On Tuesday, 3 November 2020, American voters decided who holds the balance of power in Washington. President-elect Joe Biden won the election (7 November, ET), and at the time of writing (9 November, HKT), President Trump has not formally conceded defeat.[1] In this note, Kai Kong Chay, Greater China specialist, will examine the potential investment implications for Greater China equities after the election.

The potential impact of the US presidential election on Greater China equities

We believe that the relationship between China and the US could remain under pressure following the US presidential election and a new administration. While geopolitical tension is likely to endure, we think that the impact on Chinese equities should feasibly be well-contained and diminishing. Indeed, over the past four years, the US administration has strategically used various tools, such as trade tariffs, sanctions, and its entity list, against China. Given this uncertain backdrop, we believe the Chinese government and corporates have become better prepared to continue the country's economic development.

We believe China's pre-emptive response is already laid out in its Five-Year Plan: "dual circulation" led by "internal circulation"

At the fifth plenary session of the Chinese Communist Party, which took place at the end of October, the Chinese government unveiled its 14th five-year plan (2021-2025) that will serve as the guiding principles for the country's future economic development.[2]

Against a more challenging external environment, and at a key domestic-development stage, President Xi's "dual circulation" strategy has already placed a strong emphasis on "internal circulation" as the primary growth engine, while "external circulation" is expected to serve as a supplementary driver. The goal is to extract China's growth potential through faster technological progress, consumption boosts, new urbanisation, and internal supply-chain enhancement while allowing the domestic and foreign markets to lift one another.

The implications of China's fundamental economic development – home-grown innovation and self-sufficiency

Strengthening innovation capacity and achieving breakthroughs in core technologies are key for the "dual circulation" strategy. We expect to see more domestic national champions strive for homegrown innovation in areas like biotech and electric vehicles. Furthermore, we anticipate the rollout of additional fiscal support and policies, such as tax incentives or low-cost funding, to facilitate import substitution and self-sufficiency. This will likely boost supply-chain upgrades and industrial automation across the regions.

Another focus of China's "internal circulation" is domestic consumption. There is plenty of unmet demand for lifestyle-related services, and these are likely to enjoy higher growth thanks to their repeatable nature. Also, e-commerce penetration should be supported by product-category expansion (e.g. medicines and grocery) and wider age-group adoption.

[1] Bloomberg "Joe Biden declares victory, calls on Americans to mend divisions", 8 November 2020.

[2] Communique of 5th plenary session of 19th CPC Central Committee, 29 October 2020.

Tech and supply chains matters – wait and see, but new opportunities exist

In terms of the Sino-US relationship, we will wait-and-see what path the new administration pursues. Nevertheless, the race to self-sufficiency in China's core technology sectors, such as semiconductors, provides opportunities along the value chain. For example, among the upstream semiconductor supply chain, equipment is one of the segments with the lowest level of localisation. This explains the highly targeted and supportive central-government policies and tax incentives aimed at fixing this from the outset.

Electric vehicles (EV) present another opportunity set for Chinese enterprises looking to develop brands that cater to local tastes and the physical environment. Backed by the endorsement of leading global EV brands, Chinese auto component makers are breaking into the global EV supply chain. The success story of Chinese enterprises gaining market share from the global tech supply chain could well be replicated in the EV segment.

Capital-market liberalisation and a fostering of Chinese equities – an invitation to global investors to participate

More importantly, we expect that China's growth will continue to show a differential from the rest of the world – even more so in the post-pandemic world. It is likely to attract more foreign capital to renminbi-denominated assets or high-growth and well-managed Chinese enterprises.

Meanwhile, the Chinese government is giving the green light to foreign institutions that are willing to participate in China's growth opportunities and connecting with global investors by liberalising its capital markets.

For example, Shanghai STAR board and Shenzhen ChiNext have adopted registration-based listing regimes [3] (as opposed to the previously lengthy approval process) and market-determined pricing.

Foreign financial institutions, such as brokerages and asset managers, can now take a majority stake in their Chinese joint ventures[4]. And from April 2020, they have been able to set up wholly owned units.

Many foreign asset managers[5], including those from the US and Europe, have responded positively by increasing investment in China, despite rising tensions in Sino-US relations.

Conclusion – identify stock drivers with a bottom-up approach

For fundamental reasons, we remain cautious on export-oriented sectors. We believe that global-demand recovery still depends on whether there will be a third wave of the pandemic, and post-pandemic requirements and behaviour may imply changes in terms of product specs and design. Domestic manufacturing will likely need time to adjust and restructure its production change.

Despite the geopolitical uncertainties and short-term volatility, we believe it is important to focus on long-term fundamentals. Investors should continue to look for investment themes (i.e. consumption upgrades, innovation and policy beneficiaries) that ride on secular megatrends and are unlikely to be reversed no matter who takes the US president's office. If there are any indiscriminate sell-offs, these could be viewed as buying opportunities.

[3] Source: China daily, 25 August 2020. The registration-based IPO system was firstly launched in China Shanghai STAR board in July 2019, followed by Shenzhen ChiNext in August 2020.

[4] "Relevant Measures Concerning Further Expansion of External Opening of the Financial Sector", State Council's Financial Stability and Development Committee, 20 July 2019.

[5] Xinhuanet "China lifts foreign ownership limits on securities, fund management firms", 1 April 2020.

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