

# Grappling with the changing face of China

## Decoupling from the West is easier said than done

Global Emerging Markets Equities

November 2022



**Michael Bourke, Head of Global Emerging Market Equities**

“It is incredibly tricky for the West to isolate China in the next decade without inflicting tremendous economic pain on itself and, even more so, on many Asian allies. In addition, no other emerging market today can match China’s manufacturing scale, productivity, or efficiency.”

---

The value of a fund's assets will go down as well as up. This will cause the value of your investment to fall as well as rise and you may get back less than you originally invested. Past performance is not a guide to future performance. The views expressed in this document should not be taken as a recommendation, advice or forecast.

### The changing face of China in the world

China has been on a trend towards greater economic and especially technological self-sufficiency, a trend that continues following the Communist Party Congress that took place in October. At the same time, China continues to focus on maintaining the standards of living for its broader population.

While there are currently tensions between these two goals, we would not expect either of these priorities to trump the other.

In the US, policymakers of both political stripes are clearly making concerted efforts to reduce the reliance of the US economy on Chinese imports and slow China’s economic and technological ascendancy. The Biden administration has made no effort to roll back former President Trump’s tariffs and indeed has ramped up decoupling efforts with the imposition of sanctions against the provision of advanced node US semiconductor technology in any form.

This pressure is noticeable in that the share of Chinese exports going to the US has fallen since 2017. The unknown here is the degree to which the EU and the UK will follow the US example and reduce reliance on China across industries. In Germany, lessons have been learned in terms of (over) reliance on Russian energy, and the risks of material dependency, and these could influence decision-making by the EU when it comes to reliance on China.

However, diversifying away from China may not happen quickly as supply chains are so integrated and have been built over decades. For many consumer goods and resources, China remains firmly embedded in global supply chains – particularly in Asia.

As a result, it is incredibly tricky for the West to isolate China in the next decade without inflicting tremendous economic pain on itself and, even more so, on many Asian allies. In addition, no other emerging market today can match China’s manufacturing scale, productivity, or efficiency.

Wages elsewhere, for example in Thailand and Vietnam, are lower than in China, but the trade-off is often lower productivity – which requires both time and committed investment to improve. It is also likely that, rather than decoupling at scale, any unravelling will be narrower and industry-focused. As mentioned above, technology is one of the most obvious sectors to be affected, as well as some parts of the financial system.

While this could be the case in some small corners of the market, more broadly, we would expect little change. Given what we see as very attractive valuations, we believe that markets have already factored in a lot of uncertainty.

## How to invest in China: stay diversified

In periods of increased market volatility, we believe investors should be selective, stay diversified and focus on long-term themes.

In a sharp decoupling scenario, we consider the most exposed economies to be South Korea and Taiwan, although much of South-East Asia is also likely to be negatively impacted. The beneficiaries of efforts to reduce reliance on China would include India, Thailand and Vietnam within Asia, and Mexico within the context of the USMCA (formerly NAFTA), ie, the US, Mexico & Canada free-trade agreement.

## De-risking China from your investment thesis

The extent to which investors choose to de-risk from China will be a function of risk appetite and investment horizon. However, with valuations at generational lows, reducing exposure now may come at a high opportunity cost. We think that for active investors like us there are good opportunities at these valuations and, while we remain selective, we are looking to take advantage of these opportunities. Longer term, asset allocators may look to cap their exposure to China. However, the impact of such a move in the near term may not be substantial, as global investors are so underweight both China and broader emerging markets relative to the global market.



**For Investment Professionals, Institutional Investors and Professional Investors only. Not for onward distribution. No other persons should rely on any information contained within.** This information is not an offer or solicitation of an offer for the purchase of shares in any of M&G's funds. **Distribution of this document in or from Switzerland is not permissible with the exception of the distribution to Qualified Investors according to the Swiss Collective Investment Schemes Act, the Swiss Collective Investment Schemes Ordinance and the respective Circular issued by the Swiss supervisory authority ("Qualified Investors"). Supplied for the use by the initial recipient (provided it is a Qualified Investor) only.** The Portuguese Securities Market Commission (Comissão do Mercado de Valores Mobiliários, the "CMVM") has received a passporting notification under Directive 2009/65/EC of the European Parliament and of the Council and the Commission Regulation (EU) 584/2010 enabling the fund to be distributed to the public in Portugal. M&G Luxembourg S.A. is duly passported into Portugal to provide certain investment services in such jurisdiction on a cross-border basis and is registered for such purposes with the CMVM and is therefore authorised to conduct the marketing (comercialização) of funds in Portugal. In Hong Kong, this financial promotion is issued by M&G Investments (Hong Kong) Limited, Office: Unit 1002, LHT Tower, 31 Queen's Road Central, Hong Kong; in Singapore, by M&G Investments (Singapore) Pte. Ltd. (Co. Reg. No. 201131425R), regulated by the Monetary Authority of Singapore; in Switzerland, by M&G International Investments Switzerland AG, Talstrasse 66, 8001 Zurich, authorised and regulated by the Swiss Federal Financial Market Supervisory Authority; elsewhere by M&G Luxembourg S.A. Registered Office: 16, boulevard Royal, L-2449, Luxembourg. For Hong Kong only: If you have any questions about this financial promotion please contact M&G Investments (Hong Kong) Limited. For Singapore only: All forms of investments carry risks. Such investments may not be suitable for everyone. The information contained herein is provided for information purposes only and does not constitute an offer of, or solicitation for, a purchase or sale of any investment product or class of investment products, and should not be relied upon as financial advice. For Taiwan only: The information contained herein has not been reviewed or approved by the competent authorities and is not subject to any filing or reporting requirement. The information offered herein is only permitted to be provided to customers of an offshore banking unit of a bank ("OBU")/offshore securities unit of a securities firm ("OSU") which customers reside outside the R.O.C. Customers of an OBU/OSU are not eligible to use the financial consumer dispute resolution mechanism under the Financial Consumer Protection Law. Products offered by M&G Luxembourg S.A. may be made available for purchase by Taiwan OBUs/OSUs acting on behalf of non-Taiwan customers of such units but may not otherwise be offered or sold in Taiwan.