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Hello and welcome to Fidelity Connects – the Fidelity Investments Canada podcast - connecting you to the world of investing and helping you stay ahead.

Today's podcast features Catherine Yeung, Investment Director at Fidelity International based in Hong Kong.

With host Pamela Ritchie, Catherine discusses the market outlook for Asia-Pacific equity markets, and where opportunities can be found overseas in 2021. This includes an outlook leading up to Chinese New Year in March, comments on value investing in China and the potential shift towards a domestic trade.

Catherine also looks at the potential vaccine rollout in China and addresses the topic of investor concerns about investing in China.

This podcast was recorded on January 8th, 2021.

[01:41]

Pamela Ritchie: Catherine, welcome back to Fidelity Connects. So glad to see you again. Happy New Year.

Catherine Yeung: Happy New Year, Pamela.

[01:47]

Pamela Ritchie: Glad to have you join us here and I think we'll start if you don't mind with still the biggest unknown to an extent, really the virus and how it is being handled in various parts of the world, and the vaccine rollout. Can you bring us up to date a little bit on some lockdowns, lots of progress and the vaccine discussion in China and more broadly, Asia?

Catherine Yeung: Well, you know, as you just highlighted when we look at the flattening of the COVID curve, it's one of the three drivers for us when looking at markets, and China, even year-to-date as well as 2020 after the first quarter last year, had done remarkably well in terms of containing the virus. Now at the moment we have seen a bit of a flare-up in a province just near Beijing, so it's the Hubei province, and what we've now seen is basically this province in the city is being locked down. So, you can't travel or leave this province for the time being. The government is concerned that as we approach Chinese New Year, which is in mid-February, we're going to see a lot of people travelling around the country. So, they're really encouraging people not to leave their hometowns or their provinces unless it really is urgent. So, it's going to be a very different Chinese New Year versus the previous Chinese New Years that we have been celebrating.

So, whilst we are seeing this containment effort, the track and tracing is stellar in China relative to a lot of other markets or economies. We're also seeing the development of a Chinese vaccination, so we've got the Pfizer, the

AstraZeneca vaccination. The Chinese have now just received numbers, about 75-78% efficiency or effectiveness, and so we're going to see this now being rolled out and for many economies again it's flattened the COVID curve, which is really, really key for future economic growth.

[03:36]

Pamela Ritchie: And we'll come back much more specifically to China but as I understand, China has done a number of the vaccine testing processes in countries around the world, largely because they don't have enough spaces to test domestically. But what does that mean for handing out the vaccine around the world? There's sort of this thought that China may well be the provider of vaccines to many countries that are not producing their own or don't have access.

Catherine Yeung: Well, this is also the big debate. With the potential success of the vaccination, no matter which drug company or pharmaceutical company provides it, you're going to have this gap between the wealthier countries that can afford it versus the non-wealthy countries. And even last year during the development period with the vaccination in China, the Chinese government officials were indicating or suggesting that they would definitely provide the vaccine to a lot of the emerging and frontier markets. So again, it's something on the agenda. It's probably going to fall under the Belt Road Initiative to a degree.

[04:35]

Pamela Ritchie: Very interesting. Tell us again where China sits in terms of the amount of stimulus it sent out. The economy as we understand has largely recovered in huge parts, I mean far more than other countries around the world, and China has not from the government perspective spent to the levels that other countries have. Remind us of where that has China sit in terms of options that it could use if it needs to.

Catherine Yeung: Yeah. Well, you know again, that's another driver we look at – policy response and implementation, and as you've highlighted, versus other central banks around the world, the Chinese government or policymakers have been really disciplined and a lot less aggressive in terms of the supportive measures that they've implemented. So, where we're at now is that, even in the second half of last year or going into the fourth quarter more so, there was indications of a move toward definitely a tightening kind of bias, a mild tightening bias. We don't think we're going to see a big hike or any kind of meaningful hike in monetary policy. What the policymakers are really targeting is for example tightening liquidity because there's just so much liquidity, not just in the Chinese market, but globally, and this is why we've seen equities for example perform very, very well. This tightening of liquidity is occurring. Fiscally speaking we still have a balance sheet that could provide stimulus. So, let's say we do get some economic data on the downside in 2021, then the government in China still has the tool set that they need to implement some kind of easing.

Interesting to note though Pamela, when we look at the tightening levels or the measures and I refer back to liquidity, property remains the backbone of the Chinese economy. And even around September last year, we started seeing some tightening measures. So, with the property developers, we call it the "three lines" and so looking at their ratios, their debt ratios for example, and if they cross one of these lines, then their access to credit diminishes. And so, the government was pre-empting the overheating of the property market, and so from the 1st of January these measures have been put in place in terms of policy wise but, the property developers themselves were given months to submit their numbers to the various governments, provincial governments.

[06:59]

Pamela Ritchie: I want to go into sort of the equities obviously and some different pieces within the equities story in China. The first one, and the one that is making headlines a lot, obviously has to do with U.S. President Trump's executive order that has to do with Chinese telecoms not being able to trade in the form of ADRs in the U.S. Is there anything more that you know that you can let investors understand? It seems a bit of a foggy question these days.

Catherine Yeung: Yeah, so in November we saw the initial list of companies being released by the Treasury Department in the U.S., and then subsequently we've seen modifications and we're probably going to see further names being included, so whether they're subsidiaries for example. So, it's a really fluid situation. Even this week you saw the New York Stock Exchange saying they're going to delist the three telco names, and then they weren't going to delist, and now they're delisting. So, it is quite complicated. There's a lot of uncertainty. I mean we now know that with these 35 names you can't buy any more of these names as of Monday, if you can buy that is. You have until November this year to sell out of these names or exit these names. But because it's a very fluid situation, because we are about to see a new administration come in, we don't know whether this whole executive order will be overturned. So, it's just something we're monitoring very, very closely. It changes on a day-to-day perspective. I mean this week alone being so busy in terms of the names, adding, what classifies these names, but from a Fidelity perspective we are complying with the restrictions.

[08:42]

Pamela Ritchie: What sort of percent do American investors through ADRs make up of (inaudible) – I mean there are the A-shares, there are the mainland shares, there's also these companies have listings in different places. Just sort of remind us of, I mean these are a bit of shifting plates a little bit in terms of who is allowed to invest where. Can you bring us up to date a little bit on the opportunities really?

Catherine Yeung: Yeah so, the ADRs which are the Chinese names listed in the U.S., the names like Alibaba, Tencent, the three telco names. So as a percentage of overall market cap, 29% were U.S. investors. But compare that to U.S. investors as a percentage in the Hong Kong market or H shares, it's more like 15% and in the A-share domestic market it's 1%. So, no surprise there in terms of most domestic investors make up the majority of the market cap in China.

What we have seen is whilst this news again is very fluid, and we've seen the indices remove certain names like the three telcos, whether it's MSCI or FTSE from their indices, we have seen some interesting buying from non-U.S. investors. So, for example through our Connect System, you know, you're sitting in Canada. You can go directly and buy Chinese A-shares. Chinese investors in China can buy a Hong Kong list of names, so it's called the Connect System. So, going into China is northbound trading, and China going into Hong Kong for southbound trade. And we've seen a lot of buying in the southbound trade market with the names that have been restricted.

So whilst again we're in this very fluid situation, I go back to the point that we've been talking about over the past few episodes regarding the growing influence and rise of the Chinese domestic investor base. And we're probably going to see more and more of this occur as we see more and more income growth and household wealth increasing.

[10:39]

Pamela Ritchie: Just to put it plainly, does that just point to those Chinese equities as a group just going higher, there are more investors to come in?

Catherine Yeung: Well yes, but like the rest of the world what we are seeing, especially in 2020, to a degree 2019 and even the end of 2018, a very crowded trade emerged in China. So, a lot of investors because of all the liquidity out there, it's like the Tesla trade in China. In fact, it almost became a bit of a pattern that when Tesla was up overnight our time, that all the EV companies, all the big tech companies in Asia would rally. So, everything was very, very synchronized.

What we're probably going to see this year though is more diversification away from those very well-loved sectors, and on top of this in terms of this crowded trade mentality, we've also seen some regulatory changes. So, in terms of competition, antitrust regulation which is impacting some of the big players such as Alibaba, to a degree Tencent in China. So, in fact Alibaba has seen its shares fall, its IPO, the Ant IPO in November was delayed at the last minute. So, lots of things that the company is working through in terms of its various business units. Don't forget, this is still Alibaba. It's still a huge name in China. It employs so many people and it's got a great brand, but at this point in time it's fallen. We could even perhaps define it as a fallen angel.

[12:10]

Pamela Ritchie: It's interesting. So, there's sort of speedbumps to go over but it's still this behemoth. There's been a specific question actually for you to answer, not on Tesla but on EVs, on companies that make EVs in China, their strength relative to Tesla which seems to be the ubiquitous name that gets discussed with EVs. But in fact, it sounds like some of the Chinese companies are bigger. Can you bring us up to date on that?

Catherine Yeung: Yeah, so the three main EV companies in China make up in terms of their overall market cap, they're bigger than the auto segment itself. There's a company called Nio, which is very well recognized, especially from a consumer perspective. It's well recognized in terms of its brand at a good pricing point. But with this whole EV attraction, a lot of the traditional automakers are now getting into this space too. So, for us it seems a bit frothy, especially when you look at the multiples versus the earnings growth and the earnings level coming through.

[13:17]

Pamela Ritchie: In terms of exports, and it may be of EVs but maybe just exports more broadly, where does that stand? We've been receiving certainly in Canada anything that is coming from China is getting through and things that are coming from other places earlier in the pandemic weren't because the bounce back had happened. What's the picture on exports? How close is it to surging right back to where it was? What is the update?

Catherine Yeung: So, the November data was up 15%. Exports have been incredibly robust. In fact, has surprised us on the upside in terms of the data coming through. This is probably going to decline though, these levels of growth, because whilst China, because it's normalized the country – again, going back to the COVID curve flattening. Whilst a lot of other economies are still seeing flare-ups and disruption from a manufacturing perspective, a lot of the export or manufacturing has gone back into China. So that's why we've seen relatively strong data coming through. But as the world recovers, mainly due to the vaccination program, you're going to probably see manufacturing in other places resume, and that's why the exports numbers in China will probably come up a bit because we're seeing a resumption of activity globally speaking.

[14:31]

Pamela Ritchie: Right. It sort of becomes more relative. Let's go a little bit to the geopolitical to an extent. You mentioned new administration obviously coming in, in the United States. Biden generally thought to be a more global-looking president. We don't know yet, but that's sort of is some of the discussion. But there are many other relationships being put back together or re-brokered or strengthened. I'm thinking of Europe and China for instance in terms of their trade going forward. How are the plates of trade relationships changing to China's benefit in many ways?

Catherine Yeung: I mean when we look across the world, most countries are reassessing their trade agreements with others, and obviously the headline news flow is still about the Chinese-U.S. relationship. After everything that happened in Washington this week, we don't think you're going to see a monumental shift in terms of the trade relationship between the U.S. and China. So, it's probably going to be a bit more of a status quo. Again, it'll be interesting to see what the Biden administration does regarding certain things such as whether it's tariffs, whether it's this executive order that the U.S. has put on these banned Chinese names. But in general, it's probably going to be status quo. The European-Chinese trade agreement that was very interesting and in fact, the Europeans are likely to benefit, so you know exporting a lot of goods into China which, when you think about it, China and the companies always have to further increase their innovation because the brands from Europe are probably going to be very well regarded. And it's just again, a bit of a catalyst for the Chinese companies to continue to be very, very competitive, especially when it comes to innovation.

[16:14]

Pamela Ritchie: Interesting. Hear a lot about Chinese cosmetic companies and how much better they're doing than some of the traditional names that you hear, or just how they're all working together on a different competitive field. I want to sort of bring in the telecom question, or really the 5G discussion because it gets talked about a lot. Does the world bifurcate along telecom technology and the 5G future? Where does that stand? Where are the opportunities for that right now?

Catherine Yeung: Again, so when I was talking earlier about the crowded trade and the big tech space, or tech in general being very, very popular, one because of situation with COVID, so people buying stuff a lot online or living their lives online, whether it's education or buying services and goods, etc. But what's supporting this is the 5G network, and China is incredibly proud of the 5G network it has in terms of the cost, in terms of the availability and really you do need this network, for all this innovation and all these apps and services that people are gravitating towards. So, it really is key and when you look at where China is at let's say versus the U.S., they're years ahead in terms of their 5G network.

[17:27]

Pamela Ritchie: Years ahead, eh? Interesting.

Catherine Yeung: A few years ahead.

[17:33]

Pamela Ritchie: A few years ahead. We have been talking nonstop about the rotation towards a sustainable value direction in equity markets since vaccines were announced in November. To what extent is that coming? Has that arrived in Chinese equities?

Catherine Yeung: Unfortunately, it hasn't. The ingredients are all there for this rotation and a prolonged rotation. Usually when you see a value rotation, and especially in this period we're in, we see a recovery in terms of global growth and again, this is going to be driven more than likely by the vaccination rollout. You see discussions about inflation coming back, and certainly over the past few weeks more and more commentators are indeed talking about inflation refreshers. In China again when we look at commodities, PPI numbers, there has definitely been higher inflation with the soft commodities or high commodities, etc. So that usually relates to the bond yield story.

And then finally just the market participation, so that shift away from the very crowded trade, whether it's regarding very, very expensive valuations or whether it's the China situation, maybe regulatory issues, and uncertainty with that. In November we did start seeing this shift, but then in December maybe again because of the executive order and there was so many old economy Chinese names linked to that list or on that list, we started to see the crowded trade once again emerge. So, it's really, really tough. Again though, when we look at the Chinese market, if we do see a rally, the ingredients for the rally are going to be different to let's say the global rally. And by that, I mean, as I mentioned earlier with the policy implementation and policy direction, if we do see stronger GDP growth, and the expectations are for China to grow maybe even at 10% this year, coming from a very low base though, that the first quarter data is probably going to be a lot higher again coming off that low base from last year.

And so probably after Chinese New Year you're going to see more and more of the policy shifting again towards tightening, tightening of liquidity in particular. Again, not so much tightening of monetary policy. And so, whether the market behaves in a direction, as we've seen this year I should say, every time stimulus is being announced markets just keep on soaring. So, whether the market in China has a bit of a pullback because of this shift in tone, again, towards a tightening perspective, or maybe it will just see a shift in terms of diversification into a lot of the unloved names.

[20:20]

Pamela Ritchie: It's interesting. I mean because China has done such a good job containing the virus, which we've been learning about for some time, the urgency for the vaccines obviously is urgent, but in other parts of the world where it hasn't been contained as well, it seems to be even more urgent, so much so that it actually just completely shifted the course of equity markets in November. Do you see the vaccines being announced by China for the Chinese population, and perhaps for other parts of the world, having that kind of catalyst potential or not necessarily? It might be other things.

Catherine Yeung: I don't think in either case referring to the vaccinations not being a silver bullet, but it's definitely going to help and the world needs to at some point normalize in terms of opening of borders, people actually working. It's interesting in China by the way, whilst we have seen the country normalize to a degree, or I guess New Zealand, some of the Pacific Islands are living in kind of a normal state. But in terms of the Chinese economy, what's been interesting to see is over the past few years the household savings rate has been around 30% or hovered around that level. In 2020 it jumped to 37%.

Don't forget, the Chinese government really the key aim for growth is going to be driven by consumption and services. But people aren't going to spend if they're concerned about their job or not having a job, and employment or unemployment is going to be a key area to watch out for globally speaking. But with China there's such an emphasis on ensuring the labour market remains healthy because they know that they want to see how [21:58 inaudible] is actually spending and that 37% to go down whether it's on services or other goods.

[21:06]

Pamela Ritchie: Has it already happened that the shift to the domestic economy in terms of consumption has happened? There have been so many other pieces to life and to the economic story lately, but obviously that was what was aimed for even five years ago. We're in the world that we're in now. Is it very obvious that, that switch to a domestic consumption model has happened? Are we still in early stages? How would you put that?

Catherine Yeung: Definitely it's happening and it's going to continue to happen, and from a policy perspective from the very senior government point of view, it's really, really key - the health of the domestic economy, the rise of domestic brands, the rise of the Chinese consumer. It's still the story or theme that has got multiple decades to play out.

[22:58]

Pamela Ritchie: There was an update by the IMF a couple of months ago now sort of noting that China will become a powerful single power. What does that mean to you from an economic perspective, from a trading perspective? I wonder what's really meant by that in terms of investors needing to know such phrases.

Catherine Yeung: There's a lot of expectations now that China will surpass the U.S. over the next decade or so in terms of becoming the number one economy, or the superpower, but China can't live in isolation. It needs to have trading partners. At the moment because of the COVID situation there's a lot of discussion we'll be seeing or re-entering a period of deglobalization. Xi Jinping spoke about the dual circulation policy, so essentially this is really ensuring the health of the domestic economy, but at the same time making sure or trying to make sure that China is not disrupted too much in terms of the supply chain or its supply chain.

So again, when you look at those three drivers: the curve flattening, the policy response and the PBOC still having plenty of tools in terms of should they need to support the economy they can, and then economic recovery which is definitely happening. So, when you take all those three aspects, the Chinese market is more than likely to continue to do well, both in terms of from a relative point of view, as well as in absolute terms. But the key risk for China still remains policy response or policy implementation which is usually one of the key risks for the country and again, making sure that in this period of economic recovery, that they don't let things get overheated.

And again, that's why it was quite pleasing to see the property measures that were put in during the summertime in terms of almost pre-empting the situation and just giving the developers enough leeway to fix their books coming into 2021.

[25:00]

Pamela Ritchie: Because it's the perennial question, and you just pointed to it as a risk. And I suppose without risk there isn't reward, but in terms of the risk of knowing where policy might go and how investors either get rewarded from that, or in some cases get knocked off from that, how do you comfort investors that are concerned about whether, one, information coming from China about certain companies is correct? And two, just to kind of watch out for the policy that could come?

Catherine Yeung: It's also about being on the ground. So, we've been in China and Hong Kong for years, decades in Hong Kong, and really having strong engagement with corporates. Also, other parties policy wise, really tracking the policy, but it's really about engagement that is key in a country like China whose market is growing, more and more companies coming to market, really keeping on top of the various regulatory environment as well. So even this antitrust regulation, it didn't just appear. There were signs and conversations being had that they were looking at addressing the situation.

Again, following policies really, really important even though we can be a bottom-up stock picker and investor. Really monitoring policy, not just in China, but policy direction across the region is really, really vital. Again, it's quite interesting that we were talking to one company just earlier this week, one of the materials companies who are doing big buybacks of their stocks. And some of the old economy or [inaudible 26:32] enterprises are in fact buying back their stock. Maybe has something to do with again the situation, the uncertainty regarding what's happened this year and going into the end of last year.

But I thought it was interesting the companies themselves buying back stock. We haven't seen too much activity from what we call the national team. It's a group of companies who come in and support the market. Haven't really seen too much of that behaviour, but don't forget the market ended on such a high at the end of the year and is still doing relatively well.

[27:05]

Pamela Ritchie: Fascinating. So perhaps when we speak to you probably after the Chinese New Year more focus on the buybacks, and if there are any more and where that's going, because as you say it's not really been the focus globally of equities in the way that it was. It's very interesting.

Catherine Yeung: Yeah.

[27:22]

Pamela Ritchie: Anything just as a final thought Catherine to leave investors with?

Catherine Yeung: Nothing goes up in a straight line and whilst the market did do very well last year, again it was a very crowded trade. It was one segment of the market doing well. A lot of people are talking about this K-shaped recovery, so some parts of the economy doing well and certain sectors while others don't. Volatility often lends itself well to some great stock picking opportunities. What's really, really important is, even if it continues to see this economic recovery in China, even if we now start seeing a global recovery, really making sure that the companies that we invest in still have that earnings ability, their strategy is being put in place, that there's not too much debt on their balance sheets. In fact, you don't really want to have any debt issues in an environment like we're in, and they still have that competitive edge. And you can find value in names across the entire market, again, not just in those sectors that have done really, really well.

[28:19]

Pamela Ritchie: It's a great pleasure speaking with you always. Catherine Yeung, thank you for joining us on Fidelity Connects.

Catherine Yeung: Thanks Pamela.

[28:26]

Pamela Ritchie: All the best. That's Catherine Yeung joining us from Hong Kong.

Ending: [28 :31]

Voiceover:

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