

# Letter From China

**Standard Life  
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Donald Trump: China's unlikely ally?

China invests in America

VIEW FROM ABOVE

INVESTMENT INSIGHTS



## View From Above

### Donald Trump: China's unlikely ally?

Could the closing of a door in America provide an unexpected opening for China? With US President Donald Trump's administration talking 'America First' and China pursuing a 'One Belt, One Road' agenda (building stronger links with its neighbours along the historic Silk Road), the two economic powerhouses appear to be moving in different directions.

Indeed, just days into his presidency, Trump pulled out of the Trans-Pacific Partnership trade agreement, leading some to see this as an opening for China to step in. This has been followed by a crackdown on immigration, leading to mass protests across the country and beyond.

There are regular reports of the polluted air hanging over Beijing, but I was greeted by crystal-clear blue skies on my first visit of the year. Perhaps this helps explain why I see opportunities from this swing in geopolitics.

China's economic growth is not expected to match its historic highs, but the shift from rapid investment-led growth to one led by the consumer is a sign of strength. This is the rebalancing of the economy that is needed. The labour market has stabilised and risks of deflation have receded.

**“China's economic growth is not  
expected to match its historic highs”**



# Investment Insights

## China invests in America

During a recent return to my birthplace, Hong Kong, I encountered a thick blanket of smog that extended over China's 'silicon valley', Shenzhen. The cloud overhanging the Chinese economy is the heavy blanket of credit that has built up since the global financial crisis.

This burst of credit growth may have driven the economy forward over recent years but at the expense of future returns, with signs of overcapacity in many industries. While China will have to clean up its factories to remove the smog, keeping its economy on track will require a cleaning up of its financial sector. This will mean removing the prop for unprofitable state-owned enterprises that make it hard for their privately owned competitors to earn a decent return.

Since Trump's election in November, global equity markets have rebounded, led by the energy, commodity and construction stocks that are expected to benefit from the increase in spending on infrastructure expected in both the US and China. The Chinese sovereign wealth fund, China Investment Corporation, has indicated interest in increasing its investment in the US, both in infrastructure and beyond.

However, I am less bullish about the prospects for growth in these sectors. Curbs on speculative investment in property are leading to a slowdown in construction. This will drive down demand for steel and, in turn, the raw materials needed to make it – iron ore and coal. Auto sales are also slowing, after a boom due to favourable tax changes in 2016, removing another major driver of demand for steel.

## Will Trump walk the talk?

Fears of a trade war loom in the minds of many Chinese companies. Hopes that the rhetoric of President Trump's election campaign would make way for a more conciliatory tone have instantly been dashed.

A trade war would be detrimental to China, America and the rest of the world. The global supply chain is highly integrated. China and the other emerging economies are no longer simply a source of cheap components, but now the site for high value-added production. This makes it impossible to shift manufacturing to the US without massive disruption.

Still, a number of Chinese companies are already positioning themselves for a different future by identifying sites in the US to base at least some of their manufacturing operations. Indeed, some Chinese manufacturers have already set up factories outside China, such as auto and industrial glass maker Fuyao Glass Industry and apparel maker Shenzhou International. Fuyao set up an autoglass factory<sup>1</sup> in Moraine, Ohio, last year to meet demand from customers including Ford and General Motors.

Shenzhou International manufactures high-end knit and sportswear for brands including Nike, Adidas and Puma, and its high-quality offering means there are significant barriers to entry for potential competitors. The company has expanded manufacturing capacity in Southeast Asia, adding facilities in Cambodia and Vietnam, where wages are lower than China. Despite this, the company is looking to drive further efficiency gains through increased investment in automation.

**“A trade war would be detrimental to China, America and the rest of the world”**

**“Chinese companies are already positioning themselves for a different future”**



## Food is heaven

There is an old Chinese saying, 'to the ruler, the people are heaven; to the people, food is heaven'. What is heaven for the people is also heaven for investors, in the form of a constant source of demand. However, underlying this is a change in consumer behaviour.

There is rising demand for healthy foods, benefiting producers of vitamin water, peanut milk and energy drinks. Consumers are paying greater attention to food labelling, so packaging is becoming a more important aspect for producers. The Chinese are also becoming more willing to try different cuisines, putting a premium on greater variety. Chinese consumers are evolving and companies able to cater to these changing needs are emerging opportunities for the discerning investor.

Innovating to meet the changing taste buds of Chinese consumers has helped make Xu Shihui, chairman of Dali Foods Group, a billionaire<sup>2</sup>. On average, the Chinese snacks and beverage maker derives 20% of annual sales from new products. Next up is a protein-enriched soy milk drink, a popular breakfast-time beverage in China, that will be packaged to suit the upwardly mobile lifestyle of the Chinese consumer.

So, despite the combination of a slowing economies and growing geopolitical risks, I believe there are still plenty of investment opportunities to be found in China.



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<sup>1</sup>Company press statement, October 2016  
<sup>2</sup>2016 Forbes China Rich List, October 2016

**“The Chinese are also becoming more willing to try different cuisines”**

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