globalmatters Weekly

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global investment management

Reform with Chinese characteristics

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3 June 2024

This week marks 35 years since a key moment in the history of modern China, the Tiananmen Square incident in Beijing. Following the death of ousted Chinese Communist Party (CCP) secretary Hu Yaobang in April of 1989, large-scale protests, initially led by university students, called for democratic, social, and economic reforms. After declaring martial law in May, events culminated on the evening of 3 June, as military forces advanced into Tiananmen Square, ending in a devastating loss of civilian lives.

The event was poignantly captured through the image of a lone demonstrator who stood facing oncoming tanks as they rolled into the Square.

The events of Tiananmen Square saw economic reform stagnate as the CCP looked to cement its political authority across China, however, progress reignited in 1992 when China's then-leader Deng Xiaoping toured the country's special economic zones, which had been created in the early 1980s as part of the CCP's economic reforms.

What followed was a significant downsizing in the role that China's state-owned enterprises (SOE) played in the economy, which in turn unleashed a previously state-owned workforce into private entrepreneurship, driving economic growth. The State-owned Assets Supervision and Administration Commission of the State Council (SASAC) was established in 2003 to oversee SOEs, acting as a mechanism for the CCP to allocate state capital and today it is one of the largest economic entities in the world.

While SOE reform is not a new phenomenon, changes appear to have gathered pace over the last 18 months, beginning with the 'Three-Year Action Plan' in November 2022, which set out a strategy to improve corporate governance and communications. Revised key performance indicators for central SOEs were introduced by SASAC in March last year, including a focus on return on equity and cash flow generation. With over 200 million Chinese retail investors investing in domestic equities, the CCP is acutely aware that improved financial performance for listed SOEs is not only beneficial to the state (through increased distributions) but also essential to keeping the country's emerging middle-class content, particularly in light of the ailing property market which has become less attractive as a vehicle for wealth creation.

A number of policy directives have also been introduced by regulators this year, partially in response to the heightened market volatility across Chinese equity markets. In March, the China Securities Regulatory Commission outlined the 315 Policy series, which encouraged listed companies to raise dividend payout ratios and create share buyback policies. This led to the Shenzhen and Shanghai stock exchanges amending listing rules in April, designating those listed companies that failed to meet payout and buyback requirements as 'Special Treatment' stocks. Finally, a '9 Point Guideline' by the State Council was also introduced in April, which strengthens regulations to improve investor protection, along with further warnings to those companies with no or low dividend payouts.

All of the above are positive developments for investors in China, but selectivity is key. Under the tenure of Xi Jinping, market-led reform is making way for state-driven policy, with this reversal perhaps most widely reported in Western media through the fallout across the technology and private education spaces. Even for listed state-linked enterprises, preference is given to those aligned with local and central government. This can include access to cheaper financing and favoured subsidy allocation. Those SOEs operating within economic and socially important segments that are implementing sensible strategies to improve financial performance are seeing increased interest from active fund managers that we speak to as part of our fund research efforts.

Central SOE and SOE linked companies have often been viewed as un-investable by many institutional asset managers. The tide of negativity towards Chinese equities may be beginning to turn, and SOEs find themselves in a sweet spot amongst a market which has been very out of favour over the last two years. Clouds certainly remain, not least in today's geopolitical landscape and China's relationship with the West. However, a combination of low valuations, improved profitability and a focus on shareholder returns are often the ingredients for an attractive investment opportunity.

"China's state-owned enterprises find themselves in a sweet spot amongst a market which has been very out of favour over the last two years."

Market Review - week ending 31 May 2024

- Global equities fell 0.5%
- OPEC+ announced extended production cuts through 2025 and plans to phase out voluntary cuts by the end of the year
- Brent crude fell 0.6% to $81.62 per barrel
- Gold fell 0.3% to $2,327.33 per ounce

US

- US equities fell 0.5%
- Headline PCE met expectations at 0.3% month-on-month and 2.7% year-on-year. Core PCE was 0.2% month-on-month and 2.8% year-on-year as expected. However, real personal spending fell by 0.1%, indicating potential consumer weakness
- The US Conference Board's consumer confidence index rose unexpectedly to 102.0 in May, easing fears of a significant economic slowdown and tempering expectations for future rate cuts
- The Richmond Fed's manufacturing index rose to 0 in May, its strongest level in seven months

UK

- UK equities fell 0.6%
- Bank of England (BoE) figures showed a slight drop in mortgage approvals, despite an increase in lending. In April, there were 61.1k mortgage approvals for house purchases, slightly down from 61.3k in March, the highest level since September 2022. However, net mortgage borrowing increased significantly to £2.4bn from £0.5bn the previous month

Europe

- European equities fell 0.3%
- May flash HICP exceeded expectations at 2.6% year-on-year, with the core number also higher at 2.9%, casting doubt on the ECB's rate cut plans
- German inflation rose to 2.8% on the EU-harmonised measure, above expectations, causing markets to anticipate a less aggressive rate-cutting cycle from the ECB in the coming months
- Euro Area unemployment rate fell to 6.4% in April, its lowest since the euro's inception
- The ECB's April Consumer Expectations Survey revealed lower inflation expectations for 1 and 3 years at 2.9% and 2.4%, respectively
- France's credit rating was downgraded from AA to AA- by S&P due to the government's post COVID-19 deficit issues

Rest of the World/Asia

- Global emerging market equities fell 3.1%
- Japanese equities rose 1.2%, while Chinese equities fell 3.0%
- Japan's services PPI grew by 2.8% year-on-year in April, the fastest in nine years, and industrial production fell by 0.1%. Retail sales grew by 1.2%
- China's manufacturing PMI declined to 49.5 (vs 50.5 expected), and the non-manufacturing PMI to 51.1 (vs 51.5 expected). Nevertheless, the weaker data has been seen as raising the likelihood that there might be more stimulus
- The Caixin manufacturing PMI for May improved to 51.7, the highest since June 2022

Past performance is not indicative of future returns. Source: Bloomberg Finance L.P., returns in local currency unless otherwise stated.

Market Performance - week ending 31 May 2024

		Cumulative returns			
Asset Class / Region	Currency	Week ending 31 May	Month to date	YTD 2024	12 months
Developed Markets Equities					
United States	USD	-0.5%	4.9%	11.1%	27.6%
United Kingdom	GBP	-0.6%	1.9%	9.0%	15.8%
Continental Europe	EUR	-0.3%	3.6%	10.0%	17.8%
Japan	JPY	1.2%	1.2%	18.4%	33.1%
Asia Pacific (ex Japan)	USD	-2.5%	1.9%	4.4%	12.2%
Australia	AUD	-0.3%	0.9%	3.2%	12.9%
Global	USD	-0.5%	4.5%	9.5%	24.9%
Emerging Markets Equities					
Emerging Europe	USD	-2.3%	3.4%	15.1%	41.6%
Emerging Asia	USD	-3.1%	1.4%	5.8%	12.6%
Emerging Latin America	USD	-2.9%	-3.1%	-10.2%	12.6%
BRICs	USD	-2.9%	1.1%	5.0%	13.2%
China	USD	-3.0%	2.4%	6.8%	4.3%
MENA countries	USD	-2.6%	-5.6%	-6.0%	0.0%
South Africa	USD	-6.2%	-0.1%	-4.3%	12.6%
India	USD	-2.2%	0.1%	4.0%	21.9%
Global emerging markets	USD	-3.1%	0.6%	3.4%	12.4%
Bonds					
US Treasuries	USD	-0.1%	1.5%	-1.8%	-0.4%
US Treasuries (inflation protected)	USD	0.3%	1.8%	-0.1%	1.4%
US Corporate (investment grade)	USD	0.0%	1.9%	-0.6%	4.7%
US High Yield	USD	0.0%	1.1%	1.7%	11.2%
UK Gilts	GBP	-0.3%	0.8%	-3.8%	2.9%
UK Corporate (investment grade)	GBP	-0.2%	1.0%	-0.9%	8.7%
Euro Government Bonds	EUR	-0.4%	-0.1%	-2.1%	1.9%
Euro Corporate (investment grade)	EUR	-0.1%	0.2%	-0.2%	5.2%
Euro High Yield	EUR	0.1%	1.0%	2.6%	10.7%
Global Government Bonds	USD	-0.2%	1.0%	-4.2%	-1.3%
Global Bonds	USD	-0.1%	1.4%	-3.0%	1.3%
Global Convertible Bonds	USD	-0.3%	0.9%	-1.5%	6.2%
Emerging Market Bonds	USD	0.0%	1.7%	0.6%	9.3%

		Cumulative returns			
Asset Class / Region	Currency	Week ending 31 May	Month to date	YTD 2024	12 months
Property					
US Property Securities	USD	1.7%	4.6%	-3.4%	8.5%
Australian Property Securities	AUD	0.0%	1.9%	9.1%	19.0%
Asia Property Securities	USD	-1.7%	-3.1%	-7.8%	-3.5%
Global Property Securities	USD	0.8%	2.9%	-2.8%	9.9%
Currencies					
Euro	USD	0.0%	1.6%	-2.0%	2.0%
UK Pound Sterling	USD	0.0%	1.8%	-0.3%	2.8%
Japanese Yen	USD	-0.2%	0.2%	-10.4%	-11.1%
Australian Dollar	USD	0.2%	2.4%	-2.8%	2.7%
South African Rand	USD	-2.3%	-0.1%	-3.0%	5.0%
Swiss Franc	USD	1.2%	1.6%	-7.1%	1.2%
Chinese Yuan	USD	0.0%	0.0%	-1.9%	-1.8%
Commodities & Alternatives					
Commodities	USD	-1.7%	1.3%	8.7%	16.5%
Agricultural Commodities	USD	-1.7%	3.6%	7.0%	13.1%
Oil	USD	-0.6%	-7.1%	5.9%	12.3%
Gold	USD	-0.3%	1.4%	12.8%	18.4%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

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