



China Thematic Investment Strategy 2021

China Investment Themes for 2021: A Summary

Chen Guangzhi, CFA / 65 6202 1191 / guangzhi.chen@kqi.com

China macro conditions are consistently recovering

Even though major countries and regions in the northern hemisphere are still suffering from the COVID-19 pandemic during the current winter season, China is clearly on the path of a full-blown economic recovery. Overall economic conditions in the country have turned around and are resuming their vibrancy. The respective quarterly GDP growth YoY was -5.3%, +3.11%, and +5.54% in 9M20. Upon breaking down the growth details, the recovery was mainly due to strong exports which grew by 17.9% YoY in 11M20. Medical products and related raw materials exports were the major contributors to export growth due to the ongoing upsurge of infection cases in Europe and America.

However, China's lukewarm domestic consumption is only mildly upholding the overall recovery as gains in online sales are offsetting losses in offline sales. Government expenditures are barely growing, and the soft fixed-asset investments YTD indicate that China has yet to execute a full-blown fiscal stimulus, leaving more room for China to ramp up its infrastructure expansion in 2021. Meanwhile, the turnaround of foreign direct investment as a result of widening real yield spread (10-year China government bond and 10-year US Treasuries) reinforces the positive outlook that global investors view China as a sweet spot for capital allocation.

The Central government has allowed deficit rates to be raised from 2.8% to above 3.6%, indicating the deficit will increase by RMB1tn to RMB3.76tn. As of October, the local government debt level increased by 18.93% YTD to RMB237.6tn. Meanwhile, it is expected to reduce the overall tax amount by RMB2.5tn in 2020. The overall fiscal stimulus is moderate compared to some other major developed western countries. On the other hand, China's monetary stimulus is relatively more aggressive. Credit impulse (credit issued from the private sector as a percentage of GDP) growth in October surpassed the peak in the last cycle from mid-2015 to mid-2018, approaching 10% growth YoY.

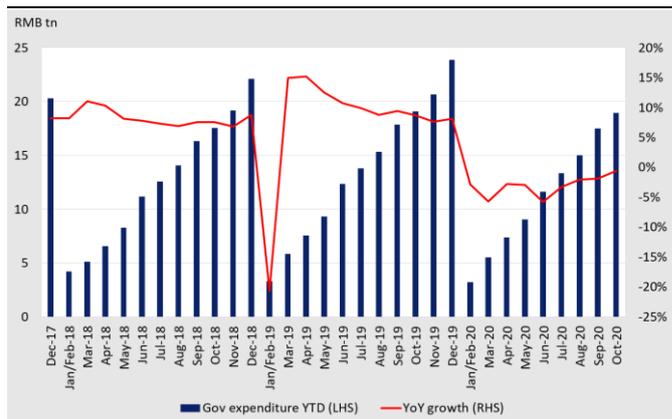
2021 is the onset of the 14th-Five-Year Plan, which is a blueprint for China's overall development, including the economy, national governance, culture, environment, legislation, and public well-being. The gist of the economic development plan is China's transformation from being quantity-oriented to being quality-oriented. New infrastructure developments with a focus on 5G, artificial intelligence, industrial network, internet of things and clean energy will be the main drivers. Supported by both expansionary fiscal and monetary policies, these segments present huge investment opportunities.

Figure 1: China retail sales of goods and services growth YoY



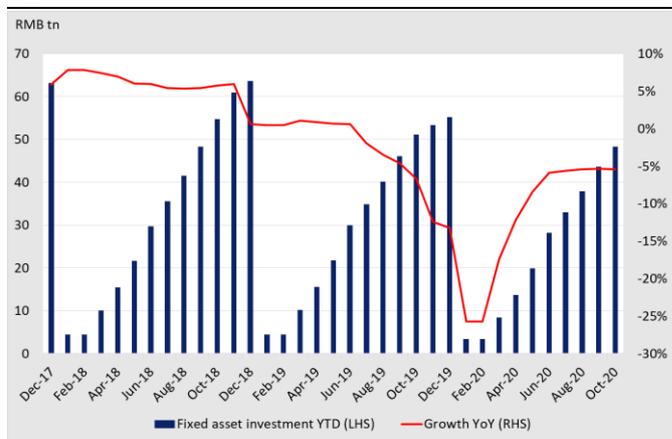
Source: NBS, KGI Research

Figure 2: China government spending YTD



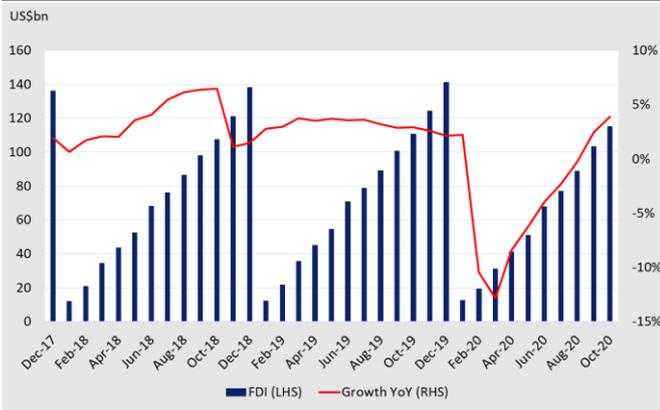
Source: NBS, KGI Research

Figure 3: China fixed asset investment YTD



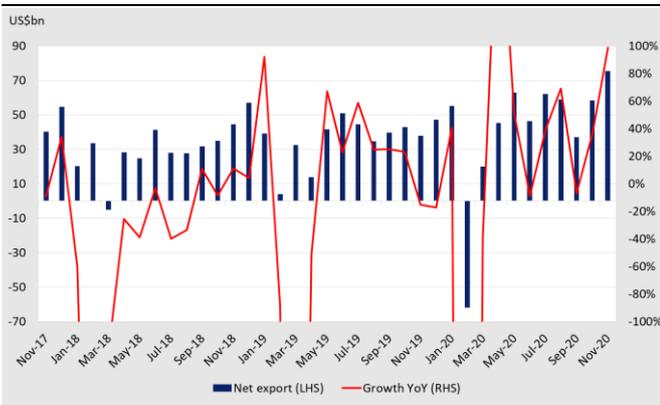
Source: NBS, KGI Research

Figure 4: China foreign direct investment YTD



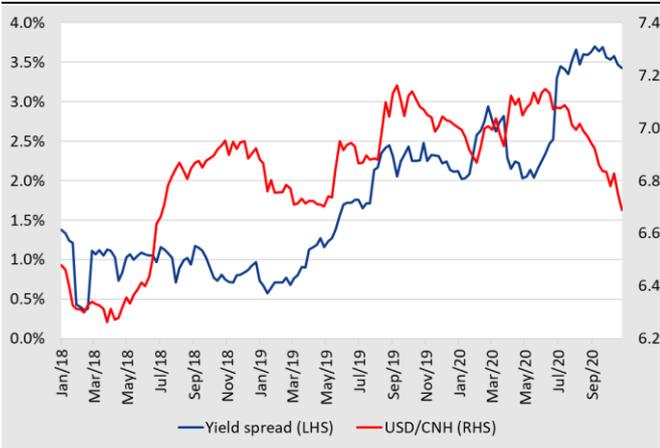
Source: NBS, KGI Research

Figure 5: China trade balance



Source: NBS, KGI Research

Figure 6: 10-year real China-US yield spread and USD/CNH



Source: Bloomberg, KGI Research

Figure 7: China credit impulse 12M change



Source: Bloomberg, KGI Research

In the following reports, we will discuss several areas of our investment strategy as we follow the value chain, starting from upstream, to midstream and then finally, to downstream. Here, we quote the investment philosophy taken from venture investing: Invest in the race track instead of betting on the racer. This also applies to investment in the public markets. Below is the basic and simple SWOT analysis of China's current status:

<p style="text-align: center; color: #90EE90;">Strength</p> <p style="text-align: center; color: white;">Huge consumer market with 1.4bn population</p>	<p style="text-align: center; color: #FF69B4;">Weakness</p> <p style="text-align: center; color: white;">Huge consumption of resources and low production efficiency</p>
<p style="text-align: center; color: #90EE90;">Opportunity</p> <p style="text-align: center; color: white;">Abundant capital and talent with a strong execution system</p>	<p style="text-align: center; color: #FF69B4;">Threat</p> <p style="text-align: center; color: white;">Reliance of import for key technologies and spare parts</p>

Therefore, our recommended investment strategy for 2021 that aligns with a combination of the 14th-Five-Year Plan and an understanding of China's status is as follows:

1. Resources and Raw Materials
2. Research and Production
3. Distribution and Platform

In terms of specific sectors, we will discuss:

1. Industrial metals: copper, aluminum, iron and steel, and lithium
2. Semiconductor, Electronic Vehicles
3. E-commerce, Cloud Computing

KGI's Ratings

Rating	Definition
Outperform (OP)	We take a positive view on the stock. The stock is expected to outperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Neutral (N)	We take a neutral view on the stock. The stock is expected to perform in line with the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Underperform (U)	We take a negative view on the stock. The stock is expected to underperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Not Rated (NR)	The stock is not rated by KGI Securities.
Restricted (R)	KGI policy and/or applicable law regulations preclude certain types of communications, including an investment recommendation, during the course of KGI's engagement in an investment banking transaction and in certain other circumstances.

Disclaimer

This report is provided for information only and is not an offer or a solicitation to deal in securities or to enter into any legal relations, nor an advice or a recommendation with respect to such securities. This report is prepared for general circulation. It does not have regard to the specific investment objectives, financial situation and the particular needs of any recipient hereof. You should independently evaluate particular investments and consult an independent financial adviser before dealing in any securities mentioned in this report.

This report is confidential. This report may not be published, circulated, reproduced or distributed and/or redistributed in whole or in part by any recipient of this report to any other person without the prior written consent of KGI Securities. This report is not intended for distribution and/or redistribution, publication to or use by any person in any jurisdiction outside Singapore or any other jurisdiction as KGI Securities may determine in its absolute discretion, where the distribution, publication or use of this report would be contrary to applicable law or would subject KGI Securities and its connected persons (as defined in the Financial Advisers Act, Chapter 110 of Singapore) to any registration, licensing or other requirements within such jurisdiction.

The information or views in the report ("Information") has been obtained or derived from sources believed by KGI Securities to be reliable. However, KGI Securities makes no representation as to the accuracy or completeness of such sources or the Information and KGI Securities accepts no liability whatsoever for any loss or damage arising from the use of or reliance on the Information. KGI Securities and its connected persons may have issued other reports expressing views different from the Information and all views expressed in all reports of KGI Securities and its connected persons are subject to change without notice. KGI Securities reserves the right to act upon or use the Information at any time, including before its publication herein.

Except as otherwise indicated below, (1) KGI Securities, its connected persons and its officers, employees and representatives may, to the extent permitted by law, transact with, perform or provide broking, underwriting, corporate finance-related or other services for or solicit business from, the subject corporation(s) referred to in this report; (2) KGI Securities, its connected persons and its officers, employees and representatives may also, to the extent permitted by law, transact with, perform or provide broking or other services for or solicit business from, other persons in respect of dealings in the securities referred to in this report or other investments related thereto; and (3) the officers, employees and representatives of KGI Securities may also serve on the board of directors or in trustee positions with the subject corporation(s) referred to in this report. (All of the foregoing is hereafter referred to as the "Subject Business".)

However, as of the date of this report, neither KGI Securities nor its representative(s) who produced this report (each a "research analyst"), has any proprietary position or material interest in, and KGI Securities does not make any market in, the securities which are recommended in this report.

Each research analyst of KGI Securities who produced this report hereby certifies that (1) the views expressed in this report accurately reflect his/her personal views about all of the subject corporation(s) and securities in this report; (2) the report was produced independently by him/her; (3) he/she does not carry out, whether for himself/herself or on behalf of KGI Securities or any other person, any of the Subject Business involving any of the subject corporation(s) or securities referred to in this report; and (4) he/she has not received and will not receive any compensation that is directly or indirectly related or linked to the recommendations or views expressed in this report or to any sales, trading, dealing or corporate finance advisory services or transaction in respect of the securities in this report. However, the compensation received by each such research analyst is based upon various factors, including KGI Securities' total revenues, a portion of which are generated from KGI Securities' business of dealing in securities.

Copyright 2020. KGI Securities (Singapore) Pte. Ltd. All rights reserved.