

Staying Positive on China

We remain positive on the outlook for China generally across risk assets.

1. Political reform is happening in the open and behind the scenes. At the Fourth Plenum, China elevated the constitution and announced the establishment of circuit courts free from local government influence.
2. Part of the reform is the wide scale anti-corruption effort which has ensnared some high profile officials previously believed off limits.
3. China is embarking on credit market reforms including eschewing blanket bailouts, encouraging more market discipline, regulating local government financing methods, prescribing collateral eligibility in swaps and repos. The recent policing of equity market margin trading is another encouraging measure.
4. Monetary policy has turned loose and is likely to stay that way. The PBOC reacted to US QE by tightening monetary conditions for the past 5 years expecting inflation. Inflation has abated and external economies are at risk of deflation. The PBOC has moved to compensate. Expect further macro prudential as well as traditional loosening.
5. The Chinese economy is slowing which is to be expected. That said, it is still the fastest growing large economy. The slowing economy will encourage the PBOC to be more aggressive.

The outlook is good for China risk assets. The investment strategy should be, A) avoid the obviously non viable, B) diversify among the remaining alternatives.