While global markets faced a challenging year in 2020, China’s onshore A-share market (those shares listed and traded on the Shanghai and Shenzhen stock exchanges) saw US$150 billion-worth of inflows from international investors through its HK Stock Connect program from January to November 2020. Senior Portfolio Manager, Chris Liu explains why global investors are increasingly interested in China’s domestic equity markets and how this asset class can meet their investment objectives.

**Q. From your perspective, what are the key reasons why investors are interested in China A shares?**

I believe investors are allocating into the A-share market as one possible source of alpha returns in their portfolios. In the past five years, active managers in China have delivered on average more than 6% excess returns annually, outperforming the benchmark and have outshined some of their peers in the emerging world as of 30 December 2019.

As China’s market reforms progressed in 2015 and the Qualified Foreign Institutional Investor (QFII) program expanded, the fundamental-based approach to stock picking from international investors started to influence the investment philosophies of domestic fund managers. In recent years, there has been a growing recognition that fundamental analysis works in China, helping both domestic and foreign fund managers to generate alpha.

**Q. For investors looking for growth, what can be considered as long-term opportunities in China?**

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.

Our key focus growth sectors in China are:

<table>
<thead>
<tr>
<th>Sector</th>
<th>Opportunities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Technology</td>
<td>Chinese technology, ecommerce and internet companies continue to innovate and grow. hardware manufacturers of 5G technology can also bring value to the supply chain.</td>
</tr>
<tr>
<td>Healthcare</td>
<td>Rising demand from China’s aging 1.4 bn population. Healthcare is the second largest A-share sector in China with over US$1 trillion in total market capitalization, almost 400 investable stocks and diverse subsectors ranging from biotech to medical devices.</td>
</tr>
<tr>
<td>“Green economy”, renewable energy</td>
<td>SEctors like electric vehicles will likely renewable energy benefit as China moves towards carbon neutrality. China is the largest EV user market in the world and maker of lithium-ion batteries.</td>
</tr>
</tbody>
</table>

**Q. For investors looking for income, what can be considered as opportunities in the China A-share market?**

For investors looking 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 example, some of the Chinese banks and property stocks are considered cheap with very low PE ratios (Price-to-Earnings) and the property developers are offering dividend yields of almost 6%. 
Q. What are the risks to investing in China's A-share market for 2021?

In 2020, liquidity played a role in supporting asset prices so I believe the main risk for 2021 would be any sign of tightening from the People's Bank of China (PBoC) although policymakers remain accommodative.

Investors can also risk falling into the “value trap” by taking a simplistic approach to investing. For example, some value stocks may appear “cheap”, but their share prices may continue to perform poorly due to their deteriorating fundamentals. Investors without local knowledge could face challenges in accessing the potential opportunities available in the A shares market. We believe having access to on-the-ground research is one key to success when investing in China.

Q. After a rally in 2020, how can investors position China A shares in their portfolios?

The growth drivers of China's economic transformation are expected to sustain for many years to come. Those Chinese companies developing clean energy, advanced healthcare and pioneer technology can serve as core components of a strategic asset allocation.

The A-share market had a remarkable run up in 2020. We observe that valuations of some high-growth sectors are looking a bit stretched. We need to be cautious in picking stocks in those sectors. For 2021, we see tactical opportunities in the old economy sectors which may enjoy re-rating opportunities due to their cheap valuations. We expect further upside potential for the A-share market in 2021 mainly supported by earnings recovery rather than by valuation expansion.

As we enter the digital era, Chinese companies have gained a competitive edge in growth-yielding sectors such as technology, alternative energy and healthcare. I believe investors of any kind can find opportunities among the large pool of sizeable companies and diverse subsectors of China’s A share market.

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7. Bloomberg data as of 31 Dec 2020. Note: Dividend yield is based on Bloomberg Best estimates for the next fiscal year estimates of members in the MSCI China A Onshore Local index (GICS subsector category: Real Estate Development)
Investment Risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

When investing in less developed countries, you should be prepared to accept significantly large fluctuations in value.

Investment in certain securities listed in China can involve significant regulatory constraints that may affect liquidity and/or investment performance.

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Data as at 18 January 2021, unless otherwise stated.

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