Heartwood Investment Management

28 April 2017

Investment Insight

Weekly Insight

Can positive conditions in China be maintained?

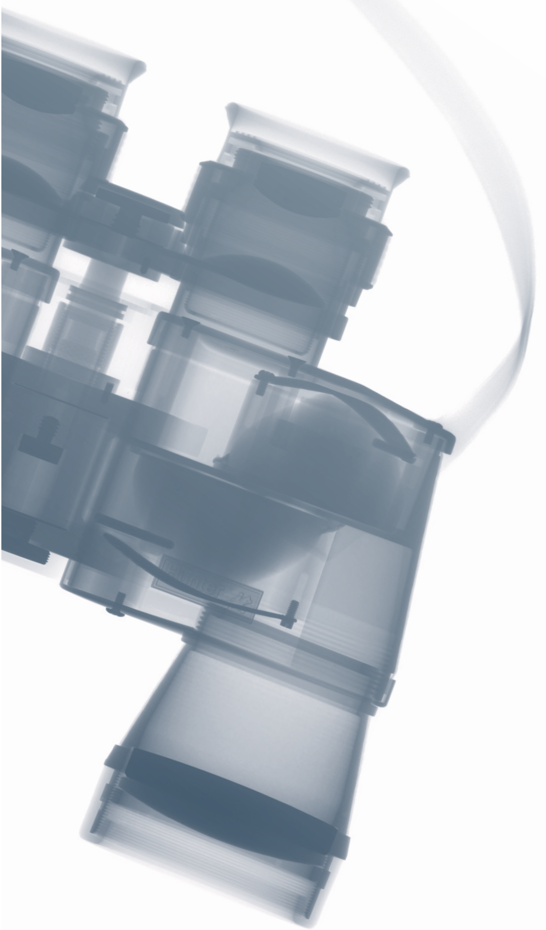
The strength and sustainability of China's economic recovery in the last 18 months has surprised many investors. The latest quarterly GDP report came in at 6.9% year-on-year, which was above our expectations and those of consensus.

China's cyclical uplift has been supported by central bank easing measures implemented in late 2015. Manufacturing surveys have recovered out of contractionary territory; fixed asset investment has picked up; industrial production has seen a sharp improvement this year; and retail sales have maintained a solid pace. China's currency adjustment on a trade-weighted basis has also supported a rebound in exports.

As the effects of previous policy measures begin to wane, we believe momentum may slow marginally in the second half of 2017. Moreover, the authorities' focus is increasingly shifting to maintaining financial stability and addressing the high debt burden in some parts of the corporate sector. Credit has been a key driver of growth in the economy but has now reached unsustainable levels. China's central bank has been increasing interbank lending rates this year and we are likely to see further measures to tighten policy in specific areas of the economy, such as property.

The authorities will need to tread a careful line, though. Stability is the key policy mantra this year as leadership changes in the Communist Party are due to take effect this autumn. So while efforts will be made to promote financial stability, the government should be willing to add support to the economy if needed and maintain a stable growth trend.

Of course, there are risks to this view, whether stemming from the undercurrent of domestic political tensions ahead of the leadership reshuffle; geopolitical risks as China plays a key role between North Korea and the US; and broader concerns around the health of the banking system - highlighted most recently by questions around the validity of certain wealth management products. Our base case scenario considers that these risks should be contained - although we will be closely watching for the foreseeable future – allowing for a relatively smooth and gradual economic transition.



The investment impact

Based on our macro view, we do not expect China to be a significant driver of emerging market performance this year, either to the upside or the downside, and we maintain a constructive outlook on the broader asset class. Over the longer term, China remains an under-represented equity market across the major global benchmarks and we still believe it has the potential to deliver compelling investment opportunities, especially in the consumer-related sectors.

Jade Fu
Investment Manager

Clear Thinking

Contact

To find out more about the Heartwood strategies, visit our website or contact your local representative.

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Registered Head Office: No.1 Kingsway, London, WC2B 6AN | Registered in England Number: 4132340
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