

# Letter From China

**Standard Life  
Investments**

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Keeping faith with China's 'core'

Confidence in the Chinese consumer

VIEW FROM ABOVE

INVESTMENT INSIGHTS



## View From Above

### Keeping faith with China's 'core'

China is undergoing a lot of change and there is likely to be more in store over the coming months. President Xi Jinping was recently anointed as a new "core leader", heralding hope that he can use his increased authority to accelerate painful reforms aimed at jump-starting the economy. The country is also bracing for a change in its political relationship with the US following the election of Donald Trump.

How will Xi call the shots? Some are hopeful that his efforts to close the gap between credit and GDP will become more evident. Even though there is still excessive industrial output (paid for with ballooning credit) and a looming housing bubble in some major cities, the current level of economic activity will likely continue with some momentum into 2017. However, with China's track record of following through with economic reforms when required, our view is that investors are likely to give China the benefit of the doubt.

Xi is set to continue on his path of achieving the "China Dream" and the "renewal of the Chinese nation". With the ruling Communist Party's 19th National Congress due in autumn 2017, a major leadership reshuffle is widely expected. This will help consolidate the influence of the newly-bestowed "core leader" and likely keep the country's medium-term economic growth on track.

**"China has a track record of following through with economic reforms"**



# Investment Insights

## Faith in the Chinese consumer

As China continues its march towards becoming an economy driven by consumption rather than investment and exports, there are likely to be opportunities for investors amid the change. I frequently come across emerging gems in many Chinese industries that are focused on maximising opportunities and overcoming business challenges.

Part of Xi's ruling doctrine is to make China a "moderately prosperous" society and the Chinese consumer is central to this narrative. Domestic consumption in China is driven largely by rising incomes, high savings and low household debt and it is unlikely that any protectionist US policies will drastically change this trend.

Furthermore, China is a great domestic consumption story in which the consumer is becoming increasingly sophisticated, with a growing appetite for technological innovation, quality and global branding. There is also the wealthy and tech-savvy millennial-generation Chinese consumer that is leading the charge in consumption, and is a growing influence in the domestic and international marketplace.

## Drivers of change

Technology has rapidly changed the way people live and communicate in China. A decade ago, workers in Beijing would typically take half a day off work just to queue at their bank to pay bills. Now they can just scan a QR code on a mobile payment platform.

Meanwhile, China's vast investment into top-class infrastructure is bridging the connectivity gap between cities and the rural towns. New airports, railways, roads and shipping ports are increasing the mobility of people around the country. And the roll-out and upgrade of internet, mobile and e-commerce infrastructure is making knowledge, products and services more accessible to residents country-wide.

There are certainly plenty of opportunities for investors to put their money into Chinese companies that are moving up the value-add chain, improving profitability and expanding their reach into local markets outside major cities and even beyond China. And these are not limited to just technology start-ups.

As an example, Chinese company Anta has evolved from a simple manufacturer of footwear to become a multi-brand adult and children sports apparel company, holding a 10% market share in China. This strategy of moving into higher value-add areas has also involved rolling out Japanese winter sports brand Descente through a joint venture, creating an opportunity to exploit potential demand from the 2022 Winter Olympics in Beijing.

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**"China is a great domestic consumption story"**

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**"Top-class infrastructure is bridging the connectivity gap"**

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## The ‘wanderlust’ consumer

One trend I have certainly noticed is that with increased mobility and wealth, mainland Chinese residents, especially the millennial-generation, are spreading their wings at home and abroad. The Chinese domestic tourism market is estimated to have grown by 10% annually on average over the last decade, according to data from the EU SME Centre.

Outside the home market, mainland Chinese tourists are estimated to spend US\$255 billion overseas by 2025, up from US\$137 billion in 2015, according to research by Oxford Economics and Visa. Thus, China remains by far the world’s fastest-growing source of tourism.

The wanderlust of the more-affluent Chinese travellers has improved margin growth for many Chinese companies. Examples of these would be Ctrip, which provides online travel services; and China Lodging, a multi-brand hotel group. And as domestic consumers rapidly shift to online transactions, companies in the travel and lodging industries have continued to invest in technological innovations. They have broadened their distribution channels into the lower-tier cities through strategic partnerships and diversified in order to improve their service offering for both local and international business.

I feel that several industries will warrant a closer look as they cater to the changing demands of the sophisticated consumer. Companies are investing in higher value-add manufacturing and brands, in hardware development, platforms and in distribution to improve the overall customer experience. I believe this will be a promising source for new investment ideas going forward.



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