



The Greater China equity market has finished the eventful 2020 on a high note on the back of steady economic activities and quick recovery from the pandemic-driven downturn seen in the first quarter. Kai Kong Chay, Senior Portfolio Manager, Greater China equities, believes that China continues to deliver differentiated growth, even after the pandemic, and opportunities can be found through careful, bottom-up stock selection, especially in the tech and consumption sectors.

Greater China equities: A resilient way forward

As the world continues to grapple with the coronavirus pandemic, Greater China equities have emerged relatively unscathed, outperforming emerging, developed, and regional markets in 2020¹. In particular, Taiwan and China equities have gained 28% and 26% year-to-date respectively, while Hong Kong has posted double-digit returns. The better visibility of earnings growth and diversification benefits have attracted inflows both home and global investors driving all three market indices all-time highs².

Economic data also appears to support the performance of China equities. With effective measures to control the spread of the pandemic, China was the first major economy to recover, posting positive growth for the second and third quarters of 2020³. Caixin's manufacturing Purchasing Managers' Index posted seventh straight month of expansion since May. Corporate earnings have also been healthy, with the latest third-quarter data showing most MSCI China constituents reporting better-than-expected or in-line numbers. Taiwan also recorded positive GDP growth for the third quarter, primarily on the back of robust demand for electronic exports⁴.

A Biden administration – China's pre-emptive response

Throughout 2020, US-China tensions lingered in the background. With a Biden administration, we believe that the relationship between the two countries could remain under pressure. As such, we will adopt a wait-and-see approach in order to assess how the situation develops. However, we believe that the impact on Chinese equities should be well-contained supported by an estimated earnings growth of 15–20% in 2021⁵.

Furthermore, China has already mapped out a response with its 14th five-year plan (2021–2025). The emphasis is now on growth through a “dual circulation” strategy led by “internal circulation” – in other words, moving toward a self-sufficient economy supported by home-grown innovation and domestic consumption. “External circulation”, as a supplementary driver, should extract China's growth potential via allowing the domestic and foreign markets to lift one another.

When combined, these factors make it probable that China's growth can continue to show a clear and positive differential compared to the rest of the world. The nature of the post-pandemic economy, although still fluid, is likely to amplify this gap.

¹ Bloomberg: MSCI Zhong Hua Index posted a 21.38% gain, while MSCI Emerging Market Index was up 10.51%, MSCI World Index up 11.72%, MSCI Asia-Pacific ex Japan Index higher by 15.06%. Total returns in US dollars, as of 30 November 2020. Past performance is not indicative of future performance.

² Bloomberg: MSCI Taiwan Index rose by 28.48%, MSCI China Index was higher by 26.18%, and MSCI Hong Kong Index was up by 12.18%.

Total returns in US dollars, as of 30 November 2020. Past performance is not indicative of future performance.

³ Bloomberg, 7 December 2020. China economy grew 3.2% and 4.9% year-on-year in Q2 2020 and Q3 2020 respectively.

⁴ Bloomberg, 7 December 2020. Taiwan economy grew 3.92% year-on-year in Q3 2020, after shrinking 0.58% in Q2 2020.

⁵ Manulife Investment Management, December 2020.

Positioning for an increasingly self-sufficient China

With China having laid out a clear path toward an internally driven economy, opportunities are now arising in the technology and consumer sectors. On the technology front, more home-grown innovation in areas like biotech is anticipated. These efforts will likely be bolstered by additional fiscal and policy support, such as tax incentives and low-cost funding to boost local R&D and reduce reliance on imports.

There are numerous opportunities along the tech supply chain, especially in areas that are crucial for fuelling the drive toward self-sufficiency. For instance, the upstream semiconductor equipment supply chain has a low level of localisation, which has spurred targeted and supportive policies. Electric vehicle (EV) development is another attractive theme, backed by both domestic demand and the local industry's increasing presence in the global EV supply chain. A few domestic mid-end models tailored to Chinese consumers have been very well received, showcasing the capability of Chinese EV brands to adapt and cater for local needs and tastes.

On the consumption front, there is still plenty of unmet demand for lifestyle-related services. Increasing e-commerce penetration is another catalyst that is seeing both product-category expansion and wider age-group adoption. Online fresh grocery is one of the examples where growth can continue to be fuelled by shifting from offline, product premiumisation and expansion to the elder generation.

In both areas, investors should remain focused on the long-term fundamentals and seek to benefit from secular themes, such as those stemming from consumption upgrades, innovation, and policy tailwinds. The opportunity set has also been expanded by the inclusion of mid-cap China A-Shares into the MSCI index. This move offers unique investment opportunities not available in the offshore universe, with a focus on under-researched ideas with stable growth outlooks. After all, we believe the global indices inclusion have raised the profile of

China equities as a whole, arousing interests from global investors to tap into the structural growth opportunities in the onshore and offshore China equities space.

Niche competitive advantages should benefit the Greater Bay Area

Within mainland China, the competitive advantages in the Greater Bay Area (GBA) – including ample policy support – can sustain strong and tangible long-term growth for the region, and reward investors by way of corporate earnings. The central government pledged to deepen economic integration by enhancing inter-cities infrastructure, talent mobility, logistic and investments within GBA. Furthermore, the push for smart-city implementation and management in the GBA, led by Shenzhen, shall create opportunities for infrastructure, education, healthcare, and more. The investment case for the GBA can continue to benefit from cross-provincial initiatives in wealth management, insurance, and property-connect programmes in the GBA region. Regional champions with their own growth dynamics will probably be best placed to exploit such opportunities.

Stock market reforms in Hong Kong and Mainland presents more opportunities

In Hong Kong, we believe that capital-market liberalisation will continue to provide investment opportunities for investors and attract further capital inflows. Since the introduction of new listing regimes in 2018, we have already seen a growing number of pre-profit biotechnology companies listing on the market⁶, some of which are already industry leaders. The relaxation of the rules has also brought CRO (contract research organisations) and CDMO (contract development manufacture organisations) companies to the market, which has helped to fund their development. The investment choices could be further enriched by the secondary listings of Chinese American Depository Receipts (ADRs) and companies with weighted voting rights (WVR) structures. The expanding connectivity and investor base can also be witnessed by the recent

⁶ On 30 April 2018, Hong Kong Exchanges and Clearing Limited added new listing rules, under Chapter 18A, to permit listings of biotech issuers that do not meet any of the Main Board financial eligibility tests. As of 30

September 2020, there is a cumulative of 40 biotech companies listed in Hong Kong under Chapter 18A.

announcement of Stock Connect Programs expansion to include biotech companies and Shanghai STAR board stocks.

Taiwan equities – a key beneficiary of the tech race

For the Taiwan market, COVID-19 does not appear to have impacted economic growth and corporate earnings in 2020. As we expect the US-China tech conflict to continue, with US policy focusing on the protection of intellectual property and high-end technology, Taiwan equities should remain the key beneficiary under this macro backdrop. This explains the market expectation of earnings per share to grow by 18% in 2021, from an already high base of 10% year-on-year growth in 2020⁷.

In 2021, we have a positive view toward the technology sector, especially semiconductors. Taiwan is well-positioned in the semiconductors industry, as it has the largest share of the global foundry market⁸. The localisation of the region's technology supply chain, coupled with Chinese companies reducing their reliance on US suppliers, should benefit the semiconductor supply chain, foundry industry, and integrated-circuit-design companies in Taiwan. Meanwhile, the demand and development of high-speed transmission continues. We anticipate investment opportunities to emerge given a robust new-product cycle in the tech sector, with developments such as new-generation wireless transmission for high-quality video and livestreaming.

In a similar vein to China equities, EV is an investment theme that we consider when looking at Taiwan equities. There are numerous upstream players with interesting opportunities in the EV market, especially power-related components.

Conclusion – well-positioned in a digitalized and de-globalised world

Even before the pandemic, we saw a pullback in globalisation trends. This has only been accelerated by recent events, which have combined with existing geopolitical tensions to push companies in the direction of shorter and more regional supply chains. The Greater China region is prepared for this shift.

China's differentiated growth expectations and capital market liberalisation initiatives are likely to attract more foreign capital to renminbi-denominated assets or high-growth and well-managed Chinese enterprises. We believe investors are becoming more confident about the growth trajectory of China's economy. With uncertainty remaining elevated where search for sustainable growth may prevail, it is vital to identify stock drivers with a bottom-up approach that seeks to uncover long-term fundamentals supported by secular themes like consumption upgrades, innovation, and policy tailwinds.

⁷ Manulife Investment Management, December 2020.

⁸ Source: McKinsey, July 2019.

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