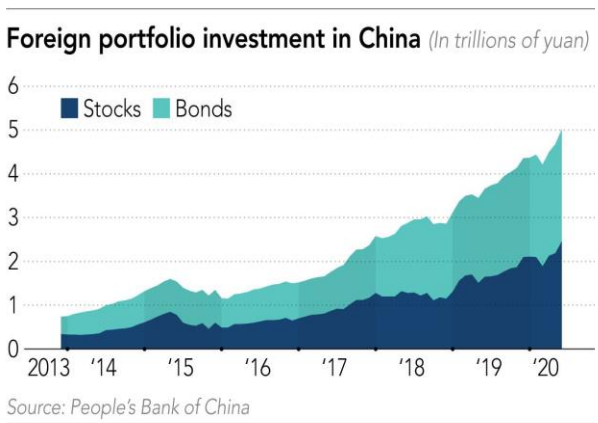
RockCreek

RockCreek Commentary:

Trump's Ban on Chinese Military-Linked Companies

Yesterday, after a period of silence on U.S.-China relations, President Trump signed an executive order prohibiting U.S. entities from investing in 31 Chinese companies the White House says supply and otherwise support China's military-industrial complex. President Trump's order also bans U.S. investors from owning or trading securities that are derived from or exposed to the banned companies. The order will take effect on January 11, 2021 and investors already holding such assets have until November 2021 to exit them.

This latest order highlights the potential short-term investment risks tied to U.S.-China relations. Before President-Elect Biden's administration takes office on January 20, 2021, President Trump and the current administration can still implement a flurry of measures aimed at China. Such measures are unpredictable and could include, among other things, forced delisting of Chinese companies from U.S. exchanges, expanding the entity list and more geopolitical confrontation, for example, through sales of defense equipment to Taiwan. Nevertheless, we see this latest move by the Trump administration as largely symbolic and ineffective. U.S. investors own about 2 percent of the value of the companies traded on China's stock market and only a small number of publicly listed Chinese companies are believed to be linked to the country's military.



The executive order would have carried more weight had it included more consequential names in China's technology ecosystem. There is always the risk that this may happen in the next ten or eleven weeks and we are working with our local partners to be prepared for that possibility.

As far as the incoming Biden-Harris Administration, we expect it to focus on domestic issues in its first hundred days, with the pandemic and the U.S. economy taking center stage. As far as China is concerned, the new Administration will likely focus on a broader strategy that will concentrate on human rights, intellectual property rights and a reconciliation with strategic allies in the region to keep Chinese ambitions at bay. We do not think banning stock and fixed income investments will be a central part of this strategy – time will tell.

The ongoing economic and geopolitical tensions between the U.S. and China should not deter investors from a growing set of opportunities. Chinese equity markets have rallied 27 percent this year despite a severe pandemic and the subsequent global slowdown. The domestic consumer has been and will likely be the driver of economic growth in China for years to come. As if to underscore the power of the Chinese consumer, hidden in the headlines this week was Alibaba's $56 billion worth of goods sold on 'singles day', a 38 percent increase from last year. The IMF projects China's GDP growth to be in the high single digits in 2021, and Bloomberg projects the proportion of worldwide growth coming from China to increase from 26.8 percent in 2021 to 27.7 percent in 2025.

RockCreek's approach of leveraging local partners to invest in China has helped us navigate geopolitical risks before, will do so going forward and demonstrates the importance of having the aptitude and established network necessary to manage top-down systematic risks. In the meantime, alpha generating opportunities abound, particularly in consumer, healthcare and new technology, all segments of the economy highlighted in the recently released 14th five-year plan.

In the coming weeks, as political power changes hands in the U.S., we cannot help but look back at the last four years and conclude China has benefited from American foreign policy. The Trump administration has catalyzed China to open up its capital markets, speeding up the country's self-reliance process in the areas of technology, food security and placing the focus firmly on China's vast domestic consumer market. As China sets off to achieve President Xi's 2035 vision, which includes lifting its GDP per capita to that of medium-developed country level by 2035, global investors should expect more sustainable and meaningful economic growth from China in the coming years.