PRESCIENT

POSITIVE SENTIMENT, STRONG ECONOMY TO BENEFIT THE 'REASONABLY CHEAP' CHINESE MARKET

After three slower years, China looks to be back on trend where growth is concerned - but low interest rates have seen Chinese property prices escalate, leading to the formation of a real estate bubble that could spoil the party.

For now, however, sentiment in Chinese markets remains positive while valuations are cheap relative to historical levels, as well as peers. As a result, the Prescient China Balanced Fund is currently 90% invested in equities.

Reporting on the fund's performance, Meyer Coetzee, Head of Retail at Prescient Investment Management, commented: "The Fund had a fantastic first quarter, rising 5.6% after fees, beating the benchmark and outperforming its peers.

"Despite being a balanced fund, the Fund also outperformed the equity index. We will remain overweight as we believe the market is currently reasonably cheap, with good sentiment and strong economic activity.

"Since inception on 30 April 2013, both asset allocation and security selection have contributed to performance. The merit of active management is evident in a market like China."

The first quarter of 2017 started with a bang for China and the rest of the world. Global equity markets rallied to new highs, while economic numbers out of China and the US were robust. Emerging Markets recovered strongly from a low base, especially in Hong Kong, where shares were sold down on the back of weak Chinese growth.

The Chinese economy recovered through 2016 with Prescient's economic models showing the country back at trend growth after three years of slower growth. Monetary policy remains easy although central banks started tightening on the back of the economic recovery. This was evident when the People's Bank of China hiked rates twice in the first quarter. Inflation has also moved back to trend.

"When analysing economic data, one can see that the economy is finally recovering after a period of hardship. The combination of a recovering economy and excess capacity reduction resulted in the end of deflation in Chinese manufacturing. It appears China is roaring back to life," said Coetzee.

Of concern, however, is that low interest rates and a lack of investment alternatives have seen Chinese property prices escalate, leading to the formation of a property bubble. Unlike equities, property easily makes up 60% to 70% of a typical household's wealth. Consequently, should this bubble burst, the resulting debt and savings crisis could sink the economy once again.

Property prices in tier one Chinese cities have been growing at 30% to 40% a year and steps have been taken to limit the severity of the bubble. Leverage is being limited while large cash deposits are required on home loans.

The Chinese government is responding to the supply shortage with long-term plans to build new cities. The newly announced Xiongan, based on the model of Pudong and Shenzhen economic zones is testimony of this and will involve the creation of a business district 80kms from Beijing. Initially it will be 100 square kilometres in size, eventually expanding to an economic area covering 2000 square kilometres.

Unsurprisingly, as the government announced these plans, speculators bought up the land in these areas leading to property prices rising quickly. This forced the government to stop speculative activity of this nature, showing once again how good intentions in Chinese markets can have unintended consequences.

Coetzee said Prescient's investment models continue to work extremely well and in line with expectations.

"The first quarter of 2017 marks one of those quarters when both asset allocation and security selection worked well. Over the long-term, the Prescient China Balanced Fund has delivered strong real returns and has performed in the top 1% of its sector since inception."

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