



Year of the Rabbit: luckier for investors?

January 2023



**Virginie
Maisonneuve**
Global CIO Equity



**William
Russell**
Head of Product
Specialists Equity
Asia Pacific

Last year was challenging for Chinese equities, as the market was buffeted by Covid lockdowns and a struggling property sector. Investors will be hoping the upcoming Year of the Rabbit is more rewarding, as the macro storm clouds clear, business confidence returns, and key sectors look set to continue to benefit from the government's drive to increase China's self-sufficiency.

Key takeaways

- The Year of the Rabbit comes as China investors hope signs of a rebound in markets at the end of 2022 – after a challenging year – spell better fortunes to come.
- With equity valuations looking reasonable, and corporate earnings potentially set to rebound, progress is being made on two issues that weighed on market sentiment over the past year – the government's zero-Covid policy and difficulties in the property market.
- Investors can also explore the long-term investment case for China around technology innovation and climate progress amid its drive for self-sufficiency.

On 22 January China marks the start of its new year, symbolised by the water rabbit. This animal is said to represent longevity, peace, prosperity and luck. The year just passed, however, could hardly be described as lucky. The MSCI China index was down 14.7%, primarily because of the country's zero-Covid policy and the troubles continuing to plague the property sector.

One of the most important events of 2022 was President Xi Jinping's re-election for a third term

at the 20th National Congress of the Chinese Communist Party in October. This historic achievement suggests that, overall, there is likely to be a continuity of policy from here.

Of particular note for investors is President Xi's ambition to make China more self-sufficient in a wider range of industries, reducing its reliance on global supply chains. This could result in a range of investment opportunities. Meanwhile, political tensions between the US and China seem to have eased for now, with President Xi meeting President Biden at the G20 summit, signalling improving relations.

2022 wasn't all bad news for investors – signs of a market rebound towards the end of the year led to hopes of a more positive 2023. This year investors in China will be hoping some of the rabbit's purported good luck rubs off, but we believe conditions could already be in place for a better year.

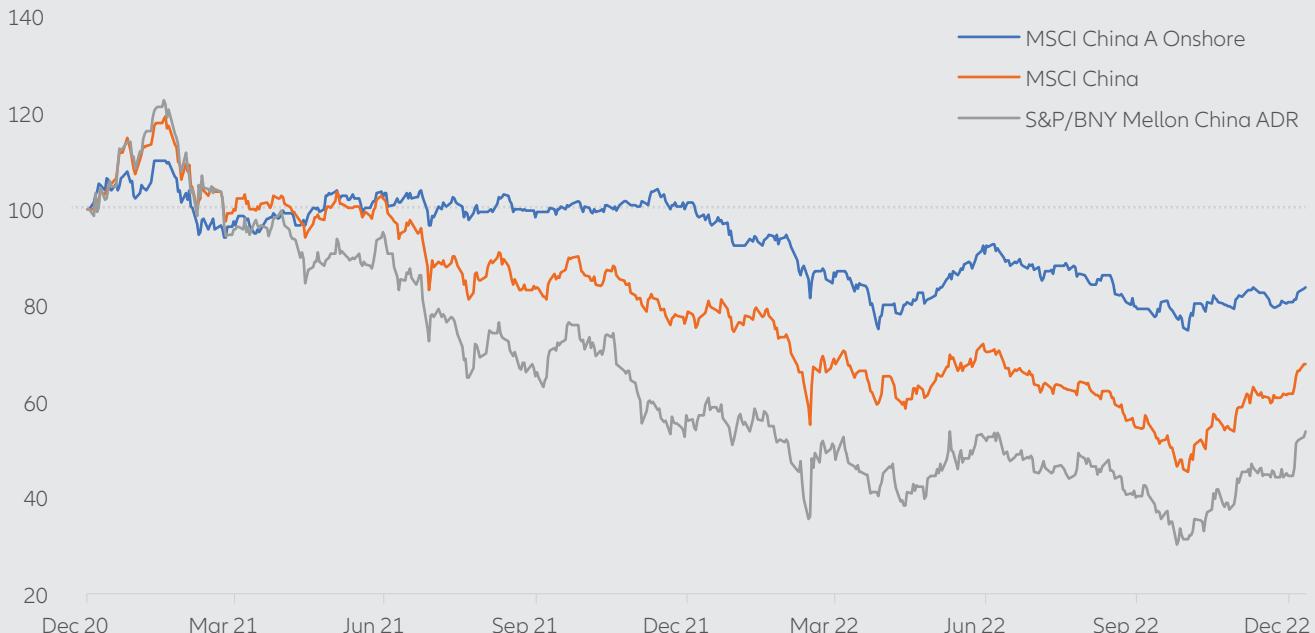
Chinese equity valuations look reasonable and corporate earnings could be set to rebound, but the most important factors are that progress is already being made in the two areas that caused the biggest problems last year – Covid and the property market, as we set out below. And looking further ahead, several secular themes may make China a compelling long-term investment case.



Interpreting
China

Allianz
Global Investors

Exhibit 1: China equity market performance since 2021 (rebased to 100, local currency)



Source: Refinitiv Datastream, Allianz Global Investors, as of 30 December 2022. Based on total return performance in gross, USD. Market and economic conditions are subject to rapid change, all opinions and views expressed constitute judgments as of the date of the writing and may change at any time without notice and with no obligation to update. Past performance, or any prediction, projection or forecast, is not indicative of future performance. The information above is provided for reference only, it should not be considered a recommendation to purchase or sell any particular security or strategy or an investment advice.

Reasons for optimism in 2023: the Covid policy U-turn...

After China's zero-Covid stance was defended at the Party Congress in October, less than a month later the policy had effectively been dismantled. Amid wide-scale public protests – a rare occurrence in China – the government decided it would no longer try to stamp out localised Covid outbreaks by implementing strict lockdowns.

Given the low rate of vaccination in China, the impact of this turnaround has been severe: there was a huge surge in Covid infections in the aftermath, estimated to be around 250 million in the first 20 days of December alone. However, markets rallied sharply on the news of the policy change and anticipation of economic reopening. Consumers were initially cautious, staying at home rather than visiting shopping malls and restaurants, but the relaxation of restrictions could start to unleash three years' worth of pent-up consumer demand as people saved money during lockdowns.

Signs are that the Lunar New Year Holiday sparked a boom in travel bookings, pointing to a revival in consumer spending. As a result, travel, retail and leisure-related stocks have been leading the stock market in recent weeks.

...and government support for cash-strapped property developers

A more stable property sector could be another catalyst for a rebound in confidence and consumption in 2023. Encouragingly, the government has begun to provide more direct support to property developers to help ensure pre-sold homes are completed. It has also enacted

policies including extending repayment periods, ensuring additional bank lending, resuming equity market financing, and expanding government bond guarantees to ease the funding pressures that developers are facing.

Given China's ageing population and falling birth rate, we think the property sector is in gradual structural decline. But over the shorter term, the easing of the financial problems facing the sector should help rebuild confidence and facilitate a macroeconomic recovery.

We expect these policy changes to pave the way for accelerated economic growth and potentially trickle down into corporate earnings, especially in the second half of 2023.

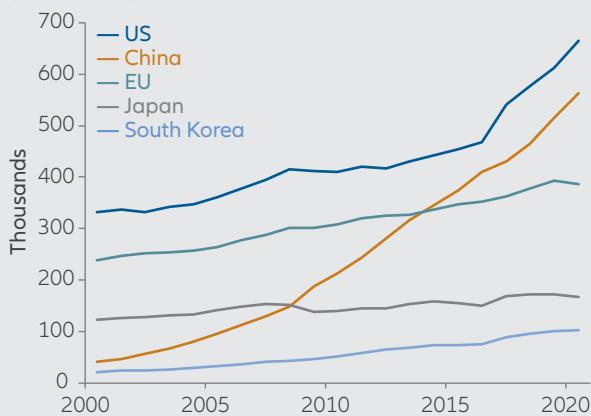
The long-term investment case: China's drive for self-sufficiency

With the near-term outlook for China improving, it is also timely to reiterate the strategic opportunities that the country may represent for active investors with a long-term horizon.

In the latest phase of its transformation, China is focused on safeguarding its economic prosperity while keeping global geopolitical tensions at bay.¹ This includes a push for greater self-sufficiency by focusing on home-grown capabilities and resources, especially in areas like software, energy and food supplies, which are closely tied to national security. China is improving its manufacturing capabilities by automating more processes and developing its domestic semiconductor manufacturing industry, which should benefit as demand linked to technological advances like smart transportation increases.

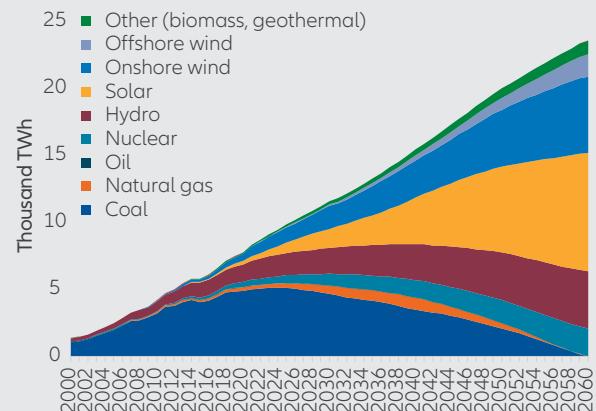
1. Read more: China's Phase 3: a new chapter in its epic story (allianzgi.com)

Exhibit 2: Global R&D expenditure and growth (USD billion)



Source: OECD data 2019. The information above is provided for illustrative purposes only, it should not be considered a recommendation to purchase or sell any particular security or strategy or an investment advice.

Exhibit 3: China power generation breakdown



Source: Goldman Sachs, January 2022. It is not a recommendation or investment advice to buy or sell any particular securities and should not be considered investment advice. A security mentioned as example will not necessarily be comprised in the portfolio by the time this document is disclosed or at any other subsequent date. The information above is provided for illustrative purposes only, it should not be considered a recommendation to purchase or sell any particular security or strategy or an investment advice.

Green tech innovation

As part of its drive for self-sufficiency, China is investing heavily in green technologies. It is already a leader in renewable energy, with more than 70% of global output across the solar production chain² and it is also the world's largest market for electric vehicles, accounting for 40% of global sales.³

China is targeting peak carbon emissions in 2030 and net-zero carbon emissions by 2060, which could represent a challenge for a country that remains heavily reliant on fossil fuels and is still building new coal plants. However, it is providing sustained policy support for solar and wind power, as well as improving related technology infrastructure, which should help its green transition.

Opportunities in healthcare and financials

There is huge scope for innovation and growth within China's healthcare sector, which has been thrust into the spotlight by Covid. China's spending on healthcare still lags that in the EU, Japan and the US as a percentage of GDP. Greater investment must be a priority because the pressure on the healthcare system will only increase as 398 million people – nearly 30% of China's population – will be aged 65 or over by 2060.

Meanwhile, reforms in the financial markets, including the ongoing liberalisation of capital markets and improvements to market infrastructure, could benefit some financial services companies and may also prove supportive of the wider economic outlook. While it is always difficult to know what the year ahead will bring, particularly in a market as volatile as China, there are some reasons to be positive as the Year of the Rabbit bounds into view.

Five reasons why the Year of the Rabbit could be lucky for investors

1. Relaxation of zero-Covid measures could release three years of pent-up consumer demand, helping to drive economic growth.
2. Policies to ease funding pressures in the property market could also support the economy.
3. Tensions with the US seem to be easing.
4. China's drive for self-sufficiency may benefit areas including software, healthcare, semiconductors and electric vehicles.
5. Chinese equity valuations are at reasonable levels and we believe the conditions are in place for an earnings recovery.

2. Forbes, as of 31 March 2022

3. Virta Global, as of 30 June 2021

Allianz Global Investors is a leading active asset manager with over 600 investment professionals in over 20 offices worldwide and managing EUR 521 billion in assets. We invest for the long term and seek to generate value for clients every step of the way. We do this by being active – in how we partner with clients and anticipate their changing needs, and build solutions based on capabilities across public and private markets. Our focus on protecting and enhancing our clients' assets leads naturally to a commitment to sustainability to drive positive change. Our goal is to elevate the investment experience for clients, whatever their location or objectives.

Active is: Allianz Global Investors

Data as at 30 September 2022. Total assets under management are assets or securities portfolios, valued at current market value, for which Allianz Asset Management companies are responsible vis-à-vis clients for providing discretionary investment management decisions and portfolio management, either directly or via a sub-advisor. This excludes assets for which Allianz Asset Management companies are primarily responsible for administrative services only. Assets under management are managed on behalf of third parties as well as on behalf of the Allianz Group.

Investing involves risk. The value of an investment and the income from it will fluctuate and investors may not get back the principal invested. Past performance is not indicative of future performance. This is a marketing communication. It is for informational purposes only. This document does not constitute investment advice or a recommendation to buy, sell or hold any security and shall not be deemed an offer to sell or a solicitation of an offer to buy any security.

The views and opinions expressed herein, which are subject to change without notice, are those of the issuer or its affiliated companies at the time of publication. Certain data used are derived from various sources believed to be reliable, but the accuracy or completeness of the data is not guaranteed and no liability is assumed for any direct or consequential losses arising from their use. The duplication, publication, extraction or transmission of the contents, irrespective of the form, is not permitted.

This material has not been reviewed by any regulatory authorities. In mainland China, it is for Qualified Domestic Institutional Investors scheme pursuant to applicable rules and regulations and is for information purpose only. This document does not constitute a public offer by virtue of Act Number 26.831 of the Argentine Republic and General Resolution No. 622/2013 of the NSC. This communication's sole purpose is to inform and does not under any circumstance constitute promotion or publicity of Allianz Global Investors products and/or services in Colombia or to Colombian residents pursuant to part 4 of Decree 2555 of 2010. This communication does not in any way aim to directly or indirectly initiate the purchase of a product or the provision of a service offered by Allianz Global Investors. Via reception of his document, each resident in Colombia acknowledges and accepts to have contacted Allianz Global Investors via their own initiative and that the communication under no circumstances does not arise from any promotional or marketing activities carried out by Allianz Global Investors. Colombian residents accept that accessing any type of social network page of Allianz Global Investors is done under their own responsibility and initiative and are aware that they may access specific information on the products and services of Allianz Global Investors. This communication is strictly private and confidential and may not be reproduced. This communication does not constitute a public offer of securities in Colombia pursuant to the public offer regulation set forth in Decree 2555 of 2010. This communication and the information provided herein should not be considered a solicitation or an offer by Allianz Global Investors or its affiliates to provide any financial products in Brazil, Panama, Peru, and Uruguay. In Australia, this material is presented by Allianz Global Investors Asia Pacific Limited ("AllianzGI AP") and is intended for the use of investment consultants and other institutional/professional investors only, and is not directed to the public or individual retail investors. AllianzGI AP is not licensed to provide financial services to retail clients in Australia. AllianzGI AP is exempt from the requirement to hold an Australian Foreign Financial Service License under the Corporations Act 2001 (Cth) pursuant to ASIC Class Order (CO 03/1103) with respect to the provision of financial services to wholesale clients only. AllianzGI AP is licensed and regulated by Hong Kong Securities and Futures Commission under Hong Kong laws, which differ from Australian laws.

This document is being distributed by the following Allianz Global Investors companies: Allianz Global Investors GmbH, an investment company in Germany, authorized by the German Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin); Allianz Global Investors (Schweiz) AG; in HK, by Allianz Global Investors Asia Pacific Ltd., licensed by the Hong Kong Securities and Futures Commission; in Singapore, by Allianz Global Investors Singapore Ltd., regulated by the Monetary Authority of Singapore [Company Registration No. 199907169Z]; in Japan, by Allianz Global Investors Japan Co., Ltd., registered in Japan as a Financial Instruments Business Operator [Registered No. The Director of Kanto Local Finance Bureau (Financial Instruments Business Operator), No. 424], Member of Japan Investment Advisers Association, the Investment Trust Association, Japan and Type II Financial Instruments Firms Association; in Taiwan, by Allianz Global Investors Taiwan Ltd., licensed by Financial Supervisory Commission in Taiwan; and in Indonesia, by PT. Allianz Global Investors Asset Management Indonesia licensed by Indonesia Financial Services Authority (OJK).