

Q1 2020

CHINA LOOK AHEAD

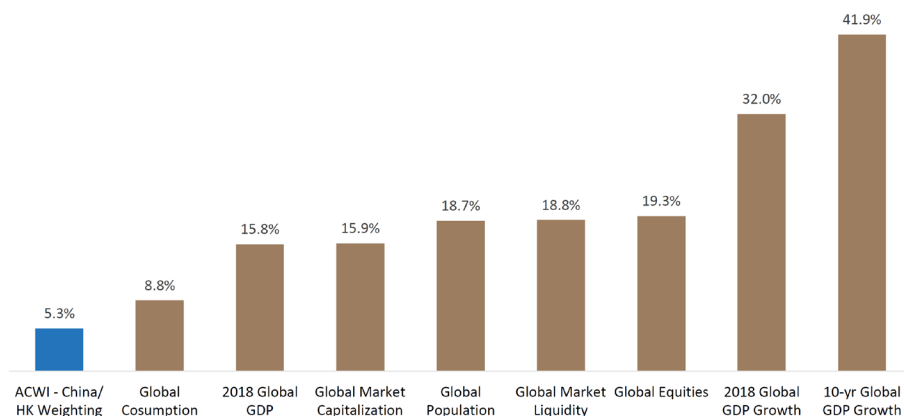
Disclaimer

Certain information in this presentation constitutes forward-looking statements. Due to various risks, uncertainties, and assumptions made in our analysis, actual events or results or actual performance of the markets covered by this presentation may differ materially from those described. The information herein reflects our current views only, is subject to change, and is not intended to be promissory or relied upon by the reader. There can be no certainty that events will turn out as presented. Data are from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented. Past performance is not a guarantee of future results.

A-Share Market Remains Underrepresented

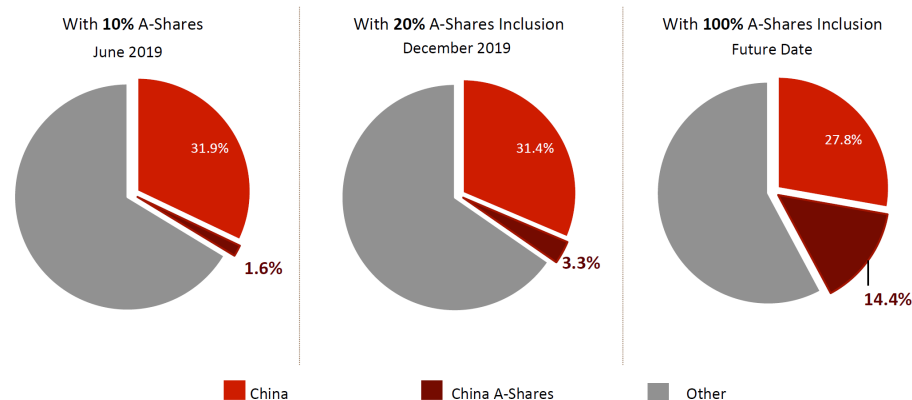
China is Under-Owned by Nearly Any Measure

China as a percentage of the world



China's Growing Role in Emerging Markets

MSCI Emerging Markets Index as of June 30, 2019

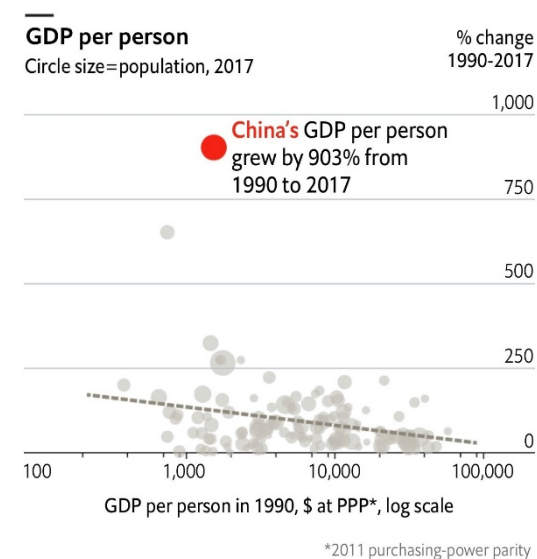
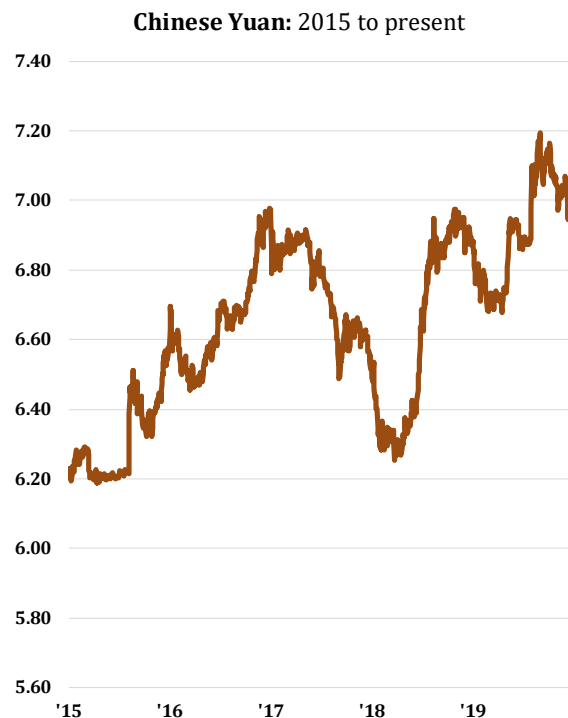
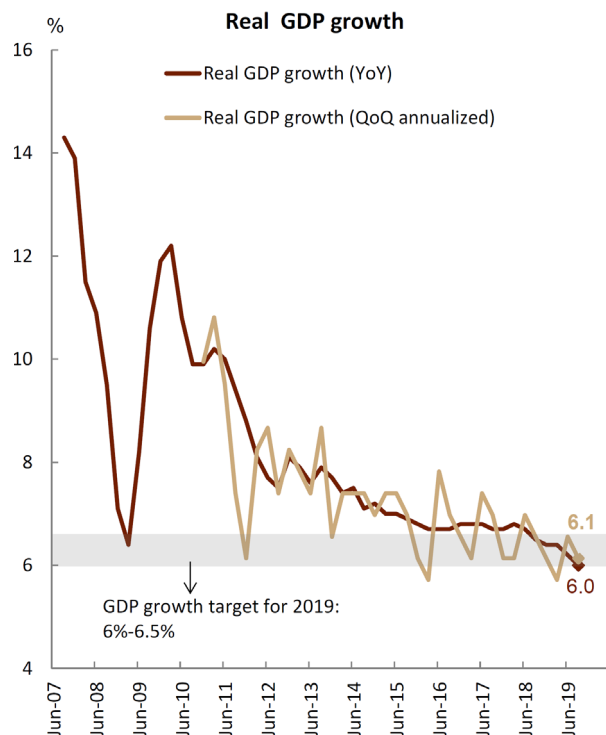


- With China being the second largest equity market in the world combined with under representation in major indexes, it is not hard to fathom additional capital inflows to China over the long-term
- There is still a significant push underway for index providers to fairly represent China, with the A-Share market making up the lion share of the growth

Data Source: Matthews Asia, "The Case for Greater China Exposure in Your Portfolio" (October 2019)

Data is from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented.

Macroeconomic Expectations



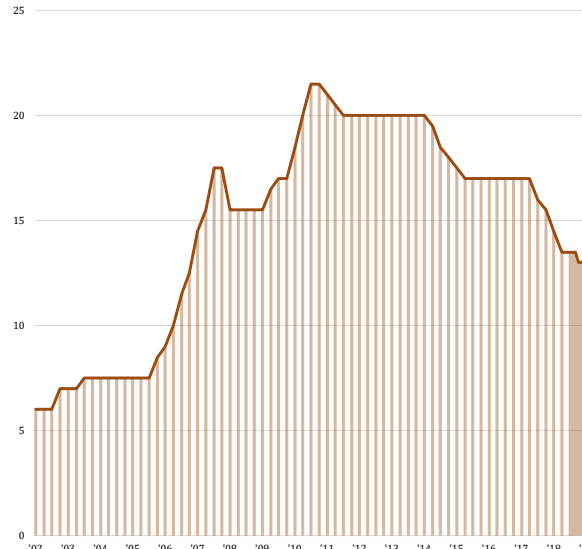
- In our view, a bottom looks to be forming in the Chinese economy.
- The Chinese economy continues to grow at a 6% rate, while the U.S. is struggling to maintain 2% growth

Macroeconomic Expectations

PBOC's Longer-Term Rates



China Reserve Requirement Ratio



China Total Social Finance Year-over-Year % Change



MONETARY POLICY

- Chinese officials kicked off the new year by signaling they would reduce the portion of deposits that commercial banks are required to set aside as reserves by 50 basis points
- The move will essentially release 800 billion yuan (\$115 billion) into the Chinese financial system
- The modest rate easing signals vigilance as the economy continues to transition.
- The lowering of credit costs is aimed at avoiding any new borrowing binges, particularly in real estate.

FISCAL POLICY

- The Chinese government said it would improve the effectiveness of fiscal policy in 2020, signaling a fine-tuning of support measures as the world's second largest economy slows.
- As the phase one trade deal with the U.S. is finalized, Chinese policymakers are focusing on stability rather than artificially boosting the economy
- Officials remain wary of boosting monetary stimulus, and are hinting that greater impact from fiscal efforts than was achieved by 2019's two trillion yuan (\$284 billion) round of tax cuts is desired.

Data Source: Bloomberg as of 12/31/2019

Data is from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented.

Hukou System Reforms

China is relaxing hukou restrictions in small and medium-sized cities to solve migrant workers' residency challenges, boost urbanization, and spur domestic consumption. Here we breakdown the new policy and what it means for China's economy and labor market.



1. What is Hukou?

- Hukou is a household registration system in China – similar to an internal passport – used by the government to regulate population distribution within the country.
- By reducing restrictions on hukou, the reform plan aims to increase urbanization rates by at least 1% by the end of 2020.

2. Hukou Reform and Property Markets

- China's latest step to encourage 100 million rural citizens to move to cities may provide a timely boost to a slowing property market.
- Cities with an urban population of between 1 million to 3 million have been directed by the government to scrap the residency registration system this year, while cities with a population of 3 million to 5 million have been directed to substantially ease residency requirements.

Valuation

FTSE China A Index vs. S&P 500 FWD P/E Ratio



- On a forward-basis, Chinese stocks remain undervalued compared to the United States, trading at around 11.5x versus 21.6x for the S&P 500
- China is also one of the most attractive countries when comparing price-to-earnings to estimated GDP growth, sporting a PEG ratio of 2.4x compared to 11.8x for the United States

Country PEG Ratios

Country	ETF	Current P/E	Est. 2020 GDP Growth	P/E to GDP Growth
China	ASHR	14.42	5.90	2.44
Russia	RSX	6.68	1.60	4.18
Malaysia	EWM	18.41	4.30	4.28
India	INP	29.63	5.60	5.29
South Korea	EWY	17.06	2.20	7.76
Singapore	EWS	12.16	1.50	8.10
Australia	EWA	20.31	2.40	8.46
Brazil	EWZ	17.91	2.10	8.53
Spain	EWP	15.63	1.70	9.20
Taiwan	EWT	19.66	2.10	9.36
Canada	EWC	17.27	1.60	10.79
United States	SPY	21.25	1.80	11.80
South Africa	EZA	14.55	1.10	13.23
Mexico	EWX	17.54	1.20	14.62
Sweden	EWD	18.96	1.20	15.80
France	EWQ	21.35	1.20	17.79
UK	EWU	18.23	1.00	18.23
Switzerland	EWL	24.66	1.20	20.55
Italy	EWI	14.23	0.50	28.46
Germany	EWG	24.45	0.70	34.93
Japan	EWJ	19.05	0.30	63.49
Hong Kong	EWH	10.87	0.10	108.69
Average		17.92	1.88	19.36
Median		18.07	1.55	11.30

Data Sources: Bloomberg as of 12/31/2019, [Bespoke Investment Research](#)

Data is from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented.

What's Ahead: Phase One Trade Deal

The United States and China have agreed on the terms of a “phase one” trade deal that reduces some U.S. tariffs on Chinese goods while boosting Chinese purchases of American farm, energy, and manufactured goods.



TARIFFS

- US will half its 15% tariffs on \$120B in Chinese goods to 7.5%
- 25% Tariffs on \$25B of goods will remain at the current 25% rate
- China has lowered some retaliatory tariffs and may lower more (for example tariffs on imported cars, etc.)
- China has established an exclusion process for its tariffs
- China has not committed to specific tariff reductions in the deal



IP & FORCED TECH TRANSFER

- China has agreed to end the practice of forcing or pressuring foreign companies to transfer their technology to Chinese companies as a condition for obtaining market access, administrative approvals, or receiving advantages from the government.
- China also committed to provide transparency, fairness, and due process in administrative proceedings and to have technology transfer and licensing take place on market terms.



COMMITTED PURCHASES

- China has agreed to increase its total purchases of US goods and services by \$200B over the next two years
- Included in the above is a specific commitment of between \$40 and \$50B in agricultural purchases



ENFORCEMENT

- The agreement will include a dispute-resolution mechanism that will serve as the enforcement arm.
- Complaints of one party will be brought to a US -China working group and if officials can't resolve their dispute, a decision will be made at the ministerial level of what action to take.

What's Ahead: Belt & Road Next Steps

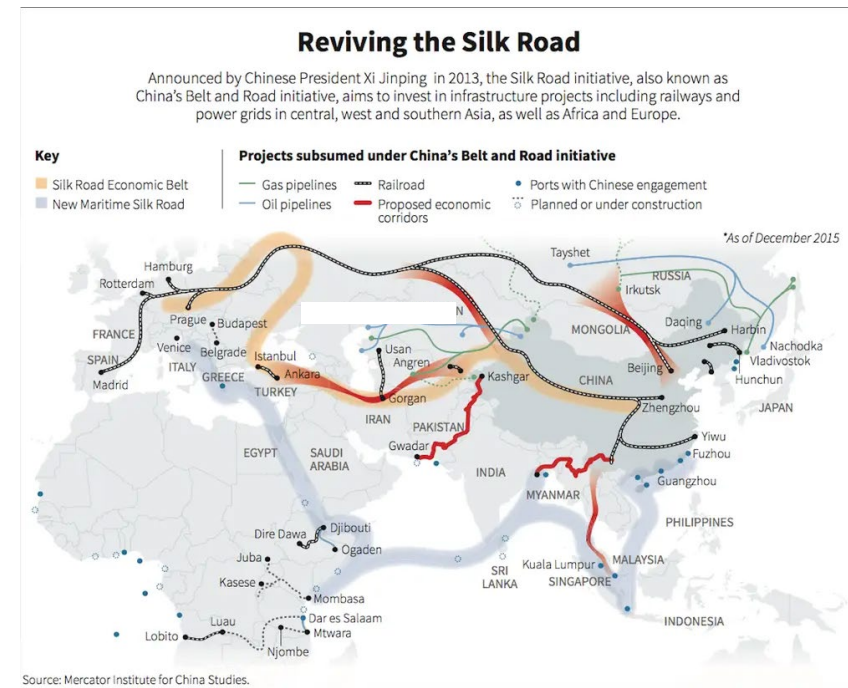
China has been making steady progress along the BRI and will continue to do so in 2020. At present, much of the infrastructure work along the BRI has been undertaken by Chinese state-owned entities, but the percentage of foreign participation is growing. China's new Foreign Investment Law, which kicked in January 1, also opens up the Belt and Road to foreign investors.

Belt & Road Progress & Initiatives

- China has so far signed 171 cooperation documents on the Belt & Road Initiative with more than 150 countries
- China-Europe freight trains have made more than 13,000 trips. The trains connect Chinese cities with 49 cities in 15 countries
- Aviation connectivity improved in countries participating in the Belt & Road Initiative. The current 387 air routes connect 33 participating countries
- China's accumulative trade volume with Belt & Road countries has surpassed \$7 trillion. It has built 82 overseas economic cooperation zones in Belt & Road countries, with investment exceeding \$30 billion

Focus Countries for Belt & Road Initiative in 2020

Cambodia
Egypt
Ethiopia
Greece
Indonesia
Laos
Oman
South Korea
Thailand
United Arab Emirates

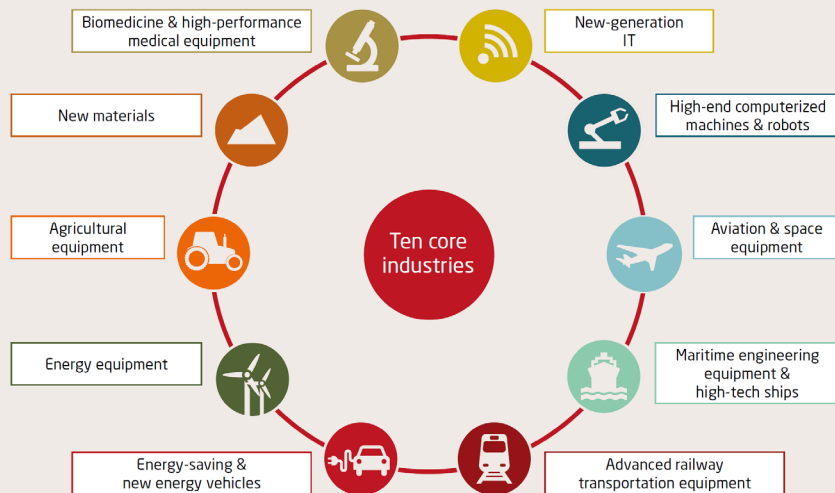


What's Ahead: China 2025 Initiatives

Five years ago, China launched the ambitious China 2025 plan to become a leading global technological superpower by 2049. The strategy defines ten core industries, such as robotics, power equipment and next-generation IT, in which China wants to achieve major breakthroughs and create globally competitive companies.

Ten core industries set the basis of Made in China 2025

China has set ambitious targets



Main steps	Milestones
2025	Major manufacturing power
2035	Global manufacturing power
2049	Leading manufacturing superpower





Source: State Council



© MERICS

Focused efforts for innovation on lower administrative levels

Comparison of MIC25 plans at different levels of government

Level	China national	Zhejiang province	Ningbo city	Yuyao county-level city																
Number of focal industries	 10	 11	 6	 4																
Characteristics	<div>Industry categories not taken up at lower levels</div> <ul style="list-style-type: none">• Aviation & space equipment• Energy equipment• Agricultural equipment	<div>Selection of focal industries</div> <div><ul style="list-style-type: none">• Green petrochemicals• Fashion & textile industry• Application-specific ICs & new components• IoT, cloud computing, big data & industrial software</div> <div><ul style="list-style-type: none">• Traditional superior industries• Emerging industries• Productive service industries</div> <div><ul style="list-style-type: none">• New equipment• New energy & energy-saving</div>																		
Number of patents/core business income of 10 billion CNY	<table><tr><th>2020</th><th>2025</th></tr><tr><td>70</td><td>110</td></tr></table>	2020	2025	70	110	<table><tr><th>2020</th><th>2025</th></tr><tr><td>80</td><td>120</td></tr></table>	2020	2025	80	120	<table><tr><th>2020</th><th>2025</th></tr><tr><td>105</td><td>150</td></tr></table>	2020	2025	105	150	<table><tr><th>2020</th><th>2025</th></tr><tr><td>110</td><td>150</td></tr></table>	2020	2025	110	150
2020	2025																			
70	110																			
2020	2025																			
80	120																			
2020	2025																			
105	150																			
2020	2025																			
110	150																			

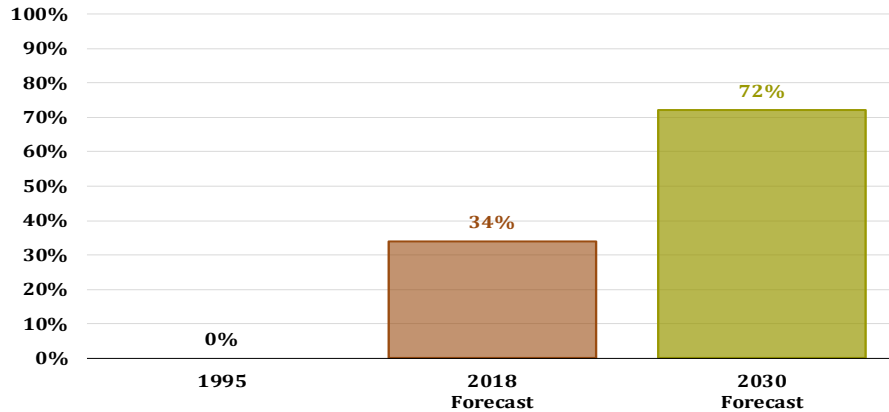
Sources: State Council, Zhejiang local governments

© MERICS

What's Ahead: Consumption Conversion

China's economy continues its historic shift to a more consumption- and service-driven model that should help sustain the country's growth, albeit at a slower rate, over the next decade and beyond. Two trends offer significant business opportunities for both domestic and foreign players:

Growth of the Chinese Middle Class
Percent of Total Population

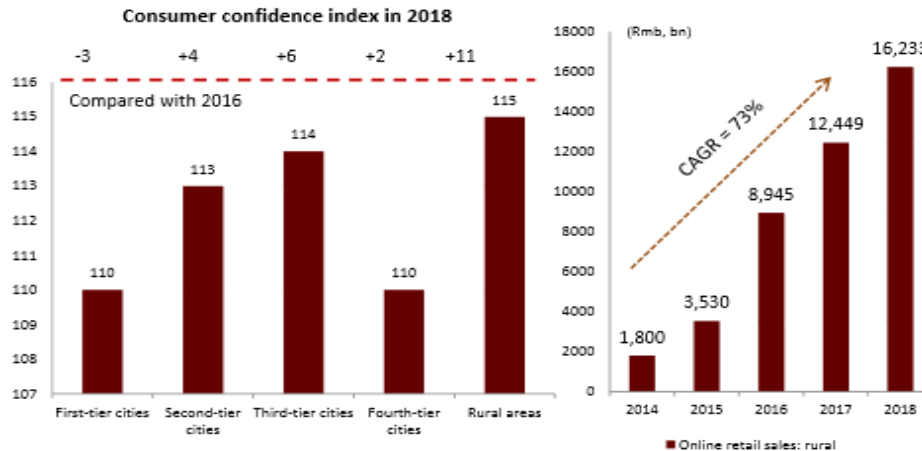


1. Chinese consumers demand more and better choices in goods and services.

- As incomes rise consumers want more choice, and, despite discussion about consumption downgrade, there is evidence of a broad trend of trading up.
- McKinsey's 2019 Global Consumer Sentiment Survey showed that 26% of Chinese respondents were trading up overall, compared with 17% in ten other top economies.

2. China's rapidly expanding consumption offers significant opportunities globally.

- China's rapidly expanding consumer market – confident, becoming richer, and increasingly sophisticated – offers a strong link between China and the world.
- By 2030, 58% of Chinese households are likely to be in the “mass affluent” category or above.
- The spending profile of urban Chinese consumers is converging with that of their counterparts in cities around the world.
- Chinese urban consumers are devoting a greater share of their income to discretionary spending.



Data Sources: CICC; J.P. Morgan Asset Management, “Guide to the Markets | Q4 2019” (December 2019)

Data is from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented.

What's Ahead: Improving Private Enterprise

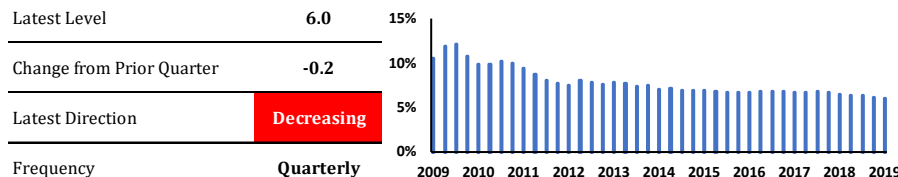
China recently unveiled its latest slate of measures designed to bolster private-sector businesses as policy makers double down on efforts to support what is by far the country's largest source of jobs. Some of the key measures outlined by the State Council are:

1. **Giving private-sector investors access to the electricity, telecommunications, railway, oil, natural gas sectors**, including allowing them to become shareholders in telecom carriers and major stakeholders of power generation and distribution businesses
2. **Allowing private companies to enter the exploration, storage and transportation of oil and gas**
3. **Supporting qualified private firms to import and export oil**
4. **Improving banking services for private firms**, including adopting a higher tolerance for the ratio of non-performing loans to small firms
5. **Supporting direct financing by private firms**, including encouraging them to be listed on China's NASDAQ-style technology board in Shanghai, supporting bond sales and debt-to-equity swaps
6. **Encouraging private firms to take part in the restructuring of state-owned enterprises and the construction of mega-city clusters**
7. **Better promote the achievements and contributions of private-sector businesses**

China Economic Dashboard

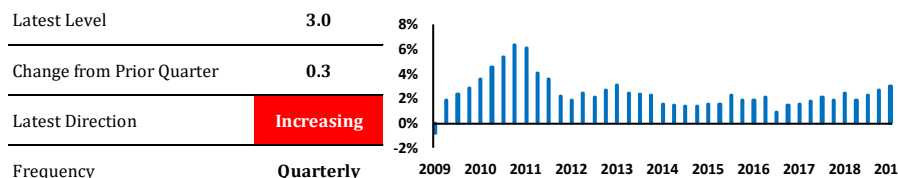
China GDP Growth

as of 9/30/2019



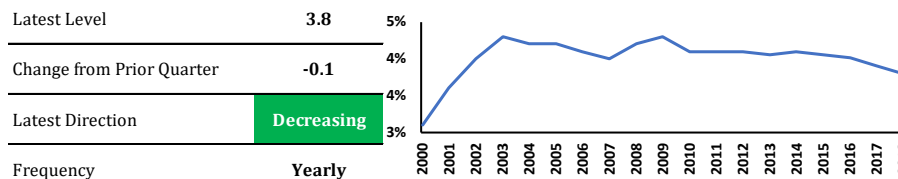
China Inflation

as of 9/30/2019



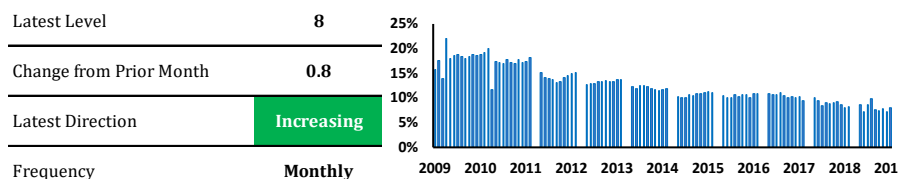
China Unemployment Rate

As of 12/31/2018



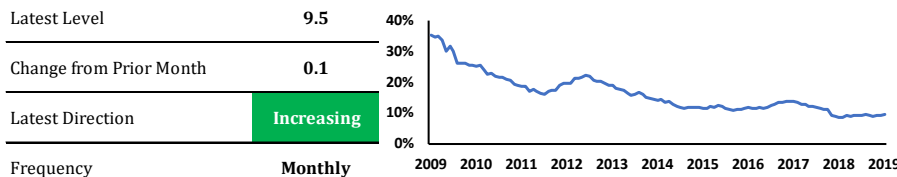
China Retail Sales

As of 11/30/2019



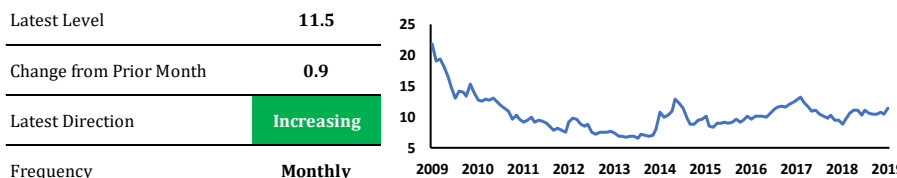
China Total Social Finance (YoY%)

as of 11/30/2019



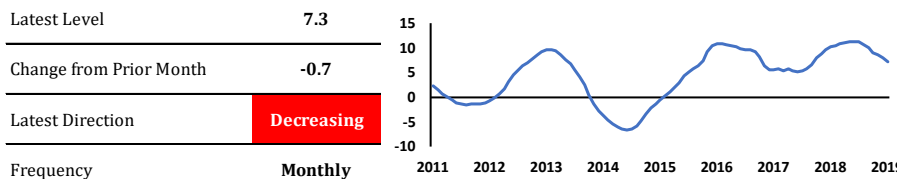
FTSE China A Index P/E Ratio

as of 12/31/2019



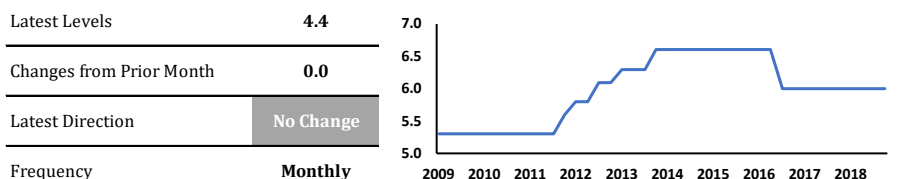
China 70 Cities Home Price Index (YoY%)

as of 11/30/2019



China 1-Year Benchmark Lending Rate

as of 12/31/2019



Data Source: Bloomberg as of 12/31/2019

Data is from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented.

THANK YOU

TPHILLIPS@PHILLIPSANDCO.COM