

China's influence on international markets



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China's global dominance is growing and it has a reasonable chance of surpassing the US as the world's largest economy in a few decades. To not invest in China may one day seem akin to ignoring US opportunities when it emerged as the world leader.

Q | China's economic growth has been a key investment theme for about two decades. What do investors need to understand about it now?

China's incredible economic growth has few parallels in history. Beyond the 800 million people lifted out of poverty,¹ it is now the world's second largest economy at US\$16.6 trillion². Why should you know about the second largest economy in the world? I believe China has a reasonable chance of surpassing the United States as the largest economy in the world in a few decades, by total GDP. To not consider the opportunities in China would be akin to ignoring the opportunities in the US as it emerged as the world leader.

Q | Speaking of the largest economy in the world, how does the Chinese economy compare to what we see in the United States?

Even if China never surpasses the US in GDP, the sheer dynamism of the economy means that many world-class companies have been created, and I believe many more will be in the next decades. These entrepreneurs and their companies should provide great opportunities for investors.

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China's industrial development came in phases; the opportunities from the trade-oriented phase of development are different than today's opportunities from the shift to an internal consumption model. The economy is well-diversified, including the only technology ecosystem to rival the US. China stopped US giants such as Yahoo and Google from coming in early and taking over their market; and that gave their own entrepreneurs the opportunity to create world class companies domestically. These tech companies innovated differently from the American tech giants, creating products and services for Chinese consumers. In studying these alternate versions of excellence, we discover both the possibilities and shortcomings for Western companies. Not having as sophisticated a financial system as in North America, Chinese internet firms developed their proprietary systems early on to facilitate e-commerce; and these are more advanced today than those of North American tech firms.

As an investable market, I believe China will be more widely held by investors in the future. Their equity markets are becoming deeper and more sophisticated. Today, the Chinese equity market accounts for 5% of global equity market value³, while the Chinese economy represents almost 19% of world GDP.⁴ This compares to the US representing 55% of the global equity market value and 24% of world GDP; and Japan representing 6% of global equity market value and 7% of world GDP.

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Q | How does China's growth affect international markets?

There are many impacts on other major markets, but some important ones include:

China is an important source of growth for many companies. This is true across industries but is most acute in luxury and industrial sectors. From elevators and jet engines to bags and cognac, leading Western firms' capital allocation increasingly reflect the Chinese market opportunity. We see it in innovation, in branding and product strategy, as well as where capital expenditures are prioritized.

China's role in global supply chains contributed to and continues to sustain modern Western economies. Wal-Mart's "everyday low prices" can't exist without China's contribution. Beyond the wealth created for Wal-Mart shareholders, this saved trillions of dollars for American consumers. The world of electronics and technology products we use today wouldn't exist without China's manufacturing. From Apple to Adidas, many leading Western companies' supply chains rely on Chinese capabilities.

China impacts other regions as a source of competition. It is already the largest electric vehicle (EV) market in the world, and its EV champions are increasingly competitive. China's investment in the solar power market has focused on producing key materials, such as polysilicon, which is the core of photovoltaic cells. Production has reached such scale that it has reduced unit costs for solar panels enough to make solar more competitive with traditional energy sources, such as fossil fuels.

Q | You seek to invest in the highest quality companies in North America and Europe. How do the companies you see in China compare with the best companies in those regions?

The highest quality companies in China compare very favourably to those in North America and Europe. Kweichow Moutai, a premium spirits company is now the largest beverage company in the world. Its history goes further back than all Western leading brands and it is as storied. Its main spirit, Moutai, has a brand power unmatched by any major North American or European spirit brand.

We all know how ubiquitous Amazon has become in North America – it now owns roughly 40% of all US e-commerce sales.⁵ In China, Alibaba owns nearly 60% of all e-commerce.⁶ Despite the dominant market positions and high quality of many Chinese companies we analyze, we often see them trading at what I believe to be discounts to their European and North American counterparts.

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1 Source: World Bank, from 1978 to 2015.

2 Source: International Monetary Fund Estimate for 2021.

3 Source: MSCI ACWI Index , May 2021

4 Source: IMF, April 2021

5 eMarketer, "Amazon dominates US ecommerce, though its market share varies by category" April 27, 2021.

6 eMarketer, "Alibaba, JD.com Lead in China, but a Few Others Are Making Dents, Too" July 2, 2019.

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