STONEHORN GLOBAL PARTNERS
ASSET MANAGEMENT

Is the China put now in play?

Investing in China has possibly just got a lot easier, even for the naysayers

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Some call events of the past week China's Draghi moment – "whatever it takes[1]" – and draw parallels to the Fed's "Greenspan put[2]." We see these events as being far less dramatic (China wasn't/isn't going broke), but the impact on the market has been remarkable.

Yes, the China-regulation Rubicon[3] has indeed been crossed, but it is a journey that was always going to happen. Many thought *the point of no return* meant perpetual negative regulation. That's not the case. **There is a backstop - the China put.** We have peeled back the layers for you, applied some common sense, and provided some perspective on recent policy announcements.

What happened: On March 16, the Financial Stability and Development Committee (FSDC) held a meeting to send key signals directly to the market. The resultant effect was extraordinary – the Hang Seng Index soared more than 9% in one day. Earlier in the week, some had called China "no longer investable."

The FSDC meeting was a strong push to stabilise battered financial markets, with promises made to ease regulatory crackdown, support property, and technology companies, and stimulate the economy. The Chinese government should "actively introduce policies that benefit markets," according to the committee led by Vice Premier Liu He, one of China's top economic officials.

Please see below the ten most important pieces of information that arose from the FSDC meeting. Under each, we will highlight our view and whether this is considered 'new' or 'not new' information.

1. **Strengthened economic growth** - The Chinese government will take substantial measures to shore up first-quarter economic growth.
   a. **Not new**
      i. In the latest Stonehorn Global Partners' quarterly report, we noted, "In response to China's difficult conditions, we expect fiscal expenditure will be brought forward, including increasing infrastructure investment. Monetary policy is also likely to become more accommodative." This is in line with our earlier expectations, "It will be front-end weighted, pro-growth approach."
      ii. Our National People's Congress (NPC) Preview posted to LinkedIn on March 4, 2022, noted that "Monetary policy should be front-loaded."

2. **Accommodative monetary policy** - Monetary policy should be at the forefront of supporting the economy, while new loans should maintain appropriate growth.
   a. **Not new**
      i. This is in line with our earlier expectations for monetary policy; we shared our views in the latest quarterly: "Monetary policy is also likely to become more accommodative."
      ii. The Central Economic Work Conference (CEWC) detailed "maintaining monetary policy autonomy," referring to the fact that while rates are rising in the West, China

[1] https://www.youtube.com/watch?v=tB2CM2ngpQg
[2] https://en.wikipedia.org/wiki/Greenspan_put
[3] https://en.wikipedia.org/wiki/Crossing_the_Rubicon

will run its own autonomous monetary policy, which will see rate cuts. This should have a positive effect on equity markets.

iii. The PBOC's 4Q 2021 Monetary Policy Implementation Report stated that prudent monetary policy should be flexible and appropriate.

iv. We have already seen rate cuts. The medium-term lending facility rate was cut 10bps on January 17, the one-year loan prime rate (LPR) was lowered 10bps to 3.7%, and the five-year LPR was trimmed 5bps to 4.6%, the first change since April 2020.

v. In our NPC Preview, we stated that "We believe a 5-10bp rate cut will occur in March-April if deemed necessary." This has not occurred yet but could happen on April 21, when new data is released.

3. **Real estate risk mitigation** - The Chinese government will study and launch effective risk prevention and mitigation solutions for real estate enterprises.
   a. **Not new**
      i. We believed this would occur eventually; in our Evergrande opinion piece posted to LinkedIn on September 22, 2021, we stated, "The potential social unrest from up to a million unfinished Evergrande homes is a bigger issue than the debt. The largest political party in the world is also the largest owner of property in China. It has a vested interest to step in and use its full powers to avoid further unrest. I expect verbal support will be used to stabilise sentiment, followed by a debt restructuring and forced asset sales. Bond and equity holders should prepare for a massive haircut while **state-owned enterprises can expect a telephone call informing them of their purchase of some distressed assets."**
      ii. Recently, we have seen news reported by Nikkei Asia on February 26, 2022, that Evergrande sold four projects to Chinese SOEs.
      iii. Xinhua News Agency separately cited an unidentified Finance Ministry official on March 16, 2022, saying China won't expand a trial on property taxes.

4. **Positive progress on Chinese ADRs** - Chinese and U.S. regulatory bodies have made progress and are working together on a concrete cooperation plan to regulate US-listed Chinese firms.
   a. **New**
      i. March 15: the Public Company Accounting Oversight Board (PCAOB) is "actively engaged" and has been meeting with Chinese government authorities to reach a deal that would give the board access to audit firms in China and Hong Kong – similar to cooperation arrangements that the regulator already has with dozens of other countries, Bloomberg reports, citing the regulator.
      ii. If interested, more detailed information can be found here.

As a side, but related topic, as part of a grander 'deal,' we see **Biden likely to exempt some of the Chinese tariffs**, which are inflationary. Specifically, 352 products on which Washington first imposed levies in 2018, when then-President Trump started a trade war with Beijing, will possibly be exempted. Don't be so surprised; there are breadcrumbs in Ambassador Qin Gang's opinion piece, Embassy of China, Washington, D.C. Embassy of the People's Republic of China in the United States of America 中华人民共和国驻美利坚合众国大使馆.

5. **Overseas listings** - The Chinese government will continue to support various enterprises seeking listings in overseas markets.
   a. **New**
      i. Previously, we have seen China do everything in its power to have DIDI delist from the New York Stock Exchange over data concerns.
      ii. In the long run, data concerns will persist in China, but as long as companies adhere to the Personal Information Protection Law (PIPL) of China, effective from

November 2021, we would most likely not expect China to object to overseas listings.

6. **Chinese tech regulations -** Relevant departments should steadily advance and complete the rectification work on large platform companies as soon as possible.
    a. **New**
        i. On March 14, 2022, the Cyber Administration of China (CAC) released draft rules regarding the online protection of minors, seeking public feedback until April 13. The set of rules has a total of 67 provisions, mainly covering: (1) teaching children how to better use the internet, (2) strengthening control of online content for minors, (3) enhancing personal information protection for minors, and (4) prevention and control of minors' internet addiction.
        ii. We have always believed that regulations will become more granular, but this indicates that we can see the light at the end of the tunnel. Regulations will likely come up again in the future, but the great regulatory crackdown seems to be past its peak.
        iii. In the FSDC meeting, it was noted that regulation of internet platform companies should be "standardised, transparent and predictable."

7. **Balance Chinese tech regulations** - Both **"red lights"** and **"green lights"** should promote the steady and healthy development of the platform economy and improve its international competitiveness.
    a. **New**
        i. Some of the green lights which might occur, while not specified, could include:
            1. The Chinese government may allow tech platforms to reduce their wage expenses and increase cost-efficiency. We have recently seen news that Alibaba and Tencent are preparing to reduce headcount.
            2. The Chinese government may allow significant share buy-back programs. Alibaba has increased the scope of its share buy-back program to USD 25b.
            3. The Chinese government might encourage IPOs, with Fintech companies of platform businesses taking the opportunity to unlock some of their surplus assets.
            4. The Chinese government may allow more M&A activity in this space.
        ii. We are thinking long and hard about what the green lights might be. Although we don't know the size and magnitude of each at this stage, we believe the green lights will have to balance some of the red lights that have occurred recently.
        iii. We believe the non-negotiable red lights will be connected to the main themes of Xi Jinping's common prosperity speech. Sam spoke about the major themes of Xi Jinping's common prosperity speech on Ausbiz TV in October 2021. We believe any actions that are perceived to have a negative impact on the following will be red lights:
            1. Rural workers, protected.
            2. Small, micro, and medium-size enterprises, protected.
            3. Affordability, the affordability of the average Chinese citizen will be protected; we saw China implement tutoring regulations last year to preserve the affordability of its citizens.
            4. Olive-shaped income distribution structure.

8. **Encouraging investment into equities** - Long-term institutional investors are welcome to increase their shareholding.
    a. **New**

b. We cannot recall any Chinese President, Premier, or Vice-Premier making such a statement. From a Chinese proverb point of view, Vice-Premier Liu He is almost inviting you into his house. There is a lot to read into the tea leaves here.
    i. A major part of creating trust lies within standardised, transparent, and predictable regulations.

9. **Financial markets stability -** The FSDC urged enhanced communication and coordination with Hong Kong regulators to maintain financial market stability in Hong Kong.
    a. **New**
        i. This marks a strategic line in the sand indicating that Hong Kong is still fundamentally important to Chinese financial markets.
        ii. Stability is the key mantra in China right now. As highlighted previously, the word stability was used 26 times in the CEWC, held in December 2021.

10. **Market-friendly policies** - Relevant authorities should actively introduce market-friendly policies and prudently introduce policies with a contractionary effect. Any policy that has a significant impact on capital markets should be coordinated with financial regulators in advance, and the FSDC will hold relevant parties accountable if necessary.
    a. **New – but previously implied**
        i. On March 21, 2022, Premier Li Keqiang of the State Council presided over an executive meeting of the State Council. There were five key focus areas we noted in this meeting.
            1. Increase the support of prudent monetary policy for the real economy.
            2. Maintain policy stability.
            3. Create a stable, transparent, and predictable market environment.
            4. Closely follow the situation in China and abroad and take targeted measures to boost market confidence.
            5. Stabilise foreign trade and foreign investment.

There is a lot to digest from the latest FSDC meeting, as well as the executive meeting of the State Council, which Premier Li presided over. Being situated in Hong Kong, reading official documents, and speaking to our extensive network, a lot of the news was not surprising to us. We didn't panic.

The FSDC meeting sent a powerful message. **China cares about its capital markets**. China wants to create standardised, predictable, and transparent equity markets. Chinese equity markets are trading at significant discounts. Although it will take time, this discount should narrow. Now global investors are digesting **the China-put.** We see this possibly leading to extraordinary returns.

Your eyes and ears on the ground.
Kind regards,
The Stonehorn Team

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