Recent Market Moves in China:

I. The background

There has been an enhanced level of volatility in Chinese stocks, triggered predominantly by enhanced regulatory attention in a range of Chinese digital, education and internet businesses. We have had a recommendation on China equities for nearly 2 years now, primarily played out via the Edelweiss/JP Mogan Greater China Fund (and also via the Edelweiss/JP Morgan EM Fund and now the ASK EM Fund). We believe that the volatility is transitory and not a long-term reflection on the China opportunity.

Figure 1: Leading Chinese technology stocks has taken a beating on the back of regulatory actions

Source: Refinitiv, ASKWA Research.

II. Setting the context

1. The regulatory actions in China are ironically (ironic given the "free market" rhetoric around it), at first principles level, similar to the issues engaging regulators across the world, including in the West, around monopoly power of large digital companies (dominance of "super-apps"), use of regulatory arbitrage (Fintech calling themselves "banks" and behaving like banks), labour treatment (delivery boys/drivers in delivery/transport apps) and so on.
2. Some of the action is also in response to recent US regulatory attention on Chinese companies – most crucially via the Holding Foreign Companies Accountable Act.
3. In short, China is seemingly trying to go down the same path as several European countries and the US in some of these concerns, albeit with Chinese characteristics.
4. Investing in China is investing "with" the Chinese government, in several ways. That is a feature, not a bug. Its pertinent to note that the feature enabled the fastest growth over 40 years that any country has seen in the history of mankind.
5. Regulatory risk is a ceteris paribus condition in EM investing – no one knows that better than us in India – but the current discounting of Chinese stocks en masse is an over-reaction.

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III. Stand out performance of the economy

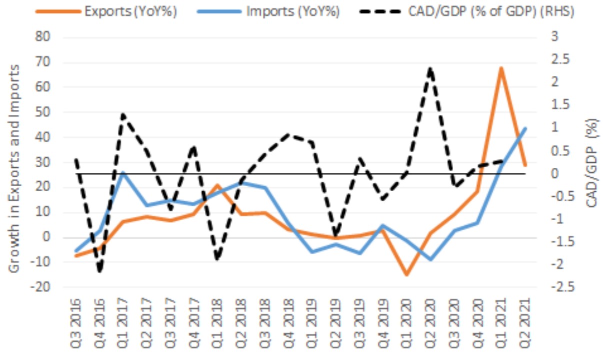
The Chinese economy is doing very well. It recovered the fastest from Covid – was the only major economy to post positive GDP growth in 2020. The glut of global liquidity has enabled both capital and trade to bounce back in classic V-shape – Chinese exports to the US has picked up smartly, despite all the noise around protectionism. Fact is, if the Chinese economy was in trouble, the government wouldn't be rushing around to spook the capital markets.

Figure 2: China stands out as only country with positive growth throughout the Pandemic

			Projections		Avg
	2019	2020	2021	2022	
Countries					
Brazil	1.4	(4.1)	5.3	1.9	1.1
China	6.0	2.3	8.1	5.7	5.5
Germany	0.6	(4.8)	3.6	4.1	0.9
India 2/	4.0	(7.3)	9.5	8.5	3.7
Japan	0.0	(4.7)	2.8	3.0	0.3
Russia	2.0	(3.0)	4.4	3.1	1.6
United Kingdom	1.4	(9.8)	7.0	4.8	0.9
United States	2.2	(3.5)	7.0	4.9	2.7
Regions					
World Output	2.8	(3.2)	6.0	4.9	2.6
Euro Area	1.3	(6.5)	4.6	4.3	0.9
EM and Developing	3.7	(2.1)	6.3	5.2	3.3

Sources: IMF, Refinitiv, ASKWA Research.

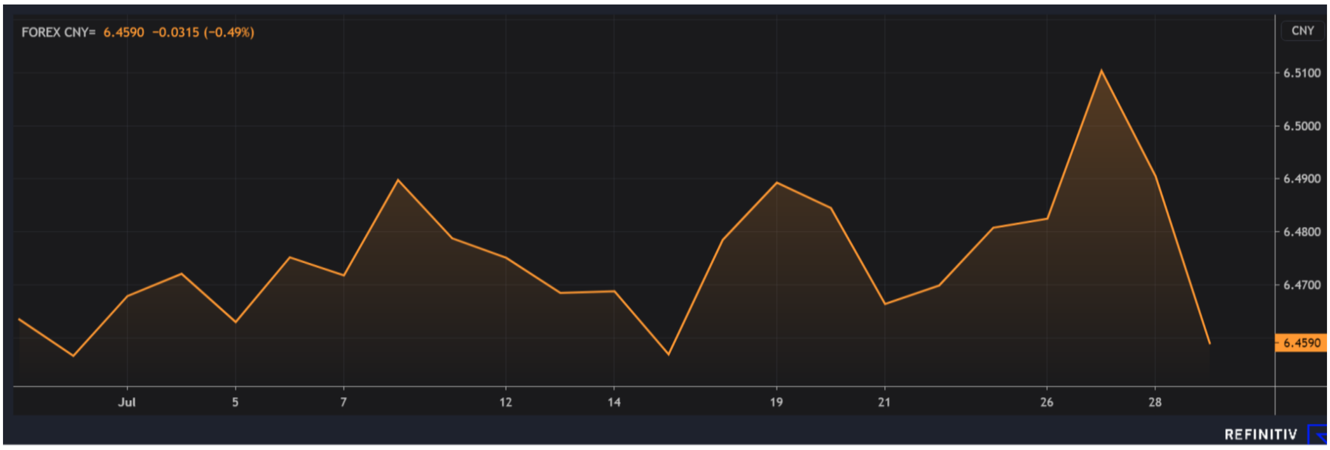
Figure 3: China's current account turns into surplus once again with huge growth in foreign trade



IV. Broader financial market unaffected

The broader financial markets are not conforming to the nervousness in equities. In the currency market, USD/CNY has remained remarkably stable through the last one month. Similarly, global cyclical commodities, another bellwether for the Chinese economy, has continued to grow with industrial performance in China and there is no relenting at sight as yet.

Figure 4: Chinese Renminbi has moved within a band



Source: Refinitiv, ASKWA Research.

Figure 5: Commodity prices continue to be driven by Chinese fundamentals

Source: Refinitiv, ASKWA Research.

V. Chinese tech opportunity – not going away

Meituan, the largest Chinese delivery company (similar to Zomato here), is running at an annual revenue run-rate of $10 bn, its already EBITDA positive, and is trading at a valuation of 8-9X sales. Its growing top-line at high double digits, while profits are expected to go up 6-7x in the next 5 years (JPM estimates). A range of such companies are available at much better valuations today than they were 3 weeks back – the fundamental growth story of the world's 2nd largest economy does not go away.

VI. Investment portfolios to play on the key investment themes:

In a Nutshell: Stay the course, take advantage of the volatility to double up or increase exposures. Our investment vehicles of choice will optimize the rest.

Our top recommendations above theme include the following.

i) *ASK Emerging Market Opportunities Fund*
ii) *Edelweiss Gr China Equity OffShore Fund*
iii) *Edelweiss EM Opp Eq. Offshore Fund*

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