Tectonic Friction:

IS CHINA OR THE US THE BEST PLACE TO INVEST GOING FORWARD

By Dr Harry Liem, Director of Strategic Research, Pacific

The size and structure of China's economy rank among the nation's greatest achievements.

From the middle-class explosion to the sweeping impact of digital transformation throughout its population and industries, China – and the global economy – are entering a new era of investment opportunities. Undoubtedly, there is money to be made by investing in China as the weight of China's domestic shares increases in the MSCI indices. Nonetheless, the United States remains at the top of the economic ranking list with a global economy that exceeds US$20 trillion and with more than a fifth of companies on the Fortune Global 500 companies coming from the United States.

China
Ranked second in the world with an economy of US$14 Trillion.

Population 1.3 billion people

United States
Ranked first in the world with an economy of US$20 Trillion.

Population 320 million people

So, is China or the US the best place to invest going forward?

According to a poll conducted at Mercer's Global Investment Forum in Sydney, there was an overwhelming preference to investing in China with 63.5% of attendees voting to invest in China, while 36.5% voted to invest in the United States.

We've shortlisted the top 5 reasons why you would want to invest in China or the US.

	CHINA	UNITED STATES
1	By 2030 China will be the heavy weight economy of the world with global GDP rankings of US$26 trillion (source HSBC Global Research), followed by the US at US$25.2 trillion.	'The land of the free' – From an American business owner's perspective you can easily access Facebook, YouTube, and Wikipedia. However, if your travels bring you to China, you will find that these apps cannot be accessed beyond the great 'firewall' of China.
2	China has engaged in the ambition 'One Belt, One Road' initiative. A strategic agenda by which the two ends of Eurasia, as well as Africa and Oceania, are being more closely tied along two routes – one overland and one maritime. The largest infrastructure plan of all time, with projects involving 68 countries, 65% of the world's population, and over 40% of global GDP, passing through Central Asia and Russia.	'Home of the Brave' – The American narrative is a story of diversity – people coming together from every walk of life to form a complex tapestry of backgrounds. Why is this of interest? Studies having shown a significant linkage between diversity and company performance.
3	'Made in China 2025' – China's target to be a world leader in 10 key sectors : 1. Electrical equipment 2. Information Technology 3. Farming Machines 4. Aerospace Equipment 5. New Materials 6. Railway Equipment 7. New Energy Vehicles 8. Ocean Engineering 9. Robotics 10. Medical Devices By 2025 China will no longer by associated with discounted consumer goods, it will be more along the lines of high-tech goods in the upper end of the technology markets.	The power behind the US dollar – It makes up 90% of global foreign exchange trades. – It makes up 60% of central bank reserves. – It has a strong dollar policy.

	CHINA	UNITED STATES
4	China controls 42% of the global e-commerce market (versus 35% for the US) and is moving aggressively into microchip design. Once the Chinese master these, they will rule the virtual world.	Debt to GDP has been kept stable in the US at whereas in China it has increased to 350%.
5	China is cheaper than American Chips. China trades at much cheaper valuations than the US, both in terms of price-earnings and price to book.	Growth does not equal return. Over the past 20 years China has achieved tremendous GDP growth of between 9 and 10%. In the same period, the US has only achieved a GDP growth of between 1 and 2%. From a local investor's perspective over this period however, US equity markets returned 5% real over US inflation. China's domestic equity markets on the other hand only matched Chinese inflation – meaning zero real return. Investors must bear in mind that high GDP growth does not necessarily translate to high earnings per share growth. This is caused by massive dilution historically.

Mercer's view:

Both countries are very strong contenders for your money and extremely innovative, but the way they go about innovation is quite different. China has a central plan for change, whereas the US is more a laissez-faire capitalist economy.

In the end, there are no good or bad assets, only assets that trade at reasonable or unreasonable prices, and from that perspective, China has the edge. While the impact of the recent MSCI index changes is limited initially, over the longer term China will form a substantial part of investors' portfolios.

At this stage we recommend exposure to China through global or emerging market mandates for the widest opportunity set. For some investors, a stand-alone allocation to China is appropriate, if they have a long-term time horizon and can withstand significant volatility. Investors should also bear in mind that some US multinationals are well-positioned to benefit from Chinese rising middle class.

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