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Wilson Sy

Common Prosperity

US stocks climbed to new all-time highs last Friday following the Jackson Hole speech of Fed Chair Jerome Powell. He explained that interest rate hikes may not be forthcoming yet even as the tapering of Fed's asset purchases may start later this year. In contrast, Chinese stocks continued to languish due to the ongoing regulatory crackdown. This prompted many fund managers and investors to downsize or exit their China exposure, thus triggering significant volatility in Chinese stocks (*China Crackdown*, August 2, 2021). The clampdown is being conducted to promote the Communist Party's goal of common prosperity, which is to create moderate wealth for all rather than just a few.

Taper without tantrum

Before Powell's speech, markets were tentative and nervous. Investors still remember the taper tantrum in 2013 when fears regarding the tapering of the Fed's bond purchases triggered a sharp correction across global markets. To quell these fears, Powell emphasized that there is still much ground to cover before the economy is said to reach maximum employment. He stated that this can delay interest rate hikes even as the Fed is likely to begin tapering its asset purchases by the end of this year. Investors deemed Powell's plan to be a **dovish taper** which consequently sparked the move of US stocks to new record highs. The S&P 500 closed at 4,509 and the Nasdaq ended at 15,433 last week.

Bloodbath in Chinese stocks

While the US markets were making new all-time highs, the regulatory crackdown triggered a vicious drop in Chinese stocks. Since June 30, MSCI China is down 16.3% while the Nasdaq Golden Dragon Index plunged 26.6%. Stocks that plummeted include TAL Education Group (-81%), New Oriental Education & Technology Group (-75.6%), Tencent Music Entertainment Group (-44.6%), Didi Global, Inc (-41.3%), Alibaba Group Holdings Ltd (-29.7%), and Tencent Holding Ltd (-21.7%). The Hang Seng Index is down 6.7% year-to-date while the CSI 300 is 7.4% lower, making them the worst performers in Asia.

Targeting tycoons and tech giants

The Chinese government seeks to rein in domestic tycoons and giant tech firms which are now considered as threats due to their immense wealth and the expanse of their businesses. Aside from them, specific sectors such as education, ride-sharing, food delivery, and internet-based tech companies are slated for a regulatory overhaul to foster common prosperity. The government has likewise targeted giant companies by fining Tencent for anti-competitive behavior and breaking the Ant Group's monopoly.

Asking the rich to give back

The Chinese government is pressuring giant tech companies and rich businessmen to distribute their wealth, share their income, and engage in philanthropy. Tencent announced that it would invest 50 billion yuan to help promote the country's common prosperity program. Large-scale dole-outs from top billionaires can provide the private sector component that will support the government's wealth redistribution plan. Corporates are mandated to share their income and look after employee welfare. Meanwhile, tech billionaires and companies have pledged billions to various charities and foundations.

Paradigm shift

In the 1980s, paramount leader Deng Xiaoping pioneered crucial reforms that transformed the Chinese economy. His initiatives were encapsulated by the slogans “let some people get rich first” and “to get rich is glorious.” As a result, China experienced an export-driven expansion which allowed it to become the second largest economy in the world. However, this resulted in widespread inequality that needs to be addressed. Deng’s government was primarily concerned with growing China’s economic pie. After claiming to have eliminated extreme poverty as of last year, Xi Jinping is leading a paradigm shift in order to put greater emphasis on how fairly the pie is being sliced.

“Common Prosperity” is the new slogan

Xi has used the phrase “common prosperity” 65 times in his various speeches this year. This emphasizes the notable tilt in his mindset and this is reflected in his government’s agenda. Common prosperity means that wealth should be more widely and equitably distributed instead of being concentrated in the hands of a few. Xi was quoted as saying that “We can allow some people to get rich first and then guide and help others to get rich together… but we must also do our best to establish a ‘scientific’ public policy system that allows for fairer income distribution.”

Addressing rampant inequality

The Gini coefficient is a measure of income distribution across a population. It is often used as a gauge of economic inequality. China’s Gini coefficient has hovered between 0.46 to 0.49 in the past two decades, and this is above the threshold of 0.4 which is considered a red line for inequality. According to a report by Credit Suisse, the top 1% in China held 30.6% of total wealth compared to 20.9% two decades ago. Moreover, Bloomberg noted that since 2015, China’s richest 20% have earned more than 10 times the poorest 20%. Though common prosperity is a key tenet of socialism, unbalanced economic development remains a problem and fixing it would be a long-term program.

Understanding Xi Jinping

Though many investors are attracted to China’s economic potential, scale, and demographics, the recent developments highlight the regulatory risk that comes with investing in authoritarian countries like China. This comes into the forefront during notable shifts in the government’s over-arching policies. As China’s President-for-life spearheads a pivot towards common prosperity, we believe that it is integral to analyze what is in the mind of Xi Jinping. Doing this may help us understand the underlying purpose of his programs and also determine whether the stock market has adequately priced in the accompanying risks. This illustrates that investing not only involves the study of finance, accounting, and economics, but also a comprehension of psychology, philosophy, politics, and the primary objectives of nations and its leaders.

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