Soft Landing; Reality Or Fiscal Manipulation?

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China's recent GDP release is good news for the market, if we can believe it.

Risk And Reward In The World's 2nd Largest Economy

China's soft landing is a reality, at least for now. Fear that the country's growth would continue to slow and possibly contract have not been fulfilled. Latest GPD data shows that the worlds largest emerging market grew at a rate of 6.7% on an annualized basis, steady from the previous quarter and above expectations. While down from the peak of 13% it is still a robust figure and one of the worlds fastest growing economies. The caveat, as of course there is, is that growth is being propped up by government stimulus, record bank lending and a real estate sector many fear are overheating.

Resilience in the economy can be seen elsewhere as global demand falls off. Exports fell a whopping 10% in September, imports only -1.9% after rising 1.5% in August, even as GDP growth remains steady. There are concerns that weak global demand could continue to weigh on China's growth but for now those fears are unrealized and countered by strength in the services sector. The services sector created jobs at the fastest in 7 months in September while overall expansion in the sector held steady at 52.0.

Of course all the good news has raised some questions, one of which is just how reliable is the data? Since China's economy and government agencies are tightly controlled there is justifiable concern the numbers are being manipulated. Skeptics have voiced concern time and time again over the past few years while at the same time evidence of smoothing or doctored data was found at the regional level. Government officials however had this to say in a recent report from the Xinhua News Agency . . . "The reality is that the government simply has no incentive or necessity to whitewash the real economic picture".

The risk lie not in the country's growth prospects but in the ever increasing level of debt that is being generated to propel that growth. Despite the risk many analyst see economic activity, if on borrowed time as policy makers work hard to rein in overheated markets. Within the GDP report signs were mixed. Industrial production fell to 6.1%, down from the previous month, versus an expected rise while retail sales did rise. Retails sales gained 0.1%, ahead of expectations, to hit 10.7% and underscores the Chinese central governments desire for the country to shift to a more retail oriented economy. Although industrial production fell on a quarter to quarter basis there are signs that the contraction of that sector is nearing the end. The manufacturing PPI rose 0.1% in September, the first rise in nearly 5 years.

Banking Crisis In China?

The Bank of International Settlement, the bank of central bankers, has predicted a major banking crisis in China within the next three years. Their measure of financial market stability, credit growth, has reached a level that has preceded financial collapse in other major world economies and has held that level much longer than ever before. The only thing supporting the system now is the fact that the economy is growing at a rate fast enough to keep pace with credit expansion. The question is, can and will it keep growing at that pace?

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Regardless the answer the country is still growing, if only at the anemic sub-4% some economists suggest is the case. With this in mind, and the fact that China is the worlds 2nd largest economy when the EU is not counted as a whole and a driving force of the global economy. Global GDP is growing as well, if at a smaller 2.5% to 3% for 2016, but is expected to tick up next year. Both the IMF And World Bank blame sluggish growth on subdued economic activity, weak trade and poor demand, the very things the global central banks, including the PBOC, have trying to fight. If this persists the drag on China's economy could increase and a crisis could ensue.

A Positive Development For Chinese Investment Markets

Chinese officials have given the green light to the opening of the Shenzen Stock Connect. This new program will open up investment in mainland companies listed on the Shenzen Stock Exchange to investors in Hong Kong, and vice versa for those living in China. The news, while generally seen a plus for the market, received little fanfare although its implications for foreign investment into China are enormous. Fund managers at JP Morgan's China Region Fund had this to say in a recent fund report. . .

"The MSCI China Index outperformed, as the long-awaited Shenzhen-Hong Kong Connect program was announced, which will facilitate both access to onshore China markets for foreigners as well as quota removal for access to Hong Kong for domestic Chinese investors."

They also see the possibilities of a market bottom and cyclical stabilization in China, as indicated by earnings results over the past two quarters. Looking forward they are expecting a less fiscally accommodating tone both in China and abroad but only slightly so, as rates are also expected to remain low long into the future.

"While the liquidity environment may tighten due to a slightly less accommodative tone in both the U.S. and in China now that the worst has past, rates remain low and equities remain relatively inexpensive. We have adjusted exposures at the single stock level in response to earnings trends. Our broad strategic stances remain unchanged, with an emphasis on the healthcare, consumer discretionary, environmental and consumer-oriented technology opportunities in Greater China."

An Opportunity For Value Investors

The JP Morgan China Region Fund is a diversified closed end fund focused on the greater China economic arena. This includes mainland and offshore markets listing Chinese owned companies doing business from within and without China on a local or global scale. This includes Hong Kong, Macau and Taiwan as well as China A, B and H shares, red chips and P chips. The investment strategy is long term capital appreciation and is focused on China's financial, technology and consumer segments.

The fund trades on the NYSE under the ticker JFC and has been trading near $16.50. The fund has recently had some volatility in its discount to NAV that is providing opportunity for value investors. The end to merger talks with the Korea Fund have caused NAV to more than double from a recent low near -5.0% to just over -12%. This, along with the 2% dividend yield and recovery in Chinese markets, makes the JFC an cheap way to enter a tricky yet fast growing market with the benefit of an experienced active management team.