China; Investment Outlook For 2018

With 2017 in the bag investors are hopeful China recovery and growth will continue in 2018.

Trade And The North Korean Situation

As trade tensions between China and the US simmer North Korea has emerged as a sticking point for resolution. The country has repeatedly snubbed its nose at the West and President Donald Trump isn't standing for it. While he agrees that trade with China is important it is not important enough for him to ignore threats from its smaller neighbor.

The latest flare up is centered on the newest round of sanctions. The sanctions limit the amount of oil allowed into North Korea and China is allegedly no compliant. President Trump, using his favored tool of communication – Twitter, pounced on Beijing with threats he would follow through with the trade restrictions he has threatened all through the campaign and first year in office.

Looking forward we can expect to see North Korea continue with its aggressive posturing and missile test launches. The question is whether or not Beijing will get on board with curbing Kim Jong Un or allow him free reign to terrorize neighbors in the region. Considering the amount of trade that flows between the US and China I'd say it is likely China will help.

Now that the GSP is expired China will need more than ever to maintain positive trade relations with the US. The GSP, the Generalized System of Preferences, allows developing nations tariff free access to the US markets. An estimated $19 billion in GSP products hit the market in 2016 alone worth $700 million in duties. Trade adviser to President Trump Dan DiMicco says “There's nothing developing about India or China any more - 600M people are in the middle class in India and that's probably three or four times the size of our middle class,”

Political Change Is Afoot

A recently reported story from the Xinhua News Agency, China's state run newspaper, suggests there could be a change to the nations constitution. If so it would be the first such change since 2004 and would pave the way for Xi Jinping to remain in office past the 2022 end to his reign. Under current law the Chinese supreme leader can server only 2 5 year terms. Speculation he would seek to stay longer than that began when the new lineup of government officials was revealed with no heir-apparent present.

China's Emerging Economy To Take Top Spot

According to a report from the Center For Economics and Business Research China's economy is expected to surpass that of the US by 2032. This is part of a major shift in global economics that has Asian nations outpacing their western counterparts. Within this shift India is expected to outpace both Britain and France in 2018 to become the 5th largest global economy. As the trend develops Asian nations are expected to dominated the top 10 spots in terms of GDP.

China's economy has been outperforming expectations in 2017 and may well do so again in 2018. The World Bank just raised its 2017 GDP target to 6.8% from 6.7% on strength in personal consumption and foreign trade. The 2018 and 2019 estimates were held steady at 6.4% and 6.3% on fears government reforms would slow growth. The IMF, OECD and United Nations forecasts all concur, China's growth is expected to slow in the coming years as it winds down from near 7% now to near 6% in 2020.

China's Growing Debt

Many analysts have feared an implosion of China's economy due to wildly skyrocketing debt on both the corporate and government side of the equation. While financial reforms have been able to curb the growth of corporate debt there is still the problem of escalating government spending and in particular that done by the local and regional authorities.

Recent statements from a spokesman for the PBOC has suggested the bank will not stand behind those local government forever. Xu Zhong, head of the PBOC's research bureau, says China needs to see some “Detroit-like” bankruptcies to convince municipalities and investors safety nets were not unlimited. “A case like the bankruptcy of Detroit would convince investors that the central government is really determined to dispel beliefs of an implicit guarantee for regional authorities.”

These sentiments were echoed by a report from the National Audit Office. They say the government should “dispel the illusion” that it would pick up the tab for local government debt. That being said it is likely the Government will allow defaults to hit the market as they arise.

The IMF released the results of a two year study less than a month ago. They identified 3 points of weakness in China's economy; the financial sector, the shadow banking sector and excessive risk taking. All areas of concern for Chinese officials and the target of ongoing reforms. The official response to the report was generally positive although there was some disagreement. The PBOC said the fund's recommendations are "highly relevant in the context of deepening financial reforms”.

Opportunity Still Exists In China

Philip Li and Norman Ho, fund managers at ValuePartners Asia Pacific Fund, continue to see opportunity in China as well as the greater China economic arena. While growth is expected to slow it is still expected to remain strong at 6%, a figure more developed nations can only hope to achieve, much less sustain. Growth in other countries within the region is expected to be much greater as the region continues to develop. This growth is expected to fuel earnings in a number of sectors for decades to come.

The fund uses a diversified approach to small and mid cap investing. They target undervalued companies in growth sectors across the region with an eye to local and regional risk factors. Current portfolio allocation is tilted heavily in favor of Info Tech, Real Estate, Consumer Discretionary, Industrials and Banks with a lesser focus on Insurance, Telecom, Utilities, Staples and Energy. The Asia