



## A Bull in a China Shop

*It all started on 3rd November 2020 when intervention by Chinese regulators halted the much-anticipated listing of Ant Financial, a subsidiary of Alibaba, one of China's internet giants. This listing was expected to raise approximately \$35 billion – making it the largest IPO in history. But that wasn't meant to be. Since then, Chinese regulators have become increasingly vociferous on a range of issues, causing Chinese-based technology companies to decline significantly. At the same time, a longstanding dispute about audit scrutiny of Chinese companies by US regulators has further soured the mood towards Chinese companies. In recent weeks, there have been signs of a thaw on these issues. That could be good news for investors, including those of us based in SA.*



**Michael  
Porter**

In 2015, Jack Ma, the rags-to-riches founder of Chinese internet giant Alibaba, persuaded regulators to recant critical reports about his company – a show of his political clout at the time. Five years later, he openly criticized China's state-owned banking system. But by this time his political star had faded. On the eve of the listing of Ant Financial – widely expected to be one of the largest IPOs in history – regulators stepped in to stop that listing. Ma was called in for questioning and disappeared from public view for a month. The crackdown on the Chinese technology sector had begun.

The Chinese technology sector peaked in January 2021. Prior to this, China's anti-monopoly and technology regulators were regarded as relatively toothless in reigning in China's tech titans. Bringing Ma to heel turned out to be the opening salvo in a year marked by high-profile actions against major tech companies. With regard to competition issues, the newly empowered State Administration for Market regulation (SAMR) took aggressive steps to rein in anticompetitive behaviour, issuing a record fine of \$2.8 billion against Alibaba. Alibaba was not alone. Fines were issued for wide-ranging infringements against most of the tech giants, including Tencent.

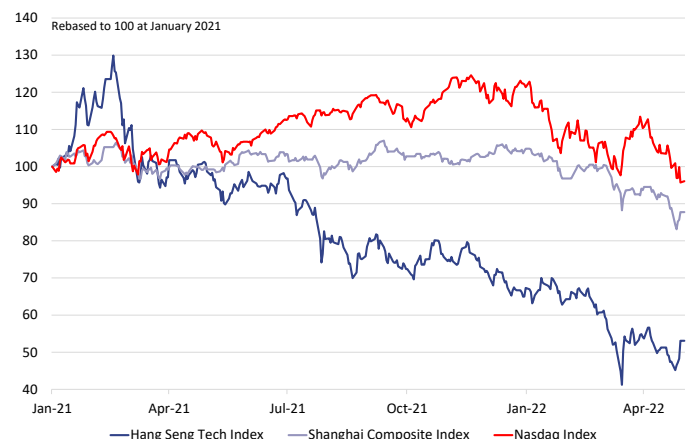
Regulators also took major actions in the data privacy space. Similar to European and US legislation (and our own POPIA Act), China passed its own versions of data privacy and protection of personal information laws. Simultaneously, they cracked down on data privacy violations, sending further ripples through the market. Share prices reacted

### SPEED READ

- Ever since the failed listing of Ant Financial in November 2020, Chinese regulators have increasingly clamped down on large technology companies.
- Adding to poor anti-China sentiment is the issue of US audit oversight of Chinese companies listed in the US.
- Strict lockdowns are slowing Chinese GDP growth – again! This has prompted a more conciliatory attitude from regulators, which would be positive, especially for SA-based investors.

accordingly. Having peaked in January 2021, the Hang Seng Technology Index has lost more than 60% of its value

### PERFORMANCE OF CHINA'S TECH SHARES



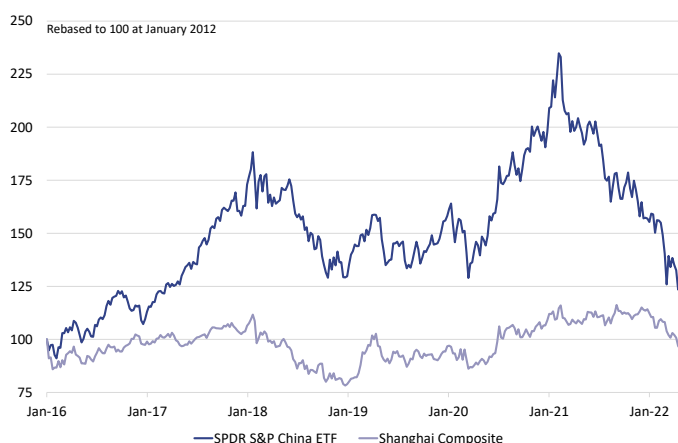
*Having peaked in January 2021, Chinese tech shares have borne the brunt of the regulatory crackdown. The Index has lost more than 60% of its value over the past 15 months, far worse than the 13% decline in the broader Chinese market, and the flat performance from the US technology sector.*

over the past 15 months, far outstripping the decline in the broader Chinese market, and the US technology sector, as represented by the Nasdaq Index.

Opinions vary as to the motivations behind the regulatory spree. Many of the crackdowns fall under the broad umbrella of “common prosperity” – Xi Jinping’s push to close the wealth gap by encouraging wealthy individuals and businesses to give back more to society. This may in turn be influenced by the political calendar. Later this year, China will hold its 20th Party Congress, where Xi will be looking to cement his leadership. Cracking down on excessive wealth in favour of the “little guy” might be a wise strategy as China pivots away from infrastructure-led growth to growth led by internal consumption fueled by rising income levels and a growing middle class.

The crackdown has soured the mood towards all things Chinese – especially shares - but it has been exacerbated by another long-simmering issue. Over the past two decades, many Chinese firms have listed in the US, attracted by its deep capital markets. But being listed on a US exchange means that companies must comply with US rules – one of them being that US regulators must have oversight and access to the audits of these companies. This was introduced after the collapse of Enron and is designed to protect investors. To date, China has refused to grant US regulators this access due to “security concerns”, which has prompted the US to declare that should access not be granted, then Chinese companies will be forced to delist from US exchanges. This is not a new issue. It has been bubbling under the surface since the early 2000s, but it came to a head earlier this year, and has only soured sentiment

#### PERF’ OF CHINA SHARES AVAILABLE TO FOREIGNERS



*The SPDR China ETF tracks the performance of China-domiciled companies in which foreigners can invest. It includes many of the tech giants but is much broader. This basket of shares has generally outperformed the broader Shanghai market as foreigners sought access to the world’s largest economy. That outperformance has evaporated as the mood towards China has soured.*



*Alibaba, founded by Jack Ma, is one of the world’s leading marketplaces but has been out of favour with China’s leadership.*

towards Chinese stocks further.

The theme of common prosperity may be even more urgent now, given the emergence of another round of hard lockdowns. China’s economy is feeling the strain. The Manufacturing PMI for April dropped to 46, the lowest level since February 2020. Forecasts for GDP growth this year have dropped to 4.8%, well below the government’s self-imposed target of 5.5%, and the lowest rate of growth for at least 30 years (apart from the Covid period.)

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**“China has refused to grant US regulators this access to audits due to “security concerns”.**

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But there are signs that this slowdown is prompting Beijing to adopt a more pragmatic attitude towards these issues. Last week, the Politburo issued a media statement scheduling a symposium between tech companies and the State for this week, in what is widely seen as the first move to easing regulation and giving platform companies (such as Tencent) larger roles to help prop up the ailing economy. Simultaneously, China has called for a joint regulatory meeting to put all regulators on the “same page” regarding Beijing’s new direction. At the same time, Beijing has started discussing the logistics to allow on-site audit inspections for US regulators. It is early days for both these issues – far more clarity is required before one can call a definite change in trend – but this is a very important, and significant, first step.

Why is this important? Why do changes in Chinese regulation matter to South African investors? The answer is Naspers! As most investors know, the day-to-day direction

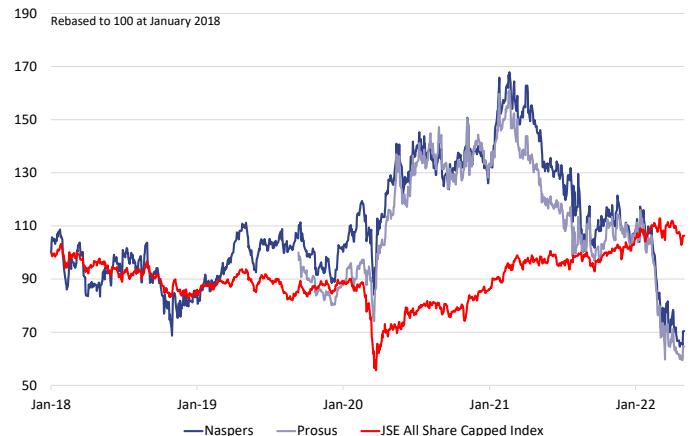


of Naspers is heavily influenced by the performance of Tencent. Since the start of 2012 to January 2021, Naspers grew fifteen-fold, whereas the rest of the JSE barely managed to double. However, those tables have turned. Since its peak in February 2021, Naspers has declined by almost 60%, whereas the broader JSE has risen by 10%. That is a significant underperformance from the country's largest company. Hindsight is perfect, and this underperformance has drawn its fair share of criticism. Commentators have rushed to point out why China (and by implication Naspers & Prosus) are a spent force.

However, the change in rhetoric from China last week saw a dramatic turn of fortune. Tencent has rallied by 15% in two days, which in turn has fed through to a sharp rally in the price of both Naspers and Prosus. As I said earlier, we are under no illusion that there is much water that still needs to flow under this bridge before the issues are fully resolved. But this event is another example of the danger of extrapolation. The weakness in Naspers had prompted many investors to capitulate – just at a time when the news may be at its weakest. We continue to believe that Tencent has a bright future – and a valuable role to play in a country

intent on common prosperity. Having underperformed for the better part of 16 months, the bull may be about to return to the China Shop”.

#### NASPERS RELATIVE TO JSE ALL SHARE



*Having outperformed hugely in the wake of the Pandemic, the tide has turned against Naspers & Prosus. But that may change if the Chinese regulatory regime becomes more predictable.*



*Shanghai's stock exchange has performed poorly of late and the domestic pressure to improve returns for local investors, may benefit foreigners too.*



We are pleased to announce our next seminar, scheduled for early June. This seminar will focus on financial planning, specifically the tools and attitude required to build an investment mindset.



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## Topic: **Building an Investment Mindset**

### Natal Midlands

Date:	9 June 2022
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

### Johannesburg

Date:	14 June 2022
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

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