CAMRADATA

China Whitepaper

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Welcome to CAMRADATA's China Whitepaper

The mantra for investing in Emerging Markets is higher risk, higher return. When it comes to China, that mantra invites exploration. Historically, investing in public equities in China has not yielded the kinds of returns to match economic growth. That was puzzling for early adopters but explained away as the mismatch between the economy in total and investable securities. As markets have grown, however, it has become apparent that the index is not merely a poor reflection of the economy but also a reflection of poor investment decision-making.

Much of the explanation is laid at the door of superstitious domestic, retail investors. Yet there is some concern that government policy – while aimed at offshore internet enterprises – also has an unsettling influence. This CAMRADATA Whitepaper will explore the risks and many benefits of investing in China today: how the State supports business growth; where Chinese companies outcompete global rivals; and which industrial sectors will flourish in the years ahead.

China Roundtable

The CAMRADATA China Roundtable took place in London on 5th July 2022.

FOR MOST WESTERN investors, two distinct means of accessing China exist: via the offshore market, notably Hong Kong, and the mainland via A-shares. There are noticeable characteristics to both routes. Many new-tech giants are headquartered off the mainland, while there is a preponderance of State-Owned Enterprises (SOEs) listed in Shenzhen and Shanghai.

China-labelled investment strategies currently tend to reflect those differences, with the majority of funds focused either offshore or onshore. But the 2022 CAMRADATA China Roundtable began by asking if the future is in Greater China strategies, covering the entire region.

"It comes down to where investors have their skill-set," said Claire Shen, head of research for China equity strategies at WTW. "In theory, a broad opportunity set is ideal. In reality we find limited investors can do both China A and offshore China well."

Shen said A-shares in particular are a good complement to asset owners with global Emerging Markets portfolios: "Skilful 'All China' investors have differentiated holdings in the offshore China book, which will not lead to doubling up the EM (Emerging Markets) exposure."

She noted that offshore exposure offered opportunities in big tech and biotech whereas the mainland one was a broader, more complete sector set.

Fei Tan, a manager researcher at consultancy and fiduciary manager, Mercer, said the firm believes that eventually there will be a "blurring of the lines" between the onshore and offshore markets. But Tan described the number of asset managers capable of covering both markets as "slim pickings" at the moment as the "All China" universe (referred to as Greater China here) is a relatively new asset class without a long track record, whereas China A-Shares are more well established. To complement the "All China" allocation, some investors have started carving out China from the EM universe by investing in EM ex China mandates, although this is similarly a nascent asset class.

Faisal Rafi, head of research at RisCura, an investor consultancy with a major client base in Africa and its own China equity fund of funds, was adamant that the best skill was in Greater China and the manager track records existed to prove it.

He said that the purpose of investing in EM was to find the best companies regardless of geography. He agreed with Tan, however, that these are early days for carving out China. Rafi noted that some EM managers might be reluctant if China had previously made an outsized contribution to overall EM fund returns. "And asset allocators have to decide if they want more exposure to this

The conversation then turned to the unexpected events and volatile market reactions in the first half of 2022, which have left most indices in double-digit negative territory. Shanghai was just emerging from two months of strict lockdown when this CAMRADATA event took place.

particular economy or less given the geopolitical risks," he added.

By the same token, however, Rafi gave the special skill-set required to invest in Chinese companies as one reason justifying the carve-out: "China is different," said Rafi.

RisCura itself has customised its China benchmark, tilting towards A-shares to compensate for existing offshore Chinese companies in global and emerging market benchmarks. "All our China managers have the liberty to go anywhere," said Rafi.

The managers' view

John Lin, portfolio manager of AllianceBernstein's A-Shares Value Strategy, said that All-China was the future, but not the present. "Clients are not ready yet," he said. "There are concerns about doubling-up Emerging Markets exposure by just bolting on more China."

He followed the consultants' concerns about risk: "Tech and growthy stocks got burned last year so clients are looking around. I do agree, however, that the skill-set defines opportunity."

Lin noted that A-shares remain dominated by Chinese domestic money and this is likely to be the case for a long time to come. Regarding the offshore market, he believed that Hong Kong is becoming more influenced by the mainland. "It's not China becoming more global," emphasised Lin.

Frank Tsui, head of ESG at Value Partners, said that practices in investment and corporate life tend to be driven by regulation: "Hong Kong has mandatory requirements to disclose ESG data. So it is much easier to find ESG data there and Chinese corporates listed in Hong Kong know how to play the game," he said.

In contrast, Tsui said that it was more labour-intensive getting data on and from mainland companies, although he acknowledged that they are developing fast.

Randy Zhou, head of investment research at Power Sustainable Investment Management said that in his firm's experience, skill defined the opportunity set. "Twelve years ago we tried expanding our skill-set to Hong Kong but we found it was totally different. Investments there are quite different. For us, the outcome is whether we can provide the best product. With A-shares we have a long-term, top-quartile outcome."

Looking forward, Zhou said that regulatory change has resulted in much lower transaction and communication costs; and more frequent communication between asset managers in Shanghai and companies listed in Hong Kong. "As information becomes more available, the capability to understand China and a team located onshore will provide the competitive edge," he said.

Zhou thus expects more asset managers to locate staff in Shanghai and Hong Kong.

Match report

The conversation then turned to the unexpected events and volatile market reactions in the first half of 2022, which have left most indices in double-digit negative territory. Shanghai was just emerging from two months of strict lockdown when this CAMRADATA event took place. "During lockdown, where food has to be delivered to your door, you can get really negative," admitted Zhou.

"Our feeling was to try to stay objective, and not be manipulated by daily sentiment. We tried to figure out what was happening on a daily basis," he said. He joked that working became even more intense than in the office. On fund performance, he said: "We did what we could. Long-term our investment framework and quantitative research methodology stays intact."

Tsui agreed that performance this year had been tough. "It's rare we see a lot of uncontrollable factors. Drastic changes like the Ukraine conflict were totally out of the blue. Inflation we did account for, but it's been bigger than we expected. We underweighted the tech sector but still got some negative impact from that. Lockdown dented market sentiment."

Tsui doubted a recovery in consumer spending. Instead, last year Value Partners was reconsidering 'unsexy' sectors such as telcos and wealth management firms. "When inflation kicked in, growth got derated. Old value came into favour. Our knowledge thesis on telcos has been more about a change in their business model from b2c to b2b."

Within the finance sector, Tsui clarified that Value Partners was not much attracted to banks and insurers. "They will be challenged," warned Tsui.

On real estate, Tsui said Value Partners was underweight. "The policy overhang on property – which encouraged developers to

Lin then wanted to scotch the notion that investing in China was all about consumer spending and healthcare.

deleverage - has given markets a doubt about revenues, although the worst is behind us."

For AllianceBernstein, Lin said it had been a good year relative to the benchmark. Over the past year to end of June, his A-shares strategy benefitted from the value style rotation and outperformed the MSCI China A onshore index by 650bps gross of fees. The tailwinds to that performance included selective picks among property developers, which became good, undervalued opportunities when other investors panicked in the third quarter last year on the back of Evergrande's restructuring. "They were overpessimistic," judges Lin.

Lin also profited from "old-school" cyclical manufacturers. "These are not doing anything fancy like genome-sequencing or gene-editing," he said. "They are competing on scale; they have a lot of capital. In April you could have been looking at 12x earnings from them; by June that had risen to 19x earnings.

"We also spied inflation coming last year, so we had an overweight in Materials coming into 2021. In anticipation of food inflation, we invested in beneficiaries such as a producer of MSG and amino acids. The company also makes xanthum gum, a thickening agent in salad dressing and lubricant for oil drills, so the earnings benefited from the high oil price.

"Stock selection is our only defence," noted Lin. "We are always fully invested and are free to go where we see fit. Nothing should be off the menu."

On the dangers of holding cash and attempting to time the market, Lin observed that if an investor had missed just the ten best days of the CSI300 index since inception, performance almost halved from 10.1% to 5.5%.

Although Lin said that his A-shares strategy has the flexibility to look at everything, he did clarify that AllianceBernstein's environmental policies made it very difficult to invest in thermal coal.

Lin then wanted to scotch the notion that investing in China was all about consumer spending and healthcare. Instead, he starts with company fundamentals: valuations and earnings strength and his bottom-up stock picking drives sector allocation. "Over time, these change," he said. What matters is to understand the drivers; and what is priced in.

AllianceBernstein strongly disagrees with another prejudice, that all SOEs are inefficient and categorically second-rate. "Some of the best companies in China and globally competitive, are SOEs," said Lin. "That label, to us, is not all that meaningful in predicting individual company quality or return potentials as stocks."

Lin gave the example of Kweichow Moutai, the country's best-known liquor manufacturer. "It's a well-run business, one of the best performing stocks in 2021 and one the most popular Chinese stocks held by foreign investors; but still an SOE," he observed.

Tsui said that as the Chinese economy has rebounded in the second quarter, materials and commodities linked to renewable energy, have risen. But for Value

Partners, these sectors remain fundamentally too expensive.

On the Beijing government's e-commerce crackdown, which hurt lots of platforms, Tsui reckoned the worst was behind us. Elsewhere, Value Partners had taken opportunities in mobile gaming stocks.

Zhou agreed with Lin that sectors can change dramatically and Power Sustainable likes to profit from that changeability. He gave the example of Electric Vehicles (EVs) and the commodities which feed these sectors.

Regarding EVs, Zhou said that the Chinese frequently discuss which car they want to buy. Choices include Tesla, Nio, Li Auto and SAIC: the market is shifting as domestic brands expand and surpass foreign peers and rivals. Much of the transformation of transportation is coming from the development of autonomous vehicles, of which electrification is merely a part, according to Zhou. It is the digitisation of driving where he sees the greatest impact on sustainability.

"For example, there could be ten variables in our firm to drive revenue: three relate to management; four to prices; and three to competition," he said. Those variables will be greater in EVs than other sectors because of the momentous change autonomy will bring. In contrast, Power Sustainable sees little of interest as a growth style manager in the precious materials within EVs.

"We don't like commodities because the miners' business model is too simple, besides the ESG issues involved," said Zhou. "Volumes are determined by the capital expenditure of the company and management in turn decide capex on expected future prices."

The CAMRADATA roundtable segued into the role of Chinese companies in the push for global sustainability. Tsui said that in some sectors, Chinese companies were leaders, for example, the EV manufacturers, who are benefitting from the rapid adoption of exhaust-free cars domestically.

On ESG adoption, he said that things could not really be so different to elsewhere because Chinese pioneers are adopting best Western practices in order to be able to work with institutional investors. Other companies, however, he described as sceptical, waiting on guidance and regulation from the Beijing government.

Shen said there are indeed sustainability challenges in China, including a low average ESG rating among listed corporates, some even worse than EM in general. China is the biggest emitter of greenhouse gases in the world. Shen nevertheless said China's sustainability development has gathered significant positive momentum, and there is more intensive work getting done in the background, including significant policy management to welcome institutional investors entering China. Shen said this push by Chinese policymakers for companies to improve disclosures benefited asset managers so that they could conform more to global ESG standards. As a result, there is a strong upward momentum among Chinese companies' ESG performance. Investment stewardship in China has also shown steady progress.

Over the long term, with China's stated plan to be carbon-neutral by 2060, Shen saw incredible climate change driven investment opportunities coming from every link in the supply chain.

No compromise

Rafi said RisCura tolerated no compromise on ESG: "We expect managers to be custodians of our assets; we are working with managers to improve their required ESG standards." He claimed that even hiring or firing could be on ESG grounds. And he said that this included controversies such as forced labour of Uighurs.

But he also encouraged asset owners to view the whole picture. "There are pluses and minuses to everything," said Rafi. "There are sectors where China owns the entire supply chain. You cannot build an EV without involving China; it produces approximately 90% of all lithium phosphate batteries. Even if you reproduced that, it would take billions of dollars to establish the apparatus."

RisCura recognised the Chinese State's goal of common prosperity and some of the shortcomings of Western firms. "Asset owners in the West grumble about Chinese people's lack of data privacy. What about Facebook here? What about the anti-competitive behaviour of US tech platforms? China has solved things we have not."

Likewise, on the reduction of carbon emissions, RisCura directs clients to look at what Chinese companies are doing in terms of mitigation and adaptation. He warned that looking at national figures on pollution did not give you as an investor a sense of where and how change was taking place.

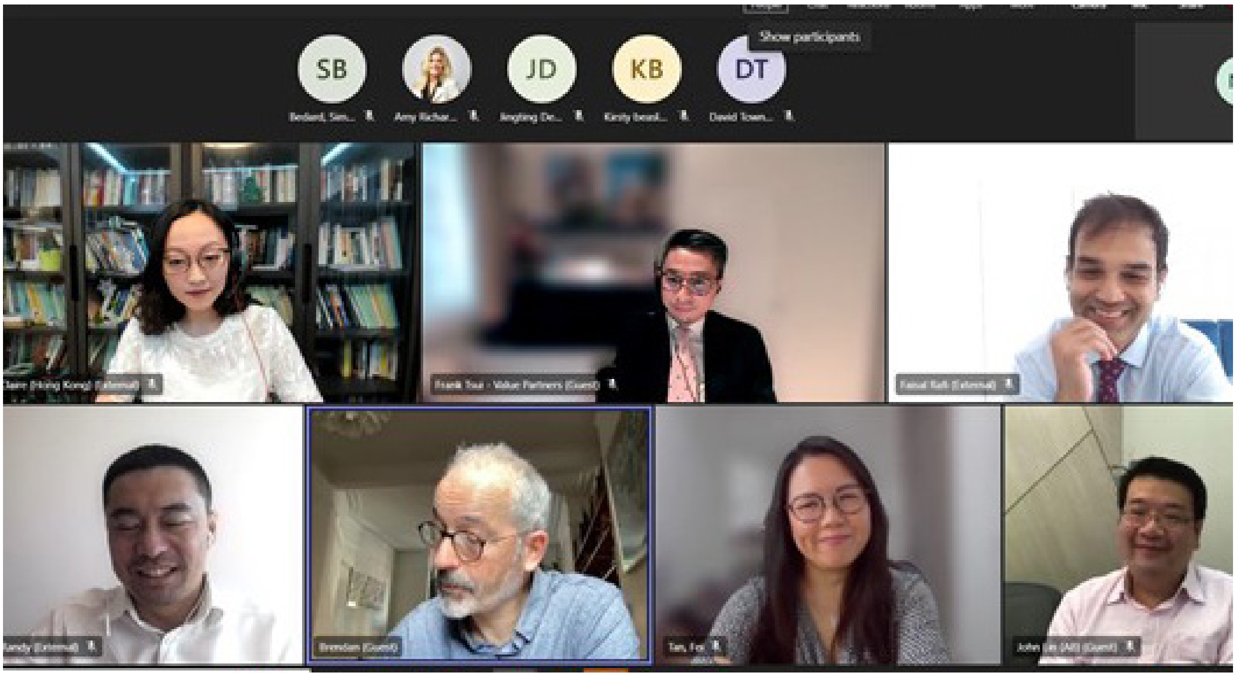
Tsui then commented on the financing of green projects. "When you want to do something huge, you need a decent financing channel," he said. "The property sector, for example, has always borrowed money. If you are looking to ESG integration, what is the impact of financials?"

Tsui said that to avoid greenwashing, the firm has on-the-ground analysts monitoring property developments. Apart from financiers' vigilance, he noted that regulatory fines related to sustainability would also drive deeper change.

More generally, Tsui noted how much green lending The People's Bank of China does. "Green projects can help to lower your borrowing costs. That gives more incentives for China's corporates to roll out sustainability."

Tsui noted that Green loans account for approximately 8% of the current China system and that the entire Green loans market is estimated to grow to 13-14% annually in ten years' time.

On the world's dependence on China, Zhou noted President



Biden's announcement in June that there would be an exemption for two years on tariffs on solar panels imported from South-East Asia. "China is the manufacturing heart of the world," he said. "It has to keep going."

He thus explained the strict lockdown in China as an understanding by the authorities that the world cannot afford for the Chinese labour-force to get sick from Covid. "If that were to happen, inflation in the supply chain would rocket in 2023/24," said Zhou. "This would endanger global stability because inflation would be out of control. Think of the Fed target of 2%. And how would Emerging Markets tackle the cost-of-living issues?"

He said that in the next few years geo-politics will still matter, but this economic status quo is necessary.

Lin said that most decarbonisation strategies tend to invest in Developed Markets, in the US or European companies; but if you don't include China, the largest emitter in carbon globally, then it's an incomplete picture. Another AllianceBernstein product he manages, AB China Net Zero Solutions, focuses on decarbonisation enablers.

Within ESG, AllianceBernstein focusses on climate. "That is the same for China as other major markets where we invest," said Lin. "But with Chinese characteristics."

China's Net-Zero targets were only a few years old. As such, investors need to be aware that this is a momentous but nascent policy

He noted that China's Net-Zero targets were only a few years old. As such, investors need to be aware that this is a momentous but nascent policy. "Understanding how China's 2060 carbon-neutral framework addresses climate change and the implications for equity investors has been a key focus," said Lin, "and has led to sizable investments in our China A-shares portfolio as well as the creation of AB's China Net Zero Solutions service."

Lin also pointed out that SOEs are more structured in their emissions-cutting targets than private enterprises.

To factor in these policies, Lin advocated asset managers do their own ESG research rather than outsource to third-party providers. "MSCI doesn't speak to companies," said Lin, "and so many are not in the standard indices anyway.

"We want to talk to every company in the AllianceBernstein portfolio. We made 129 ESG-specific engagements with companies last year and 66 already this year. This agenda gives us a different perspective."

As an example, Lin noted that SOEs typically do not hire independent board members. He said for third-party ESG agencies, that merits a points deduction against the firm's governance. But for AllianceBernstein, any purely quantitative scoring system won't capture all of the essence of an investee firm.

"There is a very different ecosystem in China between the regulator, shareholders and management," said Lin. He warned of the dangers of analysing Chinese corporate culture through a Western lens.

On the effectiveness of third-party ESG agencies, Tsui agreed with Lin. "There isn't really an external ratings company onshore," said Tsui. And so, in 2019 Value Partners started its proprietorial ESG assessment framework.

Tsui repeated the importance of engaging when assessing: "It's labour-intensive but you need to talk to companies. We have found a common situation where a lot of them may be doing ESG but they are not properly disclosed, for example, manufacturers supplying parts for EVs."

Tsui added that thousands of stock are not covered by either merely ESG agencies or many brokers. "These companies may get a low ESG score but they do publish project updates which sometimes contain ESG-related information," said Tsui. "So in effect you can find ESG material by digging deep when researching."

At the macro level, Zhou connected sustainability with stability. At the firm-level, he noted there were lots of variables. "In Power Sustainable we integrate business models," he said. "Every principal has to know how to engage with the companies on ESG issues. We are always looking for solutions but simply relying on external ESG ratings isn't good enough. We invest in companies like battery manufacturer, CATL, that are going to change global sustainability."

Zhou believed that the problems raised by ESG can be solved using industrial expertise. By automating driving, journeys will save time and energy and eventually cut carbon emissions, enabling both environmental and social gains thanks to better-planned routes and dramatically fewer fatalities on the road.

Weighting both sides

The CAMRADATA panel closed with a discussion among the consultants about how to combine manager styles, including by barbelling. Shen said WTW had no presumptions: "Consistency and skilfulness is what we are looking for. There is a range of different kinds of style," she said.

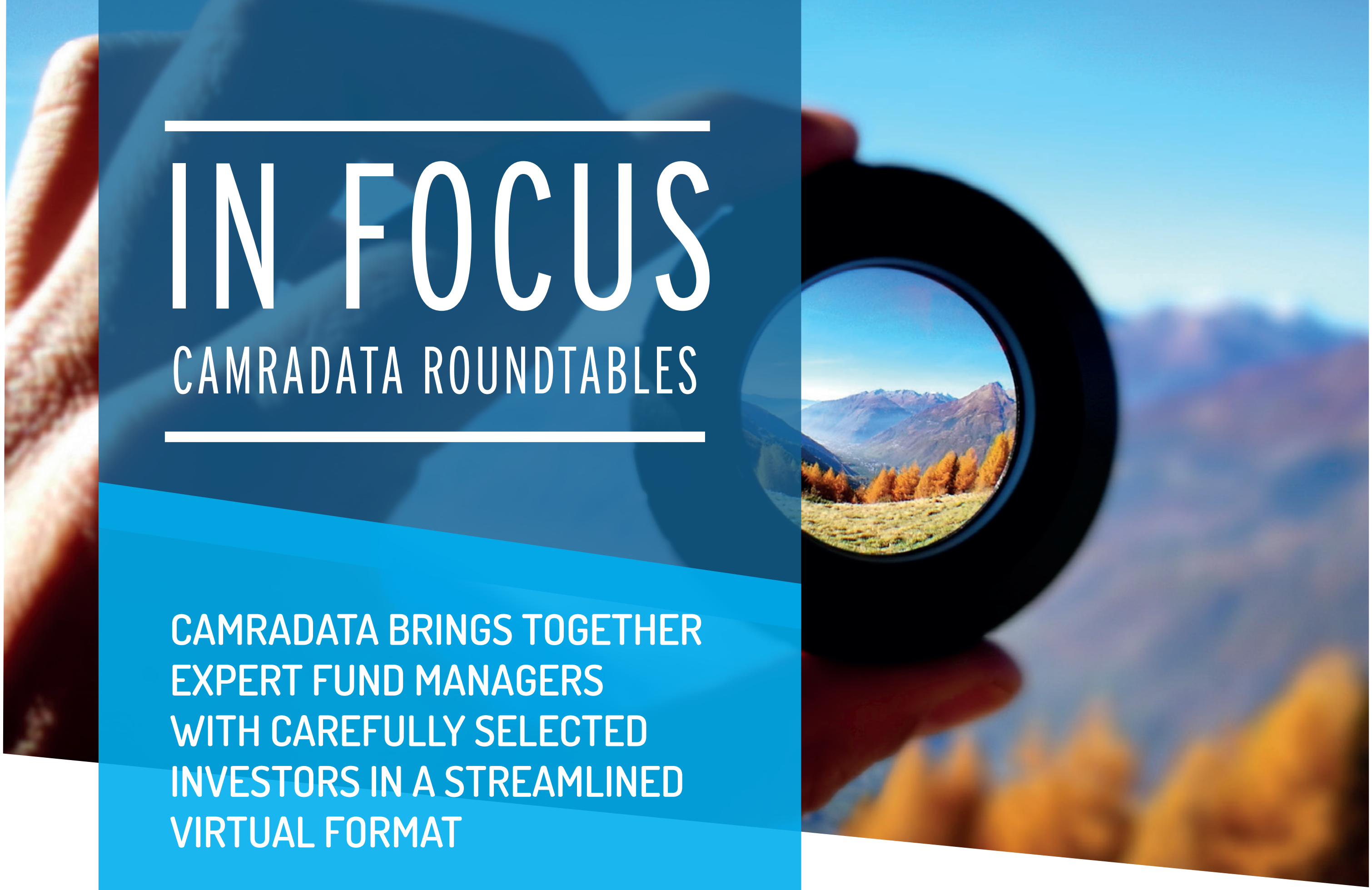
While WTW clients have a variety of different needs, Shen noted that China as a standalone region was still only a 'line item' for some clients. In terms of their total allocation, that translates into just one or two managers. Even in these cases, Shen emphasized that WTW will attempt to achieve style-neutrality, given that China is of higher-risk.

Where there are more managers required, Shen said the goal was to achieve diversification and risk management at the total portfolio level by building an unconstrained high active multi-manager portfolio.

Tan said that some US asset owners have considered China "uninvestable" for the last few years because of headline risks related to geopolitical or ESG concerns. "Ultimately, however, we want clients to avoid structural underweights to China A-shares in their portfolios. There are a lot of diversification benefits in China onshore companies," said Tan. Mercer has a great variety of clients, but she suggested that clients should have strategic weights of 5%-10% of total assets in China A-shares.

Rafi said that there were up to one thousand investable companies in China growing at a rapid rate. He reckoned that hundreds have the potential to become multi-billion dollar companies.

From asset managers this necessitates private-equity-like analysis, according to Rafi. He believed that sector bias is even more important than styles. For all these reasons "the best managers tend to be very concentrated, so barbelling is essential if you want success," he concluded.



IN FOCUS

CAMRADATA ROUNDTABLES

CAMRADATA BRINGS TOGETHER EXPERT FUND MANAGERS WITH CAREFULLY SELECTED INVESTORS IN A STREAMLINED VIRTUAL FORMAT

"I have taken part in several roundtables over the last 18 months and this was the best orchestrated by far"

Investment Director, UK Consulting firm

"Just a note to say thank you for organising the panel and having me on it. I found the full group discussion super informative."

Portfolio Manager, Global Asset Manager

"The CAMRADATA virtual roundtable went really well, as well as the live events, which was quite surprising! It was informative and interesting, and I know our Fund manager enjoyed being a part of it."

Business Development Manager, UK Asset Manager

CAMRADATA

Interactive and dynamic debate • A wide array of asset classes covered • Branding , editorial and advertising opportunities as part of all roundtables • Expert investor panels • Ability to connect and network with key stakeholders

To find out more - **Natasha Silva** (Natasha.silva@camradata.com) would be delighted to speak to you.

Roundtable Participants

John Lin

Portfolio Manager – China Equities

AllianceBernstein

Personal Profile

John Lin has been a Portfolio Manager of China Equities since 2013 and is responsible for managing the China A Shares Value, China Net Zero Solutions, China Low Volatility and All China Equity Strategies. Until 2022, he also served as a senior research analyst, responsible for covering financials, real estate and conglomerate companies in Hong Kong and China.

In 2008, Lin relocated to Hong Kong, where his research coverage included Asian financials, real estate and telecommunications services companies. He joined the firm in New York in 2006 as a research associate, covering consumer services companies for US Small & Mid-Cap Value Equities. Previously, Lin was a technology, media and telecom investment banker at Citigroup.

He holds a BS (magna cum laude) in environmental engineering from Cornell University, and an MBA from the Wharton School at the University of Pennsylvania, where he earned the distinction Graduation with Honors. Location: Hong Kong.

Company Profile

AllianceBernstein is a leading investment-management firm with $735 billion in client assets under management, as of 31 March 2022. We provide forward-looking perspective, independent research and investment discipline across asset classes, from equities and fixed income to alternatives and multi-asset portfolios. Our worldwide clients—including institutional, high-net-worth and retail investors—face new investment challenges and opportunities every day.

Through our unique combination of expertise, research and global reach, we apply collective insights and leverage our extensive global footprint to help keep our clients at the forefront of change.

Roundtable Participants

Randy Zhou

Head of Research and Portfolio Manager at Power Sustainable Investment Management (Shanghai)

Personal Profile

Mr. Zhou joined Power Pacific in 2018 and manages the research team as Head of Research, focusing on optimizing research processes and developing investment strategies.

Before joining Power Pacific, Mr. Zhou was a Portfolio Manager at Giant Redwood, investing in China A/H shares, China ADRs and US stocks with significant China exposure. Prior to that, Mr. Zhou worked at Cathay Fortune as Director, responsible for investments in Consumer and TMT in both primary and secondary markets. Mr. Zhou also worked as a sell-side analyst for six years at Goldman Sachs, UBS and BOCI. During his 15 years of cross-border investing and research experience, Mr. Zhou has developed a deep understanding of Chinese capital markets.

Mr. Zhou received a BA degree from Shanghai University of International Business and Economics and an MBA degree from University of Calgary.

Mackenzie Investments

Company Profile

Mackenzie Investments, founded in 1967, is a leading Canadian global asset manager, headquartered in Toronto with international investment teams in Boston, Dublin and Hong Kong. As part of IGM Financial Inc., a subsidiary of Power Corporation with a history dating back to 1925, Mackenzie benefits from the financial stability of a deep corporate structure while maintaining a boutique investment management profile.

Our distinct and experienced investment teams offer both fundamental and quantitative approaches with expertise across traditional and non-traditional asset classes, including equities, alternatives, currency and multi-asset strategies.

We provide investment management services to pension plans, consultants, foundations and other institutions, building trusting relationships that seek to understand client perspectives. We are committed to delivering strong investment performance and offering innovative, relevant solutions to our clients by drawing on the experience gained through over 50 years in the investment management business.

Roundtable Participants

Frank Tsui

Managing Director, Senior Fund Manager & Head of ESG Investment

Personal Profile

Mr. Frank Tsui is a senior member of Value Partners' portfolio management and research team. He is responsible for the Group's investment process and strategies and the investment team's communications efforts. He has over 18 years of financial industry experience.

As the Head of ESG Investment and the Chairperson of the ESG Committee, Mr. Tsui is responsible for leading the Group's environmental, social and governance policy. He also oversees Value Partners' Responsible Investing process, including its proprietary ESG risk assessment.

Mr. Tsui joined Value Partners in September 2015 as a Fund Manager and was promoted to Senior Fund Manager in 2019. Being a key member in establishing the Group's Responsible Investing policy in 2017, he was appointed as the Head of ESG Investment in November 2020.

Prior to joining Value Partners, Mr. Tsui was a Director at UBS Wealth Management, responsible for portfolio management for ultra-high-net-worth investors. Before UBS, he was a Vice President at Merrill Lynch Global Wealth Management, where he was responsible for managed products and equities advisory for North Asia.

Value Partners
Investing through discipline

Value Partners

Company Profile

Value Partners is a regional specialist with almost three decades of investment experience in Greater China and Asia, and is one of Asia's leading independent asset managers with AuM of US$8.3 billion1. Since its establishment in 1993, the Company has been a dedicated value investor - an ongoing commitment to this philosophy ensures the ideals of value investing are both implemented and transmitted to future generations. The Company has a well-resourced investment team, with c.70 investment professionals pursuing a fundamental, bottom up driven investment approach which benefits from our strong on the ground presence in the region. ESG analysis is fully integrated into our investment process and our ambition is to be a market leader in the consideration of such factors within Greater China and Asian portfolios. Value Partners' investment strategies cover equities, fixed income, multi-asset, alternatives, and ETF's. In November 2007, Value Partners Group became the first asset management firm to be listed on the Main Board of the Hong Kong Stock Exchange.

Roundtable Participants

Fei Tan

Equity Manager Research Principal

Fei is a principal manager research consultant within Mercer's Equity Boutique, based in Singapore. She joined Mercer in 2016 and is involved in researching and evaluating Asian equity investment strategies. Fei is a voting member on Mercer's Asian Dynamic Asset Allocation Committee, the Asia (including China) Lead Research Committee, as well as the Japan Lead Research Committee.

Earlier in her career, Fei helped to expand Cambridge Associates' Asian hedge fund manager research coverage for its institutional clients from Singapore between 2007 and 2011. She began her career as an investment consultant at Mangham Associates in Charlottesville, Virginia, working with regional small to midsized foundations, endowments and family offices.

Faisal Rafi

Head of Investment Research

BSc (Hons) Actuarial Science, Fellow of the Institute of Actuaries

Faisal is responsible for investment research at RisCura. He has 19 years' investment industry experience researching investment managers across asset classes and geographies, including alternatives. In his role as RisCura's Head of Investment Research, Faisal ensures that clients select managers that maximise their chances of achieving their investment objectives. Prior to joining RisCura in 2011, Faisal was an investment manager at Coal Pension Trustees Limited where he was responsible for manager research across asset classes. He has invested in private equity at Bramdean Asset Management, which is now part of Aberdeen Asset Management. Faisal also served as an investment consultant at Towers Perrin where he advised UK pension schemes on investment strategy and manager structure.

Mercer

RisCura

Moderator

Claire Shen, CFA

Head of China Equity Research

Claire Shen leads WTW's China equity manager research. She identifies the highest calibre equity managers in China and ensures that these managers are well represented in our clients' portfolios. Claire has been responsible for designing and the ongoing monitoring of China equity portfolios for WTW's advisory clients globally, including sovereign wealth funds in Asia and also through close collaboration with the Portfolio Management Group, she has been integral to building robust China equity allocations for our delegated clients' portfolios. Claire is one of the key authors of WTW's Standalone China Equity allocation paper (Merits of Standalone Equity Allocation to China).

Brendan Maton

Freelance Journalist

A highly experienced financial journalist with an expansive network of contacts in the UK and across Europe. Brendan has written about pension schemes and national welfare systems from Finland to Greece for 18 years and understands the retirement savings industry in each European country.
Brendan has interviewed EU commissioners and national ministers; central bankers; pension scheme heads; insurance chief executives; chief investment officers; actuaries; union officials; professional and lay trustees.He worked at Financial Times Business for eight years, finally as editor-in-chief of all international pensions titles.

Brendan has spent the last ten years as a freelancer for a number of publications, including Financial Times, Responsible Investor, Nordic region pensions news and IPE. He is also Chief webcast host for IPE.
Brendan has acted as conference chair for Financial News, the UK National Association of Pension Funds, Dutch Investment Professionals Association (VBA), Corestone, Insight Investment, Marcus Evans, Robeco Asset Management, Sustainable Asset Management (SAM), Towers Watson.

China's Growth Push Adds Optimism to Equities

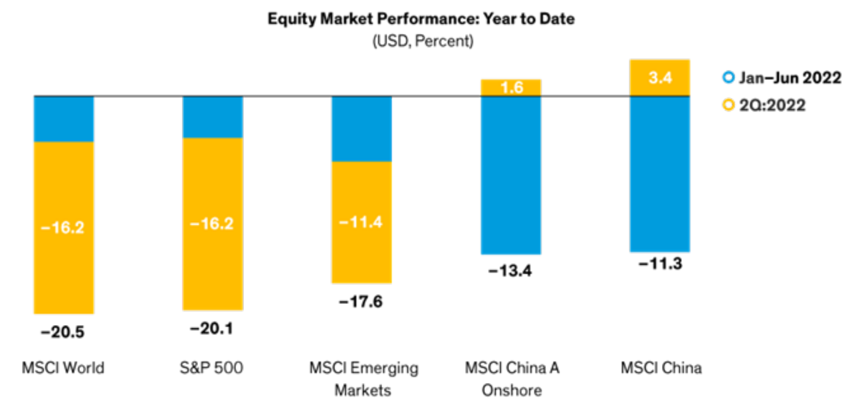
Chinese stocks have been staging a comeback that contrasts with market declines in most of the world. While a zero-COVID policy has weighed on the economy, a renewed focus on growth could provide fuel for equities, particularly in industries set to benefit from fiscal spending and green reforms.

Investor sentiment toward Chinese equities has improved with the gradual reopening of the economy. While the MSCI China A Index of onshore stocks fell by 13.4% in USD terms in the first half, it rose by 1.6% in the second quarter, with solid gains in May and June. In contrast, the MSCI World Index of developed markets fell by 20.5% in USD terms, as US stocks slipped into bear market territory amid growing fears of a recession.

China's relative resilience follows a tough 2021. Last year, Chinese stocks underperformed as troubles in the overheated property market and a regulatory crackdown on education and technology companies rattled the marke

"Investor sentiment toward Chinese equities has improved with the gradual reopening of the economy."

Chinese Stocks Rallied in 2Q and Have Outperformed Other Markets



Past performance does not guarantee future results.
As of June 30, 2022
Source: Morningstar, MSCI and AllianceBernstein (AB)

Equity Market Recovery Reflects Policy Support

What's changed in 2022? This year's performance divergence reflects China's markedly different position in the economic cycle. Economic growth in China was weak in early 2022, weighed down by COVID-related shutdowns. As a result, monetary policy remains relaxed, while the government is ramping up fiscal stimulus to support growth. Meanwhile, in the US and Europe, central banks have taken aggressive efforts to combat inflation, which threatens to prompt a slowdown or recession.

China isn't out of the woods just yet. The zero-COVID policy remains in place, but the economy is gradually reopening and President Xi Jinping has reaffirmed a GDP growth target of 5.5% this year. Although the sluggish start will make that target hard to achieve, the government appears to be reshuffling its priorities and plans to pump more stimulus into the economy to support growth.

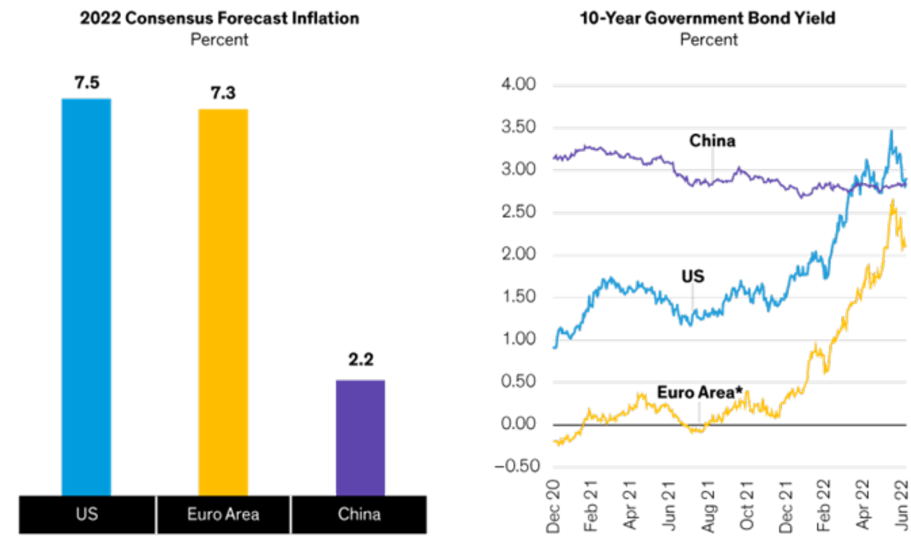
Inflation is Benign—and Interest Rates are Falling

China can push harder for growth because inflation is relatively moderate. The consumer price index in China rose by an average annual rate of 0.9% in 2021 and is expected to reach 2.2% in 2022, according to consensus estimates. Inflation is low in part because China's zero-COVID policy has suppressed consumer spending. China is also buying Russian oil at a discount, mitigating energy inflation. As the economy reopens, however, inflationary pressures may surface.

For now, though, China's monetary policy is asynchronous to other major central banks. Chinese government bond yields are falling, while US and European bond yields have risen and are widely expected to increase further (Display).

Author:
John Lin,
Portfolio Manager of China Equities

China Faces Less Rate Pressure Given Relatively Benign Inflation



Historical analysis and current forecast do not guarantee future results.
*ECB Euro Area 10-Year Bond yield
As of June 30, 2022
Source: Bloomberg and AB

Earnings to Benefit from Growth Push

What do these trends mean for company earnings and stocks? Here, too, China is on a different trajectory than most developed markets.

Until recently, investor sentiment toward Chinese stocks was negative. But corporate earnings forecasts have been revised downward, so much of the bad news is already priced into the market, in our view. In the US, earnings revisions remained positive at the end of June, and are widely expected to begin coming down amid growing expectations of an economic slowdown or recession.

We believe Chinese earnings forecasts will soon begin to turn up because of the supportive policy backdrop. The gradual reopening of the economy will also help, along with a reduction in regulatory scrutiny, which has been clearly telegraphed by government officials seeking to prioritize growth.

Equity Valuations Are Attractive

For now, Chinese stock valuations are very attractive, in our view. The MSCI China and MSCI China A onshore indices traded at a price/forward earnings ratio of 11.1x and 12.5x at the end of June, representing a discount to its own history and to US and global markets (Display).

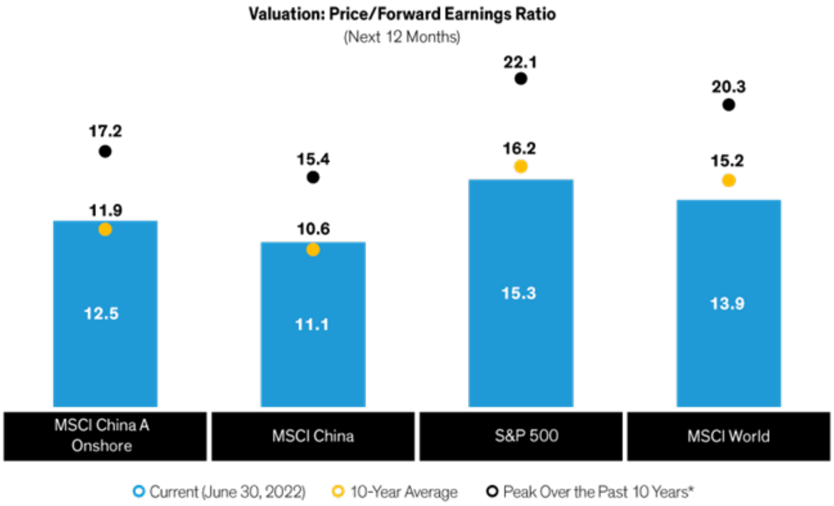
Two Types of Opportunities

At these valuations, we're seeing attractive opportunities in two areas—companies that were badly hurt by the domestic downturn over the last 18 months, and companies that should benefit from new stimulus.

In the first group, many consumer-facing companies suffered a severe drop in sales and profits because of the COVID lockdowns. Consumer confidence sank and cash-strapped households simply couldn't afford goods and services. Similarly, manufacturing companies faced major operational disruptions as lockdowns kept workers confined to their homes. Some companies, such as automakers and technology manufacturers, were hurt by both trends. Their shares fell victim to extreme pessimism and select stocks now trade at extremely depressed valuations that understate their recovery potential.

Potential beneficiaries of fiscal stimulus can be found in several areas. Expansionary spending is expected to be funneled to areas including infrastructure and alternative

Chinese Stocks Trade at Attractive Valuations



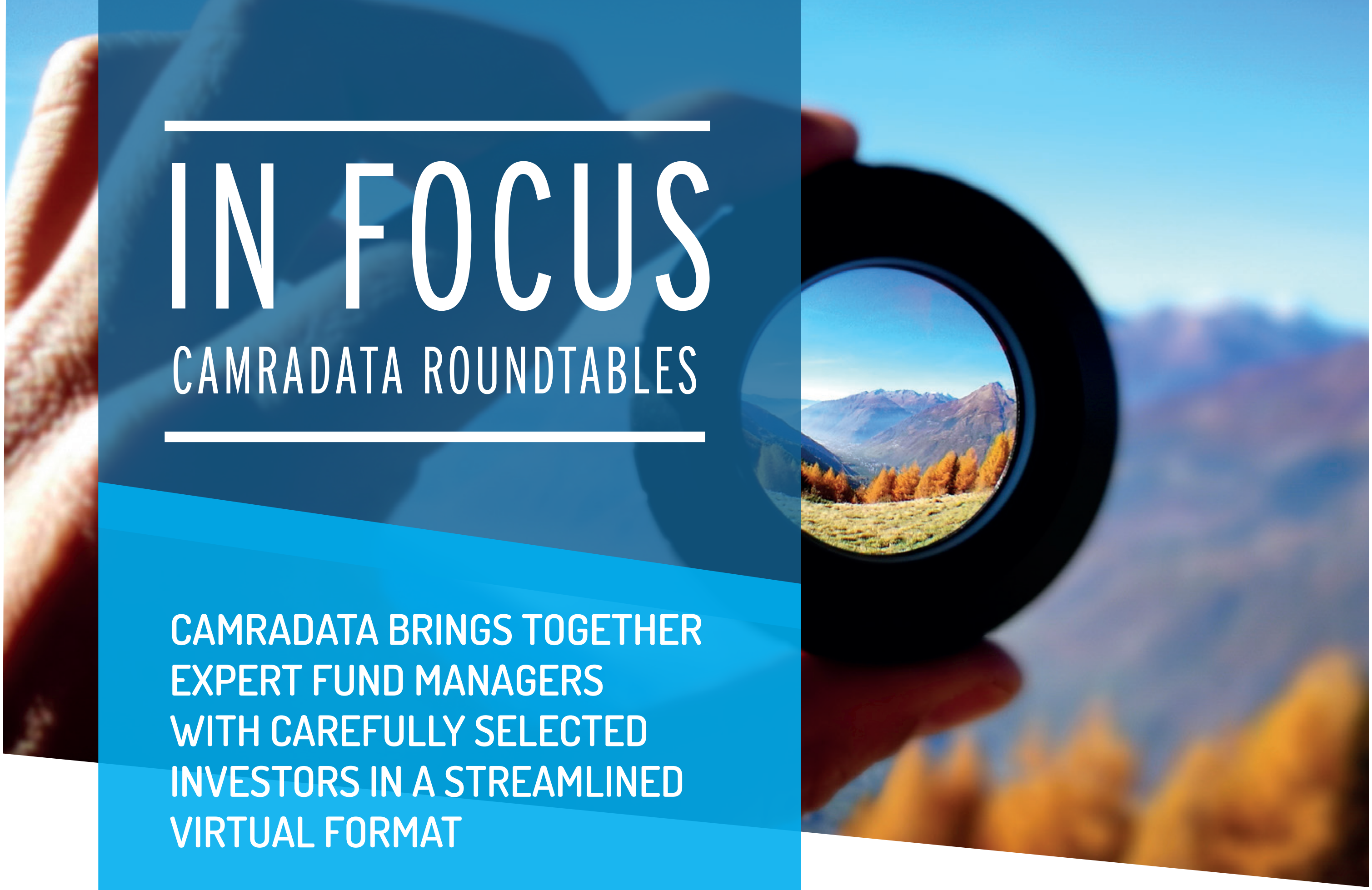
Historical analysis does not guarantee future results.
*10-year peak for MSCI China A Onshore was in May 2015. For all other indices shown, 10-year peak was in December 2020.
From June 30, 2012 to June 30, 2022
Source: Bloomberg and AB

> ***"In all these areas, investors must be selective and look for companies with quality features and solid fundamentals."***

energy. Infrastructure investment to upgrade the country's electric grid network will support companies that are integral to these efforts. Incentives to promote electric vehicle adoption should fuel earnings for the battery and auto components supply chain. And China's net-zero efforts will spark stronger performance of alternative energy companies, such as manufacturers of solar wafers and wind turbines, in our view.

In all these areas, investors must be selective and look for companies with quality features and solid fundamentals. Sustainable cash flows, robust business models and sturdy balance sheets will be essential to differentiate winners from losers if companies begin to show signs of stronger earnings growth later this year.

Investors who have had little or no allocation to China may want to take another look. With the market being driven by a very different macroeconomic narrative than the developed world, we believe a carefully curated portfolio of Chinese equities can provide equity return potential that will be hard to source elsewhere in the months ahead.



IN FOCUS

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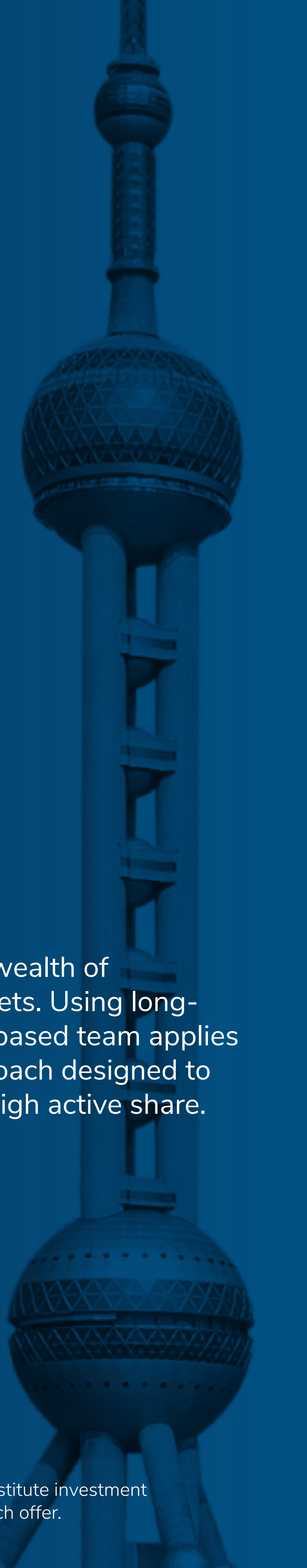


China's contribution to global sustainability

MACKENZIE Investments

2022 has been another challenging year for China's economy. Tensions between China and the US have escalated following the outbreak of war in Ukraine, and more recently, after the visit of the Speaker of the US House of Representatives, Nancy Pelosi, to Taiwan. Lockdowns in response to Covid-19 cases in Shanghai, the heart of the country's economy, worsened already sluggish demand. China's real estate market is still recovering from efforts by policy-makers to rein in overleverage and speculation 6 months ago. Despite these challenges and uncertainties, the focus of this article will be on the forward-looking and long-term question of "How are Chinese companies impacting global sustainability initiatives?" The answer is simply that China is an essential part of the solution to global sustainability, even from the eyes of US Secretary of State Antony J. Blinken.

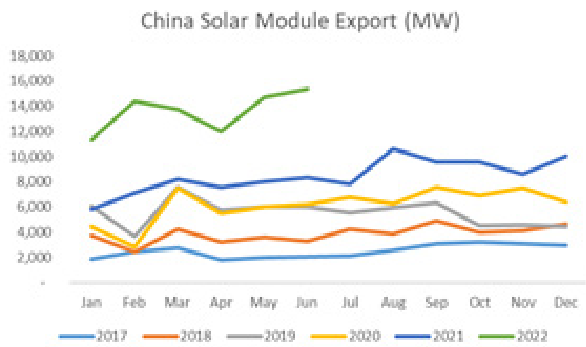
"China is […] integral to the global economy and to our ability to solve challenges from climate to COVID." - Antony Blinken, US Secretary of State, May 26th, 2022

With over 1.4B inhabitants each, China and India have the planet's largest populations. After the US, China is the second largest economy in the world in US dollar terms. China is the world's top exporter. Finally, China has been the single biggest contributor to global growth over the past 40 years. As a result, China today has the world's largest total greenhouse gas emissions – although still of fraction of Western peers in per capita terms. Therefore, the question can be broken down into two parts: China's role in the world climate change challenge; and the sustainability of China's economy on a domestic level.

China as a provider of solutions

China is in the driving seat of the world's attempt to address climate change. Chinese firms are over 70% of the planet's wind, solar and battery supply chains, and have been instrumental in the radical cost reductions of the last 20 years. Exhibit 1 shows the export volume of China manufactured Solar photovoltaic modules from the past five years on a monthly basis. Despite the increased raw material prices across the value chain and eventually inflated solar module prices, China's solar industry provides a remedy to the stressed global energy industry. From a global perspective, the EU, US to domestic China, and other major economies have laid out policies and targets on transitioning to sustainable energy. It is quite clear that China is an essential part of the transition.

Exhibit 1: China Solar export jumped in 2021 and 2022 YTD.



Source: China Customs

"Gigafactory Shanghai is tough to beat" by Elon Musk. During the annual shareholder meeting 2022, Musk reinforced his comments to the Gigafactory Shanghai thanks to the astonishing efficiency the China-based team has achieved compared with both other Gigafactories and other OEM factories globally. China has exported more electric vehicles YTD 2022 than the entire year of 2020 as seen below in Exhibit 2. This impressive growth would be impossible without the country's labour force and its comprehensive value chain. In the next decade, we expect domestic OEMs, such as BYD, Nio, SAIC and many others to expand upon global exports and accelerate the transition away from internal combustion engines and lead the way to a cleaner, more sustainable transportation industry.

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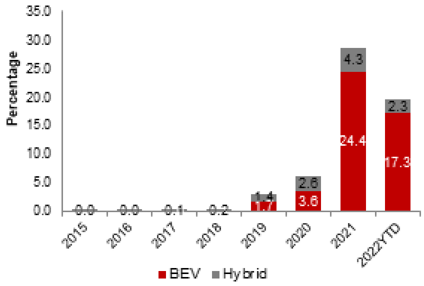
Exhibit 2: NEV exports have surged since 2021



Source: China Customs

China's sustainability drive at home

Domestically, China's 14th Five-year plan was approved in March 2021 as one of the most comprehensive and important policy documents in the country. It officially outlined China's commitment, which has been verbally reiterated by President Xi, to develop an action plan with a goal of reaching peak carbon by 2030 in addition to including green development as one of the key priorities. The plan was studied and lauded by various government departments, which consequentially set out a number of energy and carbon intensity targets. With the long-term commitment to meet net zero carbon emissions by 2060, the plan clarifies the direction to be taken and how this might affect various Chinese corporations. Since then, a great deal of initiatives have been launched, ranging from big projects in the northwest region of China to wind and solar installation targets of over 1200GW by 2030 to introduction of national emissions trading schemes.

Meanwhile, officials have announced that poverty has been eliminated in China in November 2020, recalling that 231 million people lived under the poverty line in 2010. This achievement is not only a spillover effect of growing economy, but also is a result of a top-down state-council led initiative to improve human rights and reduce inequality among the population. Moreover, investing in life sciences and guaranteeing access to healthcare and pharmaceutical services in rural areas is the government's next objective.

China's mindset toward sustainable development is not just a policy-driven statement but is demonstrated by actual results and benefits that can be quantified by investors. Sustainability-led investing has generated tremendous interest. As a team with investment professionals on the ground, we have witnessed the changes brought about by Chinese companies over the last decade. Their efforts are not only limiting their products and services to solve the sustainability issues, on both a domestic and global level. It is clear to us that China is uniquely positioned to shape global sustainability practices and trends.

Why proprietary ESG assessment is crucial in China

In today's world, environmental, social, and corporate governance (ESG) factors have become key drivers for business sustainability. As these factors can materially affect the performance of investment portfolios, integrating ESG factors into the investment process has become even more crucial, providing an additional layer to both mitigate risks and identify opportunities.

"ESG has become an intrinsic part of our investment process used to both mitigate risks and identify opportunities. Our proprietary ESG assessment now covers 100% of the companies we invest in on behalf of our clients."

We believe the need for a proprietary ESG assessment is essential when covering the China markets due to the challenges of data inefficiency. The region's disclosure awareness continues to diverge among firms, and disclosure quality varies, given the different regulatory regimes across jurisdictions. Adopting a proprietary approach to assessing ESG factors also enables more effective engagement, as it provides analysts and portfolio managers with structured, proprietary insights when meeting with the investees' management.

More resources needed

Unlike its western counterparts, China remains an inefficient market, with challenges surrounding information and data gathering. When it comes to ESG analysis and integration, a lack of credible data is amongst the most cited challenges in the region. While the lack of data is not an arguable fact, we believe that some ESG data is available but that it is not properly disclosed, which means more time and resources are required to dig out this information.

In China, for example, more companies are making an effort to disclose ESG information. However, as ESG reporting is still at an early stage in the country, we see a significant divergence in terms of the quality of disclosures, with more large-cap companies adopting international reporting standards relative to their medium- and small-cap peers. Companies are also not required to disclose information in English, making it more difficult for foreign firms to initiate coverage in this market. Given these difficulties, additional resources are needed to unearth, translate, and interpret ESG information.

Indeed, as we started our ESG journey five years ago, we saw how intricate and challenging it is to cover these markets. We quickly realised that we needed more dedicated resources to gather ESG information and that it was essential to develop our own proprietary system for analysing the materiality of these factors.

Walking the extra mile enabled in ESG research

Having a proprietary assessment of ESG factors makes a considerable difference when researching companies, especially in identifying risks and opportunities.

Author

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To provide a practical example, one of the companies under our coverage is a China A-share-listed slewing bearing company that supplies products for wind energy turbines and various cranes. At a superficial level, the company could arguably be deemed to be ESG-friendly given that it supports the transition to new energy solutions. However, the company's ESG data was not easily obtainable, given that it did not have proper ESG disclosure practices. With a lack of ESG data, it was therefore difficult to gauge how the company is performing from an ESG perspective. These facts would therefore have merited the Company receiving a low ESG score from many industry practitioners. However, as we were undertaking our own proprietary ESG assessment of the company, we discovered that the data was actually available, therefore enabling us to examine the company further and engage effectively with its senior management.

Although the company did not have dedicated ESG reports, it did publish "Project Reports" in Chinese on its website. While the reports were intended to provide updates on the progress of the company's projects, they also detailed ESG-related metrics and initiatives, including, amongst other things, data relating to the amount of waste reduction and carbon emissions. This data has enabled us to

Value Partners
Investing through discipline

develop a much better and more holistic picture of where the company stands on its own ESG journey, the metrics it is measuring its progress against and how it is specifically improving its own ESG practices. In addition, it also forced us to recognise that the company is making a real effort to disclose ESG-related information; but that it just did not know how best to showcase this information to the public in a widely-accepted disclosure standard.

Engaging with the company

Engagement is a crucial step in conducting ESG assessments in our process. Our proprietary assessment provides our analysts and portfolio managers with a more focused and structured ESG framework of understanding with which to engage with companies, enabling us to learn more about the company's strengths and to more effectively express our concerns.

In the case of the slewing bearing company, whilst the engagement allowed us to scrutinise its sustainability practices based on local standards, we were also able to suggest how they could articulate their ESG disclosures in a manner that was more aligned with the Sustainable Finance Disclosure Regulation (SFDR) requirements. This constructive engagement should ultimately help the company to receive a more appropriate recognition for its ESG practices.

An ongoing journey

So far, the initiation of our proprietary ESG assessment framework in 2020 is the most crucial and essential milestone in our ESG journey. It sets the ESG foundations for Value Partners' investment process and will continue to enable ESG research developments in China's inefficient markets.

ESG has become an intrinsic part of our investment process used to both mitigate risks and identify opportunities. Our proprietary ESG assessment now covers 100% of the Companies we invest in on behalf of our clients. However, we are far from complacement and our ESG journey continues. We continue to refine our proprietary ESG assessment, in order to constantly improve our engagement with our investees and firmly believe that it is pivotal for us to proactively engage in structured discussions with investees on ESG-related practices. In our opinion this should ultimately lead to sustainable value creation and long-term resilience.

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