FINANZ und WIRTSCHAFT

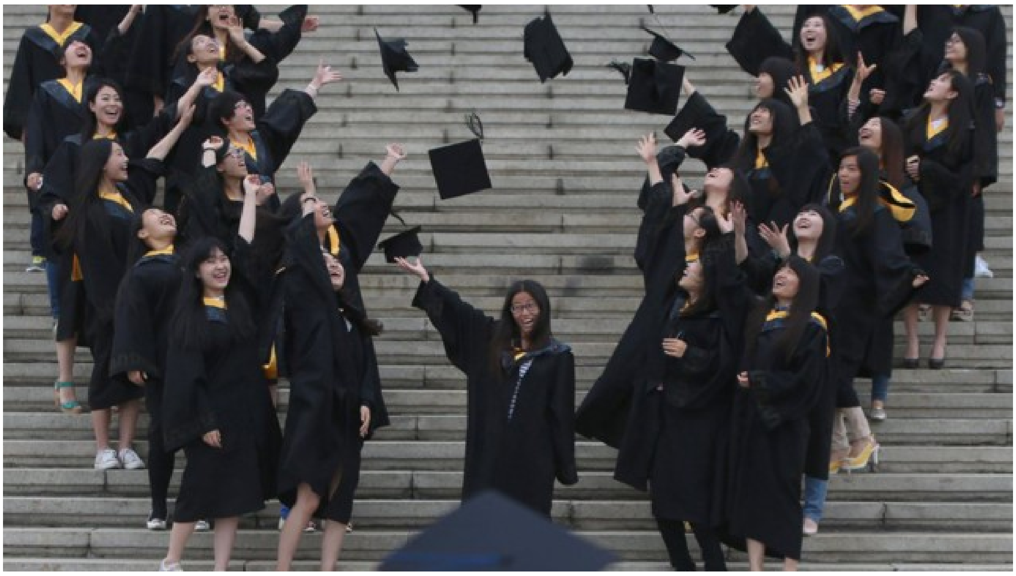
27.03.2019 – 16:19 MÄRKTE / MAKRO

Deutsche Version »

«The quality of China's growth is improving»

Stefan Kräuchi, CEO of Hong Kong fund provider HSZ, believes the recovery of Chinese equities is justified, and sees potential in the private education sector.

ERNST HERB



Stefan Kräuchi: «The high standing of education has a long tradition in China, as well as being one of the key drivers of the country's success story.» (Bild: Wu Hong/EPA/Keystone)

Mr Kräuchi, is the still unresolved trade dispute between China and the US dragging the global economy into recession?

Concerns of this kind do explain the increase in volatility that we are currently seeing in global markets. But there are clear signs pointing to a resolution of the Sino-US trade dispute. For example, there has been progress in negotiations over the further opening-up of the Chinese market and better protection for intellectual property. This is providing a boost to the shares of Chinese companies.

What do you think are the biggest obstacles to an agreement?

The two sides are still far apart when it comes to the role played by state-owned companies. The US is calling for an end to special treatment for Chinese state companies. This is not something Beijing is prepared to budge on. But on this issue too, a compromise should ultimately be found.

China's economy has already cooled significantly. How great is the risk of a hard landing?

The growth slowdown is not that dramatic. The Chinese government has downgraded its growth target for 2019 from around 6.5% to a bandwidth of 6 to 6.5%. That's still a handsome figure in an international comparison. At the same time, the quality of growth is improving. Consumer spending is gaining in importance compared to investment.

The Shanghai stock exchange has significantly outperformed the other equity markets this year, with a rise of more than 22%. Do you see any further upside potential?
Valuations remain modest, despite the recent strong rise. The estimated price/earnings ratio – based on anticipated corporate earnings for the next 12 months – amounts to around 12x at index level for both the MSCI China and the CSI 300. In other words, valuation ratios are broadly in line with their 10-year averages. The stocks of banks, other financial service providers, and real estate companies remain cheap.
Shares in the cyclical consumer spending, healthcare, IT, and telecom sectors are more expensive, however.


Stefan Kräuchi Bild: ZVG

What signals should investors be particularly looking out for in the current market cycle?
A further de-escalation of tensions in the trade conflict would deliver further stimuli. The market has responded positively in recent weeks to the growth-supporting measures initiated by the government. These include tax cuts and a slight loosening of monetary policy, for example.

The Chinese equity universe is heavily fragmented. On the one hand there are A-shares for the mainland exchanges, while on the other there are the H-shares listed in Hong Kong. Do you favor one group over the other?
No. The focus for us lies on the companies in question, not the place where the shares are traded.

Mainland stock exchanges nonetheless remain undiscovered territory for many foreign investors. What kind of knowledge of local equity markets is needed?
In contrast to the Hong Kong Stock Exchange, individual investors continue to play a dominant role in Shanghai and Shenzhen. In addition, it is also well-known that equities are frequently purchased with borrowed capital. That said, the volume of credit-financed equities in Shanghai and Shenzhen is now only half what it was at its 2015 peak. That's a clear sign that the current price recovery in the Chinese equity market is based on a solid footing.

The banks have generally become more restrained when it comes to credit lending. How serious do you believe the problem of indebtedness is?
China's debt mountain is more than 250% of gross domestic product. That's certainly a high figure, but it's not exceptional globally. In contrast to many other countries, China is above all indebted domestically rather than elsewhere, which makes it less exposed to external shocks. Where the recently observed rise in private sector leverage is concerned, it needs to be borne in mind that private liabilities are often matched by significant assets. This has the effect of defusing the debt problem to some extent.

China will probably report a balance of payments deficit this year for the first time in decades. Should investors be bracing themselves for a rise in exchange-rate risks?
In my view, existing controls in payment transactions involving a foreign element will remain a guarantor of stability on the exchange-rate front. After all, we saw this back in 2015, when China faced a rise in capital outflows. But it is interesting that the Chinese currency has become a theme in the ongoing trade discussions between the US and China. Washington is calling for the renminbi to be kept at a stable level against the dollar.

How will the ongoing inclusion of Chinese equities in global indices impact on market events?

Chinese equities remain massively underrepresented in the portfolios of international investors. It is typical for Chinese stocks to make up just 3% of the equity component, compared to 50% for US stocks. In the past such a positioning was viewed as prudent, but given that China is now the world's second-largest economy such a positioning must be viewed as outdated, if not plain wrong. Index providers such as MSCI and FTSE Russell are taking account of this development by gradually increasing the weighting of Chinese A-shares in their indices. Accordingly, these shares can be expected to deliver superior performance over the next few months compared to the A-shares traded in Hong Kong or the ADR certificates listed in New York.

Are investors also prepared to follow this trend?

Institutional investors both in China and elsewhere have recognized this in particular, and have now started to treat Chinese equities as a stand-alone allocation within their global equity portfolios. I suspect it will take rather longer for private investors to follow suit.

Which sectors have particularly attractive growth potential in your view?

Companies that are exposed to consumer spending are interesting. Among other things, the education sector particularly catches the eye, given that the average Chinese household spends some 25% of its disposable income on education. The high standing of education has a long tradition in China, as well as being one of the key drivers of this country's success story. In the longer term, the areas of e-commerce as well as digital banking and insurance solutions look particularly promising. The Chinese are very open to new technologies.

How do you hedge your fund against major stock market corrections?

We invest exclusively in privately controlled companies that have a strong market position. Another key feature is that the interests of management are aligned with those of shareholders, for example through the corresponding compensation systems. In addition, for the HSZ China Fund we only consider stocks that are valued significantly below our calculation of their fair value. This difference provides a margin of security that gives the fund a certain degree of natural protection.

Give us an idea of the kind of companies you mean?

We hold a substantial position in the stock of the pharma company SSY Group, which generates significantly higher margins than its competitors thanks to a clear cost advantage. I would also cite the online platform Alibaba , which is the undisputed Chinese market leader in the area of e-commerce. Furthermore, our core investments also include insurance stocks such as that of Ping An. Private insurance in China has significant upside potential given the relatively low penetration of the insurance business so far.

What sectors are you avoiding?

We are steering clear of the big banks – the so-called policy banks – as well as state companies. We also have no holdings in the real estate area.