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# INVESTMENT COMMENT

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## China is a compelling equity investment theme

- **From "Made in China" to "Created in China"**

  This may come as a surprise to many investors who still perceive China as a low-cost manufacturing powerhouse that is particularly good at copying products from the West: China has become a leader in innovation. In 2015 (the latest year where figures are available), China accounted for 38% of all patent applications globally (over 1 million filings). Coming in second was the US with 20% followed by Japan with 11%.

- **The transformative impact of Chinese digital entrepreneurs**

  The country is moving toward a cashless society, where even beggars on the streets receive contributions via QR codes. China's mobile payment market reached USD 9 trillion last year - 90 times the size of the U.S. mobile-payment market ($110 billion). Online payments in China are predominantly handled by Alibaba (through its subsidiary Alipay) and Tencent (through its Tenpay application), which along with internet search powerhouse Baidu, are driving China's growing dominance in digitalization. Coined "BAT" (Baidu, Alibaba, Tencent), the three have a combined market capitalization of $950 billion. This compares with a combined market capitalization of $2.5 trillion for their US counterparts, the "FAANG"s – Facebook, Amazon, Apple, Netflix and Google.

- **Artificial intelligence (AI) in the forefront**

  The recently launched new iPhone boosts facial recognition technology to bypass the need to use passwords or fingerprints to unlock the phone. This technology has been used in China since 2015, where selected banks deploy it for their ATMs to bypass cards. China has developed a roadmap to become the global leader in AI innovation by 2030.

- **"New China" versus Old China**

  To gain exposure to China, avoid buying China ETFs where 60% is allocated to Old China (many are state-owned enterprises). Look for Chinese equity specialists to identify the winners in New China – companies in the technology, healthcare and consumer discretionary sectors that are more profitable, grow faster and have stronger cash generation while relying on lower financial leverage than their Old China counterparts.

- **Valuation and risks**

  The Chinese market is trading at a discount to many developed markets. China's Shiller PE is 17x versus 29x for the U.S. and 19x for developed Europe. Risks do remain, however. Between October 18 and 25 this year, the National People's Congress will meet (once every five years) to set the direction for the country until 2022 and policies may change. Furthermore, the country's debt to GDP ratio is forecasted by the IMF to increase from the current 235% to almost 300% by 2022.

## Synchronized global growth – the first time in a decade

- All 45 countries tracked by the OECD are expected to grow in 2017 with 33 expected to accelerate their growth versus last year. A backdrop of central bank stimuli (low interest rates) and crises fading have created this positive environment.