

## **China at the Heart of Global Investing**

**We rarely believe in asset allocation by geography. Decades of prosperity frequently have little benefit to stocks/stock markets. We are usually sceptical about claims of major shifts in economic power. Dusty bookshops still offer copies of treatises from the early 1990's describing how Japan would rule the world.**

**But despite such cautions we are at a turning point: China not America will be the heart of the investment narrative for the next fifty years. We believe that China will eventually be as rich as the US per capita. It has the human, social and physical capital to achieve this - or more. The context is that the IMF and World Bank peg current per capita Chinese GDP at market value as slightly below 15% of the American level. Yet in historical context equality or better would simply represent a return to the normal state of affairs. The oddity is the brief interregnum of Western dominance. It's still a fascinating debate that has spawned wonderful research as to why the Great Divergence between China and the West ever happened.**

**But more importantly for investors in the near future the largest companies in the world will be predominately Chinese. 2017 has seen this prospect come considerably closer with the market capitalisations of Tencent and Alibaba now similar to their US technology peers but if we are right this is but an early step in the ascent of corporate China. It's hard to overestimate either the rarity or the significance of companies valued at \$500bn still growing at 50% or more in revenues and profits.**

**From low cost manufacturer to technology driven domestic growth:**

**When I was in China in November our final meeting was with Jack Ma, the founder and Chairman of Alibaba. We were especially fortunate as he was about to host the extraordinary internet shopping festival that is Singles Day. It attracts an audience that is larger in size than the US Super Bowl. Mr Ma projected peak initial transaction volumes of 360,000 per second. Alibaba failed. It only reached a 357,000. To give a comparison with the US 30 seconds at this pace would cover the entire 24 hours of Amazon's Cyber Monday transaction volume. Of course this is an apples and oranges read across as it compares peak and overall pace but it captures the extraordinary pent up frenzy of excitement in China. Or to give an idea of the size of the Chinese market relative to that of India: Singles Day alone generates sales equivalent to almost 9 months of Indian e-commerce.**

**Yet the most intimidating feature of Singles Day doesn't lie in these comparisons. It resides in the rationale. This invented holiday isn't really aimed at marketing or pumping up sales. It's critical function is to test the systems necessary for how every normal day will be in 5-10 years time. As Alibaba currently generates more than 10 days normal volume on this one**

day the processing and distribution challenge involved, the future growth envisaged and the willingness to think ahead are all beyond the Western norms.

These anecdotes are part of a much wider pattern that delineates the Chinese era. It's characterised by interlocking networks, mentalities, assets and practices that are reminiscent of the alignments that bred Dutch then British and finally American global leadership. The system functions as a whole. We may or may not like that this is so but denial is not an adequate investment response. That Alibaba works with millions of small and far-flung companies to provide them with the resources and intelligence to penetrate markets that they could not hope to access otherwise is building a completely different economy than the caricature of low cost manufacturing exports that dominates perceptions. That it also relies on the extraordinary infrastructure build by layers of government is natural. So too is the mutual support in building a prosperous China that is thereby tolerates continued leadership by the Party.

Chinese leadership in the global digital economy is just as evident in social media. Facebook are prepared to admit their honest acknowledgment of Tencent's superior platform has morphed into frustration that their efforts to give Messenger a similar centrality is doomed. Against the sound and fury that is the Western internet that China offers an all-embracing but more practical version. It's the way to navigate the huge cities and the ever-present pressures of a population fourfold that of the US. It's easier to do this if intellectual capital is correspondingly deep. In the coming decade China will boast 4-5 times as many science and technology graduates annually as America.

China is now forging a society that is becoming powered by big data, machine learning and -ineluctably -Artificial Intelligence. 1.4 billion people mostly running their lives through mobile phones and now happily transacting their financial requirements and planning their travel needs and desires in the same way produce an amount of knowledge that then becomes a dominant force in itself. At some moments of history size is an advantage just as others being a small island or city-state was superior. As one leading entrepreneur put it to us 'Scale is as much, no more, of an advantage in a data driven world as in manufacturing.'

It's usual to be suspicious of optimism. That's even more the case as regards China -especially seen from America. There's never much affection for the next Superpower. State Communism with increasingly Capitalist Characteristics is Un-American. This has led to an outpouring of suspicion- much voiced by hedge fund titans who regard it as beneath them to visit China. Their prime supposition is that excessive debt will eat away at the Chinese miracle. But China has the savings and the sovereign ability to print money that normally provides a path through capital misallocation far worse than its own. As for angst around the combination of

**environmental degradation and the apparent impossibility of the entire population aspiring to Western life that seems to undervalue the response. The Chinese recognise this conundrum. A transition away from the past is a necessity- and is already moving ahead through serious investment in innovation. From solar power to electric vehicles it's becoming a reality in a way that is a real struggle in Trump's America. As the founder of the unquoted electric vehicle company NIO, in which Scottish Mortgage owns a stake, put it to us 'it's easier to work with the grain of society than against it'.**

**For the first time in my investing life I think it's better to be focused somewhere other than Silicon Valley. Amongst all the thriving Chinese cities I'd choose Hangzhou. Marco Polo described it as 'without a doubt the finest and most splendid city in the world'. Perhaps it's just chance that Hangzhou is the home of Alibaba.**

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