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Nine themes for investing in China's transformation

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As China's economy quickly transforms itself, a thematic approach based on structural macro trends is an effective way to identify the winners.

Only ten years ago, China had a reputation as the “workshop of the world” – a country where goods were not only mass-produced, but intellectual property was disregarded and products were copied. It was far from being the pioneering marketplace that it is now. In fact, China today leads the development of semiconductors, solar panels, artificial intelligence technology, biotechnology and dynamic new business models.

At Allianz Global Investors' June 2021 Asia Conference, one of the key topics was how China's high-tech transformation has unfolded. Head of Thematic Equity Andreas Fruschki, Portfolio Manager Shibo Wang and Director of Research Terence Law explained how China has changed fundamentally. Patent filings within the country are outpacing those in North America by three to one. In terms of research and development investment, China ranks second in the world, just behind the US.

In truth, China is transforming far faster than anywhere else in the world. Macroeconomic trends across several dimensions define its rapid evolution: strong economic growth, decarbonisation, urbanisation, technology innovation, deep industrialisation, increasing disposable income and demographic change. Taken together, these trends mean that China is likely to be as different 10 years from now as it was in 2010.

Key takeaways

- China is transforming into a high-tech leader, developing semiconductors, solar panels, artificial intelligence technology, biotechnology and dynamic new business models
- But only a small segment of companies will be “winners” – which is why investors may want to turn to a thematic approach as an effective way to participate in change
- We've defined a set of themes – including environmental commitment, healthcare transformation and food security – to help identify companies best positioned to profit from the country's rapid transformation

The winning themes

Just as at any time of rapid structural change, however, there are winners and losers. “Only a small segment of companies will be winners from China's growth themes,” noted Mr Fruschki. “That is what you can identify with a thematic approach to investing. It's a very effective way to participate in change.”

Drilling down into China's broad macro trends, Allianz Global Investors has defined a set of themes to help identify those companies best positioned to profit from the country's rapid transformation. The current list of themes includes:

1. Import substitution
2. New consumption
3. Environmental commitment
4. Digital life
5. Healthcare transformation
6. Frontier technology
7. Quality education
8. Financial inclusion
9. Food security

Import substitution, the environment and consumption

The first three themes in particular illustrate the emerging investment opportunities. For instance, "import substitution" describes the growing number of Chinese companies that are catching up with foreign competitors and taking market share. On a recent research trip, Mr Wang visited several companies along the semiconductor value chain, which are developing fast due to growing demand for chips.

"The good news is that today it's not just computers that need semiconductor chips, but also TVs, cleaning robots and the whole development of the internet of things," he noted. "This offers a great opportunity for young Chinese semiconductor companies to finance their R&D spending."

Turning to new consumption, the pandemic's aftermath is disproportionately favouring high-end Chinese brands instead of the old European favourites. "People are spending their money on high-end Chinese brands," said Mr Wang. "Some of these companies are growing very fast, especially if they have innovative business models."

Another major theme is environmental commitment. In 2020, President Xi Jinping pledged that China would become carbon-neutral by 2060. Chinese businesses are already leading the global transition. China has the world's largest market for electric vehicles, by far the biggest lithium-ion battery manufacturing capacity and the largest usage of polysilicon for solar panels.

"We believe that the journey to carbon neutrality will result in significant winners and losers," explained Mr Wang.

Like other countries throughout history, China is undergoing an economic revolution that will enrich the architects of change. What makes today's China different, however, is the sheer pace of reinvention. The investor's challenge is to identify the winners – a task that can be simplified by focusing on the country's growth themes.

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