HANDPICKING MEANINGFUL INVESTMENTS

AS CHINA CONTINUES TO OPEN ITS FINANCIAL SECTOR TO FOREIGN INVESTORS AND EMBED ITSELF EVER DEEPER INTO THE GLOBAL ECONOMY, NOW IS THE TIME TO HANDPICK THE STOCKS AND INVESTMENT TARGETS THAT FOREIGN INVESTORS CRAVE, SAYS **JUN LI**, CHIEF INVESTMENT OFFICER OF SAGARD CHINA.

THE FIRM, WHICH is a subsidiary of Power Corporation of Canada, is responsible for managing its balance sheet money in China, mainly through the Qualified Foreign Institutional Investors [QFII] programme. In November 2018, Sagard China set up shop as a wholly foreign-owned enterprise (WFOE) in Shanghai after the city's government gave the nod.

"You will see more investment houses who, like us, are a 100% foreign-owned entity registered in Shanghai providing services for foreign investors and potentially later, we can also get a licence and provide services to local clients too," forecasts Li.

Sagard China has a 13-year track record of investing mainly in China's A-shares market, which historically has not been very open to overseas investors. But with greater access and participation, foreign investors can not only capture the growth potential that the market offers, but also make meaningful investments into meaningful businesses in China, notes Li.

A sophisticated consumer

Over the past decade, the purchasing power of Chinese consumers has been rising steadily. Indeed, consumption was the key driver of GDP growth in 2018, accounting for 76.2% of new economic activity.

"There is a very secular trend of Chinese consumers being richer, more well educated, demanding higher-quality products – both domestic and globally," says Li. This inevitably leads to diverse and individualised demands and expectations for value for money.

China endured a tough 2018, characterised by the government's deleveraging drive and trade tensions with the US, culminating in its slowest pace of economic growth since 1990. Consequently, several sectors are facing pressures in the first half of 2019 – namely in consumer discretionary as the liquidity squeeze constrains the amount that consumers can borrow and spend.

> **"PLAYERS ARE ABLE TO OFFER PRODUCTS BASED ON A PERSONAL NEED."**
> Jun Li, Sagard China

For big items such as automobiles, home appliances and mobile phones, Li anticipates demand will take a knock, but demand for staples such as dairy, condiments and beer is expected to remain stable.

As the wealth of Chinese consumers continue to grow, there will be a continued demand for products and services. But which sectors and innovations are investors looking to capitalise on?

Data delivers services

One obvious example is the online space where increasingly wealthy consumers spend money on products and services they can enjoy, such as video games, movies and karaoke. There is also a strong online demand for physical goods, demonstrated by the fact that China now accounts for 83% of all online retail sales in the Asia-Pacific region, according to a 2018 Forrester report.

Consumer needs have been ever-evolving and this is reflected by providers of products and services.

"One of the most obvious advancements is the use of data, internet and increasingly, artificial intelligence (AI) in delivering product services that are tailored to Chinese consumers' needs," says Li. "China is well known as the market that has the highest penetration of e-commerce and by recording each consumer's transaction, the players are able to offer products based on a personal need, providing a personal touch in the offerings they give to consumers – especially Alibaba."

Tracking consumer data over time allows the company to provide a personal touch in the offerings they give to consumers. "Technology, internet, big data and AI technology have continuously been improving the interactivity between the service product provider as well as the consumer and there is much better bridging now," says Li.

She points to the constraints of the retail sector, which was limited to store membership and a record of the customer's transactions before the emergence of e-commerce. Today, however, technology giants can track consumers' mobile location, consumption data and how many products the consumer considered before coming to a decision. This can then be fed into a huge database for AI-facilitated analysis to make the offers much more compelling.

Indeed, China has two major food delivery platforms: Alibaba's Ele.me and Meituan-Dianping, backed by tech giant Tencent. In both cases they track not only the consumer's behavioural data, but also use AI to calculate the discount that attracts most of the consumers to plan out the route of the riders to ensure timely product delivery to optimise the whole system.

"It is amazing, and we see that happening on a national basis – the penetration of the mobile internet, AI technologies and tailored personal services," says Li. "That will become more prevalent with advanced equipment and AI algorithms, so that is where there is a lot of excitement and exactly where a lot of consumer needs can best be met."

Food delivery and online entertainment platforms are all well and good, but are the needs of the Chinese consumer being met by companies – and recognised by investors?

Meaningful investments

While Beijing seeks to attract greater inflows of long-term funding by opening its financial sector, China's public equity market allows foreign investors not only to capture the growth potential, but also to make invaluable contributions to areas such as healthcare, where tech giants are playing an ever-greater role, according to Sagard China's chief investment officer.

With an ageing population, China is seeing rising demand for better health-related products and services. "I see investors talking about their investment in hospital services in China," says Li.

"We looked at eye-operation businesses – this is a nationwide service that people with short-sighted problems are provided with. These are the types of life-changing services that foreign investors can have access to through investment into A-shares. There are a lot of good purpose businesses and there are a lot of good entrepreneurs needing the backing of longer-term capital from foreign investors. That will be a great bridging between good companies as well as long-term committed capital."

China's stock markets have a reputation for being highly volatile, given the dominance of short-term retail investors who are looking for a certain level of return and are not concerned with the fundamentals of the business. On the other hand, foreign institutional investors are much keener on discussing operations, business plans and areas for improvement with the company and in some instances, foreign investors also bring resources and ideas to those businesses that can make a difference. But there are still plenty of pitfalls for overseas investors to avoid, warns Li.

Black box

Although it is much easier for foreign investors to access China, it is better to rely on professional investment houses to get very high-quality access because there are language and cultural issues, as well as the issue of long-distance investing into an area that investors are not too familiar with, says Li.

"Investors outside Asia sometimes talk about China as a black box because they do not really understand what is going on. Effective access to a market is really through people who understand the dynamics – professional investment teams that have been running for a long time, understanding the culture, the business, the macro part of the economy, the business operations and the people who are running it," concludes Li.

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GROWTH POTENTIAL – Thanks to China's A-shares market, foreign investors can take a meaningful stake in meaningful businesses, says Jun Li.