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CHINA INSIGHTS

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LARRY ZHANG IN AN INTERVIEW

More and more investors are considering China as an important component of their portfolios. Current regulatory changes and corporate events in the country are also generating intense interest and discussion potential in Europe. Against the back-drop of Evergrande's potential default, we invited Larry Zhang, CEO of Fosun Asset Management (FAM) - our affiliated company and cooperation partner - to outline his view on the key issues facing our institutional clients.

ABOUT LARRY ZHANG – CIO OF FOSUN INSURANCE GROUP AND CEO OF FAM

Larry has over 25 years of experience in the field of global and China equity investment. In an interview, held by our HAGIM-experts, he reflects on the long-term regulatory effects and current market developments.

WHAT DOES THE RECENT REGULATORY CRACK-DOWN IMPLY?

- With the Opening of China policy, China has been focusing on economic development for decades. While the previous intention has been “Efficiency first”, lots of entrepreneurs have benefited from government policies and have accumulated considerable wealth. The wealth cumulation of the rich is partially due to the flawed tax system, that there are no capital gain tax, no property holding tax, and no inheritance tax in China. As a result, the nation has become extremely polarised in wealth distribution. The top1% of the population owns 30% of the country’s wealth and the bottom 25% of the population only own 1% of the wealth. The nation set its goal to pursue “Equality” by encouraging or forcing the rich to take more social responsibilities and redistribute their wealth back to the low- & middle-income class.

- The German model is frequently discussed in China and it could influence China’s next step. An olive shaped society, a strong middle class, and a manufacturing-based economy backed by hundreds and thousands of hidden champions with specialisations in each segment may give China more choices.

- Overall, I read the current regulatory developments as positive in the longer run. However, the communication could be done in a better way.

HOW DO YOU INTERPRET THE EVERGRANDE EVENT IN RELATION TO CHINA CAPITAL MARKETS?

- Personally, I think this is a single case targeted by the government to set an example in mitigating the real estate bubble. Evergrande has been very expansive in the past, loading up debt to support land acquisition and project development. While the government has ordered real estate companies to deleverage for some time, Evergrande stands out as a negative case. We have observed that the lending banks were instructed not to roll over their position, so that a liquidation of the company would be possible. Their assets and debt may be taken over by the other companies, but in an orderly process.

- Again this is a very tightly controlled process to squeeze out existing stakeholders, where I see limited spill-over impact to other related real estate companies or credits. Although the total debt of Evergrande may be eye-catching on a stand-alone basis, they account only for a marginal share of China's total outstanding corporate debt. And secondly, as lots of local debt issued by municipals is related to the real estate sector, China would prefer to see the real estate price to stabilize rather than decrease sharply. Last but not least, it has never been the intention of the Chinese government to let corporates fall in general. In the opposite way, as in the case of Huarong Asset Management, although it also faces default risk, the Chinese government jumps in and bails out the company. So investing in China you need to always understand what the regulator thinks. In Huarong's case we see lots of foreign holders selling their position. But as we talked to the industry experts and also company management, our feeling is that the company will be protected.

HOW DO YOU ACCESS THE IMPACT OF EVERGRANDE CASE AND FUTURE CHANCE OF DIFFERENT ASSET CLASSES?

- On the equity side, we truly believe that China will continue to grow its economy. However, we need to be more selective. While buying and holding big tech names like Alibaba or Tencent with monopoly market positions has been a proven practice in the past, we do believe that the mindset has been changing towards small and mid-sized companies. These companies are specialised in niche market, but established themselves as market leaders and from our view will benefit from the overall regulatory and economic cycle. And again, in order to pick these companies you need deep knowledge and expertise.

- Regarding central bank policy, while the PBOC was more reluctant to reduce the benchmark rate in order to support the currency, what we have observed during the Covid19 pandemic has given us more comfort. As world manufacturing came to a halt during 2020, China was able to rebuild the supply chain. The world's strong demand on Made in China and dependency on China's manufacturing chain will surely support the RMB, and give the central bank more room to manoeuvre, e.g. reduce the rate to stimulate the economy when necessary.

- As for Fixed Income, the expectation of further rate cuts will support bond prices. What's more, Chinese issuances still offers attractive yield premia relative to USD or EUR denominated bonds of similar rating quality, so I do see continued demand and upside potential for the Chinese bond market.

WHAT IS YOUR EXPERTISE IN CHINA AND WHAT VALUE CAN YOU ADD TO GERMAN INVESTORS?

FAM is obviously an integral part of the Fosun group and subsequently has access to the vast resources of the group in China and abroad.

FAM provides discretionary and non-discretionary fixed income and equity investment management services to institutional investors in key financial markets. FAM's investment teams possess deep experience and understanding of China, proprietary insights into local industry trends and businesses, as well as entrenched local networks with access to senior management teams. In the meanwhile, FAM also has a long-term track record in managing and advising on various insurance mandates.

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