China Shares – Opportunities Despite Trump

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The trade war between the US and China severely depressed Chinese stock prices. Long-term investors should, however, understand the current level as an entry-level opportunity. Especially the Chinese financial sector has great potential.

For months, the newspapers in Hong Kong have been covering just one topic: The threatening trade war between the US and China - the two largest economies in the world, confronting each other with ever new accusations and burdening their economies with new customs tariffs.

The effects of a prolonged trade war are highly negative for both sides - but has the correction and increased volatility in the Chinese onshore equity markets uncovered some interesting buying opportunities? The quite surprising answer is "YES". Whatever your opinion about the trade war between the US and China, it's worth remembering that trade wars do not last forever and markets recover from such shocks.

The unfortunate correction we have had since the beginning of the year on the Chinese market is largely due to the political confrontation with the US. This weighs on the stock market and the Chinese economy because the we can't predict the end of this trade war.

China's economy is currently changing from an export-oriented economy to one in which domestic consumption is playing an increasingly important role. The domestic economy is already responsible for about 60% of the country's total economic output. At the same time, China's economy continues to grow at an annual rate of around 6.5%, and the share of investment in the Chinese economy is continuing to increase.

Growth forecasts persist

Gone are the days when China was a destination for cost-effective, polluting and labor-intensive productions. If the current growth forecasts prove true, the Chinese economy should overtake the US before the end of the next decade. Maybe this will take a year or two longer - but China's path to becoming the largest economy in the world continues unabated.

The trade war between the US and China unofficially began on January 23, 2018, when US President Trump introduced a tariff on foreign solar cells (China is the world's leading manufacturer) and foreign washing machines. On March 22, Trump asked the United States Trade Commissioner to investigate putting tariffs on US$50 billion of Chinese goods. China countered on April 2 with the introduction of tariffs on 128 US-made products - and the trade war expanded since then.

Foreign investors, however, do not seem particularly concerned about these arguments. This is shown by the capital movements of the "Hong Kong Shanghai Stock Exchange Connect" program. Since the end of 2014, international investors have been able to use this program to order and settle shares in Shanghai via the Hong Kong Stock Exchange. One can also trade Shanghai shares in Hong Kong. A similar program is also available for the Shenzhen stock market.

Both programs will simplify the purchase of Chinese domestic shares for foreign investors and partly exempt them from the previously applicable volume limits. Important Data: Most recently, there was greater money flow from Hong Kong Stock Connect (HKSC) to the Shanghai Stock Exchange than

from Shanghai to Hong Kong. It was the other way round in the first quarter. In addition, the inflows in the Shanghai stock exchange direction increased by 18% between April and July. There were also more inflows into the Shenzhen Stock Exchange, but they were not as pronounced as in Shanghai. These results lead us to conclude: foreign investors buy in particular, the larger-cap Chinese stocks listed in Shanghai to build their strategic asset allocation in China's capital markets.

ETFs make it easier to get started

If you, as a European investor, also want to use the low equity prices for getting started, you should opt for a listed index fund (ETF). The ETF market is also the easiest way for professional investors to implement a Chinese equity strategy. However, choosing the right index is very important.

Why? Not all industries are worth buying. The trade war currently only affects about 11% of the Chinese Exports to the US, which is why not all sectors are affected equally. From a subjective point of view, the FTSE China A50 Stock Index currently appears to be the best ETF underlying. Granted, among the 14 ETFs launched by CSOP, there is also an ETF on the FTSE China A50 Index. But this index is recommended for an objectively understandable reason: in contrast to the CSI 300 or the MSCI China A Index, the FTSE A50 can best withstand the waves of a trade war.

Advantage financials

Examining the A50 index shows that it has a very low weighting in Industrials, Materials and Healthcare, which are particularly affected by the new US tariffs. On the other hand, the index has a very high proportion of financial stocks that are less affected by the trade war.

However, there is another factor that weighs in favor of financial stocks: since June of this year, foreigners have been allowed to own over 51% of fund companies, securities dealers and insurance companies. In a few years the limitations should disappear altogether. This is a great opportunity for foreign banks, but above all, it is a positive for the Chinese financial industry.

In the past, such market opening has regularly led to greater momentum. Each time a Chinese domestic sector has opened up to foreign competition, the big winner was the domestic Chinese sector. Foreign competition has regularly helped Chinese industry to grow. Even in the financial industry, the new competition from experienced foreign players will drive Chinese companies to greater efficiency and boost business overall.

Bloomberg Intelligence predicts that the profits of Chinese Banks will roughly double by 2025. Ultimately, they will benefit from a market with a 35% savings rate. Therefore, a high weighting of Chinese financials will probably be beneficial to your portfolio.

Investors with a long term view should consider China shares. Mainland shares are at 2016 levels. The data from the StockConnect program show that far-sighted foreign investors are already taking advantage of these opportunities.

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