Heartwood
Investment Management

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Investment Insight

Weekly Insight

Supportive policymakers open up Chinese equity opportunities

In a recent *Weekly Insight*, we noted that weakness in onshore Chinese equities was being inaccurately attributed to the ongoing trade war with the US. While Chinese currency moves can certainly be linked to US tariffs, we observed that the onshore stock market was in bear territory for very different reasons, including slowing economic activity in part linked to a slowdown in loan growth rates.

Chinese authorities have now reacted. A series of easing efforts have been introduced – individually small but with a potentially large cumulative impact. The measures span from fiscal and monetary policy to regulatory change, and appear to have been stepped up in the last few days alone.

Is this good news for investors? While very recent policy developments are unlikely to provide a major uplift in growth, they do set a clear new tone for future Chinese policy, which could prove meaningful for investment markets.

Importantly, the latest fiscal updates do not constitute a ‘big bang’ project. Nor should investors expect a repeat of the large scale stimulus rolled out in the wake of the global financial crisis. Rather, this week’s developments are designed to speed up and bolster previously announced measures, encouraging the Ministry of Finance, central bank and financial regulators to support growth by boosting domestic demand. Specific measures range from bond initiatives for local infrastructure projects to tax breaks for corporate research and development, and from financial support for small to medium enterprises to the promotion of private investment projects. Of course, ‘guidance’ for financial institutions to support the measures has also been included.

Little surprise, then, that new monetary policies are also being introduced. China’s central bank appears to have ceased raising its own interest rates in response to US Federal Reserve rate hikes, while also cutting reserve requirements for Chinese banks. Other interventions include a surprise cash injection into corporate bond markets (currently facing record levels of default), rewarding banks for investing in lower-rated corporate bonds, and allowing new ways for banks to boost capital adequacy. Regulators too have played their part, easing the pressure to aggressively unwind China’s infamous ‘off balance sheet’ lending systems (shadow banking). New asset management rules published last week clarify guidance around investing in non-standard assets and new assets, reducing the pressure on corporate refinancing.

However, one key area of the Chinese economy remains comparatively untouched: the onshore equity market. The market is among the world’s worst performing in 2018 so far, pushed lower by disengaged domestic retail investors. Current government inaction today stands in sharp contrast to the flurry of (now anaemic) state-sponsored rescue funds enacted during 2015’s sharp falls. For now at least, onshore Chinese equity markets are essentially being left to their own devices.

Against this backdrop, though, some indicators suggest that global investors are increasingly positive on the local stock market. Analysis of the bigger economic picture (accommodative new policies) and the market itself (priced low enough to represent a potential buying opportunity) implies growing potential for onshore Chinese equities.

But while we believe the outlook is more supportive for onshore Chinese opportunities following market pull backs, there are still missing pieces in the puzzle. First, domestic Chinese investors must re-join the fray. Second, investors are unlikely to welcome further trade war escalations and in turn further currency weakness. Nonetheless, while there is little doubt that risks remain, we believe that the attractiveness of the onshore market has increased.

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Clear Thinking

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