

THE CHINA SYNDROME

First Rule of EM Investing:

When the Government decides to screw you...

You are screwed.

WHY TAKE ON CORPORATE CHINA NOW?

THREE STRATEGIC OBJECTIVES

UNDERSTANDING CHINA - THE BIG PICTURE

The most important policy shift is based on the identification of principal contradiction

Evolution of China principal contradiction as identified by the Party

Period	Principal contradiction	Direction
1948	Capitalism vs socialism	Socialized existing capitalism economy
1956	Economic and cultural growth cannot meet people's demand	Increasing productivity and focusing on economic growth
1958	Capitalism vs socialism	It is the only change made within short period and a top leadership struggle ensued. More ideology oriented and it eventually led to Cultural Revolution
1981*	The ever-growing material and cultural needs of the people vs backward social production	Aggregate economic growth is most important task
2017	Imbalanced and inadequate development vs the people's ever-growing need for a better life	Narrow income inequality, address demographic challenge and focus on areas of national/strategic importance

Source: CCPNews, GMO; Note: *it was first mentioned by Deng Xiaoping in 1978 and formally acknowledged by the Party in 1981

XI'S CHINA DREAM-CHINA REJUVENATION

He aims to make China the most powerful nation in the world again



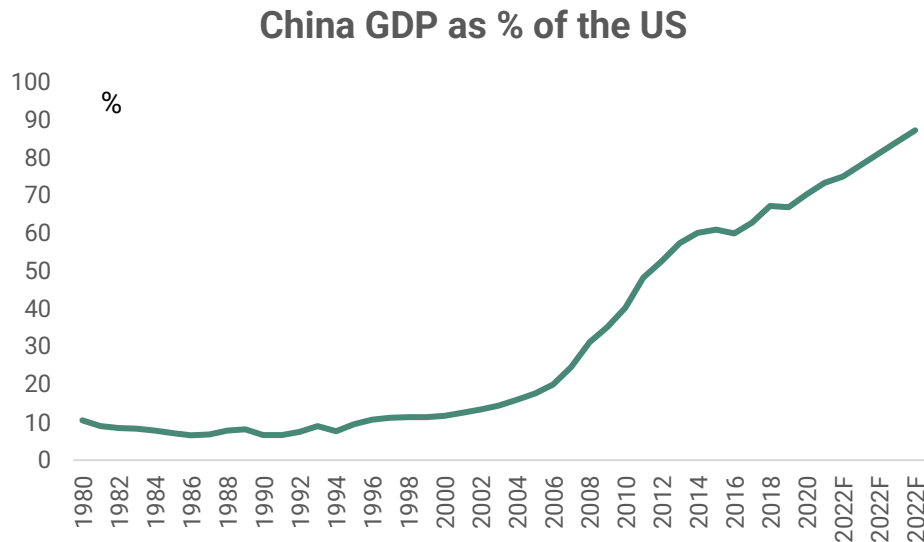
"China is a great nation...After the Opium War of 1840, however, .. the country endured intense humiliation...national rejuvenation has been the greatest dream of the Chinese people and the Chinese nation"

-President Xi during 100th anniversary of CCP, July 1, 2021.

Source: SCMP

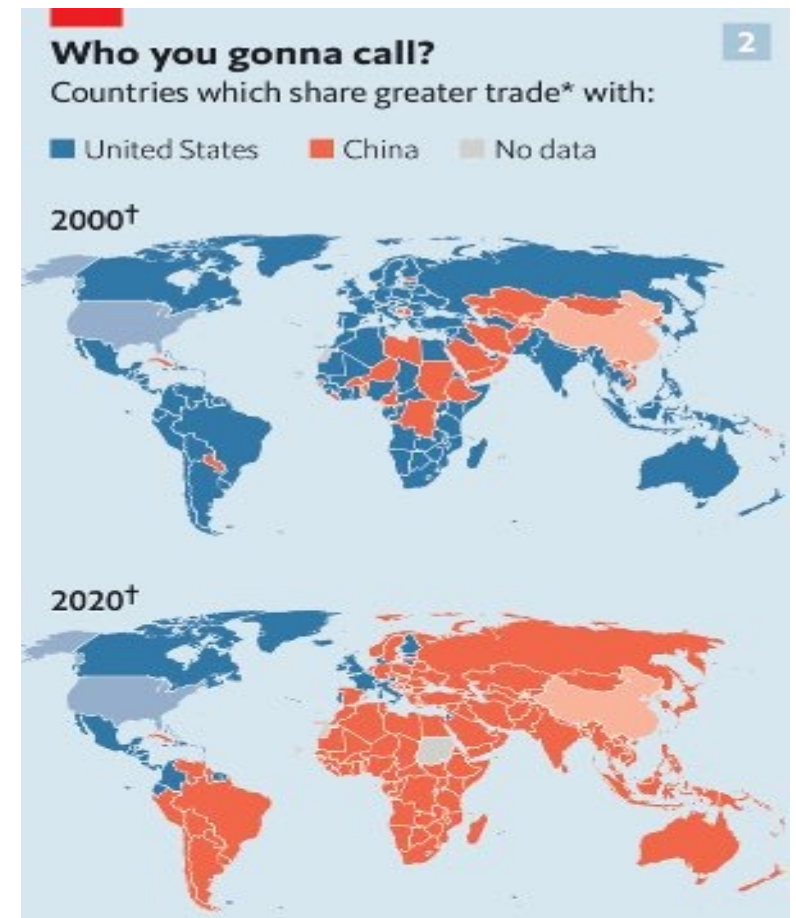
THE AMBITION IS WITHIN REACH

China's ascendance of economic power



- China's influence as international trade, manufacturing output has exceeded the US and there is decent chance China's GDP will exceed the US under President Xi's ruling.

Source: IMF, the Economist



BUT CHINA HAS ARRIVED AT A STUMBLING BLOCK

China identified an important roadblock to this ambition in 2017

Xinhua Insight: China embraces new "principal contradiction" when embarking on new journey

Source: Xinhua | 2017-10-20 22:41:54 | Editor: Yamei



Source: Xinhua

“What we now face is the contradiction between unbalanced and inadequate development and the people's ever-growing needs for a better life....

The evolution of the principal contradiction represents a historic shift that affects the whole landscape and that creates many new demands for the work of the Party and the country”

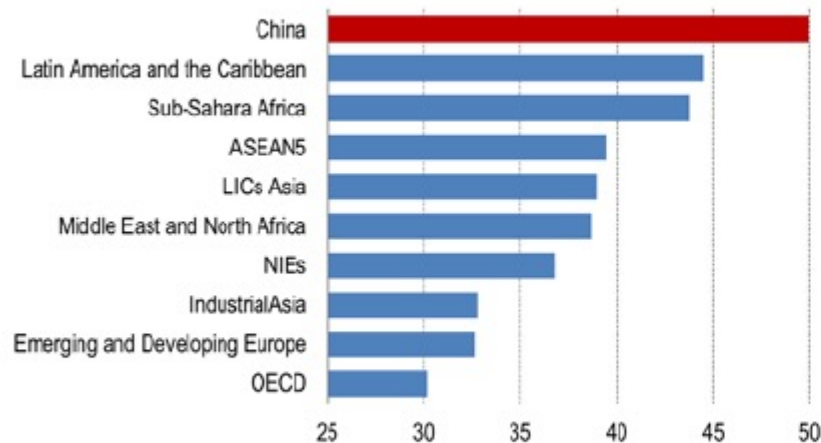
-Xi Jinping Oct 18, 2017

CCP – THREE STRATEGIC OBJECTIVES

A. Reduce income inequality – China’s inequality is worst among regions and has increased rapidly since 2015

Figure 1: Regional Comparison of Income Inequality Levels

(Net Gini Index; in Gini points; year of 2015 (or latest available); average across the region)

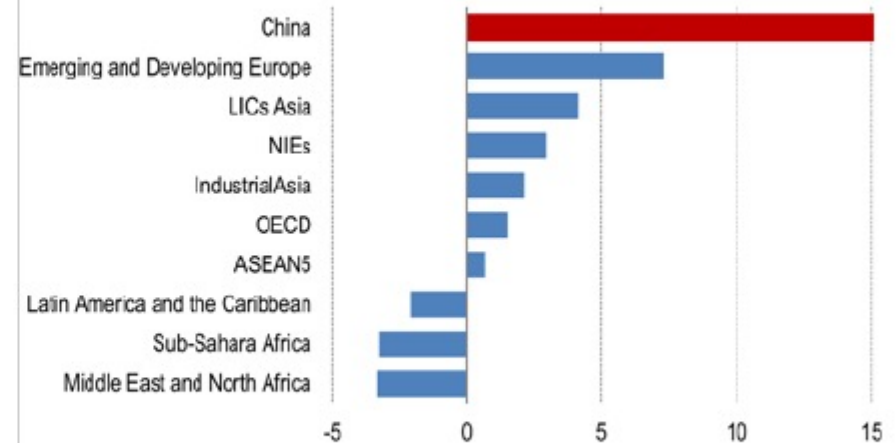


Sources: SWIID Version 5.1; IMF, and IMF staff calculations.

Note: ASEAN = Association of Southeast Asian nations; LIC = low-income country; NIE = newly industrialized economy; OECD = Organization for Economic Cooperation and Development

Figure 2: Regional Comparison of Income Inequality Trends

(Net Gini Index; in Gini points; change since 1990; average across the region)



Sources: SWIID Version 5.1; and IMF staff calculations.

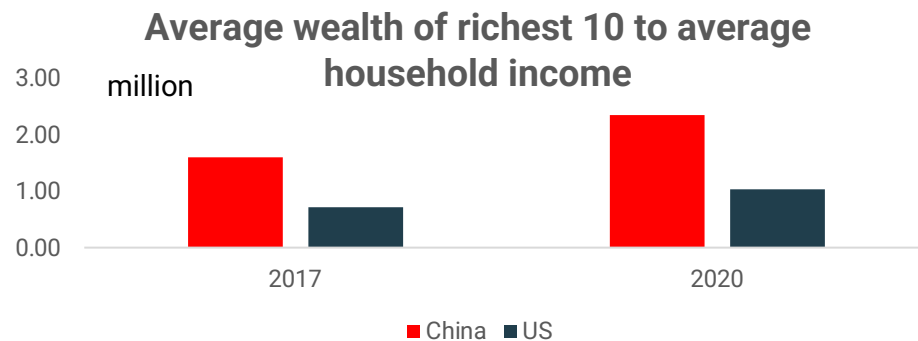
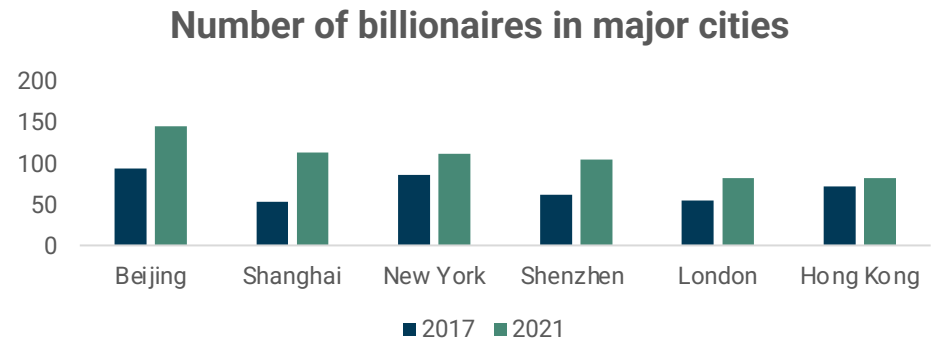
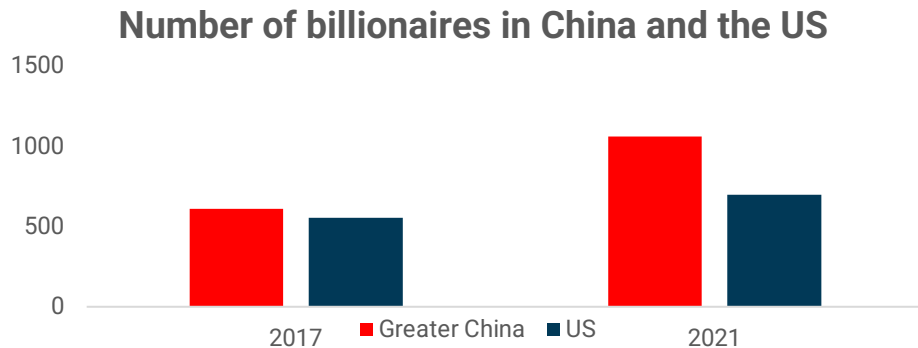
Note: ASEAN = Association of Southeast Asian nations; LIC = low-income country; NIE = newly industrialized economy; OECD = Organization for Economic Cooperation and Development

- Capital might be viewed to have benefited disproportionately in the past and sometimes they become too powerful to control

Source: IMF

CCP – THREE STRATEGIC OBJECTIVES : CHINA ULTRA RICH HAS BENEFITED MORE SINCE 2017

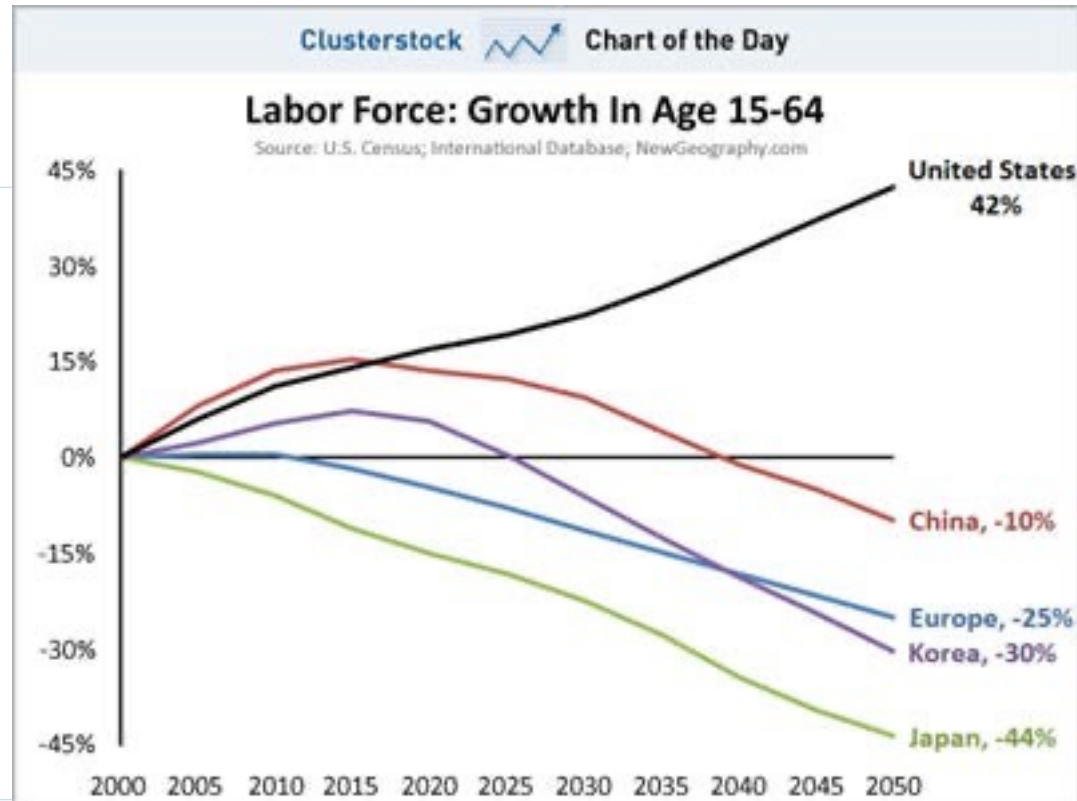
A. Even Shenzhen on track to beat New York in terms of number of billionaires



Source: Hurun Global Rich List, Forbes

B: THE DEMOGRAPHIC TIMEBOMB

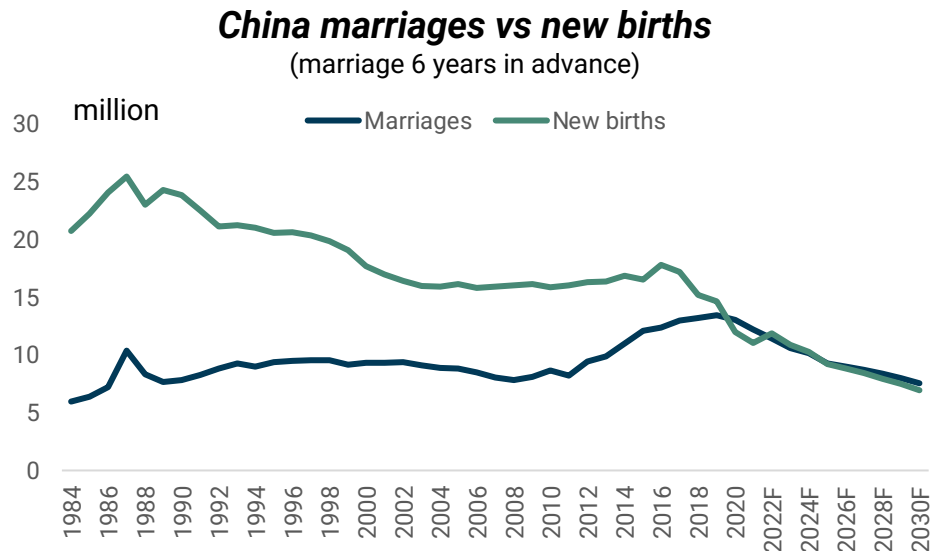
$$\begin{aligned} \text{GDP Growth} = & \text{Productivity Growth} + \\ & \text{Labor Share} * \text{Growth in Workforce} + \\ & \text{Capital Share} * \text{Growth in Capital} \end{aligned}$$



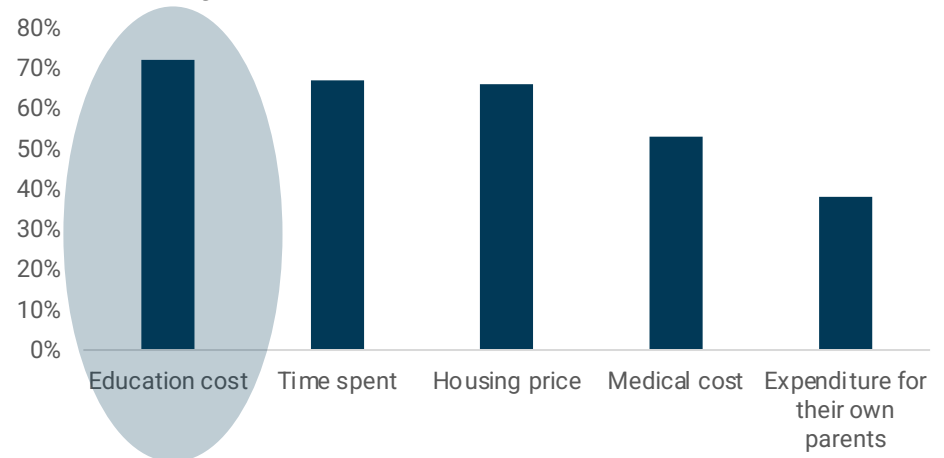
Labor force will shrink 25% from 2015 to 2050, while US will grow 25%

CCP – THREE STRATEGIC OBJECTIVES

B. Address Demographic Timebomb – China is rapidly aging



Important factors affecting choice of having a baby (Zeping Macro online survey)



- In 2020, China new births dropped to 12m, or 47% of the peak in 1987.
- Based on our forecast, with current trend continues, it will be 7m by 2030, 27% of 1987 and further drop to 5m by 2040, 20% of 1987.
- Factors contributing to low birth rate should be addressed to mitigate decline in birth rates

Source: Wind, Zeping Macro, GMO

CCP – THREE STRATEGIC OBJECTIVES

C. Prioritize industries of strategic importance - Advance technology development to secure supply chain and achieve self sufficiency

CNBC

MARKETS BUSINESS INVESTING TECH POLITICS CNBC TV WATCHLIST PRO

TECH

From No. 1 to No. 6, Huawei smartphone shipments plunge 41% as U.S. sanctions bite

PUBLISHED THU, JAN 28 2021 2:46 AM EST | UPDATED THU, JAN 28 2021 3:36 AM EST

Arjun Kharpal
@ARJUNKHARPAL

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KEY POINTS

- Huawei shipped 33 million smartphones globally in the fourth quarter of 2020, a 41% year-on-year decline, making it the sixth-largest vendor in the world.
- The latest figures mark a sharp fall for Huawei versus the second quarter of 2020 when it was No. 1 in the world by shipments.
- U.S. sanctions have cut Huawei off from key software like Google Android and critical components like chips which have hurt its sales.
- Huawei's woes come as Apple shipped a record number of iPhones in the fourth quarter.

TRENDING NOW

U.S.-China
a tense stalemate

Hong Kong
index closed
4% down and
educational
plunge

In this article AAPL -0.96 (-0.65%)

THE WALL STREET JOURNAL

Home World U.S. Politics Economy Business Tech Markets Opinion Life & Arts Real Estate WSJ Magazine Sports

China Wants a Chip Machine From the Dutch. The U.S. Said No.

Biden administration, continuing a Trump policy, seeks to stop ASML from selling China machines crucial to advances

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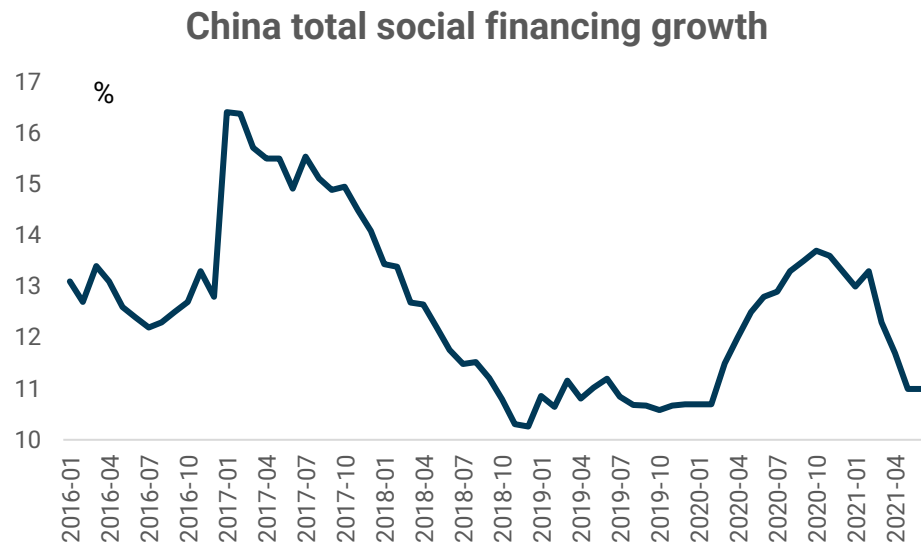
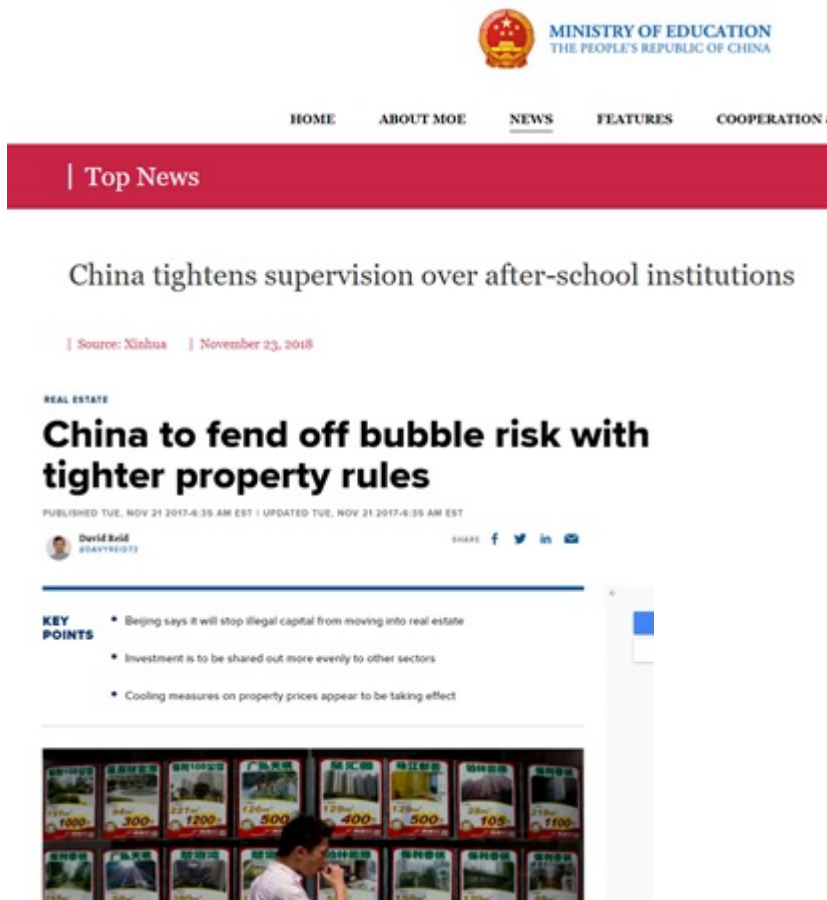
ASML employees working on the company's semiconductor lithography system in the Netherlands in 2019.
PHOTO: BART VAN OVERBEEKE/AS/REUTERS

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Source: CNBC, WSJ

CHANGE UNDERWAY SINCE 2017

Coincidentally, deleveraging in 2018 reversed and problem might have exacerbated



Source: Wind

IN EM, STAKE HOLDERS TAKE THE HIT. IN THE US, RESERVE CURRENCY & LEGAL SYSTEM PROVIDE PROTECTION

Is \$10,000 In Student Loan Forgiveness Next, After Biden Administration Cancels \$1 Billion?



Adam S. Minsky Senior Contributor @
Personal Finance
I'm an attorney focused on helping student loan borrowers.

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WASHINGTON, DC - MARCH 18: U.S. President Joe Biden speaks in the East Room of the White House on ... [+] GETTY IMAGES

This article has been updated.

Yesterday, Education Secretary Miguel Cardona announced a policy shift that will result in \$1 billion in student loan forgiveness. But what does that mean for the ongoing efforts by progressive lawmakers and consumer rights activists to convince President Biden to cancel student debt?

\$1 Billion In Student Debt Will Be Cancelled

WHAT MAKES CHINA DIFFERENT IS MUCH MORE CONCENTRATED POWER AND EXECUTION CAPACITY

CCP 100th anniversary celebration



- To achieve his goal, he strengthens the Party's absolute control over the Country and his absolute control over the Party
- **The Party controls everything**
- **Two upholds:** "Resolutely uphold General Secretary Xi Jinping's core position on the Party Central Committee and in the Party as a whole, and resolutely uphold the Party Central Committee's authority and its centralized, unified leadership"

Source: twitter, government documents

TECHNOLOGY House Democrats about to uncork 5-pronged assault on tech

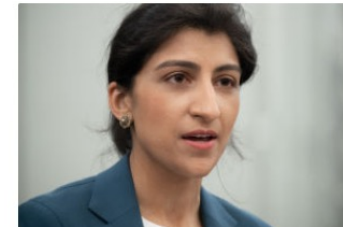
Bills set to be announced in the coming days would make it easier to break up giant tech companies, block them from merging and prohibit them from hobbling their rivals.



Facebook Joins Amazon in Calling for FTC Chair to Step Aside on Antitrust Cases

By Max A. Cherney Updated July 14, 2021 2:50 pm ET / Original July 14, 2021 2:48 pm ET

Text size - +



Facebook petitioned for Federal Trade Commission Chair Lina Khan to recuse herself from involvement in the stalled antitrust case against the company, arguing Khan's history of criticizing the company and others would deny it due process.

Facebook made the request

IS CHINA CHEAP AFTER CORRECTION?

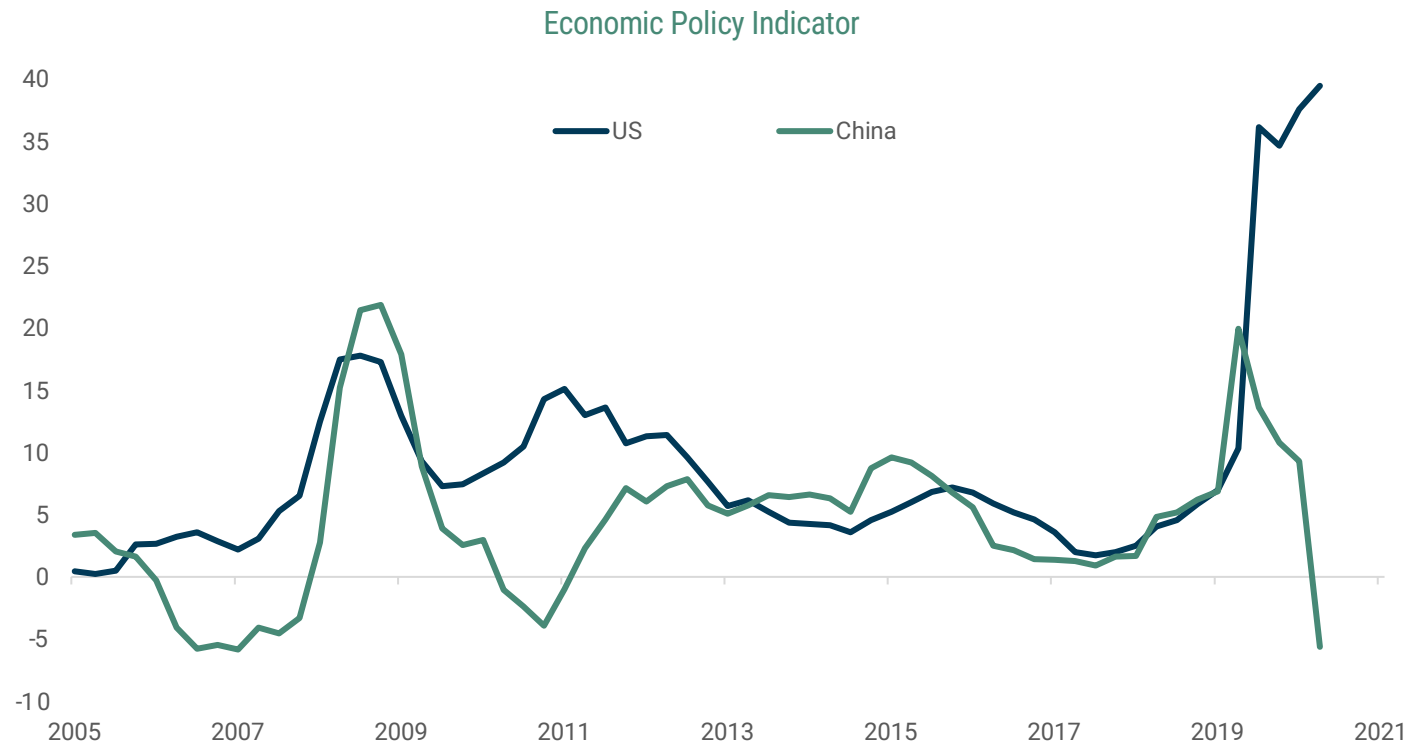
CHINA MARKET HAS GONE BACK TO PRE COVID LEVELS

China market has gone back to pre covid levels



MACRO BACKDROP HAS BEEN TIGHTER THAN US

Much tighter policy than US



EPI is defined as money supply growth in excess of nominal GDP growth plus fiscal deficit
As of 06/30/21 | Source: Bloomberg, CEIC

IS CHINA CHEAP AFTER CORRECTION

How policy changes alter fair value significantly

TAL Education Group

5.51 USD

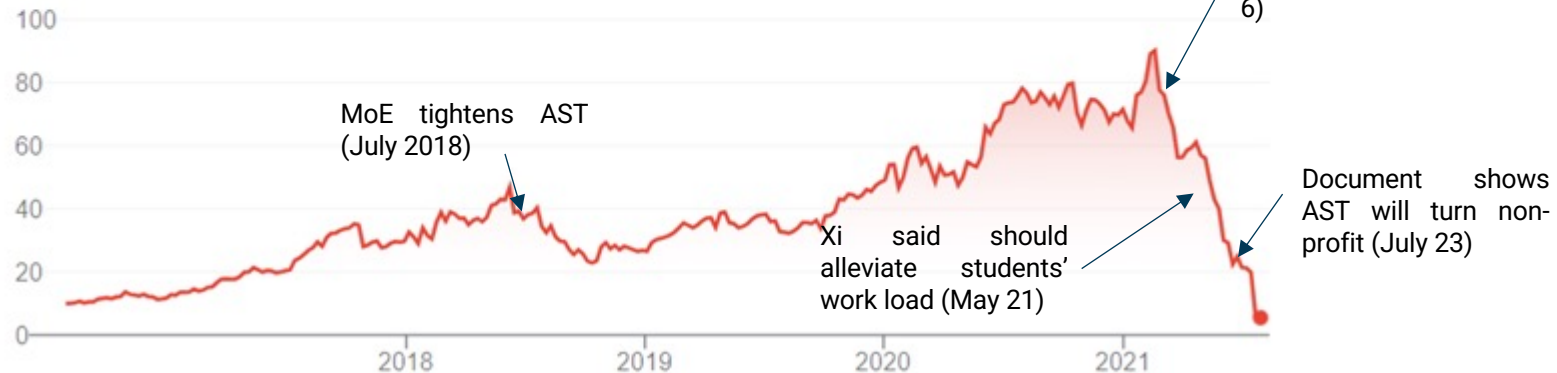
NYSE: TAL

-4.53 (-45.12%) ↓ past 5 years

Closed: 27 Jul, 7:59 pm GMT-4 · Disclaimer

After hours 5.78 +0.27 (4.90%)

1D | 5D | 1M | 6M | YTD | 1Y | 5Y | Max



Market Cap has dropped from \$60 billion to \$4 billion (and is likely going to zero)

Source: Google, GMO

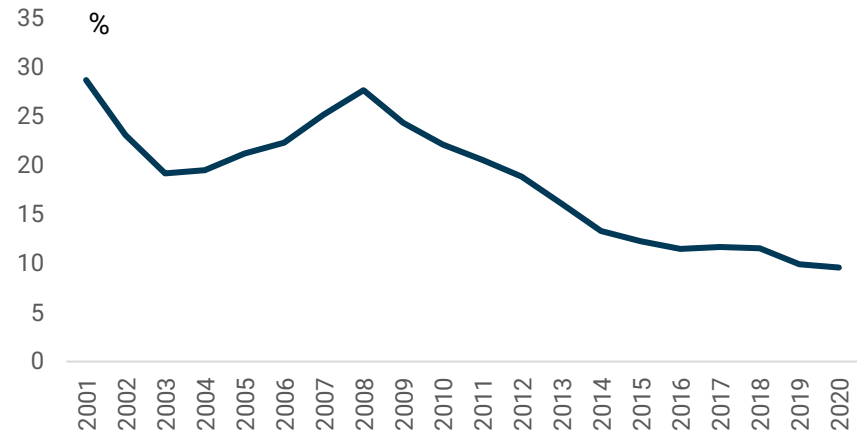
THE PARTY GIVETH AND THE PARTY TAKETH AWAY – WILL CURRENT MARKET LEADERS SUFFER THE SAME FATE?

Is Internet the new China Mobile?

Weight of China Mobile in MSCI EM



ROE of China Mobile



“The focus is no longer the data but every user behind the data. Internet should back to “water-electricity-coal” (services provider). While still putting efficiency at top priority, it should balance fairness. Regulation is cooling down the disorder fever and make the infrastructure “on the cloud” materialized”

-Securities Journal commentary July 28, 2021

Source: Wind, Securities Journal

FRAMEWORK TO IDENTIFY FUTURE WINNERS/LOSERS

FRAMEWORK TO IDENTIFY FUTURE WINNERS/LOSERS

China Strategic Goals

- Narrow income inequality
- Ease household burdens
- Technology advance/Supply chain security
- Demographic improvement

Social Impact

- Create positive social benefit
- promoting patriotism
- Wasteful Time spent

Security

- Improve data security

Control / Ownership

- State Ownership
- Effective Control

Inequality/ Excesses

- Too many billionaires
- Excess in sector

Valuation / Market Signals

- Valuation – discounted ?
- Sentiment

FRAMEWORK TO IDENTIFY FUTURE WINNERS/LOSERS

Risk Score

	Achieve China's Dream	Social Impact	Security	State in control	Excessive Wealth Created	Market Sentiment and Valuation	Total
Energy	0	-1	0	1	0	1	1
Material	0	-1	0	0	0	1	0
Industrial	1	0	0	0	0	0	1
Real estate	-1	0	0	0	-1	0	-2
Banks	0	0	0	1	0	1	2
Utility	0	0	0	1	0	1	2
IT	0	0	-1	0	0	-1	-2
Media & entertainment	0	-1	-1	-1	-1	-1	-5
Automobile	1	0	-1	0	-1	-1	-2
Retailing	0	0	-1	-1	-1	-1	-4
Consumer staples	0	0	0	0	0	0	0
Healthcare	-1	0	0	0	-1	-1	-3
Alibaba	-1	0	-1	-1	-1	0	-4
Tencent	0	-1	-1	0	-1	0	-3

GROWTH SECTORS MORE AT RISK THAN VALUE

