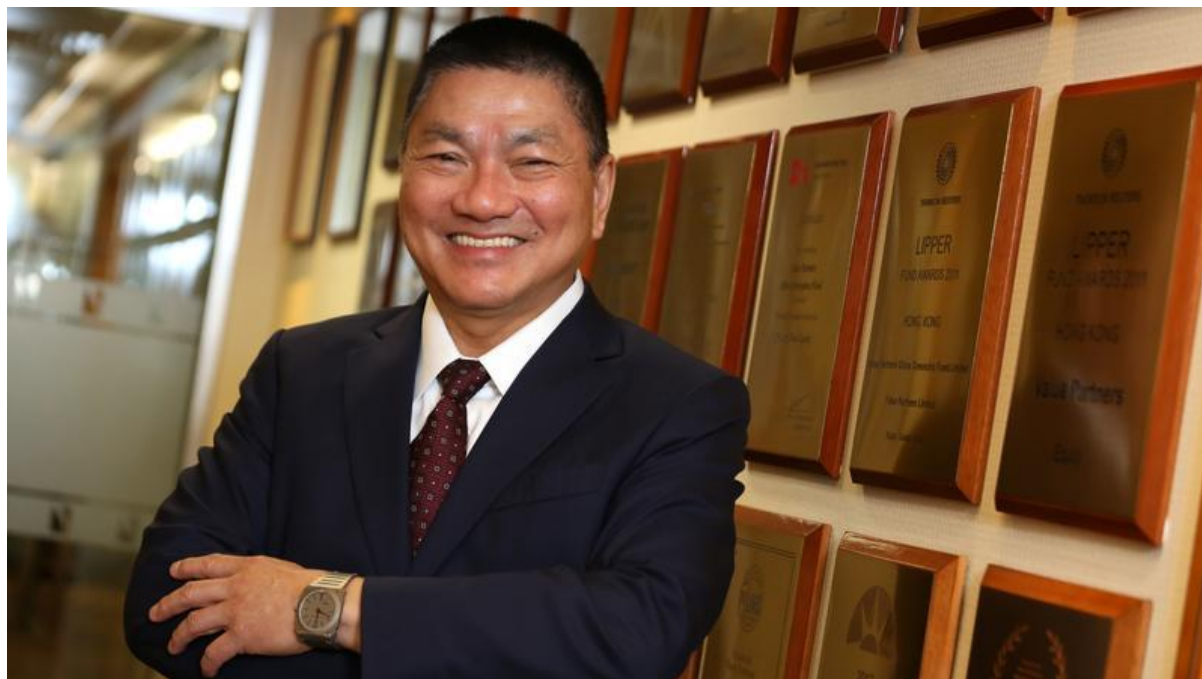


## **Domestic consumption helps China weather trade stalemate**

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### **Cheah: domestic consumption helps China weather trade stalemate**

**Value Partners Co-Chairman and Co-Chief Investment Officer Dato' Seri Cheah Cheng Hye was interviewed by iMoney – a leading Hong Kong financial publication - last week. Mr. Cheah shared his views on the Sino-US trade war and A-share opportunities. He said: "One of the few things I know is if the trade war continues, there will be a lot of suffering for China but China will be able to survive."**

Below is an edited transcript of the interview:

Many professional investors – myself included – were actually quite optimistic about the trade war up to early May. We thought the two sides will find a way to reach a deal, but in early May, the situation became very complicated and we were caught by surprise. I didn't expect the two sides to end up in such a difficult situation.

### **Reevaluate the situation**

Trump's decision in early May to increase the tariff rate on US\$200 billion of Chinese goods to 25% has forced many professional investors to reevaluate the situation. For me, I was too optimistic. Back then, I thought there was a 70% chance of a deal. I now realize that the differences between the two sides go beyond just trade and are much more serious. America considers China to be a strategic rival (and) a competitor. We have now become more pessimistic. We think that even though the two presidents will meet in Osaka at the

end of June, it would only be an agreement to continue talks. Chances are, they still won't be able to reach a deal (by that time).

That said though, the two sides are still willing to talk. The talks have not broken down, but both the US and China have taken on a more hardline attitude and are much less willing to compromise. The assumption I'm building into my portfolio is that a deal will still be reached – but only towards the end of 2019. Because 2020 is an election year in the US, we think Trump will probably want to settle this before then. By then, it would become an important election issue and with the way that things are playing out, many Trump supporters have become affected by the tariffs. President Xi is quite anxious to settle the issue because people are starting to worry about so-called "double dips" in China. The economy slowed down last year. Although the economy appeared to be recovering in the first quarter (of this year) with a 6.4% growth rate, the trade war may cause the economy to slow down again. This will put a lot of pressure on China.

#### **Difficult but acceptable slowdown**

A 5.5% GDP growth rate is very low for China, but it can still survive. China has enough internal resources and tools to sustain a 5.5% economic growth rate. While this may present a somewhat difficult situation, it is not unacceptable. It is painful but not a national disaster. It can be handled.

Trading volumes have declined. Market participants are not buying or selling – they are just observing from the sidelines. Since early May, there has been negative news almost every week. But we are very calm. There is no panic. There is increasing emphasis on making portfolios more defensive. That means increasing the level of cash and focusing on domestic consumption in China. If the trade war results in huge setbacks for China's economy, the Chinese government will increase fiscal stimulus and relax policy. This is good for domestic consumption goods, including household appliances, healthcare, education, domestic tourism and, to a certain extent, real estate. But I believe the Chinese government will not overreact. They also know excessive stimulus is bad for the economy because it will increase bad debt and create more problems down the road. In the worst-case scenario where there is no agreement between China and the US, China will have to wait for the next US president to resume negotiations. Even if that is the case, China's economy can still grow at a 5.5% rate each year. For such a large country, it is still a lot of growth. Some sectors such as the export sector will be badly impacted. But what can you do? That's the reality.

#### **Opportunities in A-shares**

We are increasingly more interested in the domestic Chinese A-share market versus the Hong Kong market. The A-share market has been opening up very quickly since last year, when MSCI started to include A-shares in its indexes. I recently went to the US to meet professional investors and discovered that their level of interest in A-shares is actually even higher than their level of interest in Hong Kong-listed Chinese companies. The A-share

market has become the world's second largest market, in terms of size and trading volume. But only 3.5% of it is owned by foreign investors, which is very low. The majority of buyers are still local mainland Chinese investors. Based on what we see in other markets like Japan, we think foreign ownership will increase from 3.5% to around 15% to 25% in the next 10 to 15 years. There will be a lot of foreign money flowing into A-shares, but it will be a long process. We think the opening-up of the A-share market has its own story. We are very confident that foreigners are coming for that. Not because they like or dislike China, but because they have to diversify away from their own very expensive markets.

From the point of view of US-based fund managers, the home market looks very much overvalued. The US stock market has been in a bull run for 10 years. A 10-year bull run is very long. A big reason for the bull run in New York is share buybacks. Professional investors in the US know about that, and they want to diversify. To them, the market across the Pacific Ocean has lower price-to-earnings multiples, higher growth, and is still under-owned. It looks very attractive. I am very confident that despite the deterioration in Sino-American relations, over the 10 to 15 years, more and more money will flow in from the US to invest in the A-share market.

#### **Bull on domestic consumption**

We are a bit more cautious now about investing in tech stocks. We prefer stocks that reflect China's continuing economic development, especially rising domestic consumption. Domestic consumption has now surpassed exports to make up the biggest part of the Chinese economy. When you talk to me about investing, I am usually very decisive and clear because I feel that what I know is probably more than what I don't know. But for the first time in many years, honestly speaking, I'm thinking what I don't know is more than what I know, because it is all in the hands of politicians. One of the few things I know is if the trade war continues, there will be a lot of suffering for China but China will be able to survive. Even if this no-deal situation continues, there will still be growth [in China's economy].

Everybody, including me, is focusing on the trade war right now, but the longer-term story is not really about the trade war, it's about the demand chain. China, together with the US and the European Union, are the only three places in the world that have developed their own demand chains. Demand chain means that your domestic market is so big that you are becoming increasingly independent and self-reliant. China, in the last few years, has developed a powerful demand chain. Even if China depends on just its domestic market, it will still be world-class market.



## **ABOUT PREMIUM CHINA FUNDS MANAGEMENT**

Premium China Funds Management (PCFM) is a boutique funds management group providing specialist Asian equity and fixed-income funds to both Australian and New Zealand investors.

Capturing the growing economies and influence of emerging Asia, PCFM has developed 4 actively managed funds - the Premium China Fund, Premium Asia Fund, Premium Asia Property Fund and Premium Asia Income Fund.

The funds are managed by a large and experienced team with offices in Hong Kong, Shanghai, Singapore and Kuala Lumpur. The directors and investment managers of Premium and its fund offerings have extensive knowledge in Asian equity and credit markets, wealth management, and other financial services.

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