COMMENTARY

Janus Henderson Horizon China Fund

May 2019

Fund manager names: Charlie Awdry & May Ling Wee

Overview

May began with a break down in trade negotiations between the US and China. President Trump suggested China reneged on agreements while China blamed the US. Perhaps whatever was agreed around the table could not be endorsed back in Beijing by President Xi. Unsurprisingly, China's stock markets, which had been drip fed good news tweets by President Trump up to that point, fell precipitously in May. So too did the currency as the yuan ended the month flirting with the psychologically important CNY 7.0 to the US dollar level that appears to be a line in the sand (currently) for the People's Bank of China to defend.

Performance and activity

The fund fell 11.5%* compared to the benchmark fall of 13.1%. Year-to-date the fund is up 8.8% compared to the benchmark return of 4.6%.

At the stock level the top two contributors were A-share listed Chongqing Brewery, as the market continues to like the profitability outlook for the beer industry, and Hong Kong-listed life insurers and financial conglomerate Ping An Insurance.

The two largest detractors were A-share listed technology and surveillance company Hangzhou Hikvision, which is being considered by the US for supply restrictions, and US-listed online travel agent C-trip, as it announced it was increasing its ownership stake in Indian online travel agent Make My Trip.

In terms of portfolio activity we took profits on Techtronics and Sany Heavy as we felt they were fully valued and enjoying overly positive investor sentiment. In addition to topping up some existing holdings we added online games company Netease and local stock broker and investment bank China International Capital Corporation.

Outlook

The escalation in the trade dispute between the US and China is symptomatic of the evolution of the bilateral relationship from one of constructive mutual engagement to one of strategic rivalry. This is a turn for the worst and clients must realise this increasingly antagonistic view towards China is not solely driven by President Trump as both sides of the US political spectrum are developing a more hard-line view towards China. The G20 meeting in Osaka at the end of June is an opportunity for the two Presidents to find some compromises to de-escalate the trade issues. Frankly, nobody knows what will happen but the rhetoric from both sides is becoming more entrenched. On the Chinese side President Xi has talked of a "New Long March" which serves the dual purpose of a nationalist rally cry and reinforcing the importance and strength of the Communist Party. Globally it seems like countries are being asked to choose one side – The US or China – and so the era of anti-globalisation progresses with China having fewer friends than it thought.

On the economic side we are seeing more targeted domestic stimulus and as usual the automobile sector is likely to be a key beneficiary. The currency will also be a point of focus because traditionally in emerging markets when other stimulus measures fail and when interest rates aren't cut (this would really stress the Chinese banking sector as net interest margins would contract) currencies weaken. This is why the CNY 7.0 to the US dollar is coming into focus now.

For China this negative turn in trade comes at a time when economic recovery momentum is proving weak and as it continues with the important deleveraging programme that now pleasingly includes a tougher line on zombie banks. We have seen Baoshang Bank being restructured where corporate deposits aren't fully guaranteed, which means that credit risk is becoming a real thing in domestic Chinese credit markets. Over the long term this is a very positive step but over the short term it may disrupt financing channels and the interbank market – a development we are watching closely and which makes us more confident in our zero weight position in banks shares.

Meanwhile, back in the equity markets this sell-off is increasingly bringing growth company equities back to attractive growth at reasonable price levels and as such we are seeing opportunities to buy. However, it is looking likely to be another turbulent summer for Chinese equities.

Source: Janus Henderson Investors, as at 31 May 2019

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*Gross of fees - gross of 5% initial sales charge. Calculated on a bid to bid basis, with gross income reinvested in USD.

Note: Reference to any specific company or stock is for information purposes only and should not be construed as a recommendation to buy or sell the same.

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