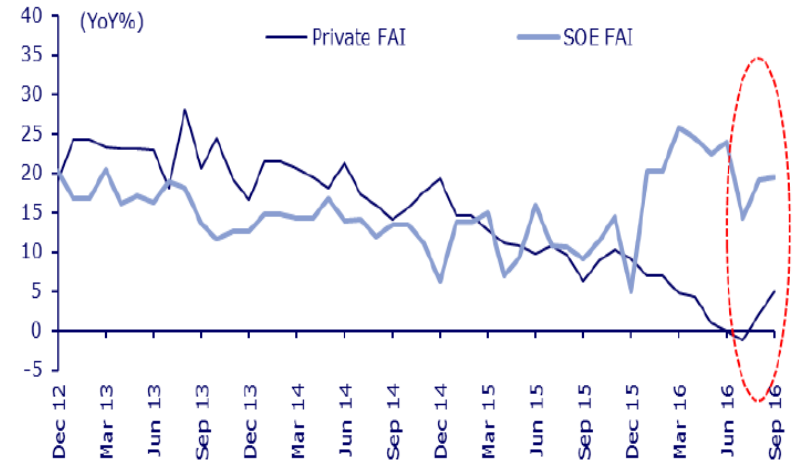
### China: Local government bond issuance

RMB bn



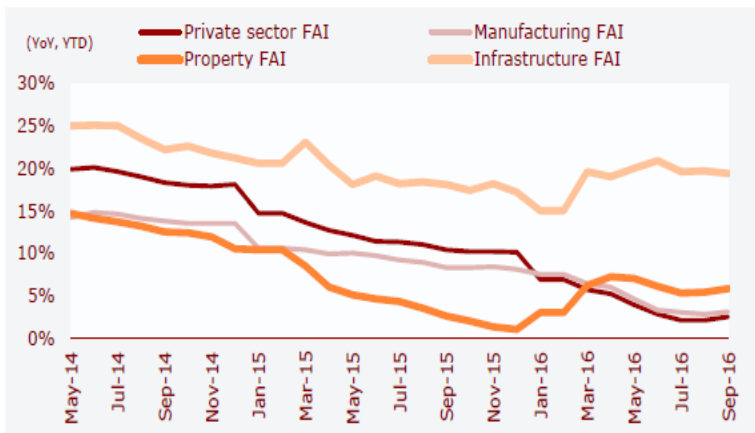
Source: CEIC, JPMorgan

## SOEs vs Private



Source: CEIC, CLSA

## Fixed Asset Investment by Key Sectors



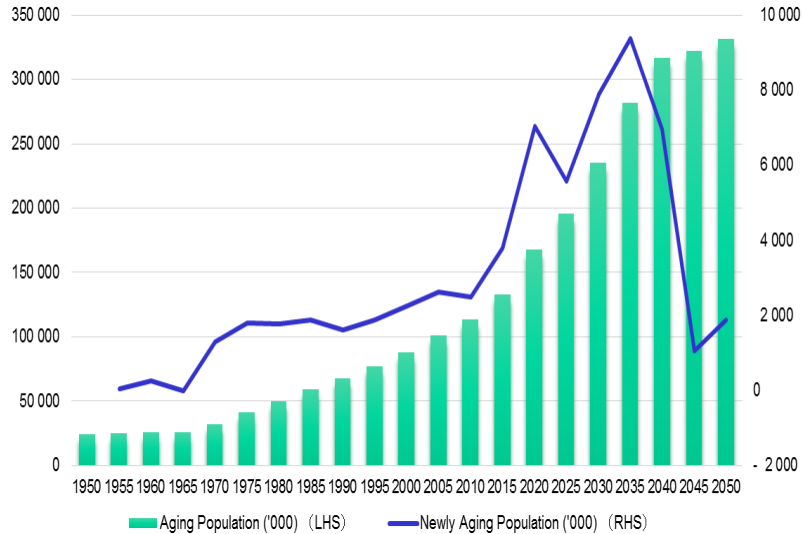
Source: CEIC, China Reality Research

- Government financing activities, including special policy bonds and local government bond swaps, have been accelerating since late 2015.
- Growth of SOE and state controlled investments, concentrated in infrastructure and public services, reflects government attempts to support overall FAI and the economy by increasing investments in these areas.



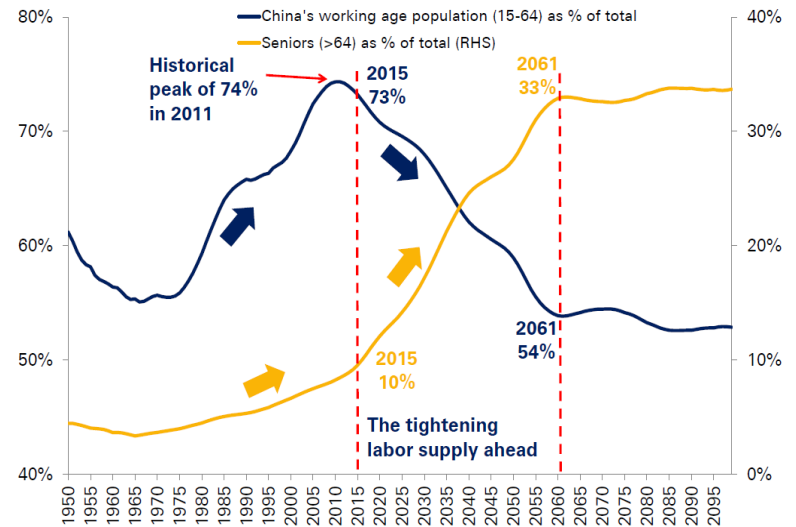
# Population and Labor Market Trends

## Population Aged 65 Years and Above



Source: SYWG, UN

## Working Population Secular Trend



Source: Haver Analytics, Deutsche Bank Strategy Research

- In 2012, the population aged 65 or above in China stood at 117 million; this number is expected to grow to more than 330 million by 2050.
- The population will start to age between 2015-2035, similar to Japan's experience between 1970-1990.

# Investment Themes

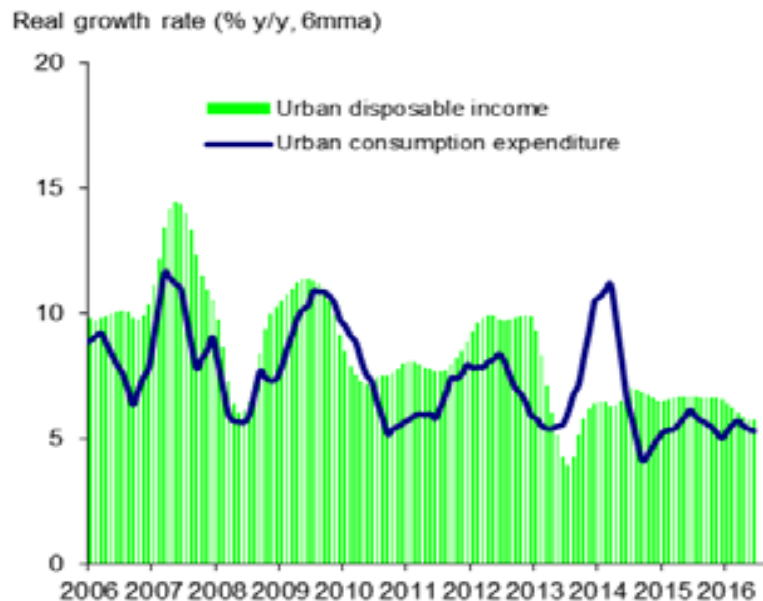
- Urbanisation
- Manufacturing Upgrade
- Consumption Upgrade



# 1. Urbanisation

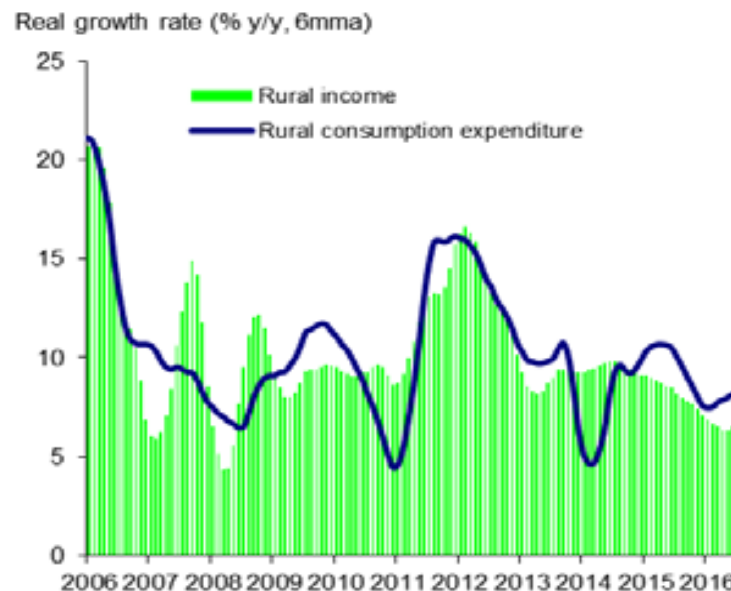
## Growth in national real disposable income

### Urban Disposable Income and Expenditure



Source: CEIC, UBS

### Rural Income and Expenditure



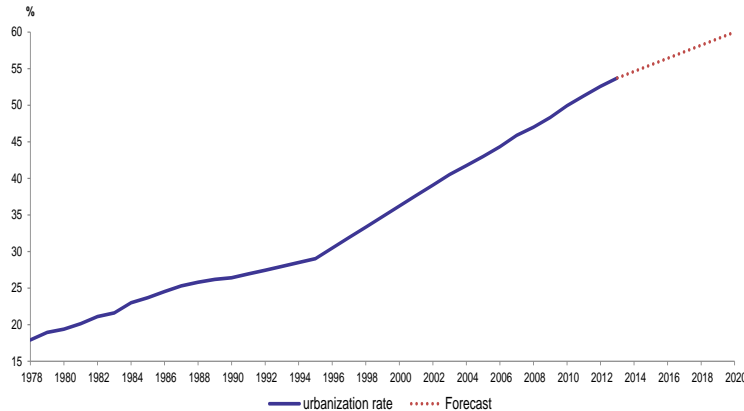
Source: CEIC, UBS

- Disposable income growth remains positive
- Driven by government policies supporting income growth, lowering corporate financing costs and sustaining employment levels
- Expect real consumption growth to persist

# 1. Urbanisation

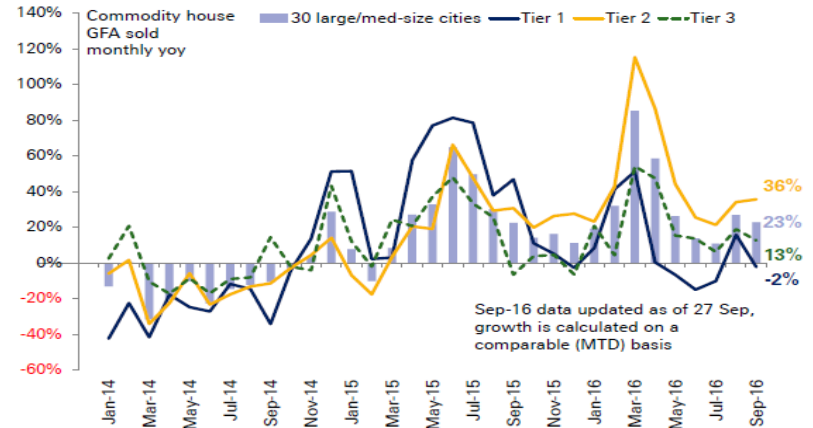
## Fundamental anchor for housing demand

Urbanisation Rate



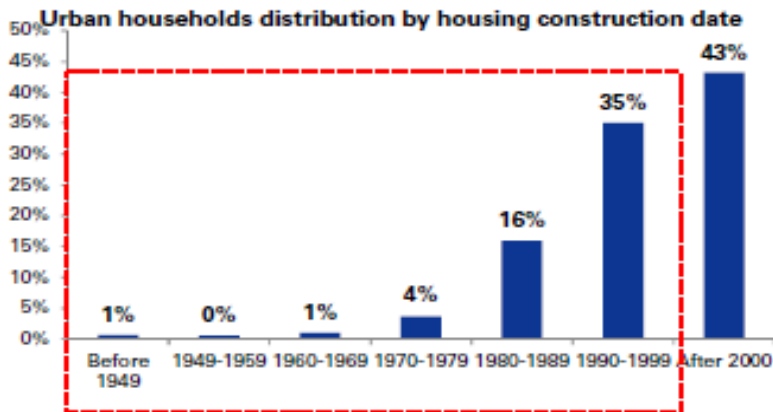
Source: CEIC, Fullerton

Property Sales Growth



Source: Wind, Deutsche Bank Strategy Research

Ample Upgrade Demand



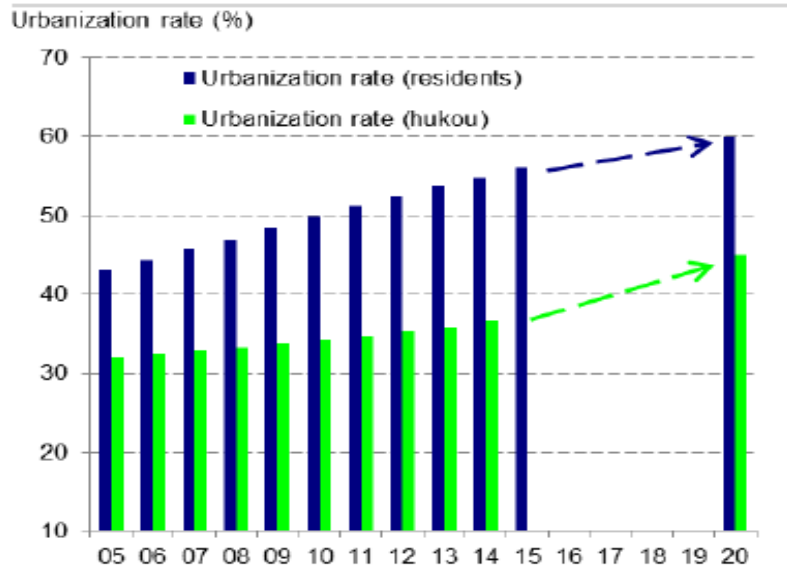
Source: Wind, Haver Analytics, CEIC, NBS, Goldman Sachs Global Investment Research

- Urbanisation will support the property sector and promote consumption upgrade
- Development tilt to lower tier cities
- Rural reform to let farmers move to cities
- Government support to improve living standards in rural areas

# 1. Urbanisation

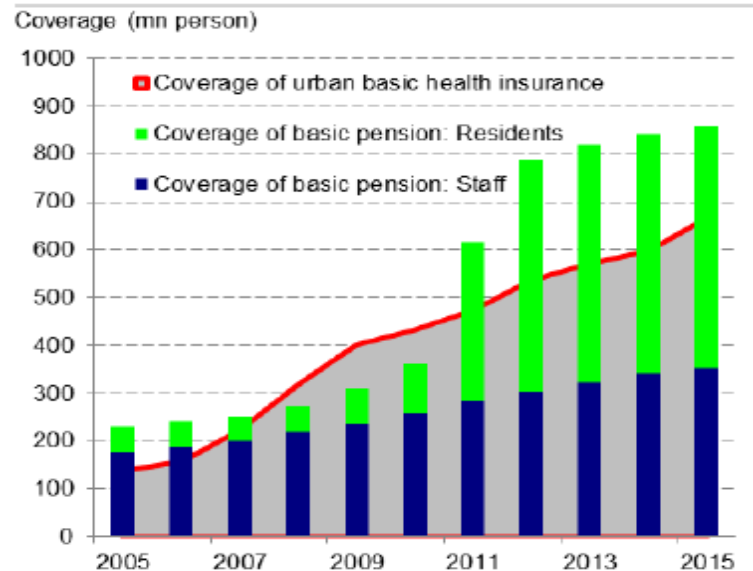
## Improving equality and social welfare

Hukou Urbanisation vs Residents Urbanisation



Source: CEIC, Official Documents, UBS

Expanding Social Safety Net

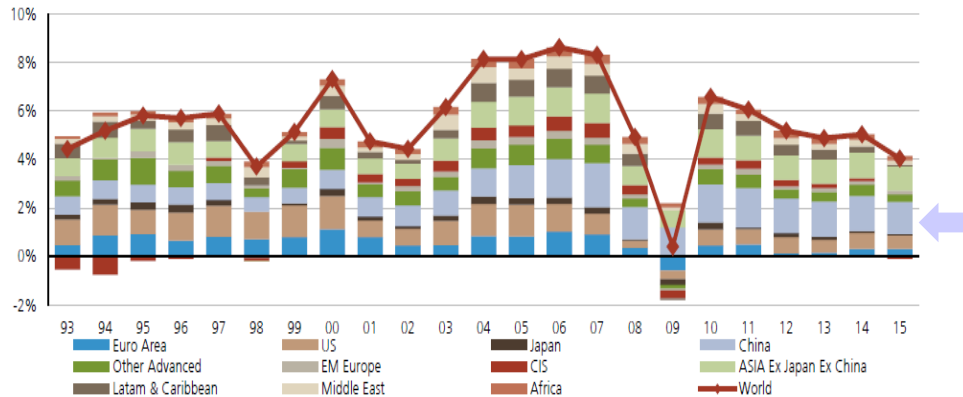


Source: CEIC, UBS

- 13<sup>th</sup> Five Year Plan focuses on improving equality, reducing poverty and expanding social welfare coverage
- Objectives: to lift current 56 million rural population with an annual income of less than RMB 2,300 (at 2010 price) out of poverty by 2020 and establish targets to improve social safety net, create basic pension system and health care insurance program, as well as social security funds

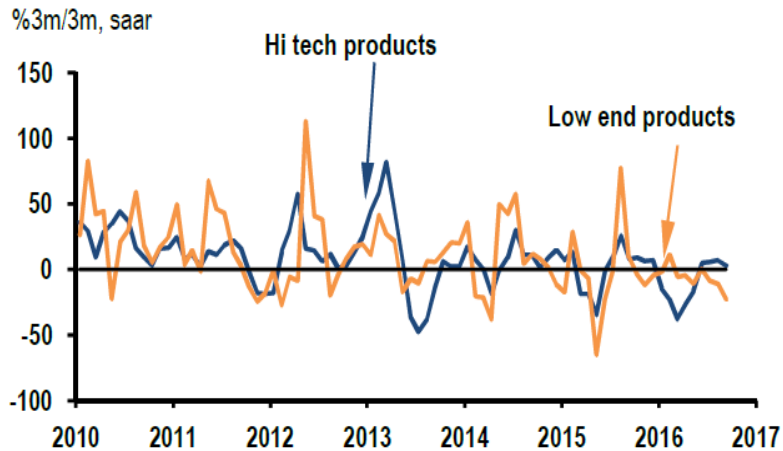
# 2. Manufacturing Upgrade Becoming a player in the global value chain

Contribution to Global GDP (PPP terms)



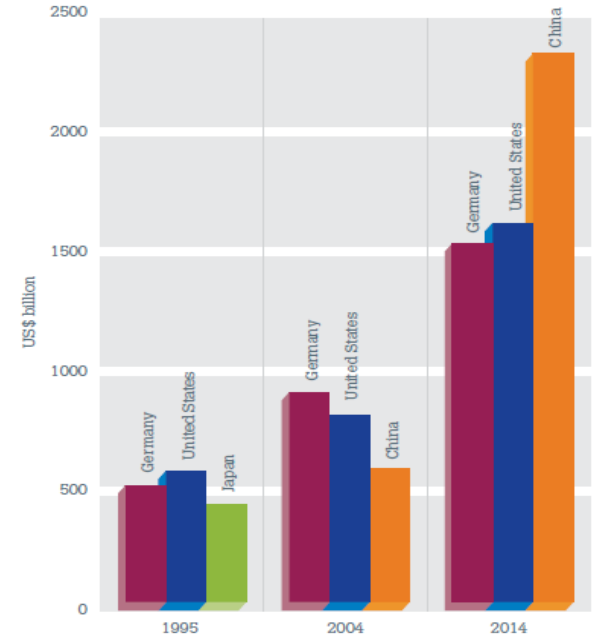
Source: IMF, Haver, UBS

Major Export Categories



Source: China Customs, JPMorgan

World's Top Exporters, 1995-2014

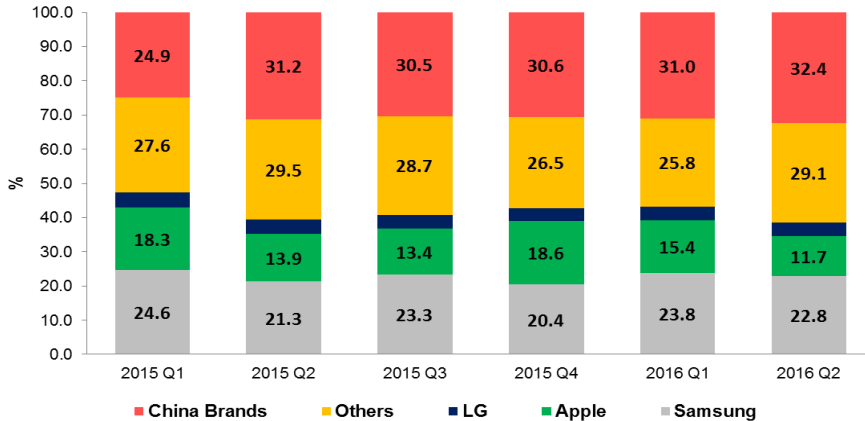


Source: World Trade Organisation, International Trade Statistics 2015

- From import substitution to industrial transfer
- Having increased the share of imported components in her exports, China has benefitted from investments in infrastructure and resources to become a factory of the world.
- One Belt, One Road to be the next driver of trade

# 2. Manufacturing Upgrade Driving innovation

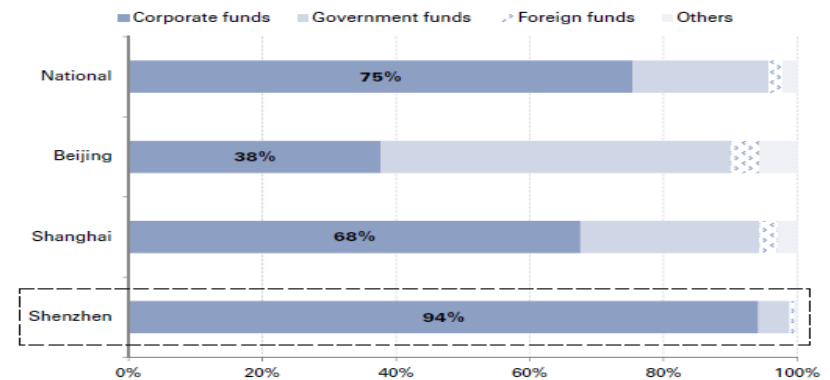
Smart Phone Unit Shipments Market Share



Source: Bloomberg, Fullerton  
 Note: China brands comprise Huawei, Lenovo, Xiaomi, ZTE, Oppo, TCL-Alcatel and Vivo

- Innovation has emerged as an alternative driver of China’s development, propelling the country up the industry value chain.
- Shenzhen, with the highest R&D spending as a percentage of GDP by the private sector among Chinese major cities, is a good model as the city embarks on its journey to become China’s innovation leader.

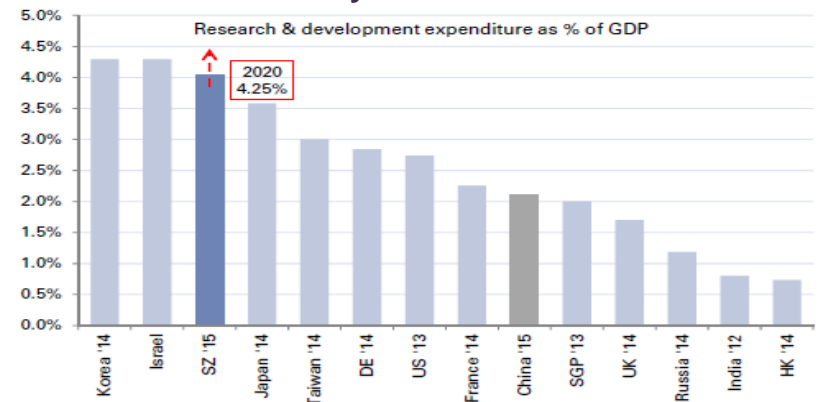
R&D Expenditure in China



Note: the above % data for SZ/Beijing/Shanghai is based on 2nd R&D nationwide survey in 2010 and for China is based on R&D statistical communique in 2014.

Source: National Statistical Bureau, Goldman Sachs

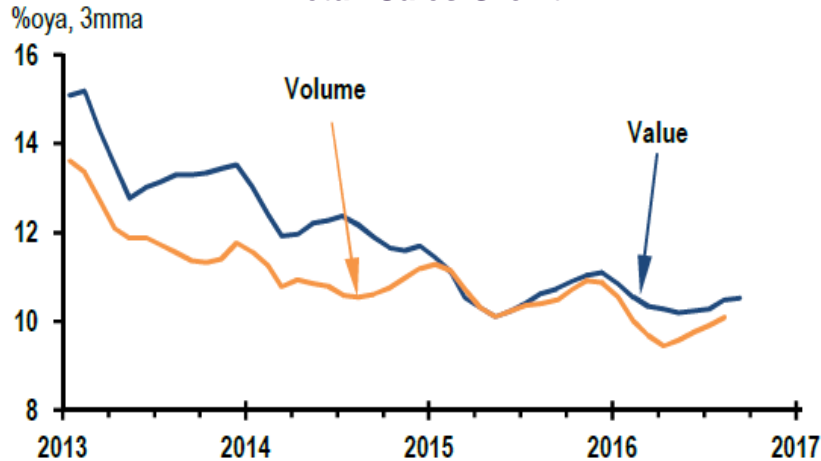
R&D Intensity: Shenzhen vs World



Source: Wind, World Bank, Local Statistical Bureau, Goldman Sachs

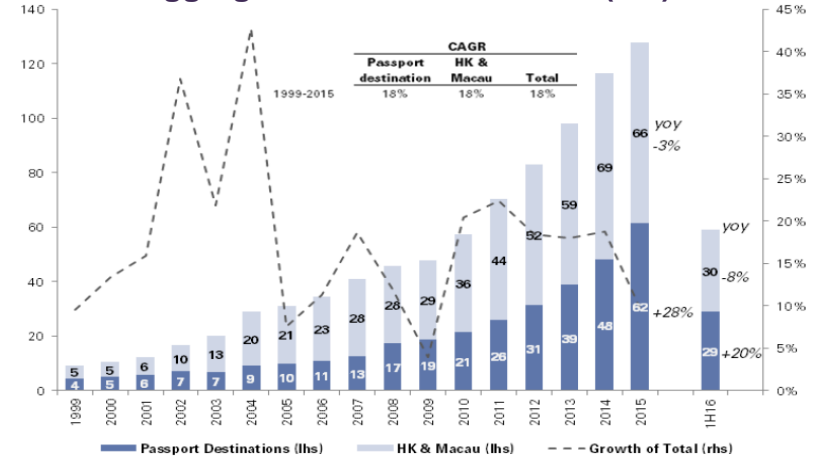
# 3. Consumption Upgrade

Retail Sales Growth



Source: NBS, JPMorgan

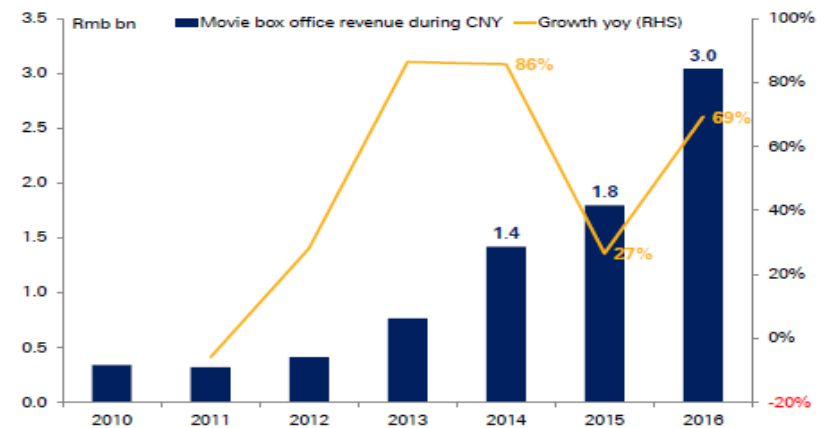
Aggregate Outbound Tourists (mn)



Source: China National Tourism Administration, CEIC, Goldman Sachs

- As an indicator of China's consumption upgrade, we have seen an increasing number of Chinese tourists and a booming box office.
- A key driver has been the rapid growth of labor income alongside China's urbanisation progress over the years.

Chinese Box Office

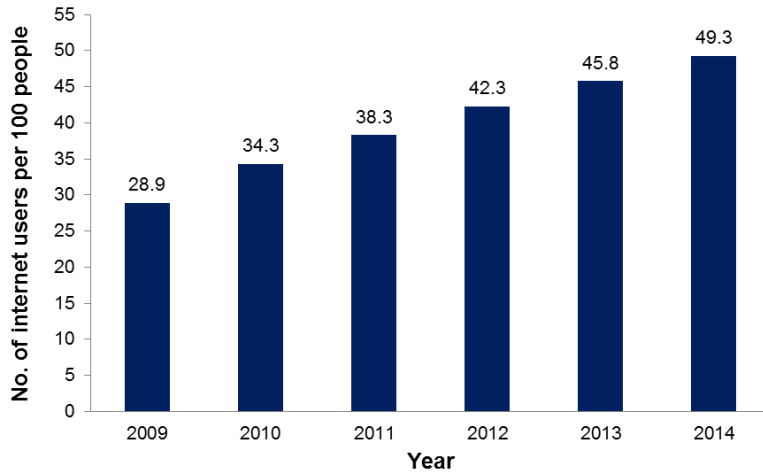


Source: Wind, Deutsche Bank Strategy Research



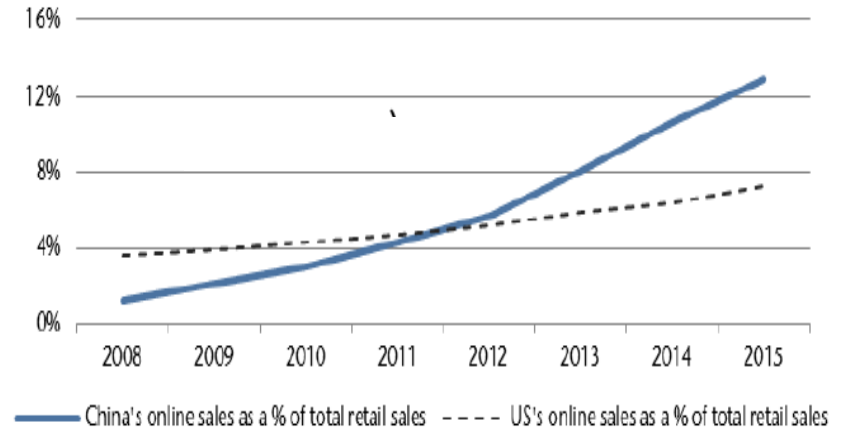
# 3. Consumption Upgrade Internet age

Internet Users



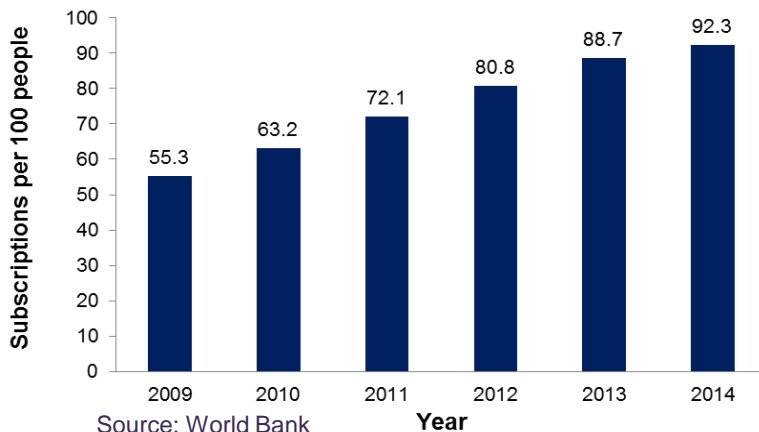
Source: World Bank

E-commerce Penetration: China vs US



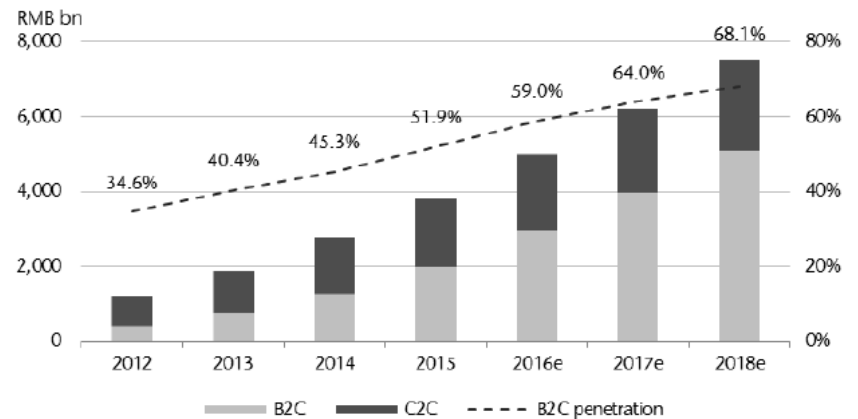
Source: comScore, US Department of Commerce, iResearch, Jefferies

Mobile Cellular Subscriptions



Source: World Bank

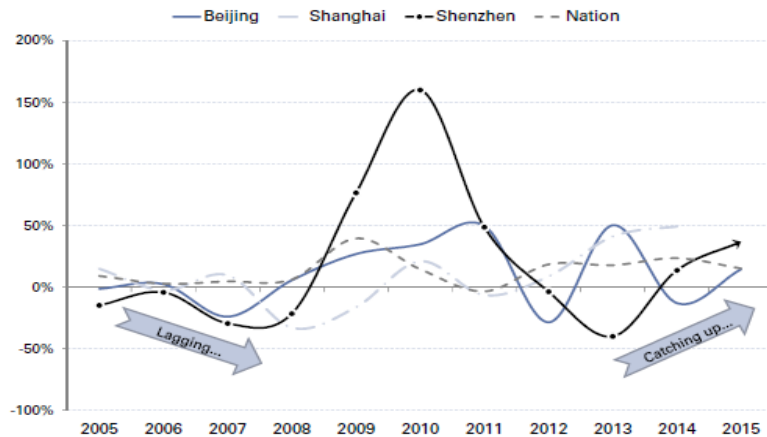
China Online Retail Market Size (B2C and C2C)



Source: iResearch, Jefferies

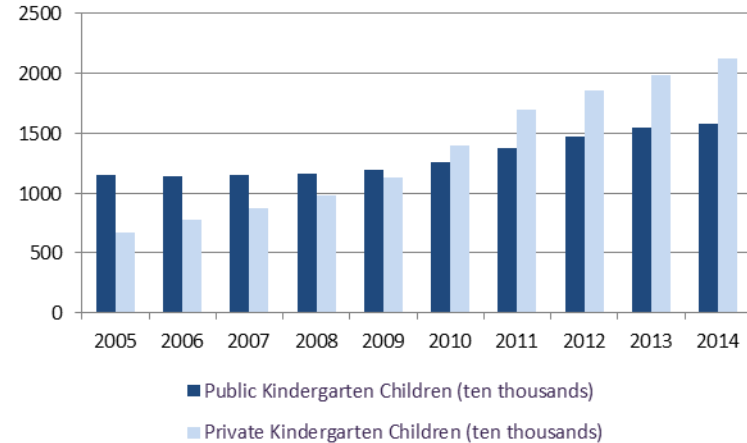
# 3. Consumption Upgrade Focus on education

% YoY Growth in Education FAI



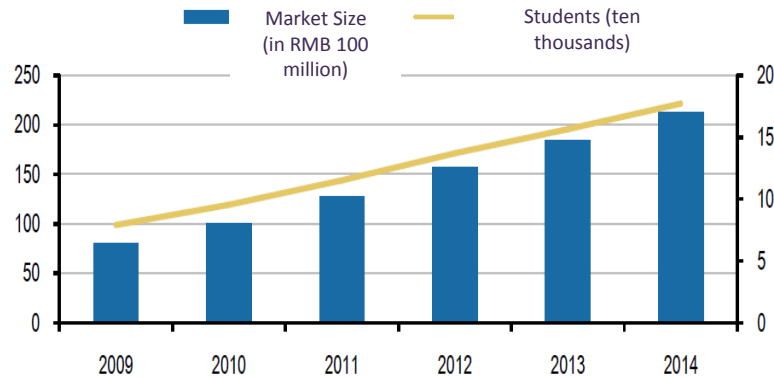
Source: CEIC, Goldman Sachs

Private Kindergartens Expanding More Rapidly



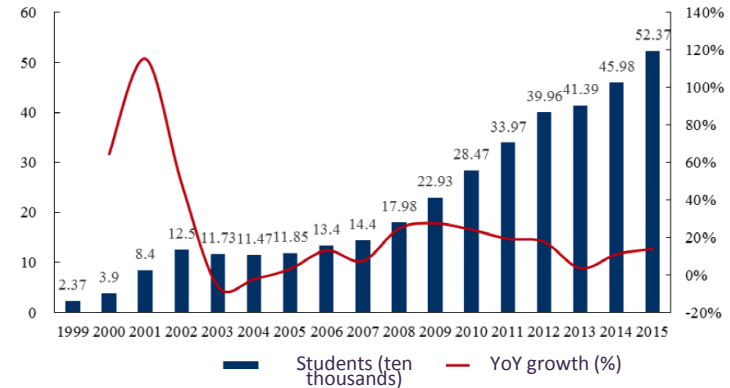
Source: Wind

International Schools' Market Size (2009-2014)



Source: GF Securities

Number of Overseas Students (1999-2015)



Source: Industrials Securities



# Conclusion

- Market valuation has become more reasonable following this year's correction but stock selection remains key
- A sound understanding of sector dynamics and positioning the portfolio accordingly to participate in changing sector characteristics (resulting from macro policy implementation) will be just as important.
- Opportunity set
  - Investable themes: urbanisation; manufacturing upgrade; consumption upgrade
  - Sustainable growth stocks, with core competitive advantages, which are still trading at reasonable valuations, existing particularly in the consumer, healthcare and advanced manufacturing industries
  - Growth stocks benefiting from the change in economic structure and reforms, e.g. clean energy/environmental protection

# Thank You



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