



Citi Global Wealth Investments Asia Strategy

November 30, 2022

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China Pivots to Recovery, while Long-Term Prospects Dim

- China's recent policy moves in pandemic management, property and geopolitics signal a greater commitment to restore economic activity, which could lift market performance after a 20-month bear market.
- Even though rising COVID cases have caused further decline in mobility and public discontent in November, we continue to see further re-opening by the spring. External cyclical risks are likely to weigh on exports, but the acute domestic demand weakness from consumption and property in 2022 could see meaningful relief in 2023 and offset the potential weakening in external demand.
- China's equities, currency and bonds have all seen notable rebound since the start of November. But these only reversed a small portion of the prior selloff. Valuations remain in distressed territory, while earnings revisions are likely to turn positive along with recovery in 2023.
- Longer term, however, there are many doubts about China's prospects. Despite the commitment to treating economic development as top priority, structural challenges, compounded with technology decoupling with the west, suggest that China's potential GDP growth is set to slow.
- But we believe there are still opportunities. While it becomes more challenging for China to surpass the US in size, China still is an economy of over \$18 trillion, with the second largest consumer and capital markets. It will have strong global influences under every scenario. As China strives to reach technological security, there could be productivity benefits, such as automation. Investors simply can't ignore Chinese markets and Chinese assets.
- To capture potential new investment opportunities, investors may follow China's tech policies and R&D spend and those sectors targeted for domestic substitution and tech breakthroughs, while continuing to pursue potential opportunities from the ongoing structural changes.

China Pivots to Recovery

China has made a political decision to pivot to economic recovery

The policy developments since the start of November signal that a decision had been made to address China's principal economic and foreign policy challenges once internal political uncertainties were settled after the 20th Party Congress in October. As China refocuses on economic development, we think a cyclical recovery in China's economy and markets could be sustained well into 2023.

Four main domestic challenges are being addressed, including COVID zero policy, the property crisis, tech regulations and geopolitical escalations. The recovery will likely move at a gradual pace, as the return of mobility is stumbling initially. Global cyclical forces also present risks. But after the MSCI China index fell 63% in the twenty months through the October trough, we believe the bottom for Chinese equities had been reached. The recovery is still in its early stages.

Though potential growth has fallen, China would still be a large market with opportunities

Beyond the cyclical recovery, however, China's long-term prospects have dimmed due to multiple structural challenges. China's potential GDP growth is set to slow. Yet, China's economy is still over \$18 trillion, with the second largest consumer and capital markets. Investors simply cannot ignore the opportunities and risks in China – they'll have to become more attuned to its economic policies.

The bumpy journey towards ending COVID zero policy

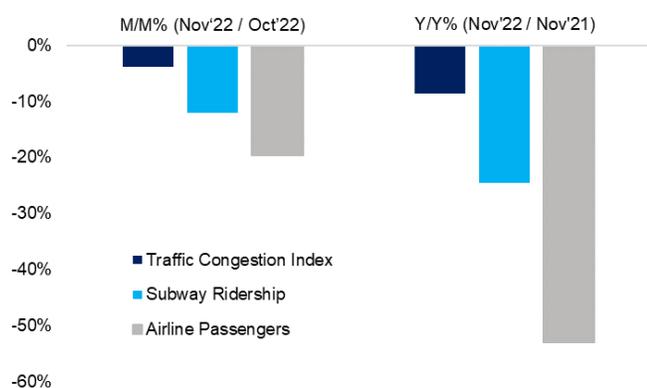
The new set of COVID zero policies were only marginally relaxed at a time when new cases exceeded 30,000 per day. Some local governments that were experimenting with a more liberal approach to pandemic management had to revert to stay-at-home policies.

Popular discontent against lockdowns drew media and market attention at the end of November. The core problem is that local governments still apply old lockdown tactics when central policy already forbade lockdowns of over 24 hours. The conflict can be easily addressed with more sensible public health targets, such as higher vaccination rates to minimize heavy symptoms and deaths. Though risks exist, we believe this may accelerate the path to re-opening, and widespread political trouble is very unlikely.

Public discontent against lockdowns may speed up China's journey towards reopening

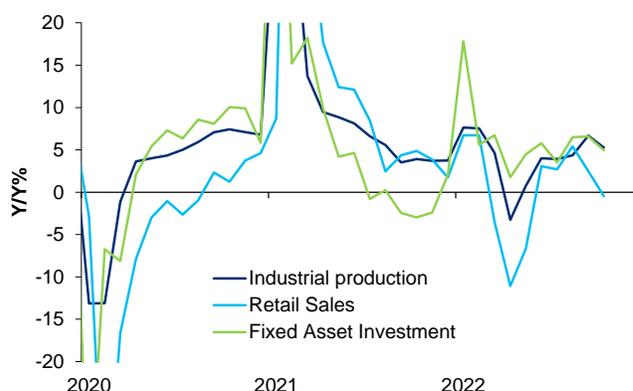
Mobility data show deterioration in November (**Figure 1**), suggesting no improvement in consumption yet from October, when retail sales already fell by 0.5%y/y, the first decline since the March-May lockdowns. Meanwhile, the slowing in fixed investment and industrial production was less pronounced (**Figure 2**). Unlike past cycles when investment drove recoveries, restoring consumption is critical to China's recovery this time, and ending COVID zero would go a long way to achieving that.

Figure 1: Recent data show still declining domestic mobility in November, as COVID cases rise



Source: Bloomberg, as of 21 Nov 2022

Figure 2: Poor macro data through October were concentrated on retail sales, making consumption the key driver for upcoming recovery



Source: Haver, as of 15 Nov 2022

The political imperative for COVID zero has turned to prioritize the economy

We believe these setbacks are unlikely to change the direction of gradually relaxing COVID zero policies, because the political backdrop has changed.

- The 20 measures to ease COVID zero policy was unveiled at a meeting of the newly inaugurated Politburo Standing Committee—China’s top decision-making body.
- These measures were accompanied by changes in government publicity. Official media have applauded HK as a success case in scientific pandemic management. Two domestic made vaccines, one inhaler and one mRNA, have been approved for emergency use. More marketing is being done to tout vaccine effectiveness and play down the severity of the disease.
- Most importantly, we believe that the political drivers of maintaining COVID zero have passed. Soaring youth unemployment and local government financial difficulties also leave the policy makers no choice but to prioritize economic revival.

Stopping real estate contagion and stabilizing the financial sector

China’s financial authorities circulated a 16-measure policy package to support real estate financing. These included support for loan and bond issuance and extension, borrower credit score protection and dedicated lending programs for project construction and debt restructuring. Shortly thereafter, the securities regulator announced a set of policies to restore developers’ access to capital markets in both Mainland and in HK.

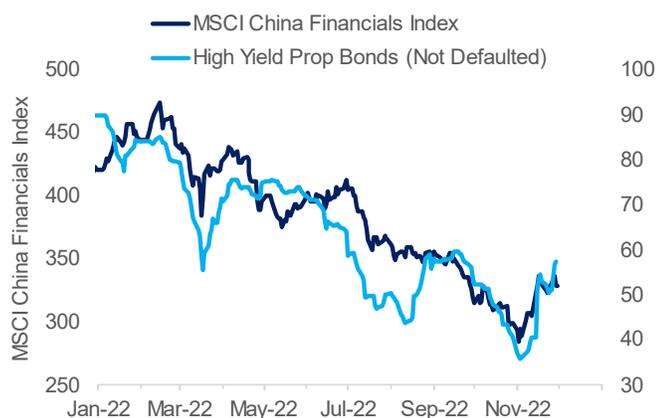
These are likely game changing measures not just for property, but also the wider financial sector. The property crisis started with a few egregiously indebted names last year, expanded to include all high yield issuers, then investment grade issuers and finally state-owned developers. Expectations for contagion have become entrenched, which weighed heavily on financial institutions with any exposure to real estate.

The key difference between the November rally and the short lived one in August is that the broader financial sector, including banks, insurers and wealth managers, have joined the rally (**Figure 3**). The market expectation for contagion may have begun to turn, which is a key element for sustaining a recovery.

For the real estate sector, the key variable is still sales. The recent measures included lifting purchase and mortgage restrictions, as well as protecting borrowers’ credit scores when renegotiating their mortgages. Accelerating project completions would also help to restore demand.

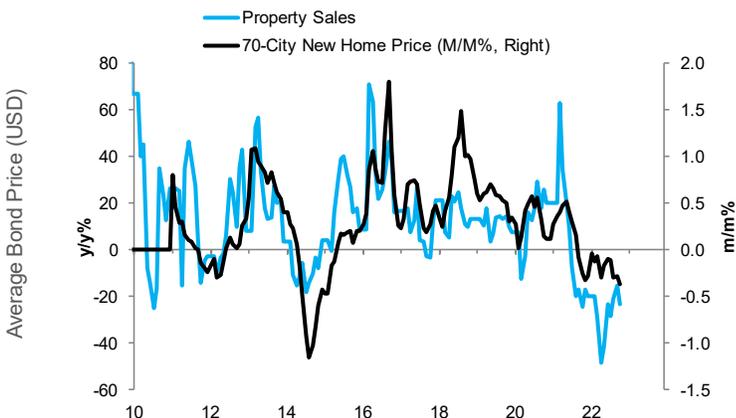
New property measures may stop contagion and helps to restore home sales

Figure 3: End to contagion lifts all financial boats



Source: Haver, as of 28 Nov 2022

Figure 4: Restoring sales remains a tough task



Source: Bloomberg, as of 18 Oct 2022

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New home sales have recovered from the -50% nadir during the national lockdowns in April, but remain 23% below year ago (**Figure 4**). Over the past two years, new home sales have fallen by 42%, while housing starts have fallen by 58%. The scale of declines is much larger than most estimates of overcapacity before the pandemic. This may even create shortages in the coming years and provide the basis for recovery.

Resetting US-China relations on a less slippery slope

In the geopolitical arena, Presidents Xi and Biden met on the sidelines of the G20 gathering in Bali, Indonesia, and produced the first agreement to soften bilateral tensions since the trade war started during the Trump administration. Biden recognized that military action across the Taiwan Strait is not imminent and Xi joined Biden to criticize Russia's invasion of Ukraine. Xi then met with the heads of state of South Korea, Australia, Japan, and others and struck similarly constructive tones.

To be clear, we believe that the future of US-China relations remains one of strategic competition. Tariff cuts remain unlikely. The geopolitical risks that made investors recoil in 2022 are likely to come back in the future. As a result, building up production capacity and supply chains at home and at friendly nations will remain national priorities for both the US and China.

Still, dialing down tensions at this point would lift a major weight off the markets. For example, will the latest de-escalation help to avoid forced delisting of Chinese companies listed in the US? The market is eagerly awaiting the verdict from authorities on whether the information provided to them during their audits in HK was sufficient. The delisting risk had weighed heavily on Chinese equities in the past year (**Figure 5**); decisively lifting that risk would boost market momentum.

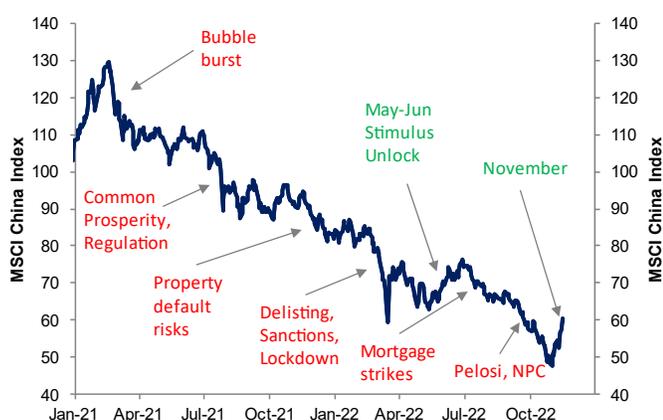
What about the capital market and tech?

The fourth hurdle, tech regulations, was settled well before the Party Congress, in that new rules had been written. However, the markets needed to see the return of blockbuster IPOs in the tech sector for assurance that access to capital markets would not be indefinitely curbed.

In this regard, IPO volume in HK had actually been rebounding notably. HK IPOs amounted to \$83bn in July through October, four times the total size of the first half (**Figure 6**). But the lack of flagship companies had left investors still wanting. Any breakthroughs in this area would likely create additional upside momentum in Chinese equities.

US-China strategic competition would continue, but may take a somewhat less dangerous path

Figure 5: Stages of China's bear market



Source: Haver, as of 15 Nov 2022

Figure 6: HK IPO volume began to rebound in 2H 2022



Note: Shaded areas denote periods of MSCI China bull markets. Source: Bloomberg, as of 18 Oct 2022

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External risks remain, but domestic factors are dominant

Domestic recovery to offset potential export drag, while rebounding interest rates in China may offset currency drag

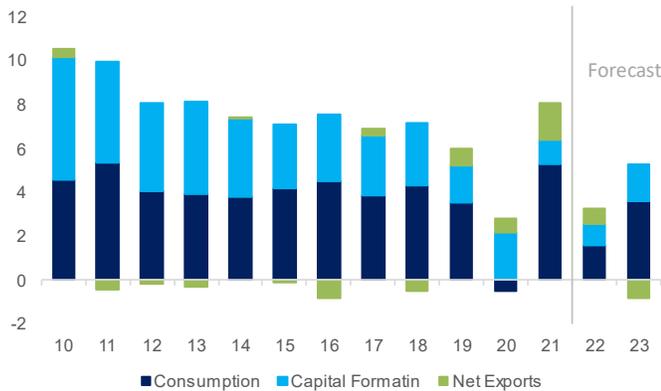
China's recovery will still be influenced by the global cycle, especially that in the US. Export growth has already slowed substantially to 7% y/y in October from 15% in 3Q. Meanwhile, import growth is gaining pace from 5.7% in 3Q to 7.4% in October. The trade surplus is likely to shrink in 2023, causing a drag on GDP growth.

However, as **Figure 7** shows, the sharp slowdown in 2022 was due to consumption and capital formation (domestic demand). We expect consumption to return to moderate growth on re-opening. Investment is likely to pick up too, as the property sector stabilizes. Still, even in recovery, we believe that the domestic demand contribution to GDP would be just at par with 2019, which was the slowest since the Asian Financial Crisis in 1997. In other words, a moderate recovery in domestic demand is sufficient to offset the potential drag from weaker exports.

The other external risk—USD strength—has become less threatening recently. Since reaching an apex of over 7.30, the Chinese yuan began to strengthen in November. The policy pivot to recovery lifted Chinese government bond (CGB) yields, with the 5yr CGB yield up 20bps to 2.61%. Meanwhile, a lower CPI reading and growth worries brought US 5yr Treasury yields 26bps lower to 3.95%. This yield gap had narrowed from 180bps to 134bps, as a result, reversing the rise that took place in October.

Going into 2023, continued recovery is likely to lift yields higher in China, while a potential downturn in the US may cause the Fed to consider rate cuts by mid-year. This is already encouraging a drop in US yields. The yield gap could narrow further and support the CNY (**Figure 8**).

Figure 7: US cyclical risks present downside risks to China's exports in 2023, but the main weakness in 2022 came from the domestic economy



Source: Haver Analytics, OCIS forecasts, as of 22 Nov 2022

Figure 8: Chinese yields are likely to rebound along with recovery in 2023, narrowing CNY's negative carry versus the USD, and supporting the Chinese currency



Source: Bloomberg, as of 21 Nov 2022

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The recovery is still in early stages

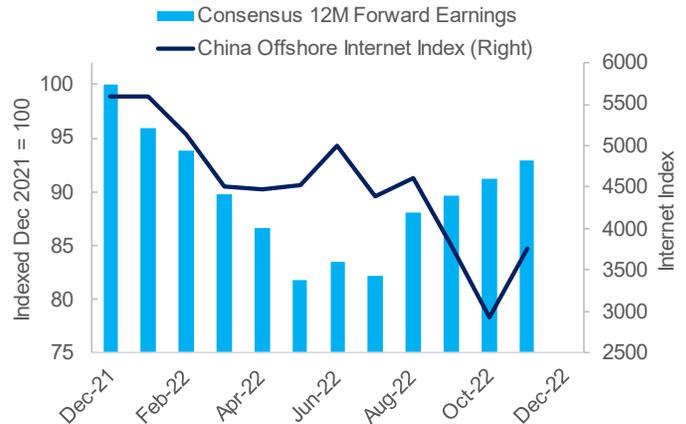
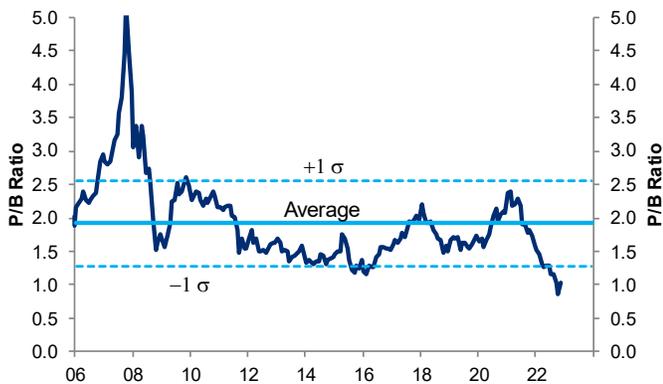
Valuations remain in distress territory even after the November rally, while some earnings expectations are being revised up

In sum, we believe this is a decisive turn in policy to support the economy. There may still be more policy updates in the capital markets arena, such as regarding tech IPOs. As strong as the rally had been in November, when MSCI China index surged 27%, the index still only reversed a bit less than half of the 38% lost in July-October, and a small fraction of the two-year bear market (**Figure 5**).

The initial short covering that drove the sharp bounce in November may have run out of steam. But the recovery is still in an early stage. Chinese equity valuations remain in distressed territory. The MSCI China index reached 0.85x book value and 8.2x forward earnings at the end of October. Since then, valuations have recovered a bit, but remain 1.7 standard deviations below mean (**Figure 9**).

Meanwhile, earnings revisions for some industries have begun to look more positive. For example, many of the large offshore listed China internet names have seen a steady upward EPS estimate revision trend for a few months, which is finally getting some recognition from investors (**Figure 10**).

Figure 9: MSCI China has rebounded to near 1x book value, which remains 1.7σ below historical mean **Figure 10: Some industries are seeing upward earnings revisions, such as the internet companies**



Source: Bloomberg, as of 19 Oct 2022

Source: Bloomberg, as of 19 Oct 2022

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China's Policy Priorities in the Next Five Years

The Chinese Communist Party's 20th party congress has set the policy priorities for the next five years and beyond. National security, technology innovation and “high-quality development” are the top three priorities, largely reflecting the rapidly evolving domestic conditions and a more challenging external environment.

China has been catching up in global innovation rank.

Domestically, structural challenges, such as rapid population aging, declining fertility rate, rising labor costs, binding carbon emission targets, and a high level of national debt, all suggest that China's potential GDP growth is bound to slow. A slowdown could be even faster than expected if productivity growth doesn't recover as expected.

Externally, there is no sign the Biden administration will lower the 25% Trump tariffs on Chinese exports, which will continue to put pressure on foreign firms to relocate some parts of their supply chains outside of China. While US trade restrictions on Chinese technology were expected, the extent to which the export controls imposed on the Chinese semiconductor sector is startling, including dramatic restrictions on US persons working to assist China's tech industry. The US sanctions will not only deeply constrain Chinese semiconductor firms, but also reshape and potentially disrupt global supply chains.

Out of these policy priorities, doubts often arise as to whether China can continue to advance in cutting-edge technology in an increasingly decoupling world, and what will happen to China's long-term growth prospects. In addition, whether geopolitical risk could rise again. These concerns will have important implications for investment decisions.

Amid both domestic and external structural challenges, China aims to ensure security, innovation and development

But is that possible?

Can China catch up in a tech-decoupling environment?

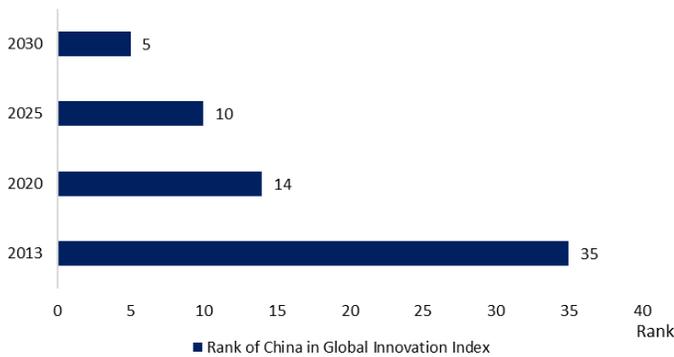
The Chinese response to the new external environment started well before this year's party congress. The 14th Five-Year Plan (2021-2025) has already elevated innovation to “core status” in China's modernization. For the first time, “technology self-reliance and self-strengthening” (*zili ziqiang*) is defined as “the strategic support for national development”. China will also develop a “**new whole-nation system**” (*juguo tizhi*) to mobilize resources for innovation, especially for breakthroughs in core technologies.

The government has launched a series of key science and technology projects in artificial intelligence (AI), quantum computing and communication, integrated circuits, life & health, neuroscience, biotech, aerospace and other strategic areas. It has ramped up the national lab system to develop Beijing, Shanghai and the Greater Bay Area (nine cities in Guangdong, Hong Kong and Macau) as international innovation hubs.

Preparations had started five years ago during the 14th Five Year Plan

Broad innovation indexes suggest China has made significant progress. The World Bank Global Innovation Index ranked China 14th in innovation performance among 129 economies in 2020, outperforming all emerging markets (EM) and many high-income economies alike. China has become the largest patent applicant in the world, with 1.24mn in 2019, followed by the US and Japan. It is likely that China will become Top 10 in global innovation rank by 2025 (**Figure 11**).

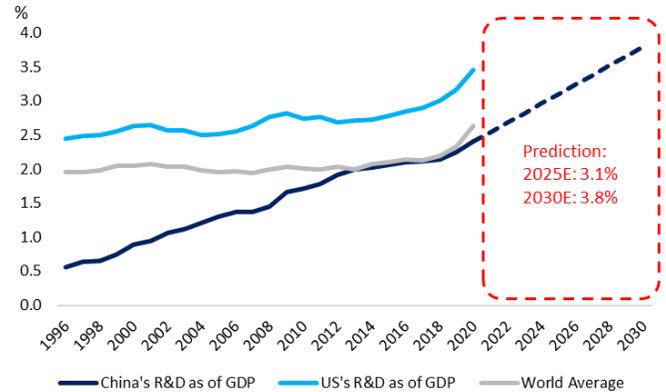
Figure 11: China's Rank in Global Innovation Index is Projected to Rise to Top 5 Globally



Source: Global Innovation Index, World Bank, Citi Research Forecasts, China's Race to the New Tech Frontier: Innovation to Create Investment Opportunities, as of 18 Nov 2022.

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Figure 12: China's R&D Expenditure as of GDP, comparing to the US and the world average



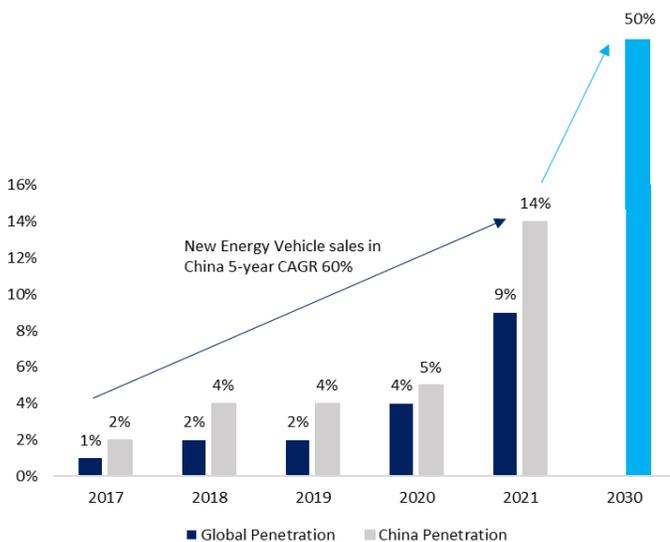
Source: National Bureau of Statistics, Citi Research Forecasts, China's Race to the New Tech Frontier: Innovation to Create Investment Opportunities, as of 18 Nov 2022.

China is gaining on R&D spend, is leading in AI, 5G and renewable energy

R&D spending has increased rapidly. China spent RMB2.43trn (USD375.7bn) or 2.4% of GDP in R&D in 2020, slightly above global average. It is expected to rise to 3.1% in 2025 and 3.8% by 2030 (Figure 12), at par at the current US level. However, relative to its economic size, China's R&D spending was still low, roughly corresponding to what Taiwan spent in 2005, Korea in 2003, Japan in 1984 or the US in 1959.

China has been on the frontier of or is already leading in certain high-tech sectors. China now has 60% of the world's 5G base stations. Based on certain criteria, China is already leading in electric vehicles (Figure 13), AI, quantum computing, 5G, wind power, solar photovoltaic power (Figure 14), and high-speed rail. However, it is also seriously lagging in semiconductors, auto and aerospace engineering, medicine and biotech.

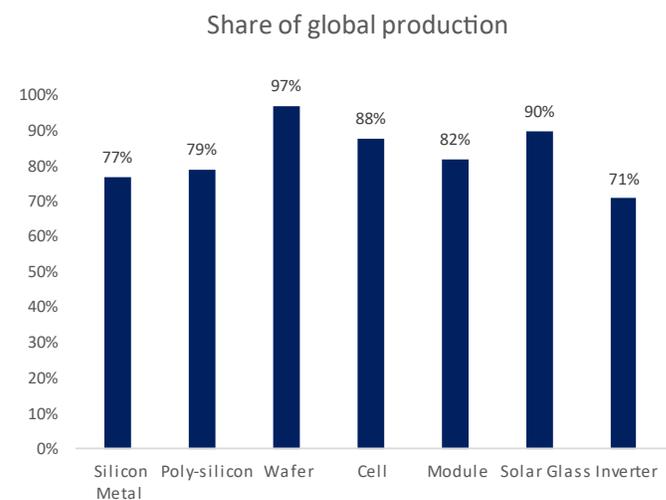
Figure 13: Electric Vehicle Penetration May Reach 50% by 2030



Source: GaoGong Industrial Institute, China Automotive Alliance, Bloomberg NEF, as of Dec 2021.

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Figure 14: China is also dominating solar value Chains



Source: China Photovoltaic Industry Association, Bloomberg NEF, as of Dec 2021.

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Can China catch up in technology innovation in general and semiconductor technology in particular? China does have the potential, but the catchup won't be an easy and straightforward process, as many still rely on foreign imports (.). We see a set of advantages for Chinese innovation:

China has the funding, market size, talent supply and industrial policy to catch up on chips

- **High savings and large capital markets:** China has the highest savings ratio at 45% among large economies in the world. China's capital markets have grown rapidly over the years, with various specialized exchanges supporting small and medium firms as well as technology firms, e.g., the STAR Board.
- **Big consumer market:** China has the second largest consumer market. The large and rapidly growing Chinese consumer market offers sufficient demand for innovative products.
- **Sufficient supply of talent:** China already has the largest number of R&D staff in the world. Out of 8-10 million college graduates each year, about 50% have a science and engineering background. Increasingly, huge investment in high-tech sectors and opportunities are also luring foreign-educated talents back (**Figure 16**).
- **Rich experience in industrial policies:** China had been using industrial policies to target development of domestic industries for three decades to varying degrees of success. This experience could help to pick winners. We also noticed that the share of top leaders with a science and engineering background also rebounded to a historical high (**Figure 17**). In particular, within the 24-member CCP's politburo, four are engineers or scientists with PhD degrees.

Large scale of government guided funds (GGFs) has been adopted to nurture and support new industries. By 2020, 1,851 funds had been established, with a targeted amount of **RMB11.53 trn**, and RMB 5.65trn already raised. The first integrated circuit (IC) industry fund was set up in Sep 2014, which received investment of RMB138.7bn from the central government and another RMB514.5bn from local governments and private investments. The first batch fund completed its investment by 2018 May, and cumulatively invested in over 70 projects and 52 firms. The second batch of the IC fund, which the central government invested over RMB200bn, has started to invest in IC firms since June 2020¹.

Basic research still requires major reforms

However, China's tech innovation and catchup will also be hampered by limited support for basic research, distorted incentives, information blockage, and inadequate IP protections. The ongoing US semiconductor sanctions and technology embargo will not only disrupt Chinese firms' near-term operations but also slow China's catchup process for many years to come.

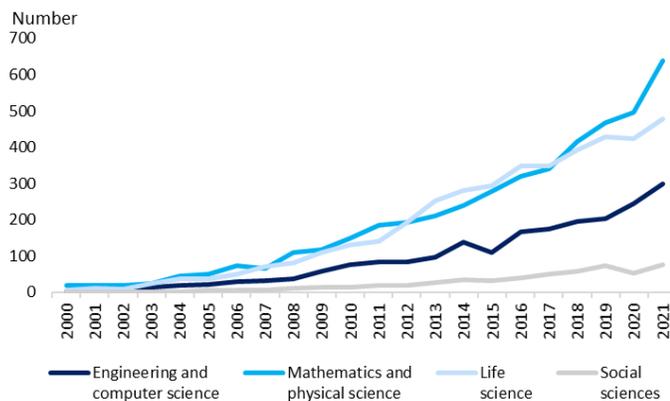
¹ Source: <https://finance.sina.com.cn/tech/2021-02-05/doc-ikftpny5008236.shtml>

Figure 15: 35 Tech Sectors that China Relies Excessively on Foreign Imports are being Targeted for Domestic Substitution and investment

Nr	Sector/product name	Nr	Sector/product name
1	Lithograph	19	High pressure-plunger pump (hydraulic equipment component)
2	Chip	20	Design software for aviation
3	Operation system	21	Photoresist (for chip production)
4	Aircraft engine nacelle	22	High-pressure common-rail system (core for diesel engine)
5	Tactile sensor (for industrial robot)	23	Transmissive capacitor (core component for life science's frozen capacitor)
6	Vacuum evaporation machine (display panel production tool)	24	Road-header's main bearing
7	Cellphone radio-frequency device (conversion component from digital signal to electromagnetic wave)	25	Microspheres (key material for panel production)
8	iCLIP tech (key tech for brand-name drug's R&D)	26	Underwater connector (undersea observation network)
9	Heavy-duty gas turbines (component for ships, trains, large-scale power)	27	Key material for fuel battery
10	Lidar (automatic driving system)	28	High-end welding power
11	Airworthiness Standard (assessment for aircraft engine)	29	Lithium battery separator
12	High-end resistor capacitor	30	Medical imaging equipment component
13	Core industrial software, e.g. EDA tool for chip manufacturing	31	Ultra-precision polishing process (basic tech for mfg)
14	Indium tin oxide material (for the production of monitors)	32	Epoxy resins (key material for carbon engine)
15	Core algorithm for robots	33	High-strength stainless steel (key material for rocket engine)
16	Aviation steel (e.g. for big plane's landing gear)	34	Database management system
17	Special steel knife (core component to maintain high speed train)	35	Scanning electron microscope (high-end electron optics)
18	High-end bearing steel (for airplane, high speed train, etc.)		

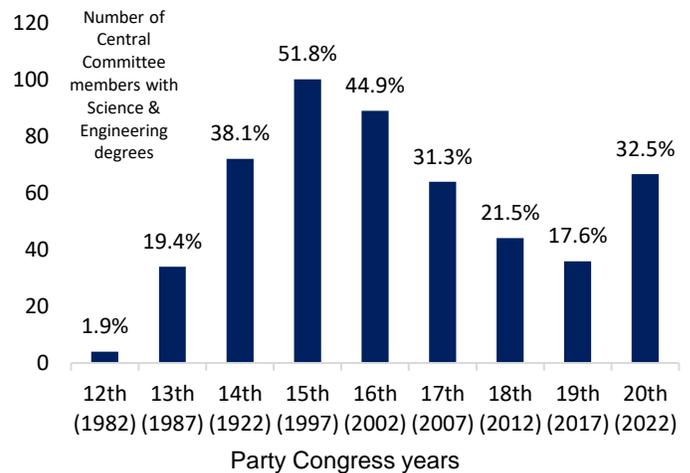
Source: Technology Daily Newspaper and OCIS, as of 18 Nov 2022.

Figure 16: Push and pull factors are driving an exodus of US-based Chinese scientists back



Source: Chinese-American Scientists and OCIS, as of 9 Nov 2022.

Figure 17: More members of CCP's Top Leadership have Engineering and Science Backgrounds, as Tech Innovation becomes Top Priority



Source: Brookings Institution and OCIS, as of 9 Nov 2022.

China's potential growth is set to slow

Demographics and investment fatigue will slow China's potential growth. China is aging at an accelerated pace. Its population growth rate fell from 0.145% in 2020 to just 0.034%, the lowest since the Great Famine of 1959-61. The main driver is a low fertility rate, which stood at about 1.3 in 2020, well below the 2.2 replacement-level fertility. Meanwhile, the 65+ group exceeded 14%, taking the dependency ratio to 45.9% in 2020, and is set to rise further, making China's demographics more like Japan's in the coming decade.

An older population, humbled property and higher debt are likely to bring down China's potential growth

High level of national debt weighs on investment. While China's on-budget debt (47.3% of GDP by 2021) looks sustainable, the general government debt, including implicit borrowings, already topped 101.7% of GDP in 2021. Like the US, an expected fiscal consolidation will further constrain investment growth. While manufacturing investment may grow faster on technology upgrading and innovation, it only accounts for one-third of China's overall fixed investment. Thus, it won't make up for the expected slowdown in both property and infrastructure investment.

Some gains in productivity are likely. Tech decoupling will make it more difficult for China to adopt new technology, but also likely accelerate its own investment in tech. Increased investment in automation, innovation, and education could boost China's total factor productivity (TFP) growth to 1.0% for the current five-year period through 2025 and to 1.2% for 2026-30. Such productivity gains may help to slow the pace in the decline of China's potential GDP growth.

Putting these factors together, we expect China potential growth to slow to 4.0% in 2025E and 3.5% in 2030E. At this pace of growth, it looks like China won't be able to become the largest economy in the world anytime soon.²

Figure 18: China's potential GDP growth to slow further

	Time Period	Labor	Capital	TFP	Potential Growth	Alpha	Emission Reduction
CASS	2011-2015	0.8	10-11	0.2	7.8-8.7	0.7	-1
	2016-2020E	-1	9-10	0.3	5.7-6.6	0.6	-1
	2021E-2030E	-0.5	8-9	0.4	5.4-6.3	0.5	-0.5
Citi	2021E-2025E	0.0	6.0	1.0	4.0	0.5	
	2025E-2030E	-0.5	5.0	1.2	3.5	0.5	

Source: China Academy of Social Sciences, Citi Research and OCIS, as of 9 Nov 2022.

² Using the potential GDP growth of China in Figure 8 and around 2.0% potential growth for the US, we calculate that China won't be able to catch up with the US even by 2035 in GDP size.

Geopolitical risk: No change in China's Taiwan policy

China retains its usual passive stance towards Taiwan, though US policy and Taiwan elections can still be key risk events

China's Taiwan policy remains passive. At the Party Congress, Xi alleviated the fear that China has a timetable to push for eventual unification with Taiwan, and he reaffirmed the long-held party policy on Taiwan—that is, the CCP “will continue to strive for peaceful reunification with the greatest sincerity and the upmost effort, but never promise to renounce the use of force.” While the military option can't be ruled out, the CCP can be patient enough on the unification issue, provided the status quo of Taiwan remains unchanged.

These statements suggest that analysts believe China will not consider the military option unless it is forced to do so, either by foreign interference or Taiwan's unilateral declaration of independence. Still, global investors should pay close attention to the status of Taiwan Policy Act, currently being debated in the US Congress after passing in the Senate Foreign Relations Committee, and the Taiwan presidential election in 2023.

On both events, if China perceived the passed version of the Taiwan Policy Act would materially undermine the One-China policy upheld by the US since 1979 when the two countries established diplomatic relations, and if the status quo of Taiwan would be further unsettled under a new (DPP) government in Taiwan, geopolitical risks across the Taiwan Strait would rise again.

Implications for investments

The changing structure of China's economy and policy priorities will have important implications for global investors. We think investors should consider following these shifting trends.

Investors should focus on industries that can contribute to China's and the world's security in technological and supply chains

Follow the tech policies and R&D spend: It appears that the 2C (to consumer) platform economy that had produced the largest Chinese companies, such as Alibaba and Tencent, from 2000 to 2019 has become a scene of the past. While it contributed significantly to China's growth and reshaped Chinese consumption patterns, this sector is winner-take-all, capital driven, but has limited tech innovation. This is not just a China issue, it is global.

It is important for investors to position for top players in leading technology sectors in both hardware and software. Strategically important sectors like **supply-chain technology, smart manufacturing, semiconductor, biotech, new energy, space communication, aerospace technologies and new materials**, among others, not only absorb significant R&D investment but will also enjoy high entry barriers once established. These sectors would harbor R&D leaders and may offer attractive investment opportunities.

Follow the sectors targeted for breakthroughs: The new tech-decoupling environment suggests that China won't be able to rely as much on foreign technology imports as in the past. The country would have to achieve breakthroughs in those 35 sectors relying excessively on foreign imports (**Figure 5**). Many technology firms could emerge from these sectors with an aim for domestic substitution, and they could consist of SOEs and mixed ownership ones that are mainly listed in Chinese equity markets.

Follow the structural changes: Traditional industrial sectors, equipped with smart manufacturing that can successfully transform and upgrade themselves, will gain market share and can't afford to be overlooked. While Covid-19 has dented China's consumption, we continue to believe consumption is bound to become an important engine for growth in the long term. As China's population ages fast in the coming decades, the rise of 'Silver Economy' is also a visible trend. Sectors related to **old-age care, medicine, medical services and retirement homes and facilities** should gain greater investor attention and awareness.

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