China Market Commentary

30 November 2020

RisCura

Ant Financial was created out of Alipay, a third-party online payment processor for Alibaba's online marketplace.

Increased Chinese regulatory scrutiny on the fintech sector caused the Ant Financial IPO to be postponed, and subsequent anti-trust regulation has impacted it and other e-commerce firms.

In October, China's economic recovery continued. During the National Day holiday - a popular travel time – the total number of domestic tourists reached 618 million, better than the 550 million expected. Retail and catering business sales totalled RMB1.6 trillion, representing a 4.9% year-on-year growth.

Chinese equities likewise returned to the uptrend with the MSCI China All Shares rising by 4.7% over the month, ahead of most global indices. The outperformance was on the back of:

1) Positive Q3 earnings results reported by many Chinese companies;

2) Continuous recovery across retail sales, industrial production and investments as evidenced by latest macro data; and

3) Improved sentiment as consensus pointed to a Biden victory for the US presidential election.

Among individual sectors, Telecom Media and Technology and Consumer Discretionary performed the best.

Increased regulation of technology companies

In last month's newsletter, we discussed Ant Financial and how unique the giant fintech company is. We also mentioned how some of our managers were not sure what the regulators were planning behind the scenes. Well, that was made clearer a week later with the issuance of draft rules that sought to raise standards for online lending and limit the amount available for borrowing. Ant Financial management was invited to a discussion with regulators, and the next day, the Shanghai Stock Exchange suspended the Ant IPO, citing the meeting and a "change in the financial regulatory environment". Surprisingly the share price of Alibaba, the largest shareholder of Ant, didn't fall as much as would have been expected.

Shortly after, new antitrust rules were brought in to curb anti-competitive behaviour such as forcing merchants to sell exclusively on one platform. This time Alibaba's share price collapsed along with other internet companies such as Tencent and Meituan. The prices have recovered somewhat since then as they continue to deliver revenue growth, but it is clear the tone of regulation is unhelpful to these companies.

This regulatory move by the Chinese government is in accordance with recent scrutiny on technology companies including Amazon, Facebook and Google by global authorities. Whilst it is still at the consultation stage with not much detail, the consensus view among our managers is that it is positive for the sector's long-term development. Antitrust regulations will introduce more competition. This is no doubt negative for the largest incumbents in the near term, but these companies are well averse to dealing with competition.

Take the success of Pinduiduo (PDD) as an example. Alibaba and JD.com had a combined market share of over 70% in e-commerce and were thought to be unassailable until PDD showed up. Over the past three years, PDD's active buyers increased from 68 million to 628 million and are now very close to Alibaba's 730 million. This was followed by the rise of social e-commerce over the past 18 months. These are purchases made on social platforms like WeChat. Total transaction value on WeChat Mini Programs grew by 160% in 2019 and 115% in the first eight months of 2020, bringing it to about 15% of Alibaba's Gross Merchandise Value.

However, this does not mean that Alibaba is losing out. Their core e-commerce business was still able to grow at above 20% in the past quarters despite the increased competition. This shows how vast the Chinese market is. There is enough room for many players to coexist and thrive. For this reason, many of our managers have not reduced their exposure to the internet stocks and are in fact looking for the opportunity to add if share prices continue to fall.

About RisCura

RisCura is a purpose-driven global firm of investment experts that offers a range of services across the investment industry. With a focus on emerging and frontier markets, RisCura has pioneered research of investment managers in mainland China for over ten years and has helped clients allocate over USD1bn into the region.