

# China position 2021:

## Sustaining institutional interest



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Written by

**ECONOMIST  
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# Foreword

Invesco has had a presence in China for more than three decades, and it's been deeply rewarding for us and our clients to watch the country's phenomenal growth. Our early entrance in the market and our long experience there convince us that China represents one of the greatest investment opportunities we'll see in our lifetimes.

China is the second-largest asset management market in the world by AUM<sup>^</sup>, and we fully expect it will overtake the US within the next few years (if not sooner). The Chinese government is being thoughtful and has made good progress in developing its financial markets. This commitment to opening its markets has helped support the tremendous growth and transformation of China's economy, rewarding investors across the continent and around the world.

Given the strong and growing interest in this crucial market, we're pleased to share with you our second comprehensive survey, [China Position 2021: Sustaining institutional interest](#), with Economist Impact. This follow-up to the 2019 study, The China Position, was conducted over June and July of this year, surveying 200 asset owners from across the globe to really understand how their investment stance toward China is evolving.

The results are fascinating. China's growing economic strength, its shift from export-oriented to a domestic-demand driven economic model, the growing number of international companies, increasing consistency in meeting global standards, and its rapidly developing financial markets – all combine to make the country an attractive investment opportunity, according to our asset-owner respondents.

Some additional highlights from the survey:

- 86% of respondents say they've either maintained or grown their China exposure over the past year, with 64% expecting further increases over the coming year. Only 12% reported a reduction in their China exposure.
- Covid-19 has increased the risk appetite of more than half of survey respondents with regards to their China exposure in the past year.
- Drivers of investment in China are a mix of market factors, such as improvement in the quality of financial intermediaries within China; expectations of the growth and expansion potential of China's economy or of listed-company profits; as well as internal factors such as improvements to an organization's own China expertise.
- More than half of survey respondents have direct investments in China, compared to 40% in broader investments (for example through an ETF or other thematic global/emerging-market/Asia vehicles).
- The majority of survey respondents (62% always or often adopt ESG investing with their China exposures, and two-thirds say their China exposure has increased significantly/somewhat due to their ESG goals.
- Approximately one third of survey respondents plan increases to each asset class, with the highest numbers in real estate 40%, direct ownership of companies 39% and alternatives 38%.

<sup>^</sup> Source: Global Asset Management 2021 - The \$100 trillion machine, BCG, July 2021, <https://web-assets.bcg.com/79/bf/d1d361854084a9624a0cbce3bf07/bcg-global-asset-management-2021-jul-2021.pdf>

Although the potential in the region is phenomenal, investing in China is not without its challenges. Continued tension between the US and China will remain an issue for investors for the foreseeable future. And, as we learned through the survey, concerns remain about lack of trust and transparency in corporate reporting, regulation, financial intermediaries, and financial systems.

Regulatory moves over the summer of 2021, aimed at reigning in large consumer internet and education companies, sent shares in these businesses tumbling. However, these regulatory actions intended to promote long-term growth and social welfare may level the playing field for small and innovative companies and spur innovation.

All of this and more are explored in the pages that follow. We're excited about the tremendous potential of the China investment management market, and believe it offers a tremendous investment opportunity. We hope you find this report helpful. As always, we remain committed to helping you achieve your investment objectives wherever the markets take us.



**Invesco has had a presence in China for more than three decades, and it's been deeply rewarding for us and our clients to watch the country's phenomenal growth.**

A handwritten signature in black ink that reads "Marty L. Flanagan".

**Marty Flanagan**  
President and Chief Executive Officer

# About the research

**China position 2021: Sustaining institutional interest** is an Economist Impact report, sponsored by Invesco. The report is a follow-up to 2019's China position study. For the 2021 research, a survey was conducted of 200 asset owners (pension and sovereign funds, endowments, banks, insurance firms, etc) to better understand the sentiment these large—often market making—funds have in terms of investment stance toward the Chinese market. The research is designed to go beyond media headlines to address the actual strategy and exposure levels of the world's largest institutional investors. Geographic range in this year's survey, which was conducted over June and July 2021, had 25% each from Asia-Pacific, Europe, Middle East and North America. Respondent seniority ranged from group director to CEO or firm owner, with about 50% at the C-suite level, while another 50% had personal investment decision-

making power. Assets under management at surveyed organisations spanned from US\$500 million to greater than US\$100 billion. The survey showed that 86% of respondents say their investments in China have either grown or stayed the same over the past 12 months, with 64% expecting further increases in the next 12 months; only 12% expected a reduction. Despite headlines of tech and trade tensions or decoupling pressures, the world's most significant class of investors remain considerably invested in China. This report explores why.

In addition to the survey, this report draws on Economist Intelligence Unit data, desk research and in-depth interviews with investment leads at asset-owner firms and funds. Our sincerest thanks are due to the following (in alphabetical order by surname) for their time and insight:

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## In alphabetical order by surname:

### **Xiadong Bao**

China fund manager, Edmond de Rothschild Group, France

### **Stéphane Monier**

Chief investment officer (CIO), Lombard Odier Private Bank, Switzerland

### **Mukul Chawla**

Joint head media, telecoms and technology, Temasek, Singapore

### **Sean Taylor**

APAC CIO, DWS, Hong Kong

### **Christophe Donay**

Head of asset allocation, Pictet Wealth Management, Switzerland

### **Michael Vos**

Regional investment manager, APAC, Zurich Insurance Group, Australia

### **Yaying Dong**

Market strategist, global macroeconomic research lead, Mercer, Australia

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**Monica Woodley** is the report author and **Jason Wincuin** is the editor.

### **Nagi Hamiyeh**

Joint head investment group and head portfolio development, Temasek, Singapore

# Executive summary

- The majority (60%) of respondents to this year's survey have better expectations of economic conditions in China relative to globally over the next 12 months.
- While that majority does represent a slip from just under three-quarters of respondents in 2019 who expected better conditions for China, it still demonstrates optimism against headwinds of covid-19, trade tensions and new uncertainties in China's heavily watched tech sector.
- A further demonstration of optimism comes from the 84% of respondents who saw no change or an increase in risk appetite as related to covid-19 and its impact on China exposure in the past 12 months. Geopolitical instability captures many headlines, but the bottom line for investors is more China exposure; 80% of survey respondents say US-China trade tensions will have moderate or significant influence for them to increase China exposure levels.
- Technology innovation and financial services remain the top investment sectors for survey respondents, consistent with the 2019 survey, with healthcare and domestic consumption themes also capturing interest. Likely given a boost from the pandemic, internet or online themes gained the most ground with investors since 2019.
- Drivers of investment in China are a mix of market factors, such as improvement in the quality of financial intermediaries within China and expectations of the growth and expansion potential of China's economy or listed-company profits, as well as internal factors such as improvements to organisations' China expertise.
- Challenges to investment mainly centre on issues of trust and transparency, such as a lack of trust in corporate reporting, low regulatory transparency and opacity in China's financial system for foreign investors.
- The majority (62%) of survey respondents always or often adopt ESG (environment, social, governance) investing with their China exposures and two-thirds say their China exposure grew due to their ESG goals.
- However, transparency remains a key issue. Asset owner respondents' top three concerns are that too few equity or bond issuers in China meet their standard for scope or quality of ESG disclosures; ESG-related data from equity or bond issuers in China are not readily available; and ESG-related data from equity or bond issuers in China are too difficult to verify.
- About a third of surveyed asset owners, on average, plan increases to each asset class, with the highest numbers in real estate (40%), direct ownership of companies (39%) and alternatives (38%).
- Overall, China exposure is growing. Half of survey respondents say holdings increased over the past 12 months, and 64% plan further increases in the next 12 months. Only 12% report plans to decrease exposure.



# How the world changed



Since the 2019 survey, investment sentiment from asset owners—some of the world’s largest and most influential investors—on their China exposures has largely held stable. Yet so much in the world has changed.

In 2019 the first China Position report from The Economist Intelligence Unit found that institutional investors took interest in China’s strong export-led manufacturing sector, consumer base of 1.4 billion citizens with rising incomes, and rapid economic expansion. In addition, these all compared well as investment drivers with the sluggish growth of Western developed markets post the 2008-09 global financial crisis. Gradual market liberalisations were making it easier for foreign investors to take advantage of the country’s growth, and investors appeared focused on using China as an important portfolio diversifier while increasing their

own expertise in the country’s markets to find the best opportunities. In particular, survey respondents saw promise in technology, financial services and “new economy” sectors.

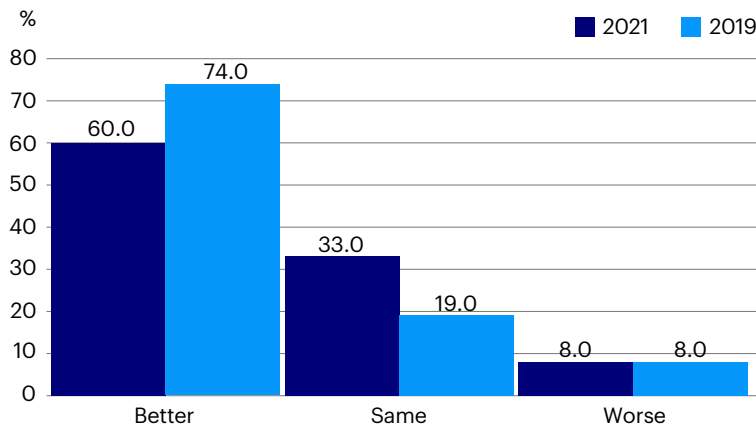
Investors were wary of China’s reporting and regulatory transparency, and uncertainties around US-China trade tensions had already arisen in 2019. Still, a majority of survey respondents planned to increase exposure across asset classes. The turmoil that 2020 was about to bring would have been far off on anyone’s radar with a global economy generally poised for growth.

Context for the 2021 survey, conducted over June and July, was practically a global reset. The covid-19 pandemic had killed over four million people globally and triggered the deepest economic recession in nearly a century.<sup>1</sup> As the first country to encounter the pandemic, China was also first to impose business-squelching lockdowns to control the virus, and the first to emerge from related recessionary effects.

<sup>1</sup> The OECD, Economic Outlook, <https://www.oecd.org/coronavirus/en/themes/global-economy>

**Figure 1. Hope against headwinds**

Expectations of economic conditions in China relative to global conditions over the next 12 months



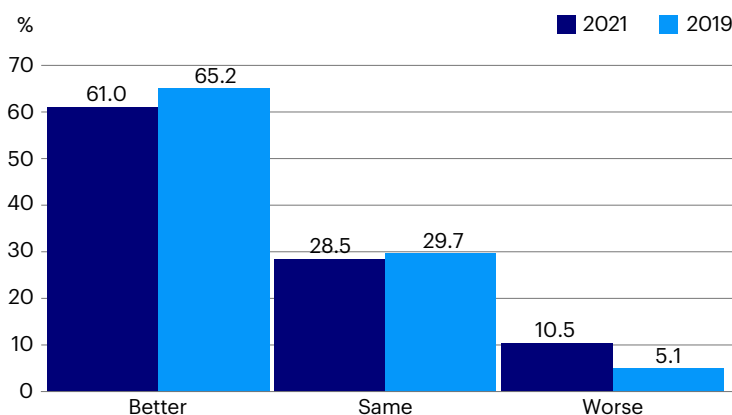
Source: The Economist Intelligence Unit; sample size: 200

In 2020, China was the only major economy to expand—achieving 2.3% real GDP growth. And while many countries still struggle to vaccinate citizens quickly enough to loosen restrictions and return to normal economic activity, The Economist Intelligence Unit’s forecasts show that China’s GDP returned to pre-pandemic levels by mid-2021 with a prediction to expand by 8% for the full year.<sup>2</sup> Aligning with that outlook, the majority (60%) of our institutional-investor respondents this year have better expectations of economic conditions in China versus global conditions over the next 12 months. But that is down from just under three-quarters who felt so in 2019. Against the headwinds of 2020, that minor slip actually looks like strong optimism.

A similar number expect global economic conditions over the next 12 months to be better than current conditions, which is down slightly from 2019. World GDP in 2020 slumped by 3.8%, but the market expects a recovery of about 6% growth in 2021. The Economist Intelligence Unit predicts the US to be the developed market with the best recovery, hitting 6% GDP growth in 2021 after contracting by 3.5% in 2020. Meanwhile, forecasts for Europe and ASEAN also anticipate a bounce-back from -6.8% to 4.6% in Europe and from -4.1% to 4.2% for ASEAN.<sup>3</sup>

**Figure 2. Down but bouncing back**

Expectations of global economic conditions over the next 12 months



Source: The Economist Intelligence Unit; sample size: 200

<sup>2</sup> China Country report, September 1, 2021; The Economist Intelligence Unit

<sup>3</sup> The Economist Intelligence Unit



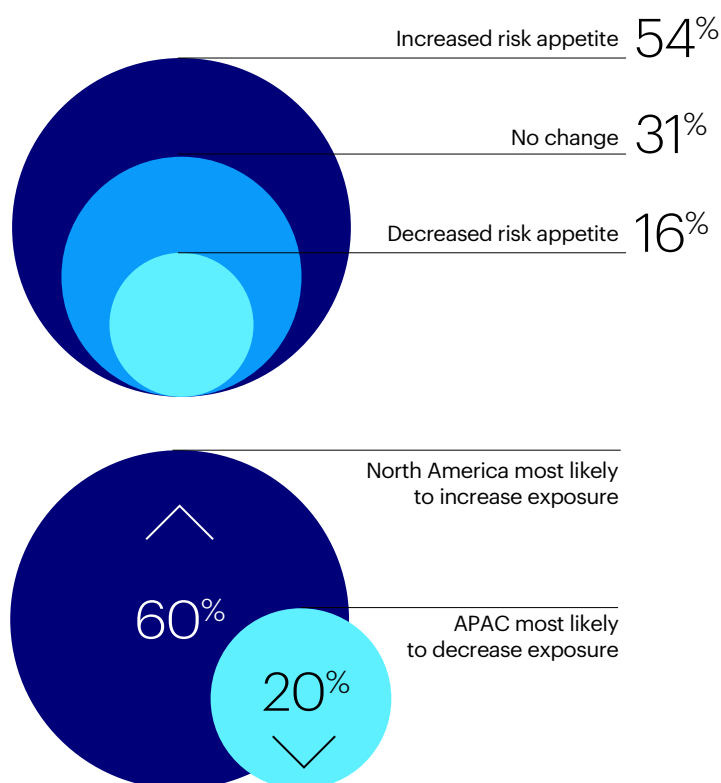
"We think that all countries are going to follow the same pattern but lag in time, with the Chinese first in line," says Stéphane Monier, chief investment officer (CIO) at Lombard Odier, a private bank. "Then the economies that have been quite good at vaccinating, such as Israel, UK, US, continental Europe. Then, unfortunately, we have to wait for 2022 for emerging markets that have not really started to vaccinate."

While covid-19 has changed many things for many people, it does not seem to have changed investors' strategic view of investing in China or where the opportunities are. Instead, covid-19 has increased the risk appetite of over half of survey respondents with regard to their China exposure.

"The pandemic has been quite a large shock to investment portfolios, and it did take quite a long time to re-establish what we were doing and what we can do in this type of environment," says Yaying Dong, market strategist at Mercer Australia, an employee benefits and outsourced CIO firm. "But what we have learned is that growth in new economy sectors—AI [artificial intelligence], automation, renewable energy—has only intensified during the pandemic, and this is the long-run strategic direction." Survey respondents agree, picking AI as the top technology interest in China.

**Figure 3. Appetites up**

Impact of covid-19 on overall China exposure (past 12 months)



Source: The Economist Intelligence Unit; sample size: 200



**... what we have learned is that growth in new economy sectors—AI, automation, renewable energy—has only intensified during the pandemic, and this is the long run strategic direction**

**Yaying Dong,  
market strategist and global  
macroeconomic research lead,  
Mercer**



A strengthened focus on technology has also intensified US-China trade tensions. According to Christophe Donay, head of strategy and asset allocation at Pictet, a Swiss bank and financial services company: “What is behind the tension is philosophy. We have the US, the technological leader since the second world war, and thanks to this, they have world economic leadership and financial-world leadership. Now China is putting the US’s leadership of technology at risk and because of that, its world leadership. It’s not just Trump versus China, the tensions are still there, if not stronger than before.”

The scene is set for increasing polarisation as the US president, Joe Biden, maintains his predecessor’s focus on battling China for technological, and therefore economic, world leadership, but with a new strategy of bolstering his position with allies’ support. For China, it has led to a strategy of “dual circulation”, emphasising security and technological self-sufficiency through indigenous innovation.

All the above is the context through which our asset-owner survey respondents must chart their investment strategies and China positions. And if they are voting with portfolios, most asset owners appear to come down on the side of China. When asked what influence, if any, their organisation expected US-China trade tensions to have on their China exposure levels in the year ahead, 80% reported that their exposures would increase.

# Tailwinds and Headwinds



Survey respondents and interviewees cite a range of factors that make China an attractive investment destination. The country's growing economic strength, shift from export-oriented to domestic-demand economic model and growing number of international companies figured largely in that outlook. Increasing consistency in meeting global standards (financial and ESG reporting) and its developing financial markets, which are progressively more open to foreign investors with better quality intermediaries, are making investment easier.

China's government has driven change from the top down, with recent changes to the Qualified Foreign Institutional Investor (QFII) scheme and the introduction of the Foreign Investment Law (FIL), which replaced three previous laws governing foreign investment and foreign invested enterprises. The changes to QFII simplify the approval process and lower the barriers to entry for foreign institutional investors, and significantly broaden the investment scope, now allowing investment in financial and commodities futures among other assets.<sup>4</sup> The FIL gives greater protection for foreign investors, as well as improved regulatory transparency.<sup>5</sup> These changes are leading more foreign institutional investors to expand their presence in China, for example, Temasek, a Singaporean sovereign wealth fund, opened an office in Shenzhen in 2020 to complement existing offices in Beijing and Shanghai.

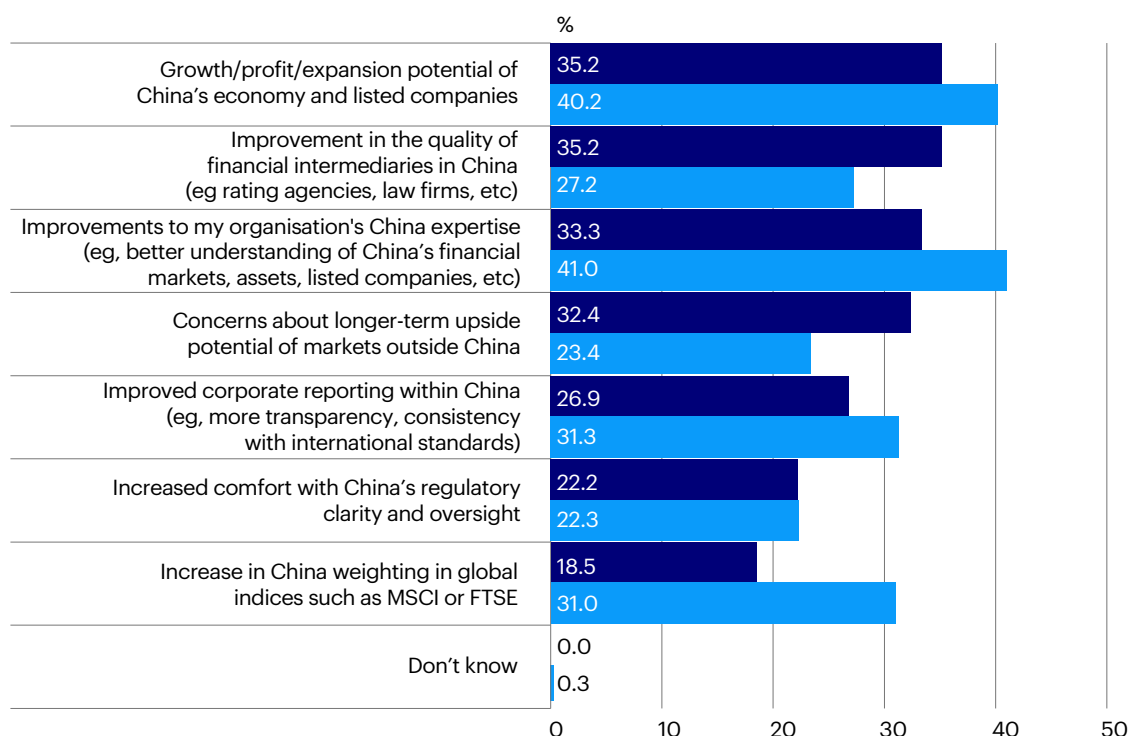
4 IFLR, "China-new rqfii regulations indicate further opening up of capital markets", December 2020, <https://www.iflr.com/article/b1pmbx14pz08w/china-new-rqfii-regulations-indicate-further-opening-up-of-capital-markets>

5 Jones Day, "China Further Opens its Market with New 'Foreign Investment Law'", February 2020, <https://www.jonesday.com/en/insights/2020/02/chinas-new-foreign-investment-law>

**Figure 4. Improvement to profit, quality and expertise**

Drivers of investment

■ 2021 ■ 2019



Source: The Economist Intelligence Unit; sample size: 108

Other changes benefiting foreign investors include the revision of the Negative List (an update of the 2019 Special Administrative Measures for Foreign Investment), which further opened up certain sectors and reduced restrictions; and the Encouraged Industries Catalogue points to more industries (such as manufacturing, technology and agriculture) in which China aims to use policy to encourage foreign investment.<sup>6</sup>

According to Mr Dong from Mercer: "China's financial system is still emerging; at present, the banking sector still plays a major role in credit and finance intermediation. So, one key policy objective from the Chinese government is to enhance the role of financial markets in allocating capital. That means on both equity and fixed income, the government is broadly supportive of liberalisation."

In correlation, the China Stock Connect programme, which allows foreign investors to trade some stocks listed in Shanghai and Shenzhen (as well as mainland investors to trade some stocks in Hong Kong), saw record trading highs in August 2021.<sup>7</sup>

<sup>6</sup> <https://www.jonesday.com/en/insights/2020/02/chinas-new-foreign-investment-law>

<sup>7</sup> CNBC, "Hong Kong's IPO pipeline still strong despite China's crackdown", August 2021, <https://www.cnbc.com/2021/08/12/hong-kongs-ipo-pipeline-still-strong-despite-chinas-crackdown-hkex.html>



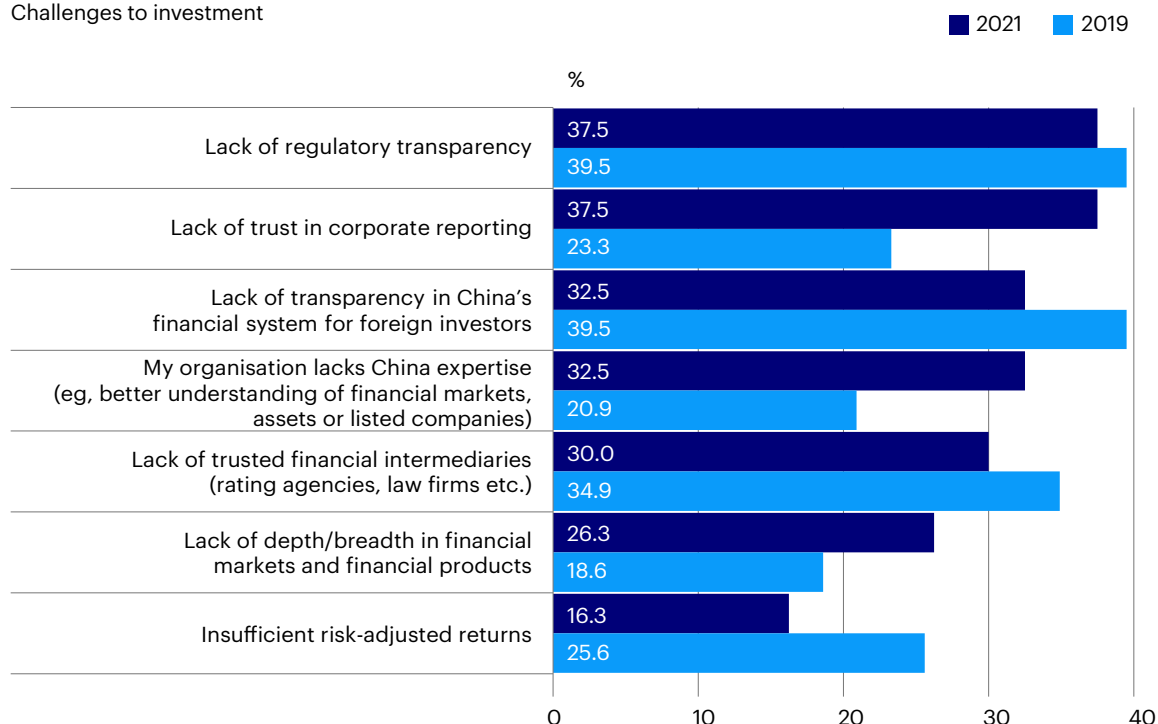
**As Chinese companies are becoming more international, they are competing directly with Western competitors**

**Xiadong Bao,  
China fund manager,  
Edmond de Rothschild Group**

Investors see change at the company level as well. "As Chinese companies are becoming more international, they are competing directly with Western competitors," says Xiadong Bao, China fund manager at Edmond de Rothschild, an independent and family-owned financial services firm. "So, if they want to refinance on the offshore market, they have to meet the requirements of the international investment community in terms of accounting and communication."

**Figure 5. Transparency and trust still weak**

Challenges to investment



Source: The Economist Intelligence Unit; sample size: 80

But change happens slowly. In the survey, concerns remain about lack of trust and transparency in corporate reporting, regulation, financial intermediaries, and the financial system. A series of bond defaults near the end of 2020 at high-profile firms including state-owned enterprises (SOEs), businesses that typically have implicit government backing, underline transparency concern and sparked a pullback both in buying and issuing of Chinese debt. Eastern and Western media reported comments from the central government at the time warning of “zero tolerance” for financial misconduct, hinting that letting bad actors fail could become more commonplace. Investigations into intermediaries, such as ratings agencies involved in the failed debt listings, were also announced. If investors saw an implicit guarantee against a murky debt backdrop before, things may now be less clear. And just as this report was heading to press, trading in debt issues from one of China’s largest property developers was halted after the company warned of default risk, indicating bond uncertainty may persist as a headwind.

Further pause comes from regulatory moves in mid-2021, aimed at reigning in consumer internet and education companies, sent shares in such businesses tumbling and left investors wondering if more sectors or big-name companies would come under target next. The moves seemed abrupt and played into existing transparency concerns.

In July, ride-hailing company Didi Chuxing went ahead with its US\$4.4 billion initial public offering (IPO) in New York despite a request from authorities to postpone, pending a data security investigation. Soon after the IPO, China’s cybersecurity watchdog announced the investigation into the company, as well as plans to review all overseas listings of companies with more than one million users on national security grounds. The same month, Tencent, one of China’s biggest tech groups and owner of WeChat, a widely used ‘superapp’, announced that it would suspend new user registrations in order to upgrade systems and meet new regulatory requirements.<sup>8</sup>

<sup>8</sup> TechCrunch, “Tencent’s WeChat suspends new user registration in China to comply with ‘relevant laws and regulations’”, <https://techcrunch.com/2021/07/27/tencents-wechat-suspends-new-user-registration-in-china-to-comply-with-relevant-laws-and-regulations>



Another development from July includes China effectively banning investing in the country's US\$100 billion private tutoring industry, saying such firms may be forced to turn into non-profits. Equities of some of the largest education companies lost more than half their value as a result.<sup>9</sup>

As a reflection, the Nasdaq Golden Dragon China index of Chinese tech stocks fell by 22% in July, its biggest monthly fall since 2008. The CSI 300 index of Shanghai- and Shenzhen-listed blue-chips fell almost 8%, a worse hit than from covid-19 in early 2020.<sup>10</sup> Overall, the Chinese tech selloff has wiped out an estimated US\$1 trillion in market value.<sup>11</sup>

Market turmoil indicates that these regulatory actions took many investors by surprise, but the plans have been in the works for a while. In October 2020 authorities halted a dual listing of the fintech offshoot of one of China's e-commerce tech giants that was spun out from the company in 2011.<sup>12</sup> Chinese regulators later ordered the company to overhaul its business and "return to its payment origins"; concerns about anticompetitive business practices, as well as practices that harmed consumer rights, were at the heart of the action.<sup>13</sup> The parent company also received a multibillion-dollar fine in April 2021 for forcing vendors to sell exclusively on its e-commerce platform.<sup>14</sup>

According to Mr Donay, some investors are "asking if it's the right time to continue to invest in Chinese equities and especially the disruptive tech giants because when they are regulated that creates a shock on profitability, on earnings growth, on their margins and so on." However, he believes, "the story is the same in the US with big tech companies where they are also discussing regulation."

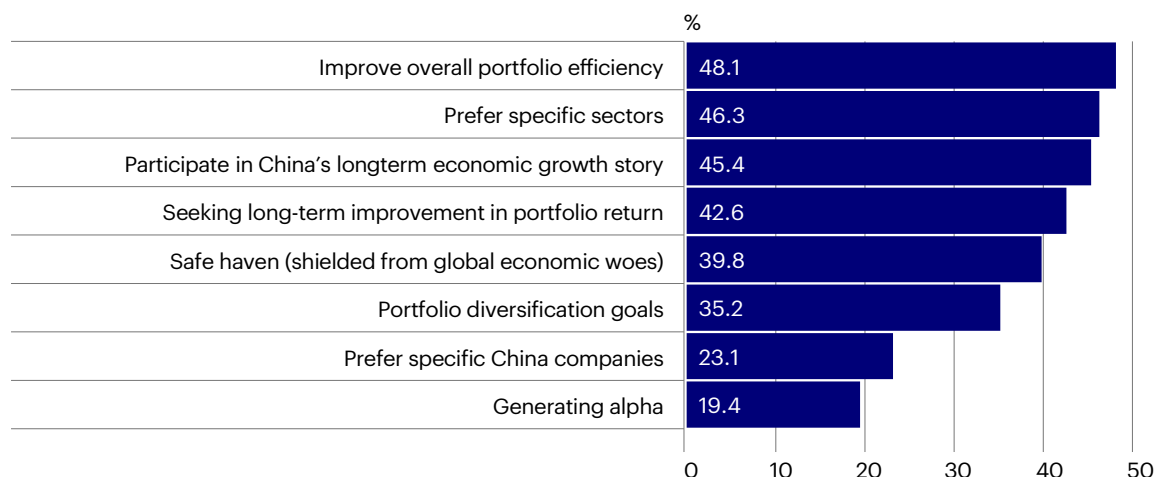


**...One of many risks is regulation and regulatory change. But it's not unique to China**

**Mukul Chawla,**  
joint head media, telecoms  
and technology, Temasek

**Figure 6. Going long**

Top objectives for investing in China



Source: The Economist Intelligence Unit; sample size: 108

9 Bloomberg, "China regulatory crackdown sends ADRs to worst rout since 2008", <https://www.bloomberg.com/news/articles/2021-07-23/china-regulatory-crackdown-sends-adrs-to-worst-rout-since-2008>

10 The Financial Times, "China tech stocks set for worst month since global financial crisis", July 2021, <https://www.ft.com/content/e7c10981-bf06-4255-82cd-01cd1abea7ed>

11 The Information, "BlackRock, Fidelity, Vanguard Among Most Exposed to China Tech-Stock Volatility", July 2021, [https://www.theinformation.com/articles/blackrock-fidelity-vanguard-among-most-exposed-to-china-tech-stock-volatility?utm\\_campaign=%5Brtsu%5D+Automated+RTS&utm\\_content=1003249&utm\\_medium=email&utm\\_source=cio&utm\\_term=1000266](https://www.theinformation.com/articles/blackrock-fidelity-vanguard-among-most-exposed-to-china-tech-stock-volatility?utm_campaign=%5Brtsu%5D+Automated+RTS&utm_content=1003249&utm_medium=email&utm_source=cio&utm_term=1000266)

12 BusinessInsider, "Jack Ma hasn't been seen in public since Ant Group's IPO was pulled. Here's how Chinese regulators slammed the brakes on the firm's would-be record-breaking \$37 billion IPO", January 2021, <https://www.businessinsider.com/what-happened-ant-group-ipo-jack-ma-alipay-2020-11?r=US&IR=T>

13 BusinessInsider, "China has ordered Ant Group to overhaul its goliath financial business and 'return to its payment origins'", December 2020, <https://www.businessinsider.com/china-orders-ant-group-change-business-return-payment-origins-2020-12?r=US&IR=T>

14 WSJ, "China Passes One of the World's Strictest Data-Privacy Laws", August 2021, <https://www.wsj.com/articles/china-passes-one-of-the-worlds-strictest-data-privacy-laws-11629429138>

Mukul Chawla, joint head media, telecoms and technology at Temasek, agrees. “We have a model where we invest against a risk-adjusted cost of capital. One of many risks is regulation and regulatory change. But it's not unique to China and I don't believe that it changes our stance on China, which remains unchanged in our optimism.”

Other headwinds for China are more global in nature; climate change threats and evolving covid-19 variants are continually lurking. While 54% of asset owners say the pandemic has increased their risk appetite with regard to overall China exposure in the past 12 months (see figure 3), new variants or major natural disasters could change that view in short shrift.

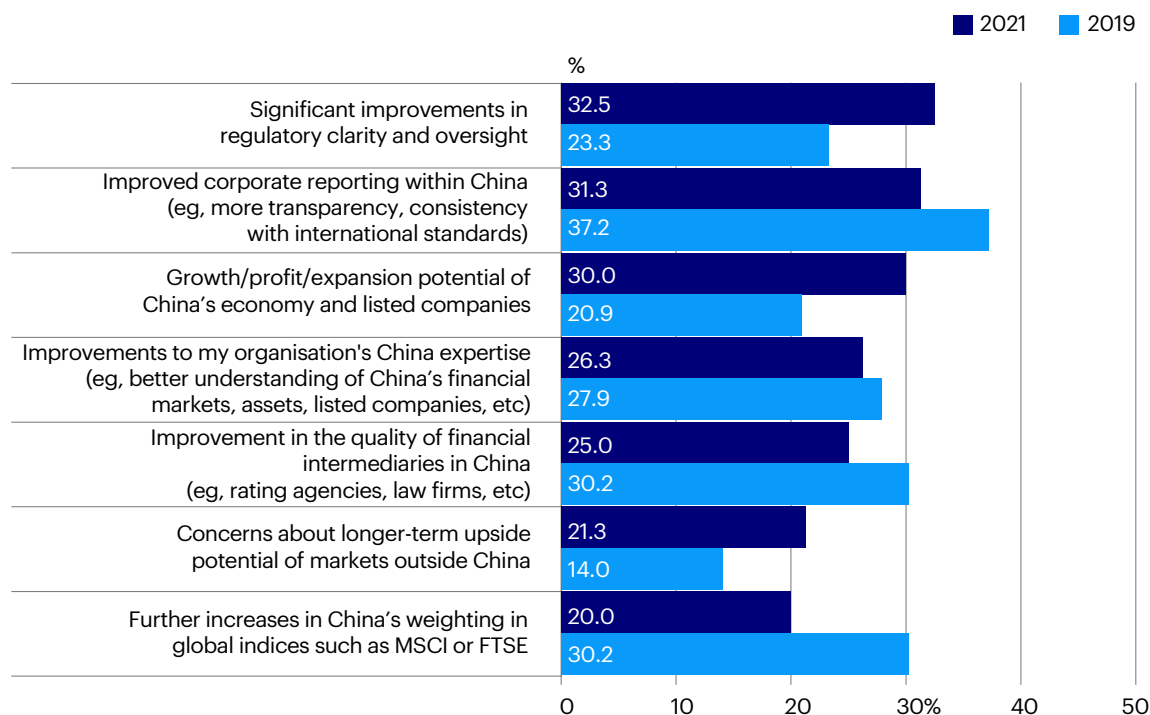
Still, asset owners tend to have a longer view and are playing the long game with China, believing that, despite any volatility, it still offers better economic growth and returns than other markets, as well as the types of companies (such as those in the technology and healthcare sectors) that will prosper in the future.

At the same time, survey respondents still would like significant improvements in regulatory clarity and oversight, choosing the factor as the number one catalyst for their organisation to consider a direct or dedicated exposure to China.



**Figure 7. Clarity and transparency**

Catalyst for an organisation to consider direct or dedicated exposure to China



Source: The Economist Intelligence Unit; sample size: 80



# Carving out dedicated China allocations



Over half of survey respondents state they have direct investments in China (defined as the organisation having a dedicated portfolio allotment specifically to gain China exposure), compared with 40% in broader investments, for example through an exchange-traded fund or other thematic global/emerging-market or Asia-focused vehicles.

The largest number of survey respondents still claim exposure as part of an emerging-market equity allocation, but broader economic drivers (see figure 4) are pushing investors to increasingly carve China out to create standalone allocations to Chinese assets.

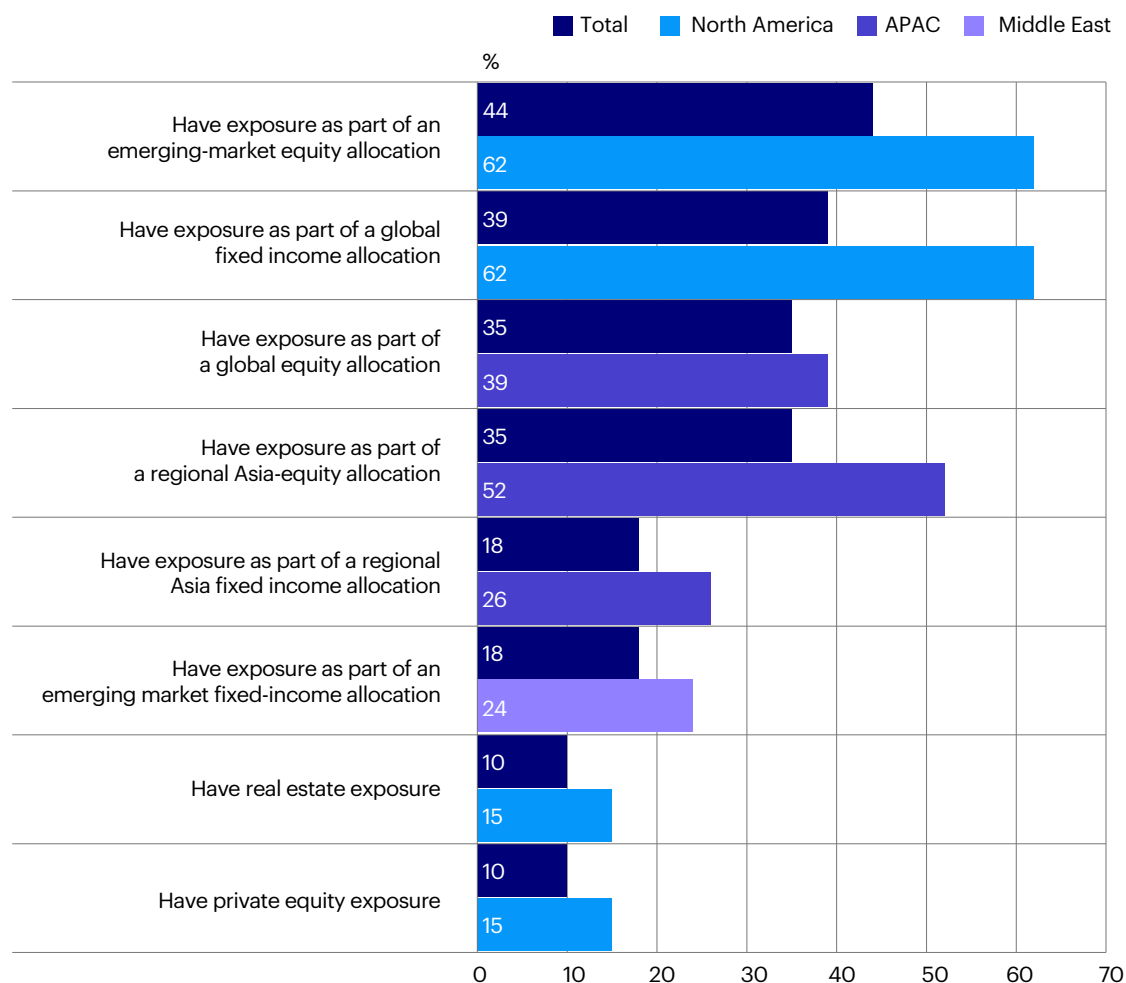


**Historically, our exposure to China was made through the emerging market benchmark, but we decided last year to add on top of this a standalone allocation to Chinese assets, both equity and fixed income**

**Stéphane Monier,  
chief investment officer,  
Lombard Odier**

**Figure 8. Carving out dedication**

Survey question: How is your organisation exposed to China? (Average and regional-lead answers)



Source: The Economist Intelligence Unit; sample size: 80; top region for each survey-answer option shown.  
Note: Europe did not top any responses by region breakdown.

“Historically, our exposure to China was made through the emerging market benchmark, but we decided last year to add on top of this a standalone allocation to Chinese assets, both equity and fixed income,” says Mr Monier at Lombard Odier.

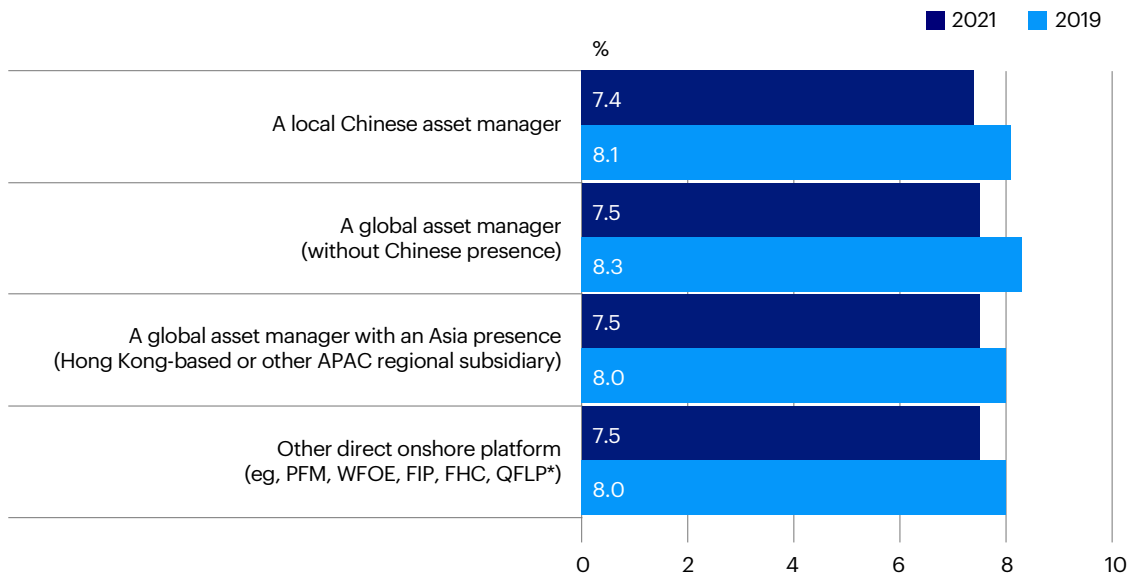
Mr Dong also “sees a number of factors that support—especially from an equity perspective—a carve out of China, compared to emerging markets.” Survey respondents point to the improvement in the quality of financial intermediaries in China; the growth, profit and expansion potential of China’s economy and listed companies; and improvements to their own China expertise.

As that internal expertise grows, asset owners also appear less likely to invest through a local Chinese asset manager, global asset manager or other direct onshore platform, as year-on-year survey results indicate.



**Figure 9. Shifting reliance**

Survey question: When implementing investments into China, how prominently do the following types of entities figure in your approach?



\*Abbreviations include: Private Fund Manager (PFM), Wholly Foreign-Owned Enterprise (WFOE), Foreign Invested Partnership (FIP), Financial Holding Company (FHC), Qualified Foreign Limited Partnership (QFLP)

Source: The Economist Intelligence Unit; sample size: 160

Half of survey respondents say their holdings have increased in the past 12 months, with just 14% decreasing. Market performance in 2020 seems to support increased exposure. Chinese stock market capitalisation as a percentage of GDP grew from 58.9% in 2019 to 82.9% in 2020, with the value of the stock market index increasing by 20% in 2019 and 21.8% in 2020.<sup>15</sup> Yields on Chinese 10-Year Treasury Bonds dropped from 3.2% in 2019 to 2.9% in 2020, indicating rising prices.<sup>16</sup>

<sup>15</sup> The Economist Intelligence Unit database  
<sup>16</sup> Tullett Prebon Information

# Most favoured investment: Tech



Technology innovation and financial services remain the top investment sectors for survey respondents, consistent with the 2019 survey, with healthcare and domestic consumption themes also capturing interest. The pandemic's influence is likely showing influence here; as locked-down consumers flocked online for a range of goods and services, online themes gained ground with investors. This segment showed significant new interest in year-over-year survey results.

Renewable energy, 2019's fourth choice, dropped to sixth place this year. While policy is supportive —China's 14th five-year plan set the target for the share of non-fossil fuel in primary energy consumption to grow from about 15% now to 20% by 2025<sup>17</sup> —the market has become so competitive, few companies

are making big profits. Mr Bao from Edmond de Rothschild is willing to play the long game here and has seen some positive effects in China due to covid-19. "We're still waiting a while on renewable energy, especially electric vehicles [EVs], batteries, solar panels, which are getting stronger as well during covid-19, because all the other production sites outside of China were suspended. So Chinese players are gaining more market share and we are keeping our overweighting positions."

Asset owners in the survey also see opportunities across technology, particularly electric or "new energy" vehicles; AI or other digital automation; online services, whether consumer or business-to-business (B2B); the Internet of Things (IoT); and robotics or other physical automation.

<sup>17</sup> Stockholm Environment Institute, "How ambitious is China's five-year plan on climate targets?", March 2021, <https://www.sei.org/featured/how-ambitious-is-chinas-five-year-plan-on-climate-targets/>

Technology innovation companies seem on firm ground. The Chinese government has long had twin ambitions for industrial policy: to be more economically self-sufficient and achieve technological greatness. But until the former US president, Donald Trump, sanctioned entrepreneurial Chinese companies, forcing them to stop relying on US technologies such as semiconductors, they had little incentive to source domestic alternatives or design the necessary technologies themselves. Post-Trump, private companies' incentives are aligned with the state's goal of economic self-sufficiency.

The dynamic continues under Mr Biden who, in March 2021, placed new limits on licences that allow US companies to supply components to a large Chinese information and communication technology company; in July the administration added 23 more Chinese technology companies to its "entity list".<sup>18</sup>

Sean Taylor, the APAC CIO for DWS, believes it may be safer to invest where interests align with the government, even if they are not immediately profitable. "We would rather put more money in Chinese semiconductors, EVs, industrial automation and solar because

ultimately, these are areas where the Chinese government really wants investment," he says. "But a lot of these stocks are long duration—you've got companies that might make money in 3-4 years' time."

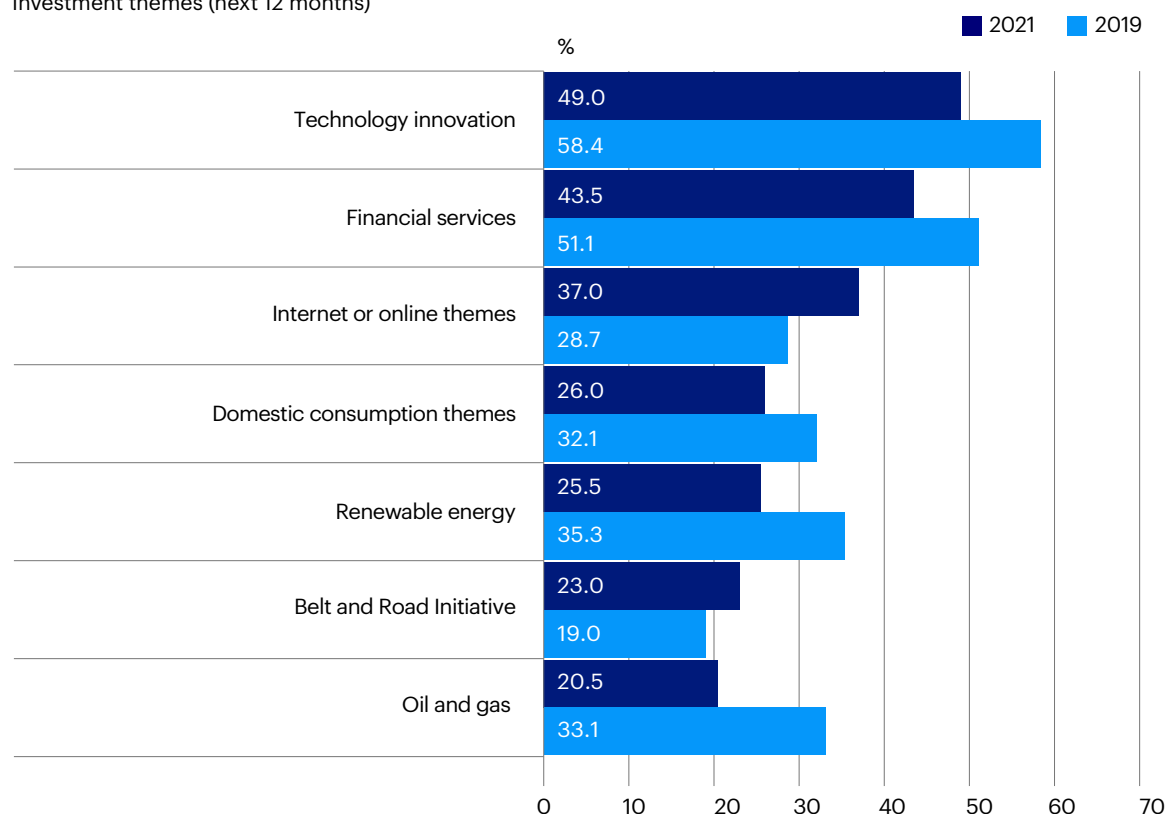


**We would rather put more money in Chinese semiconductors, EVs, industrial automation and solar because ultimately, these are areas where the Chinese government really wants investment**

**Sean Taylor,  
APAC CIO, DWS**

**Figure 10. Buying into online**

Investment themes (next 12 months)

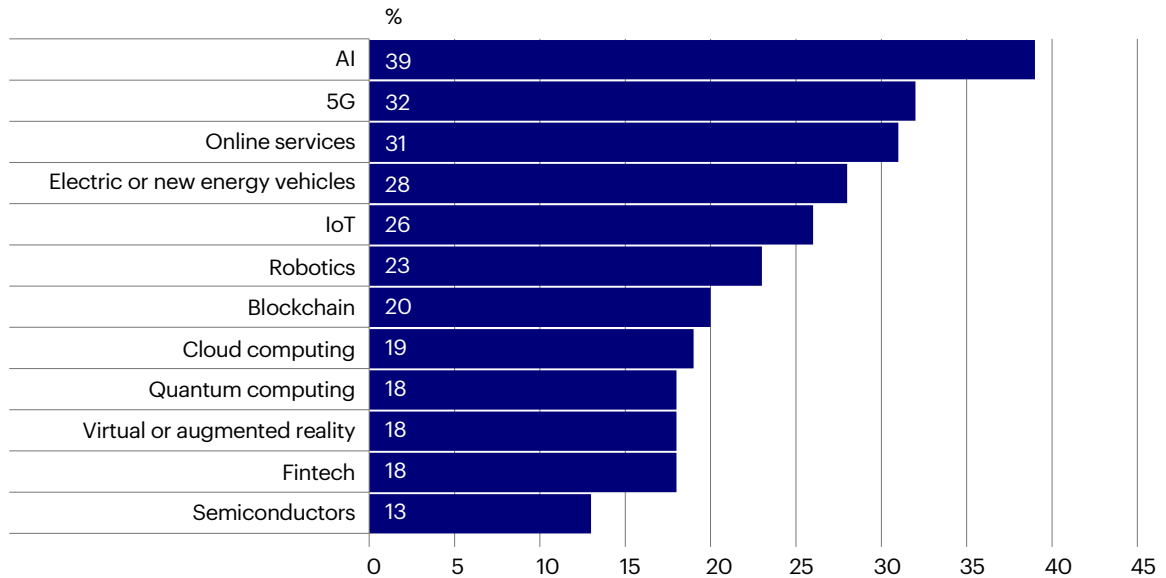


Source: The Economist Intelligence Unit; sample size: 200

<sup>18</sup> Axios, "U.S. blacklists 23 more Chinese entities over Xinjiang abuses, military ties", July 2021, <https://www.axios.com/us-china-xinjiang-entity-list-8df47c3b-f0fc-4cd1-b1db-81b1427bb2a2.html>

**Figure 11. Remote and automated plays**

### Tech themes attracting asset owner investment

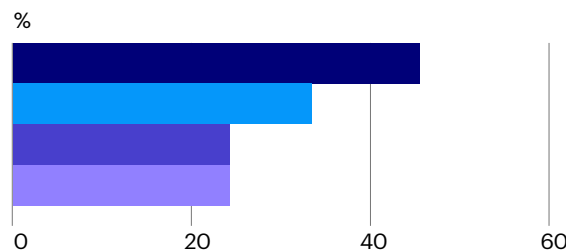


Source: The Economist Intelligence Unit; sample size: 143

### Region specific breakdown

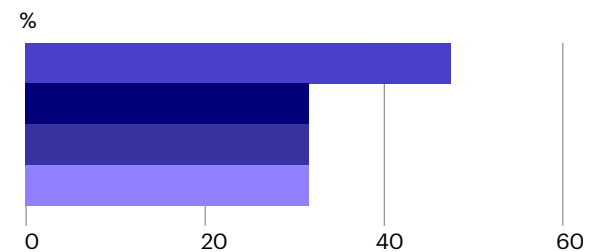
Europe

	%
5G	45.5
Blockchain	33.3
Artificial intelligence or other digital automation	24.2
Electric or new energy vehicles	24.2



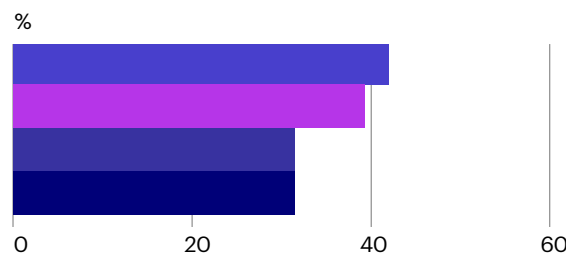
Asia Pacific

	%
Artificial intelligence or other digital automation	47.4
5G	31.6
Online services (consumer or B2B)	31.6
Electric or new energy vehicles	31.6



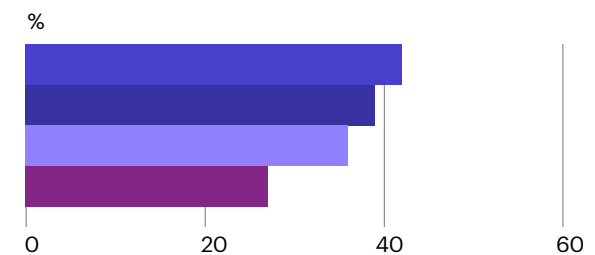
North America

	%
Artificial intelligence or other digital automation	42.1
Internet of Things (IoT)	39.5
Online services (consumer or B2B)	31.6
5G	31.6



Middle East

	%
Artificial intelligence or other digital automation	41.2
Online services (consumer or B2B)	38.2
Electric or new energy vehicles	35.3
Virtual or augmented reality	26.5



Source: The Economist Intelligence Unit; sample size: 143; Proportions may not equal 100% as respondents could choose more than one option. Only the top four choices are shown for each region.



Mr Dong from Mercer agrees that certain segments are key to China's future growth and therefore strong bets. "The next battleground in economic growth and development is still largely orientated in technology," he says. "China aims to enhance its own competitiveness and innovation across ten super sectors, from advanced materials to AI and robotics, healthcare, renewable energy, high-speed rail."

The Economist Impact's survey for this report was completed near the end of July, just as regulatory pressures in China were building. Value in some big-name stocks fell during this time, indicating a wide sell-off. However, from survey results, asset-owners at the institutional level still appear to see promise in China's tech names long term due to their solid fundamentals, as well as technology companies' leading role as drivers of change across the global economy.



## **China aims to enhance its own competitiveness and innovation across 10 super sectors, from advanced materials to artificial intelligence and robotics, healthcare, renewable energy, high-speed rail.**

**Yaying Dong,  
market strategist and global  
macroeconomic research lead,  
Mercer**

"We see eight main sources of future innovation: internet, smart materials, life sciences, energy, information and data processing, automation, space and transport," explains Mr Donay at Pictet about the company's long-term sector outlook.

In the short term, three to six months, Mr Monier of Lombard Odier believes the recent regulatory-induced rout could provide opportunities in tech. "When the picture is clear, it could be a good point to become positive again on the tech sector in China."

The picture is starting to clear as China passed the Personal Information Protection Law in August 2021, which intends to curb data collection by technology companies. In line with other global data-privacy legislations, the law tightens the previously loose rules on accessing data that for years allowed China's domestic companies to quickly develop and adopt new products and technology but that also led to instances of online fraud and data theft. There are many similarities with the EU's General Data Protection Regulation (GDPR), although China's version will restrict just private sector use of data.<sup>19</sup>

Mr Taylor points out that it is the priority of policy that's changing. "In the past, it was all about growth, but [the] government now is much more focused on balancing the economy. National security has become much more important—that's why they're protecting data. But the most important thing is addressing social inequality. That's what's recently affected the education sector. This is a different type of regulation because they're looking more at the social impact of the sector. It shows that the government's happy to put these changes in now because it's quite confident about the strength of the economy, and it's more worried about the overall society."



<sup>19</sup> WSJ, "China Passes One of the World's Strictest Data-Privacy Laws", August 2021, <https://www.wsj.com/articles/china-passes-one-of-the-worlds-strictest-data-privacy-laws-11629429138>



# ESG in emerging markets

“The biggest challenge at the moment is still getting good data,” explains Michael Vos, regional investment manager, APAC at Zurich Insurance Group, when speaking about environmental, social and governance (ESG) investing in emerging markets. “Databases are much better in developed markets than in emerging ones but emerging-market databases are growing on a daily basis; there is demand and they are starting to fill the gaps.”

That demand, in terms of asset owners, derives from two intertwined pressures. One is a need for stable, long-term returns; the other is sometimes cast as a good corporate responsibility exercise but the risks associated with climate change are now so well publicised that even if ESG approaches were to crimp returns—and evidence suggest the opposite—the PR implications of doing nothing could be an even greater threat to reputation and thereby profit for commercial firms, or politically untenable for public ones.

“We look to be a responsible investor in how we invest,” says Mr Vos, “and that incorporates, among other things, ESG integration. As a responsible investor, we’re looking to do well and do good. At the same time.”

To achieve those dual goals, asset owners typically rely on two main pillars to support ESG integrated returns: data and engagement. And according to Mr Vos, data might be the most challenging aspect for investing in emerging markets, but engagement could be the most important.

“We’re looking to reduce our [portfolio’s] carbon intensity by 25% by 2025; our ultimate goal is to get to zero. But we can’t get there overnight. It takes time and you have to engage with companies to do that.”

Almost universally, asset owners are looking for ways to make investments work double-time with financial and sustainability goals. ESG gives them a framework to get there but

the metrics and data required are already challenging in developed markets, where companies resist additional or non-financial disclosures and industry debates about materiality continue. With interest rates in developed markets also lingering near or at zero in some cases, emerging market debt, for example, can offer the higher yield that organisations such as an insurance or pension fund need.

The top two challenges with ESG investing in China for our survey respondents are: too few equity or bond issuers meeting their standard for scope or quality of disclosures; and ESG-related data from equity or bond issuers in China not being readily available. The same issues could apply to most emerging markets. But staying out of the market is no solution either. That, as Mr Vos explains, “doesn’t solve the global emission problem, it simply passes on the problem to someone else.”

Beyond debt vehicles, emerging markets can also offer exceptional equity growth with a multitude of family-owned small and medium-sized enterprises that know their markets and have the base and connections to grow. Yet these firms may score low on ESG metrics; many are family owned and the intermingled family and management structures can look bad on governance measures. Likewise, smaller firms typically have scant data about carbon intensity. Still, the climate stakes are too high to ignore emerging markets and the investment dollars they do get can help drive a virtuous circle of cleaner growth. That gives asset owners incentive to keep investing in emerging markets.

“To get to a net-zero economy by 2050 requires all hands on deck,” says Mr Vos, “because it will become too late if we sit back and wait for another 10 or 15 years. It might be just too late by then.”

# China greening up



While China's regulatory actions towards internet, education and real-estate companies may frustrate investors, the moves are a sign of the government's increasing focus on creating a level playing field, not just for smaller companies but for consumers as well, in order to achieve long-term sustainable economic growth—a focus on the “S” of ESG. A meeting of the Chinese Communist Party's Central Financial and Economic Affairs Commission in August 2021 stated its intention to “regulate excessively high incomes and encourage high-income groups and enterprises to return more to society”—an indication that regulatory action is driven by broader social goals.<sup>20</sup>

“This year, there have been a number of significant policy developments that look to enhance the social aspect of ESG investing,” says Mr Dong of Mercer. “The policies from Beijing are all designed to enhance the playing field for ordinary households. That is important when being able to achieve long-run sustainable economic growth requires government to provide to the people a fair market environment. In China the biggest challenge from a household expenditure perspective is housing affordability and second is education. So, it's not surprising to see policies to curtail the private education sector.”

<sup>20</sup> The Financial Times, “China's Xi calls for wealth redistribution and clampdown on high incomes”, August 2021, <https://www.ft.com/content/87c3aa02-f970-48c8-b795-82768c9f7634>



## There's been a recent launch of the national carbon market in China, which signifies growing interest in pricing emissions and facilitating climate action

**Michael Vos,**  
regional investment manager,  
APAC, Zurich Insurance Group

Asset owners are increasingly integrating ESG factors into their investment processes, globally and for China; 62% of survey respondents say they always or often adopt ESG investing as part of their consideration with China exposures, with just 8% saying they rarely or never do. Two-thirds of survey respondents say their China exposure has increased significantly or somewhat due to their ESG goals, as both Chinese companies and the government progressively place greater importance on ESG.

In 2020 China's president, Xi Jinping, delivered a speech to the UN virtual General Assembly saying China would strive to be carbon neutral by 2060 and reiterating a 2016 pledge made under the Paris Agreement that carbon emissions would peak by 2030.<sup>21</sup>

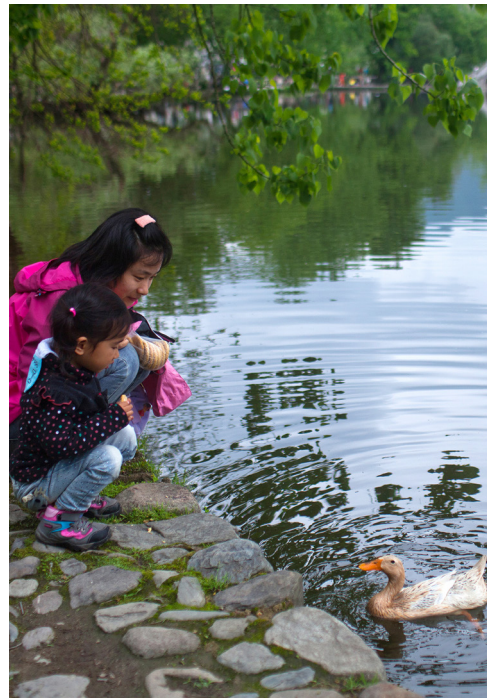
"There's been a recent launch of the national carbon market in China, which signifies growing interest in pricing emissions and facilitating climate action," says Michael Vos, regional investment manager, APAC at Zurich, an insurance company. "And China is one of the biggest issuers of green bonds in the world."

China overtook the US in global green bond issuance in the first quarter of 2021, selling US\$15.7 billion of bonds to fund green projects such as clean and renewable energy, according to Refinitiv. The volume of green bonds grew almost fourfold from a year earlier and is likely to grow even more as investment bank China International Capital Corp estimates that China needs US\$21.33 trillion of debt financing over the next 40 years to meet its net-zero emissions target.<sup>22</sup>

<sup>21</sup> The Economist Intelligence Unit, "China pledges to be carbon neutral by 2060", September 2020

<sup>22</sup> Reuters, "China leads global green-bond sales boom but faces headwinds", April 2021, <https://www.reuters.com/article/us-china-bond-green-idUSKBN2BO4FP>

<sup>23</sup> DWS Research Institute, "The paths of responsible investing in China and Europe", March 2021, <https://www.dws.com/en-gb/insights/global-research-institute/the-paths-of-responsible-investing-in-china-and-europe/>

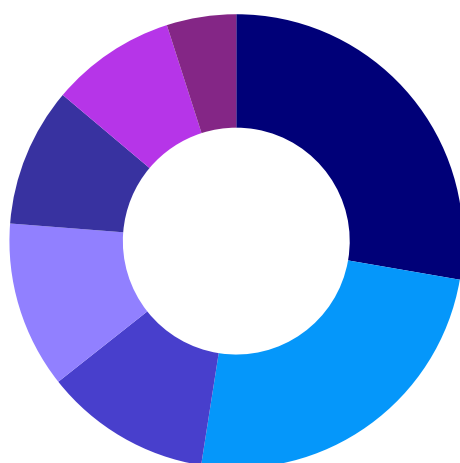


As with green investments elsewhere, there are concerns about greenwashing. Improved disclosure could help. Currently, the only requirement for listed companies now is to disclose involvement in "significantly material environmental violations", which companies themselves get to define and offers little for a 'fiduciary business' to take a decision without significant due diligence of its own. This disclosure discrepancy potentially undermines market perception of materiality of environmental issues. However, the Chinese Securities Regulatory Commission announced that it would enhance information requirements that public companies must disclose in order to raise ESG standards in line with international markets.<sup>23</sup>

Transparency is a key issue for survey respondents, whose top three ESG concerns derive from data. They say that too few equity or bond issuers in China meet their standard for scope or quality of ESG disclosures; ESG-related data from equity or bond issuers in China are not readily available; and ESG-related data from equity or bond issuers in China are too difficult to verify.

**Figure 12. It's all about the data**

Primary challenges to expanding or incorporating ESG



■ Too few equity or bond issuers in China meet our organisation's standard for scope or quality of ESG disclosure	28%
■ ESG related data from equity or bond issuers in China are not readily available	25%
■ ESG related data from equity or bond issuers in China are too difficult to verify	12%
■ My organisation does not have a consistent ESG approach to investments overall	12%
■ Lack of a unified set of guidelines on what constitutes ESG compliance in China	10%
■ Lack of unified guidelines globally or in my own region on what constitutes ESG compliance overall (not just for China)	9%
■ A lack of China expertise within my organisation inhibits our ability to judge ESG metrics for China specifically	5%

Source: The Economist Intelligence Unit; sample size: 200

Mr Vos sees signs of improving disclosure. "The biggest challenge at the moment is still getting good data. They are still lagging a bit in emerging markets—there's no question that the developed markets have gotten a head start— but emerging markets are catching up, and it's amazing how fast things do happen," he says.

So far, increasing engagement of institutional investors has driven improvements in disclosure across Asia. Mr Vos adds: "I think investors are playing a large part—I see that quite prominently in my home country of Australia, where the superannuation funds (our pension funds) are pushing very strongly."

This pressure will increase as asset owners' ESG expertise grows. Temasek, the Singaporean sovereign fund, claims it is continually building its ESG capabilities across the firm, as well as engaging with its underlying fund managers to ensure alignment with its ESG stance.

Lombard Odier is also focused on building its internal capability, as well as tapping external expertise. As Mr Monier explains, "we have a team based in London of people that have a scientific background, and we have a partnership with University of Oxford to model different aspects of sustainability

including temperature alignment. So we can say this Chinese company has a business model that is consistent with a two-degree temperature increase. We can show this data to the company and they are not always necessarily aware of that and find our research interesting."

Overall, the increased focus of the Chinese government on ESG issues and the improved disclosure by companies mean that asset owners are becoming more positive. Mr Donay from Pictet, for example, says, "China is at the core of the climate change trend and the five-year plan explicitly takes this into consideration. We see climate change as an additional source of growth for China, because if you address it through innovation, you create a new source of additional economic growth in the future."

He adds: "We put an additional 0.1% in our economic forecast per year over the next ten years for revenue GDP growth. We also believe valuations of sustainable businesses will increasingly reflect their superior resilience and lower financial, regulatory and reputational risk."

In the survey, 23% of asset owners flagged improved ESG disclosure by Chinese debt or equity issuers as a key driver that would cause them to expand their China exposure.



# Outlook and conclusion



A positive outlook is reflected in survey respondents' plans to increase exposure to China. On average, just over a third of asset owners say they will increase holdings in different asset classes, with the highest numbers in real estate (40%), direct ownership of companies (39%) and alternatives (38%). Given the current low-rate environment affecting fixed income and volatility in equity markets, the attractiveness of other asset classes may have significant draw for asset owners, which typically invest with longer-term returns in mind.

Across asset classes, survey respondents are more bullish on returns compared with other emerging markets than they were in 2019. Given that most emerging markets are progressing slowly with covid-19 vaccination programmes, and therefore have yet to fully open their economies and return to growth, that sentiment is understandable.



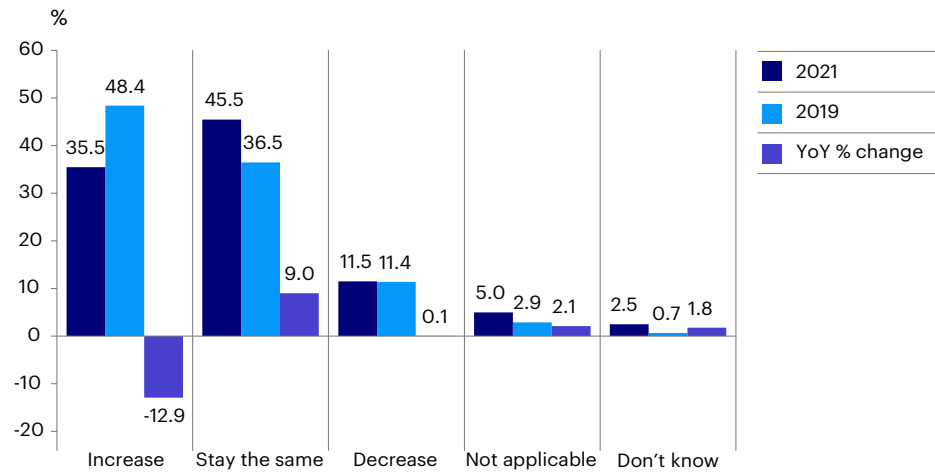
**The Chinese stock market returned more than 20% or even 25% in 2019-20.. we need to rationalise that expectation, because China is already past the catching up phase**

**Xiadong Bao,  
China fund manager,  
Edmond de Rothschild Group**

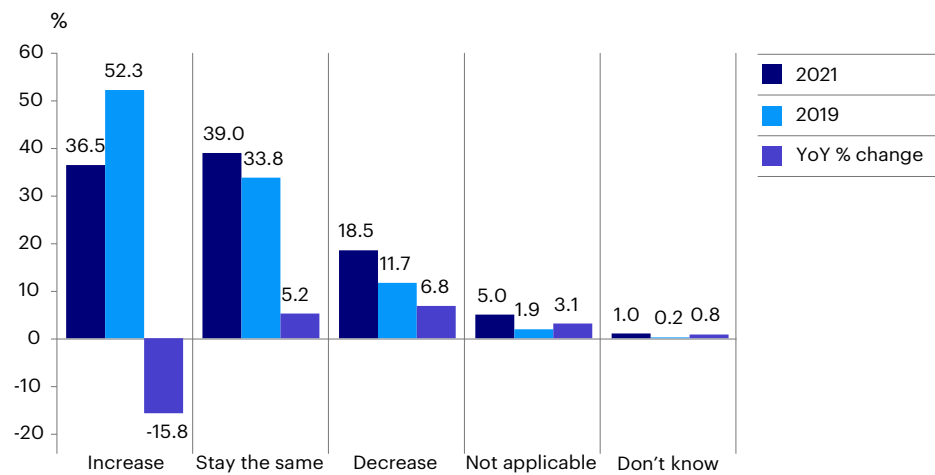
**Figure 13. Still growing**

Changes to allocations over the next 12 months

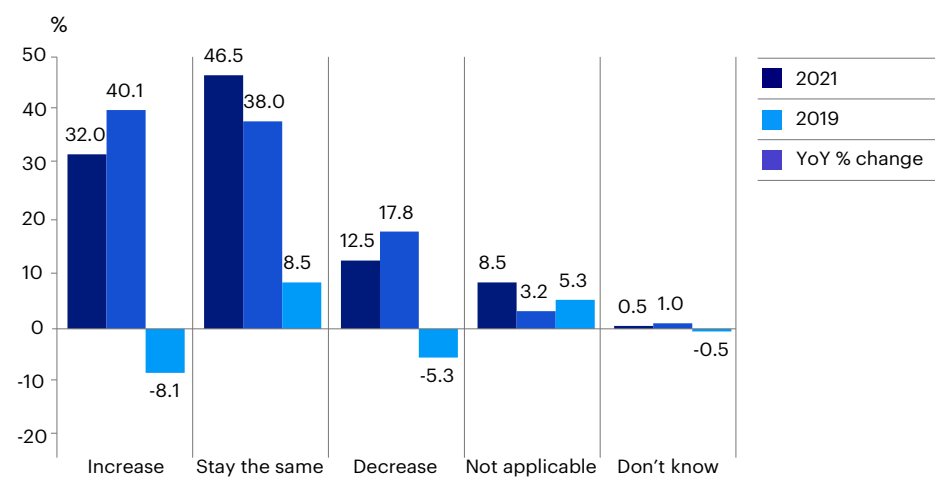
**Offshore equities (eg, H-shares)**



**Onshore equities (eg, A-shares)**



**Offshore fixed income: Corporate debt (US\$ denominated)**

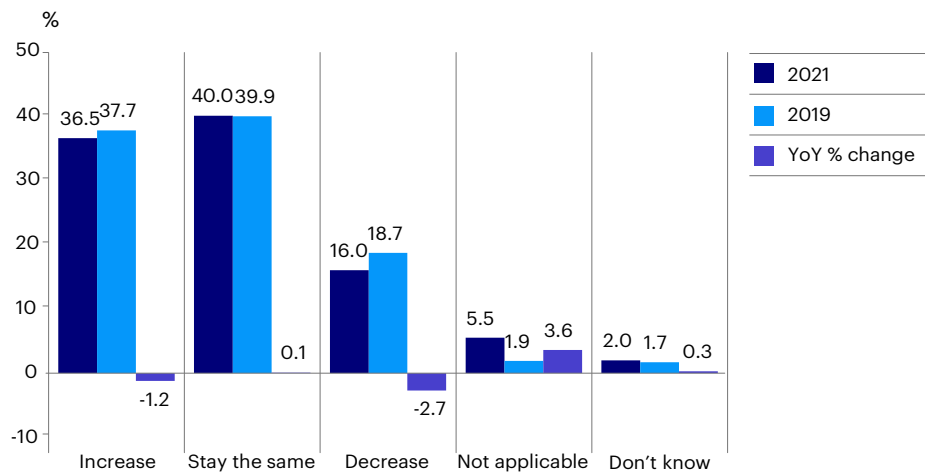


Source: The Economist Intelligence Unit; sample size: 200

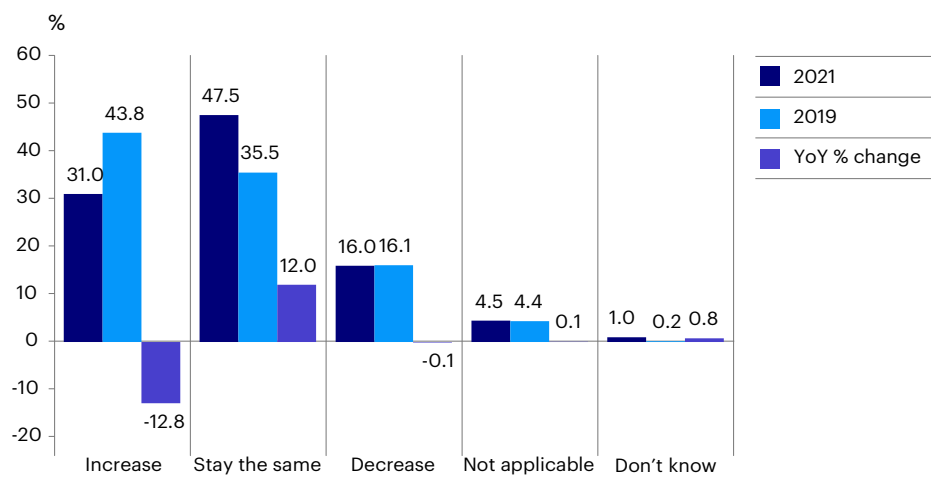
**Figure 13. Still growing (Continued...)**

Changes to allocations over the next 12 months

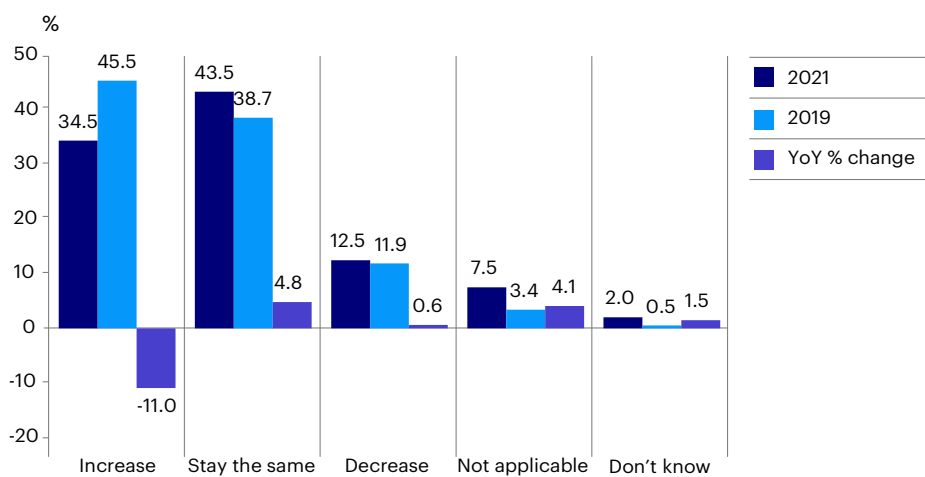
**Offshore fixed income: Government debt (US\$ denominated)**



**Onshore fixed income: Corporate and local government debt (RMB denominated)**



**Onshore fixed income: Government/Quasi/SOE debt (RMB denominated)**



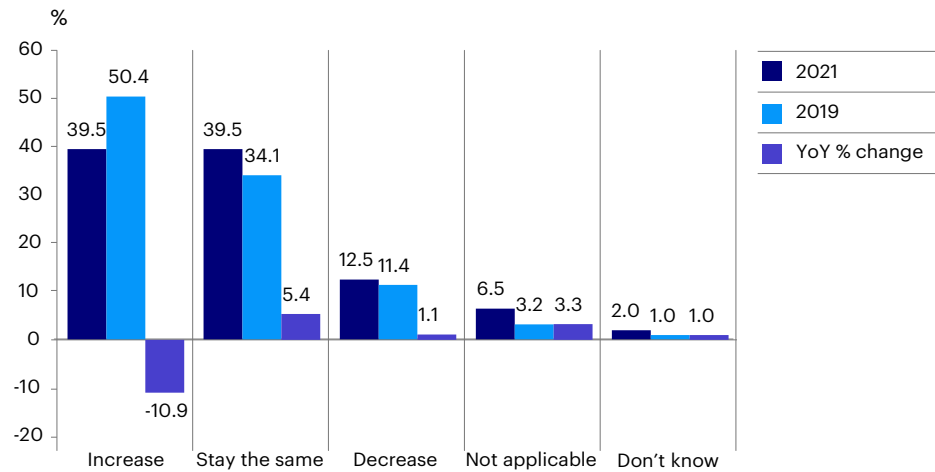
Source: The Economist Intelligence Unit; sample size: 200



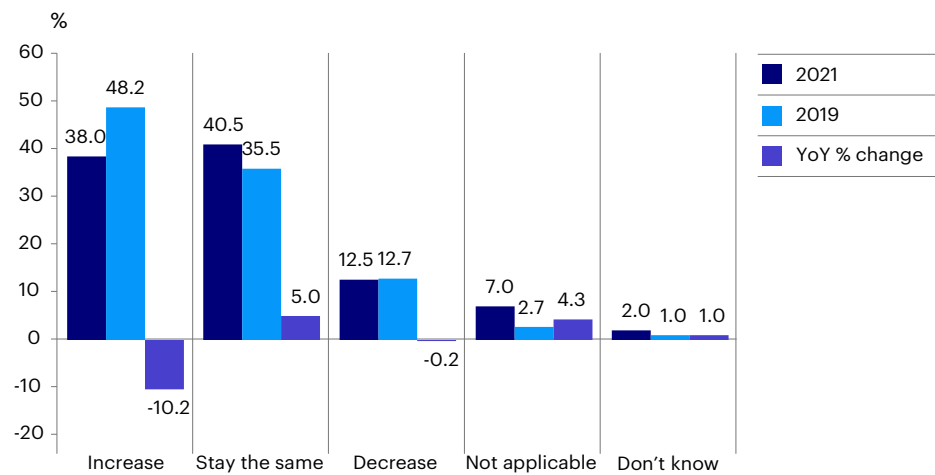
**Figure 13. Still growing (Continued...)**

Changes to allocations over the next 12 months

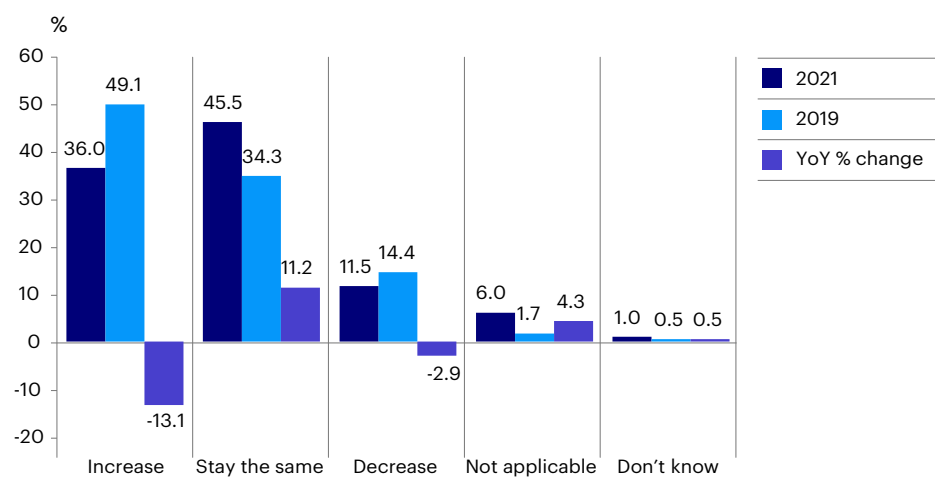
### Real estate



### Alternative assets (eg, private equity, hedge funds)



### Currency (RMB)

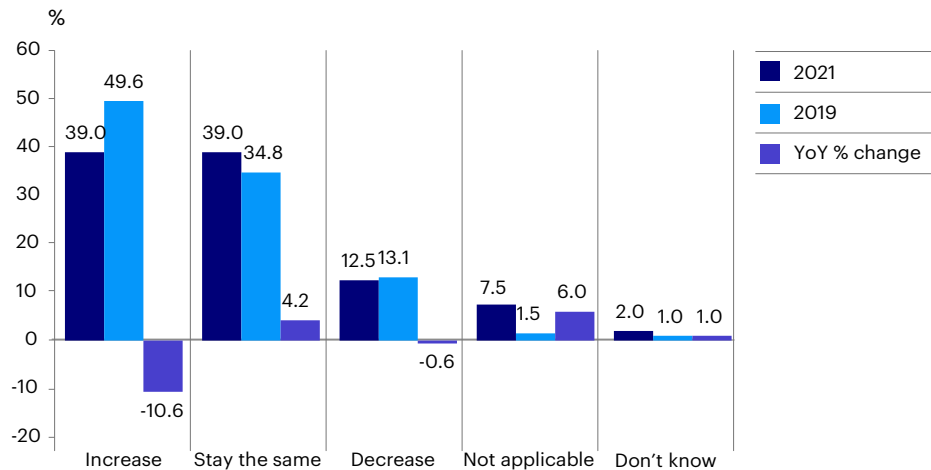


Source: The Economist Intelligence Unit; sample size: 200

**Figure 13. Still growing (Continued...)**

Changes to allocations over the next 12 months

**Direct ownership of companies**



Source: The Economist Intelligence Unit; sample size: 200

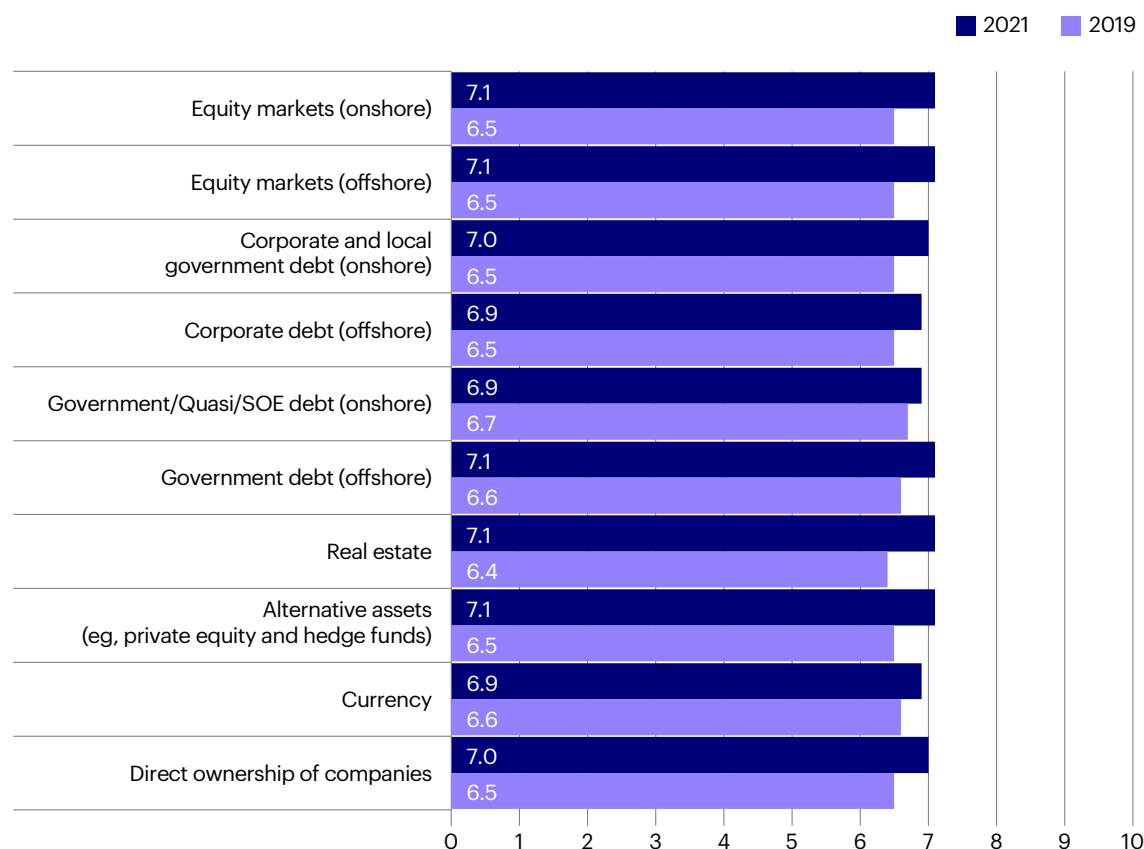
Still, Mr Bao of Edmond de Rothschild believes investors need to manage expectations. "The Chinese stock market returned more than 20% or even 25% in 2019-20," he says. "But I think we need to rationalise that expectation, because China is already past the catching-up phase, it's now in the second phase, which tends to decelerate growth a bit. A reasonable annualised return, in a normal time, should be around 10-15% for the Chinese market, given its organic growth potential internally and market share gain internationally."

Survey respondents' risk assessments are similar or slightly higher than in 2019. Mr Bao believes the risk level of investing in China is still comparable to emerging markets, "even though a lot of people say China should be treated differently, not as an emerging market economy. I think it's approaching the risk level of Taiwan or [South] Korea but it's not there yet, because the market is so huge and different provinces and different local governments have different kinds of appreciation of risk. Some of China is a developed economy, with a tighter risk profile close to what we know here in Europe, but not everywhere."



**Figure 14. Burgeoning trust**

Return assessment vs other emerging markets (rated 1 to 10)



Source: The Economist Intelligence Unit; sample size: 160

Under The Economist Intelligence Unit's central projections, nominal economic output in China should rise from US\$14.7 trillion in 2020 to US\$21.9 by 2025 (measured at market exchange rates). In comparison, US nominal GDP is predicted to reach US\$26.5 trillion in 2025. China's GDP per head will still be relatively low by 2025, at US\$10,549—equivalent to the same levels as the US in the early 1980s.<sup>24</sup>

Whether classified as an emerging market or not, China is certainly on the radar of the G7, being directly mentioned as a competitor by the group of leading developed markets for the first time in its official communiqué after the 2021 summit. G7 leaders agreed to work together to challenge China's "non-market" practices and stated they would work to reduce reliance on China.<sup>25</sup>

Geopolitics, particularly the ongoing battle for technological dominance with the US, may be both the biggest risk and biggest opportunity for investors in the near future. In 2019 survey respondents saw US-China trade tensions as having a negative effect, but even with that outlook over two-thirds still planned to increase their China exposure. In 2021 they are even more bullish, with 80% saying instead that trade tensions will have a significant or moderate influence on increasing their exposure.

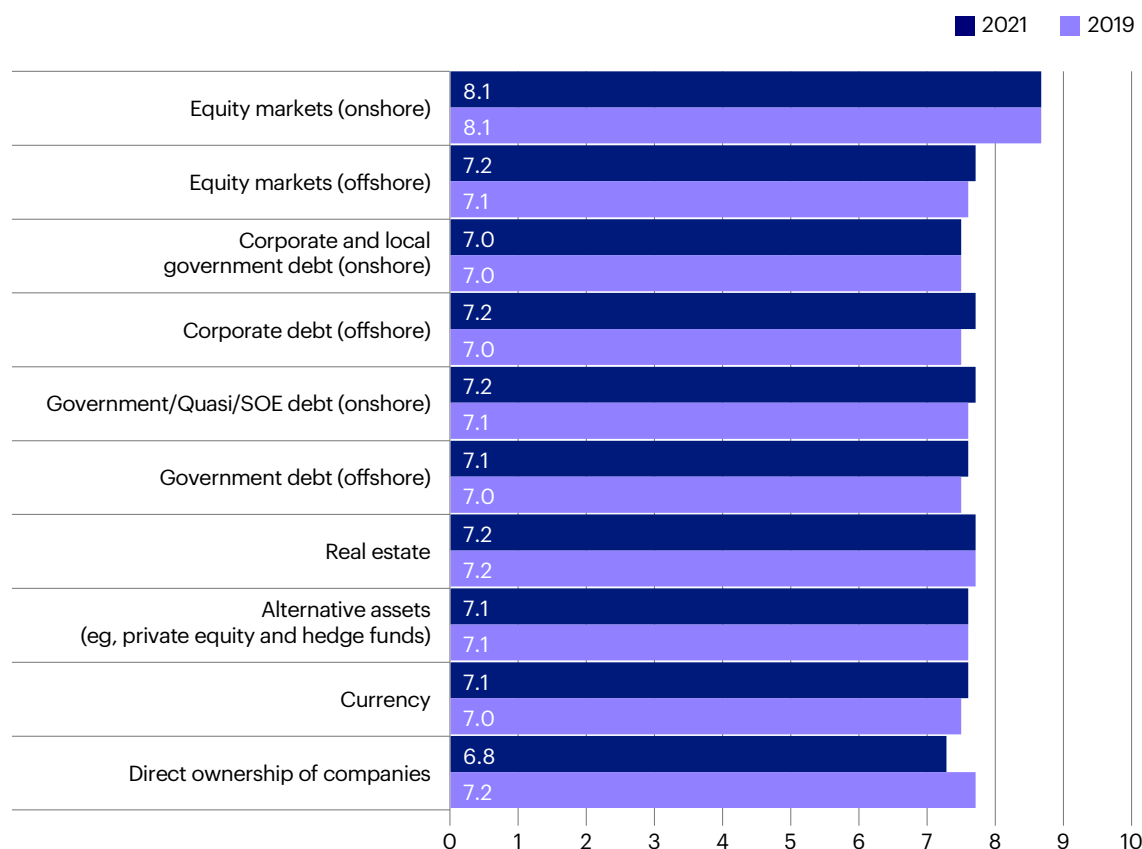
While some respondents are concerned that trade tensions are likely to dampen demand for Chinese exports, impacting China's economy and corporate earnings, more believe that many sectors in China will be resilient and may even be the beneficiary if there is a so-called decoupling. Despite the recent regulatory tightening on some technology companies, overall, the sector is likely to benefit as China seeks to reduce its dependence on foreign-owned technology.

<sup>24</sup> The Economist Intelligence Unit, China highlights, market opportunities, May 2021

<sup>25</sup> The Economist Intelligence Unit, "Key takeaways from the G7 summit", June 2021

**Figure 15. Yet uncertainty persists**

Risk assessment vs other emerging markets (rated 1 to 10)



Source: The Economist Intelligence Unit; sample size: 200

**Figure 16. Troubles with trade?**

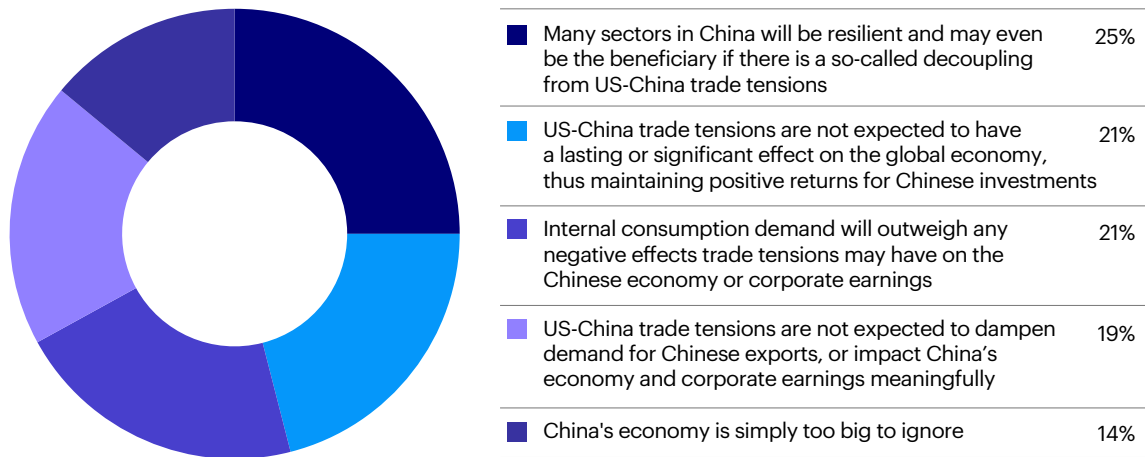
Asset owners' leading reasons for decreased investment (next 12 months)



Source: The Economist Intelligence Unit; sample size: 21

**Figure 17. Expecting resilience**

Asset owners' leading reasons for increased investment (next 12 months)



Source: The Economist Intelligence Unit; sample size: 160

While Mr Biden may be less belligerent in tone than his predecessor, he is still moving forcefully to counter China's industrial policies. "The US is moving quite aggressively with its own version of its industrial policy," says Mr Dong, "with big investment in infrastructure and homegrown innovation, mainly around semiconductors, health and other crucial sectors. China has had a first-mover advantage in these sectors, but the US is realising that this is the battleground and they are moving quickly as well."

Mr Donay says he looks at the big picture—how US-China tensions could impact global growth and even change the global economic system. "It could generate a new geopolitical landscape because these countries are confronting each other, and they could use different financial and economic tools to fight each other, including tariffs, which could limit growth and are adverse to economic developments," he says. "What is at stake is a change in the liberal framework in which we have lived since the second world war... if we switch to something else because of geopolitical tensions, it really could change the economic rules, and then how markets function."

However, he adds, "with all of these things, when we come to investments, we have to deal with it. It's not a good reason to stay away from investments or asset allocation."

That is the message coming from other interviewees and survey respondents as well—despite geopolitical tension, regulatory action and still less-than-perfect ESG disclosures, the benefits of investing in China's growing and diversifying economy and increasingly international companies are too attractive to overlook.



**What is at stake is a change in the liberal framework in which we have lived since the Second World War... if we switch to something else because of geopolitical tensions, it really could change the economic rules, and then how markets function.**

**Christophe Donay,  
head of asset allocation and  
macro research, Pictet Wealth  
Management**

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### Key Takeaways:

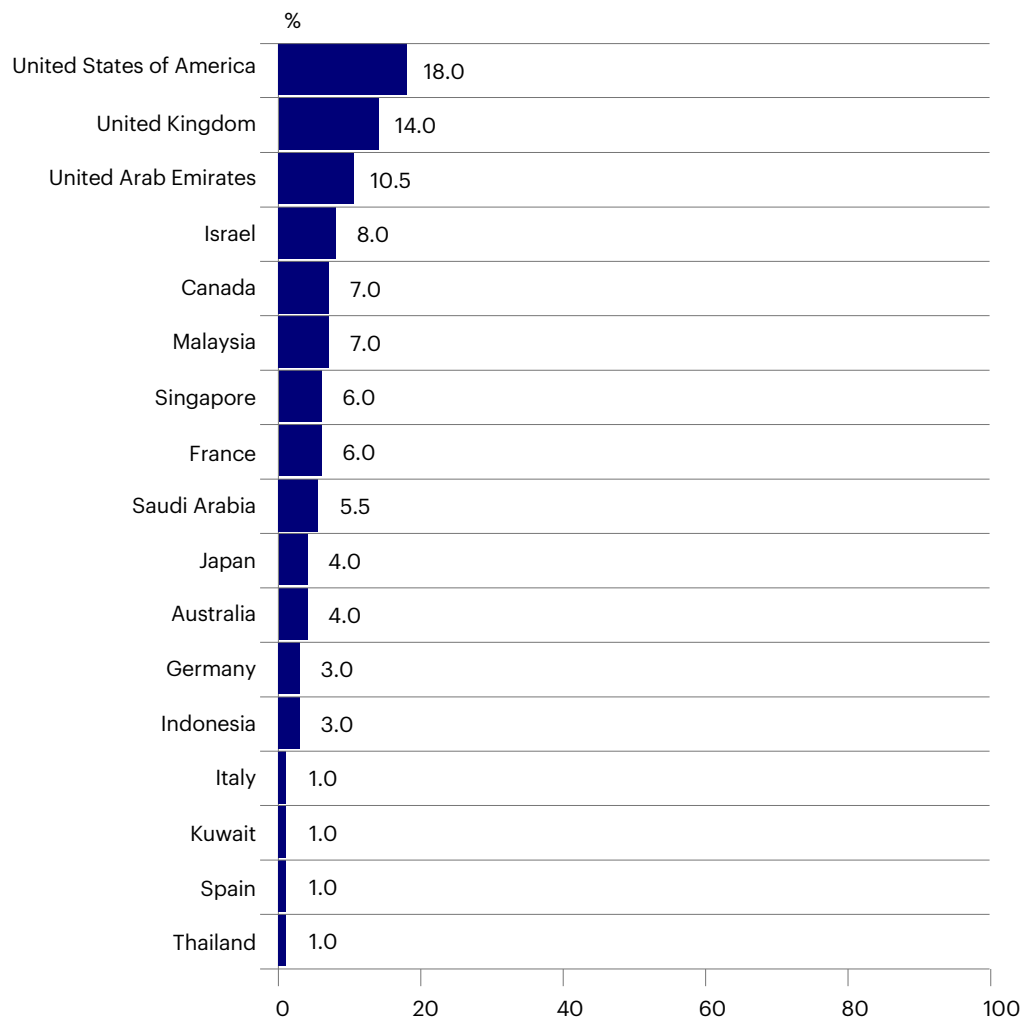
- A majority (60%) of respondents in the 2021 survey still expect better economic conditions in China relative to those globally over the next 12 months despite a context of trade tensions, regulatory uncertainty and continued pandemic-related headwinds.
  - Covid-19 has increased risk appetite for asset owners in relation to China exposures.
  - Technology themes continue to be a top draw for investors; automation and connectivity theme dominate.
  - ESG investing among asset owners is having a growing influence on China exposures; a majority (62%) of survey respondents always or often adopt ESG investing with their China exposures and two-thirds say their China exposure grew due to ESG goals.
  - Overall, China exposure is growing. Half of survey respondents say exposure increased over the past 12 months, and 64% plan further increases in the next 12 months. Only 12% report plans to decrease exposure.
-

# Appendix

## Survey demographics – all respondents (200)

**Diagram 1**

In what country are you located? Select one. (%)

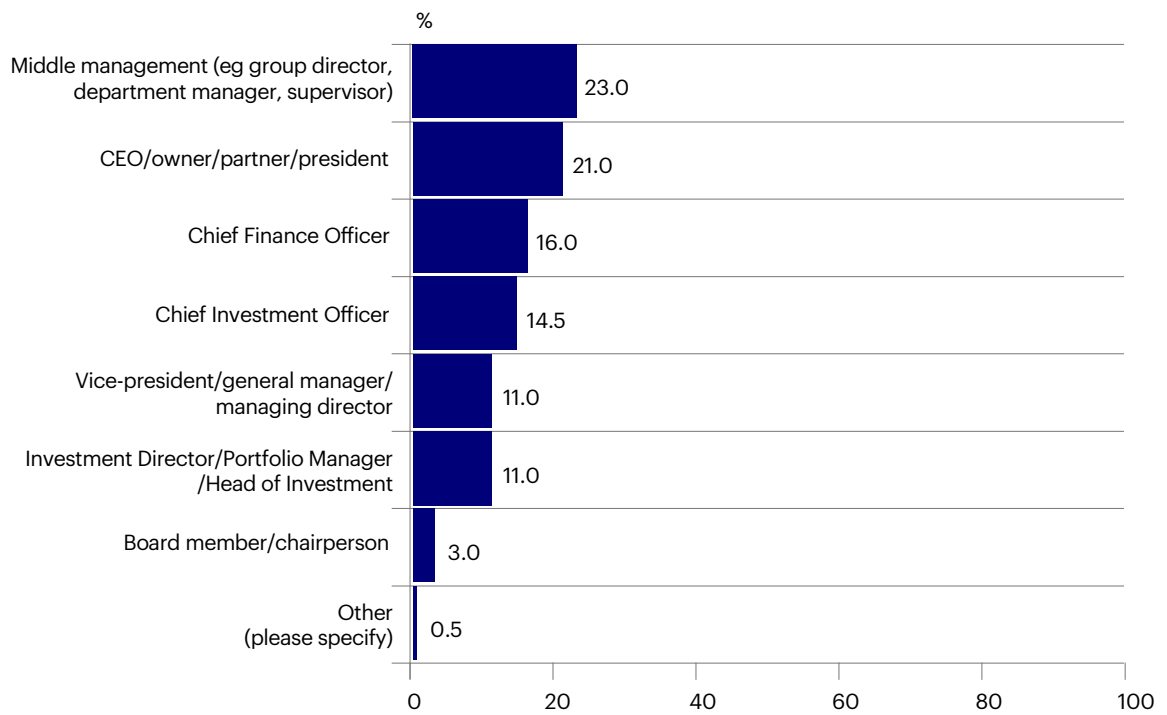


Source: The Economist Intelligence Unit; sample size: 200



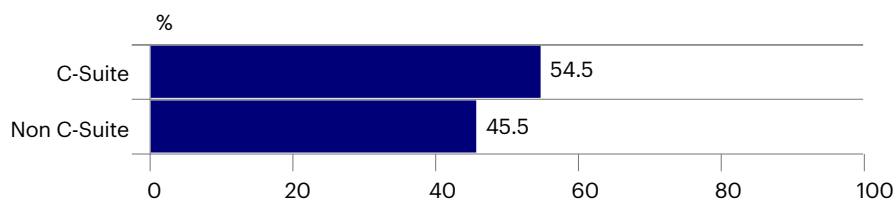
**Diagram 2**

Which of the following best describes your job title? Select one. (%)



**Diagram 2a**

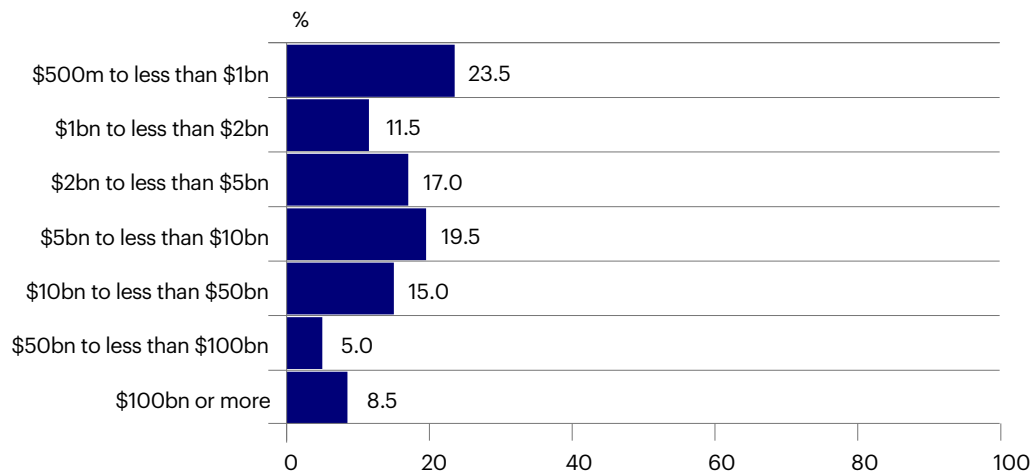
Which of the following best describes your job title? Select one. [By seniority] (%)



Source: The Economist Intelligence Unit; sample size: 200

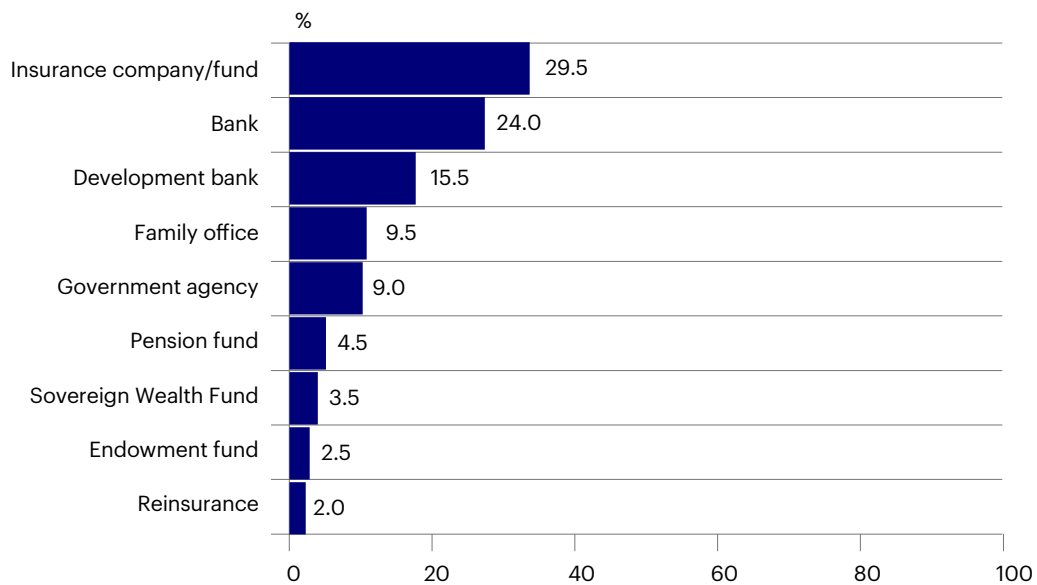
**Diagram 3**

Which is closest to your firm's assets under management (AUM) in US\$? Select one. (%)



**Diagram 4**

Which of the following most closely describes the organisation you currently work for? Select one. (%)



Source: The Economist Intelligence Unit; sample size: 200



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