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China: Navigating the headlines

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With the 2021 Olympic games now behind us, Asian markets continue to digest some of the recent market news coming out of mainland China. There has been heightened noise from across the Sea of Japan surrounding the crackdown on education companies by the Chinese government. This comes on the heels of rising regulatory pressure on Chinese technology companies (including well-known names like Tencent and Alibaba) in recent weeks.

Within the $100bn private education industry, Beijing have announced that all companies offering private tuition on school curriculum subjects will be forced to register as non-profit institutions and that foreign investment within the sector will be restricted. This effectively removes the ability for these companies to raise capital and to profit from teaching subjects on the syllabus.

With growing school admission rates for children between 6-15 years, parents are seeking private tuition for their children as a means for them to get ahead in a highly competitive environment. This policy shift by China is also aiming to ease the financial strain of educating and raising children – third-party research has highlighted that the educational cost for children accounts for almost 50% of household disposable income.

Whilst, longer term, these changes will help level the playing field in an education sector that has historically benefitted the wealthy, the recent regulatory changes triggered Chinese stockmarket volatility towards the end of the July, causing concern among some international investors with Chinese exposure.

It is important to note that the current headwinds are very much China specific, and it is pleasing that the funds within our client portfolios have very limited exposure to the educational companies that are currently in the crosshairs of the government's clampdown. Our underlying active managers are also collectively underweight the big Chinese tech companies, such as Tencent, Alibaba and JD.com, which have also faced recent regulatory pressure and fines too.

Whilst we are not short-term investors, our underlying active managers have held up well as a whole against the market; our most widely held fund, Prusik Asia, has been one of the few funds to post a positive return over the last three months. This emphasises the value of selecting active managers who can position their funds to avoid potential problem areas or limit their exposure by not being tied to index weightings in certain companies or sectors.

We remain active and diligent in our allocations to Asia and our underlying managers are being careful not to make knee jerk reactions to short-term noise and potential contagion across sectors that are unlikely to face similar issues. They are able to draw on their experience to navigate their funds through this – whilst the harsh treatment for the education sector was unexpected, the regulation headwind for technology has happened before and the long-term prospects for this sector remain strong, even in the face of short-term pressures. Active managers also have the ability to identify those companies that have future growth potential, avoiding businesses where regulation and other issues could become headwinds. Having a long-term investment horizon and sticking to one's process is important during such times.

Overall, we remain positive on the Asia Pacific region, which is expected to have a fundamentally stronger and more resilient economic growth trajectory than other parts of the world over the longer term. We see the recent volatility in China as reminder of the influence that the Chinese government can have on any company or sector it chooses, and why active management is key to investing long term in a region with high growth potential.

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