

# CIMB PREFERRED INSIGHTS

MAY 2021



## Key Highlights

- **Chinese recovery.** China's dual circulation plan focuses on both the domestic consumption market as well as external export oriented strategy.
- **Opening up.** China continues to open up, and more investors are allocating their portfolios to the A-share market for alpha returns.
- **Opportunities.** We explore some Unit Trust ideas that investors can consider for their portfolios:
  - **JP Morgan China A-Shares Opportunities Fund**
  - **Blackrock China Bond Fund**
  - **Schroders Asian Growth**
  - **Schroders Asian Equity Yield**

**Long term prospects of China.** The “Dual Circulation” strategy was first highlighted at the meeting of the Politburo in mid-May 2020, which was further included in China's 14<sup>th</sup> Five Year plan (FYP) for 2021-25.

The dual circulation plan comprises of 1) Internal Circulation which focuses on domestic market and 2) External Circulation which focuses on its export-oriented development strategy, while trying to

harmonize the both pillars. The idea is to focus on expanding domestic output and demand while at the same time drawing in foreign investment and stabilizing trade.

China has been seeking to rebalance growth towards domestic consumption and upgrade domestic industry and technology with “Made in China 2025” and other innovations. Consumption growth, innovation and modernization of the industrial system will likely play an important role in the 14<sup>th</sup> FYP.

Given the episodes seen during Covid-19 that have led to a disruption of the global supply chain resulting in less accessible foreign technology or key products, Chinese policymakers have seen an urgent need to upgrade the country's manufacturing sector, and to develop a full spectrum supply chain which is based on self-sufficiency.

**To date, China has managed the Covid pandemic well, while still sticking to conventional monetary/fiscal policies.** China has been cognizant of its high domestic corporate debt and is extremely mindful of the ultra-easy monetary policy in many developed nations as well as its own massive stimulus in 2008-09 GFC (which led to surging debt). China has thus

been seen pursuing a more prudent and targeted monetary policy of late.

On concerns regarding China's recent tightening, we believe that the bar for any policy hike will be high given the elevated debt level within the economy and the government's preference for financial stability. Hence, we opine that China will likely avoid over-tightening. Over the medium term, China should be focused on promoting quality growth and controlling risk.

**China markets continue to open up and thus present opportunities.** We believe Investors are allocating into the A-share market as one possible source of alpha returns in their portfolios. As China's market reforms progressed in 2015 and the Qualified Foreign Institutional Investor (QFII) program expanded, there has been increased fundamental analysis works in China that has helped both domestic and foreign fund managers to generate alpha.

Access for foreign investors to China A shares has been improving following significant regulatory changes. In fact, China lifted restrictions entirely for the Qualified Foreign Institutional Investors (QFII) and Renminbi Qualified Foreign Institutional Investors (RQFII) schemes, integrating both programs into one since 2020. We believe that the Chinese government will continue to open up their financial markets, which should present even more interesting opportunities for long term investors.



Source: Bloomberg

**China Tech regulation.** There were concerns about the recent regulatory stance on several Chinese tech companies, namely Alibaba. On 10 April, the China's State Administration for Market Regulation (SAMR) announced that it had completed the anti-trust investigation on Alibaba and slapped it with a USD 2.8 bn fine (which is a slap on the wrist fine), in our opinion. The amount of the fine looks to serve as a deterrent to other big platforms, but not too big to hurt Alibaba's operations too severely.

We believe that China's increasing control and more hands-on approach should be seen in the context of maintaining financial stability while ensuring that a more level playing ground can be established for the smaller or newer players. We do not think this will make the current large players any less attractive, provided they play by the rules. We do not think that stringent ruling will stifle innovation. We will monitor for signals from regulators indicating a wrapping up of this round of regulatory changes.

**For clients looking for growth opportunities,** the Chinese economy has undergone a dramatic structural transformation in the last five years, shifting from growth via infrastructure spending to present-day, where consumption, services and the "new economy" sectors are the main contributors of the economy.

**For income investors,** such as those searching for yield, the "old economy" sectors may offer attractive dividends and lower valuations, compared to new economy companies with high growth profiles and rich valuations. For instance, some of the Chinese banks and property stocks are considered cheap and offering dividend yields of almost 6%.

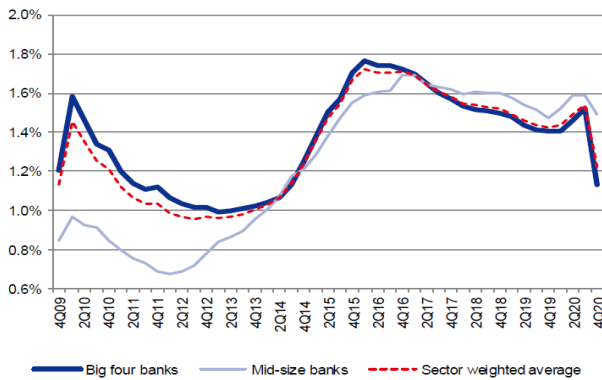
**We take a closer look at the financials as the backbone to a healthy Chinese market.** According to CGS-CIMB Research, they expect the share price out-performance to continue for banks, driven by further asset quality improvements. In the initial phase of the recovery, they believe it was the recovery of

profitability spurred the first leg of China banks' share out-performance. Therefore the strong China bank performance only partly unwinds the significant 2020 underperformance of the China banks versus the MSCI China index.

**CGS opined that China banks have successfully navigated the twin challenges of a trade war and Covid-19**, with much better-than-expected asset quality outcomes. Looking ahead, it is likely that banks' asset quality to improve.

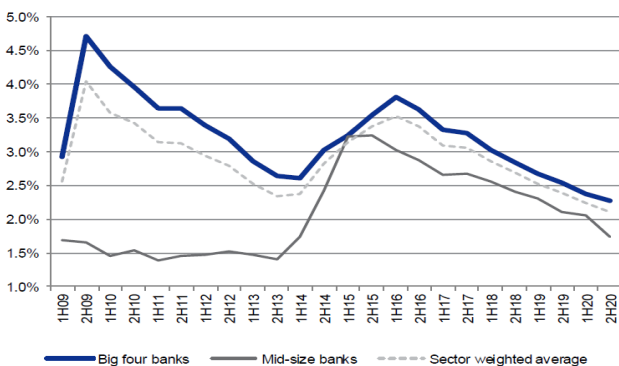
CGS looks at combined NPL and SML ratio and this has been falling in 4Q2020 for the whole system. Banks had been tightening their NPL recognition as well.

**Fig 1: NPL ratios of China Banks have recently trending downwards**



Source: CGS-CIMB Research

**Fig 2: Special Mention Loan (SML) ratios trending down**



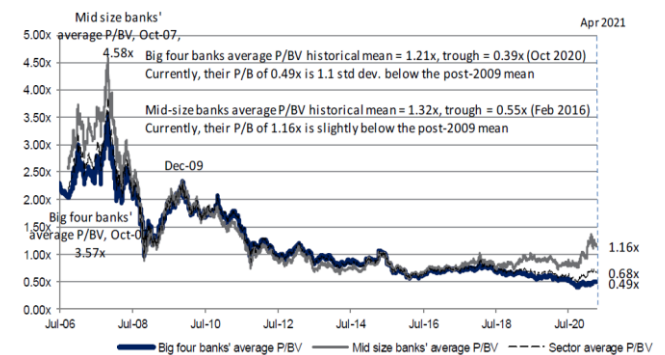
Source: CGS-CIMB Research

**Banks tend to benefit from improving economy and it is encouraging that several macro data are near highs.** The Li Keqiang Index – created by the Economist to measure China's economy using three indicators of railway cargo volume, industrial electricity consumption and loans disbursed by banks, is at a four year high.

**Valuation.** The China banks under CGS-CIMB coverage trades at attractive valuation levels. They trades at 0.7x on a 12-month forward P/BV basis, with the big four banks trading at 0.5x on a 12-month forward P/BV basis. The sector trades at 0.7 standard deviation below the post 2006 mean, while the big four banks trades at 1.1 standard deviation below the post-2006 mean.

The dividend yield of the big 4 China banks is on average 7% in April 2021 on a 12-M rolling forward basis.

**Fig 3: China banks' 12-month forward P/BV since 2006**



Source: CGS-CIMB Research

**China banks are much more "investable" now.** Stricter NPL recognition, sizeable provisioning buffers, easing concerns over policy risks amidst an improved economy, significantly reduced NPL formation, the end of monetary easing which indicates a more positive Net Interest margin and increased regulatory risk in new economy sectors led investors to see China banks as more investable now.

**Property developers.** Despite Covid-19, the Chinese developers recorded better-than-expected sales growth of 13% in 2020. For 2021, they target a 10%

contracted sales growth. CGS-CIMB Research expects core profit to up 15% for FY21F.

**CGS think housing policy will remain relatively tight in 2021**, especially in 2nd and top tiered cities, whose home prices and land prices are still strong. Tough regulatory requirements, coupled with a competitive of land market, could lead to faster market consolidation, which should benefit developers with strong balance sheet and execution capabilities.

**CGS expect developers to meet the Three Red Lines by 2023.** Given proactive deleveraging ahead, CGS-CIMB Research expects the number of developers (under their coverage) to attain the Green category under the Three Red Lines to rise. Developers need to comply with these requirements to continue to get financing.

**Sector trading at 5.4x FY21 PER and 7% dividend yield** is attractive. Chinese financial system remain well anchored by sound policies. Chinese regulators introduced tighter regulations to the property sector to get sector to deleverage. This bodes well for sector development as this will drive further credit divergence to weed out weaker players and accelerate consolidation within the industry.

**For opportunities considering the reasons mentioned,** investors may consider the following funds:

**JP Morgan China A-Shares Opportunities Fund** or **Blackrock China Bond Fund**

For more exposure into the greater Asian region, investors may also consider the **Schroders Asian Growth Fund**, or **Schroders Asian Equity Yield Fund**.

Please speak to your Relationship Manager for more details.

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