MARKET COMMENTARY

China

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A health warning

Jason Pidcock, Head of Strategy, Asian Income

Jason joined Jupiter in 2015 and is currently Head of Strategy, Asian Income as well as the manager of the Jupiter Asia Pacific Income fund (SICAV).

Before joining Jupiter, Jason was at Newton (joining in 2004) where he ran an Asian equity income fund from 2005 until his departure in 2015. Prior to that, Jason was responsible for stock selection and asset allocation in the Asia ex-Japan region for the BP Pension Fund. Jason began investing in the Asia Pacific (excluding Japan) region in 1993.

About Jupiter

The listed British investment manager with boutique-like investment approach, located in London and founded in 1985, employs more than 400 employees worldwide (thereof about 35 fund managers). Today Jupiter is one of the UK's most respected asset management groups.

„The Jupiter Global Fund SICAV" (a Luxembourg based UCITS structure) provides clients outside the UK access to the diverse investment capabilities through its 29 sub funds which are registered for distribution in several European countries. Jupiter's total AUMs are GBP 42.7 bn as of 31 December 2018.

China is battling slowing economic growth with a host of stimulus measures, but a US policy of containment, the rise of rival low-cost manufacturing hubs and a dwindling current account surplus call for caution. In this climate, I prefer to limit my exposure to China, favouring privately-owned companies with strong balance sheets, domestic-consumption driven businesses over exporters, with good liquidity in the shares so I can react quickly to events.

China is in a quandary. Stimulus measures to lower interest rates, boost lending, stimulate infrastructure spending and lift domestic consumption last year, have had little positive impact on growth so far. China's economy grew 6.6% in 2018, and while this figure beat the government's annual growth target of 6.5%, it still marked a slowdown from 2017 when we saw growth of 6.8%. Further stimulus measures to boost growth are unlikely to break that pattern if only because the Chinese authorities have limited scope to act.

Gone are the days of record current account surpluses that have been so helpful in funding the country's economic prosperity. China recorded its first current account deficit in 20 years in the first six months of 2018. It means Chinese authorities are no longer able to ramp up infrastructure spending quite as they have been up to now, as it would lead to a surge in commodity imports that would have to be paid at a time when the government coffers are looking increasingly bare.

Given this difficulty, talk of China devaluing its currency to boost its exports and current account balance has been rife. While I do not anticipate a near-term devaluation of the renminbi – a move the US would interpret as highly antagonistic at a time when it is seeking to rebalance its trading relationship with China – I do expect it to take place some time in the next three years. It would, in my view, eliminate some of the pressures in the country's financial system and boost competitiveness. For some time, China has been ceding its place as the default outsource location for global manufacturers to countries like Vietnam and Mexico. A combination of attractive wage rates and proximity to key markets, such as the US, have made Mexico particularly appealing.

Getting growth back on track is being further hindered by a strategic attempt by the US to constrain China's development. The Trump administration may have been behind this new approach to dealing with China, but it has, to my mind, gained broad cross-party agreement. The consensus view has coalesced around the idea of China as a competitor and strategic foe, that needs to be reined in. This is likely to herald a period of increasing friction between the two – a far cry from the days when the US was a willing sponsor of China's application to join the World Trade Organisation back in 2001. The situation won't be helped by the internal politics at play in China. Under President Xi Jinping, the Communist party has certainly taken a more authoritarian turn, with fewer checks and balances, to limit party excesses – hardly surprising after the removal in March last year of the two-term limit for serving presidents.

All these factors translate into limited direct exposure to China. I am invested in four companies that make up around 11% of the Jupiter Asia Pacific Income Fund: Ping An Insurance, Tencent International, China Mobile and Hengan International. All four earn most of their revenues from mainland China, none of them are significant exporters and, importantly, their areas of business do not overlap. They are all benefiting from greater consumer growth as disposable income among the Chinese continues to rise. As companies, they also offer strong balance sheets and the shares are liquid, making it easy to build up or reduce positions. Running an income fund, dividend yield is key with three out of the four companies offering what I consider very good yields. Tencent is the notable exception, offering a low dividend yield but with the prospect of decent dividend growth going forward; they have a net cash position on their balance sheet and I anticipate steady earnings growth from the company.

Limiting your direct exposure to China however cannot fully insulate the rest of your portfolio from changes in fortunes of the Chinese economy. Neighbouring Asian economies can quickly feel the impact of a China slowdown. As an investor in the region, remaining alert to the knock-on effect of a weakening Chinese economy on other Asian countries remains paramount.

Important information

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