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What China's Greater Openness Means for Investors

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Many of the things that have been leveled at emerging markets over the years are now key concerns in the West: mercantilism, political instability, the wedge between rich and poor. The U.S. tries to boost the current stock market with subdued corporate investment, share buybacks and pro-capitalist tax policy; Europe struggles with secessionism and a moribund banking system. Their tribulations are causing the West to look inward. China is stepping into the vacuum both economically and politically.

The success of China over the past three decades has been due to a willingness to open up to the world. It has reformed its economic system, opened its economy and accepted new social mores as it has pursued economic growth. The ambitious Belt and Road Initiative has sought to build out infrastructure across land and sea routes to the West, strengthening ties and bringing hundreds of millions of people into the global trading system. China is putting itself at the center of Asia and Asia at the center of global trade. Historically, countries in this position have benefited economically, socially and scientifically.

Translating Growth Into Portfolio Returns

There are obstacles to this growth being expressed in portfolio returns. Recently, a desire for more balanced internal growth between rich and poor has meant that profit growth has lagged wage growth. Government plans to expand infrastructure and health care have led in some cases to heightened competition in key industries—and hurt corporate margins. Government backing for scientific innovation and cleaner energy may have meant some wasted money, even as the quality of China's research has improved and in a few cases competes with Western scientific advances. A desire to maintain social stability has meant that other resources have been inefficiently used in a pure economic sense to maintain employment for low-skilled workers in dying industries. But despite all this, China has maintained a growth rate of around 6% over the past several years.

Chinese policymakers are aware of the need to focus on the quality of economic growth, rather than just the pace—they are encouraging more efficient use of capital, higher shareholder returns, more trusted financial institutions, more sophisticated corporate governance and more modern market regulations. In all that China has done over the past three decades and more recently, it has put its citizens in a position to enjoy a better quality of life and its economy to enjoy a better quality of growth.

Identifying Potential Opportunities

Focusing on the new China means looking across all sectors and industries to find those companies that have taken up the mantra of quality of growth, of higher shareholder returns, regardless of what business they pursue or their market capitalization. China has a vast universe of stocks—Hong Kong-listed, Western-listed and China-listed companies. The quality of these businesses may vary; indeed, on average the quality of a company may be much lower than in the West.

Yet, the sheer number of companies in the universe means that even the relatively low percentage of high-quality business represents a large absolute number of potential opportunities to benefit from China's economic and social growth. Sieving through these companies to find the real gems requires a large team of researchers, a dedicated team of investors and a strong framework for analysis. But the opportunities undoubtedly exist; given the inflection point that we seem to be at in terms of world economic leadership, it is a potential opportunity that cannot be ignored.

Investments involve risk. Past performance is no guarantee of future results. Investing in international and emerging markets may involve additional risks, such as social and political instability, market illiquidity, exchange-rate fluctuations, a high level of volatility and limited regulation.

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