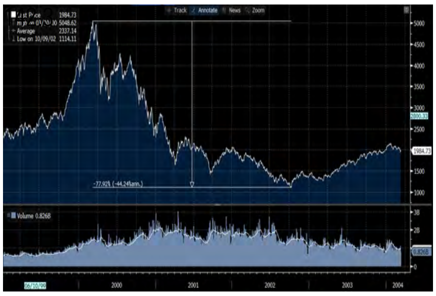
Sell off in China internet/e-commerce sector

Over the last couple of days, Chinese internet have been slashed down heavily. As shown on the charts below, **China Internet Index dropped 77% in $ since February 2021 highs**, mirroring the 78% drop of Nasdaq over 2000-02.

China Internet Index (KWEB US)

Nasdaq Index over 2000-02



Sell-off trigger ? A new round of announcements was done on March 10 regarding Chinese stocks listed in the US. SEC identified 5 Chinese ADRs under Holding Foreign Companies Accountable Act ("HFCAA") that did not comply with disclosure requirements and should be delisted by 2024. **None of those 5 stocks (BeiGene, Yum China, Zai Lab, ACM Research, and Hutchmed) is part of our portfolios.** Their steep decline has been however a source of further volatility and a key catalyst for the sector fall.

As of January, there are 30 Chinese stocks listed in the US without a secondary listing in HK, totaling $270bn market capitalization. However, most of large cap stocks such as Alibaba, JD.com, Netease or Baidu have a secondary listing in Hong Kong (overall $770bn). And most are now more traded in Hong Kong than in New York.

In addition, **some regulatory news flows** continue to affect internet stocks.

A month back the government asked food delivery companies (Meituan is the leader) to cut their fees to help restaurants during those difficult times caused by COVID uncertainties.

On Monday 14 March, there have been reports of a record fine for Tencent's Fintech arm WeChat Pay on money laundering allegations. It is the first time that Tencent is directly targeted by the government since 2018. The company faces a fine for violations of certain central bank regulations by its WeChat Pay mobile network, as Beijing toughens its regulations for fintech platforms, according to people familiar with the matter. Financial regulators recently discovered that WeChat Pay had flouted China's anti-money-laundering rules and had lapses in compliance with "know your customer" and "know your business" regulations, among other things, some of the people said. Tencent's ubiquitous mobile payment network was also found to have allowed the transfer and laundering of funds with illicit transactions such as gambling, the source added. For WeChat Pay, "know your customer" and "know your business" procedures mean it must verify the identities of users and merchants transacting on its platform as well as the source of funds for those transactions.

Heated discussions regarding reports of **layoffs at Alibaba and Tencent** appeared today on Weibo. Local news outlet Yilanshangye learned from several sources that Alibaba community group buying business unit is planning to sever ties with many employees, while the proportion of layoffs in this round will stand at roughly 20%. At present, several business lines within the company have finalized their initial layoff lists.

The strong sell off has also been exacerbated by the following announcements:

COVID spike in China with Shenzhen and Shanghai areas in lockdown:

China reported 1,807 new local symptomatic COVID-19 cases on Sunday, more than triple the caseload of the previous day (and the highest since nationwide outbreak in early 2020), as surging infections in a North-East province drove numbers higher. The city of Shenzhen (home to several tech/financial giants including Tencent, Huawei, Ping An and CMB) placed 17.5m residents under lockdown, which is due to last until March 20 - which could cause further disruption in the global tech supply chain. In Shanghai, all school students will switch to online learning platforms while all kindergartens will suspend operations. China also introduced self-testing kits for the first time as its previously testing regime has been pressured by Omicron. Meanwhile in HK, the city added over 32,000 cases on Sunday plus 190 deaths. HK now has 300k people in isolation or home quarantine, with HK's Chief Executive Carrie Lam saying that the city has not yet passed the COVID peak.

COVID situation in China:

China is likely to stick to its zero-COVID policy, despite the sharp rise in cases. In part it's because the development of domestically made mRNA vaccines and antiviral drugs has been slower than expected. On the other hand, it is due to the ambitious GDP target set for this year, which implies little tolerance for potential economic disruptions that would come with an early relaxation. Another big question is: how will **Chinese consumers** – who are much less prepared psychologically for living with COVID-19 than their foreign counterparts – respond to a rising risk of infection? We believe that most families remain cautious about COVID, and assuming mobility restrictions are lifted many of them would become even more hesitant about outdoor activities than they are under the current zero-COVID policy.

Impact on GDP growth:

Since the pandemic breakout, the Zero COVID policy has been pressuring China's GDP Growth by -0.5% to -1%. Lately announced lockdowns in Shenzhen and Shanghai will pressure GDP growth as illustrated on the left. Chinese government will need to boost the economy and consumer sentiment to achieve the 5.5% target announced at the NPC one week ago. So far, the economic data has been weak.

Source : Morgan Stanley

China's weak February credit data:

China reported surprisingly weak Feb credit data, with Total Social Financing growth moderating to 10.2% y/y (vs 10.5% y/y in Jan). The weaker TSF figure was due to (1) Slower household (mortgage) loans, reflecting the recent weakness in property sales, and (2) A contraction in shadow banking credit, suggesting no intention to ease regulatory policy in this area, despite the policy inclination to support growth. Elsewhere, mid/long term corporate loan growth remained steady, as was combined corporate and Government bond issuance. The latest data increases the pressure on the PBOC to ease monetary policy further. The China Securities Journal is also talking about the need to cut RRR and IRs to stabilize growth, with a front-page report on Monday.

Ukrainian war:

Last, investors also fear that China could take a more pro-Russian active role regarding the war in Ukraine. That would imply some sort of sanctions against Chinese companies, a doom scenario for Chinese equities.

Our Positioning:

Our exposure to China is 30.9% in GemEquity (vs. 29.6% for the EM index), hence slightly overweight.

Country	Fund	Benchmark	+/-	14-Mar-22	Sector	Fund	Benchmark	+/-
China o/w A-shares: 17%	**30.9%**	**29.6%**	**+1.3%**		Energy	8.0%	4.7%	+3.3%
Korea	10.7%	12.6%	-2.0%	ASIA	Basic Materials	2.2%	9.4%	-7.2%
Taiwan	12.5%	16.7%	-4.2%	79.7%	**Industrials**	**14.6%**	**5.8%**	**+8.8%**
India	13.5%	13.0%	+0.5%	vs. 78.0%	Banks	8.5%	16.3%	-7.8%
Asean	4.5%	6.1%	-1.6%		**Other Financials**	**7.3%**	**5.5%**	**+1.8%**
Brazil	**7.5%**	**5.6%**	**+2.0%**	LATAM	Real Estate	0.0%	2.1%	-2.1%
Others - South America	0.4%	1.0%	-0.6%	9.1%	**Technology**	**27.0%**	**22.3%**	**+4.6%**
Mexico	1.1%	2.2%	-1.1%	vs. 8.8%	Media & Internet	7.6%	7.1%	+0.4%
Russia	0.0%	0.0%			Telecom	0.0%	3.5%	-3.5%
Eastern Europe & Greece	0.0%	1.2%	-1.2%	EEMEA	**Consumer Durables**	**18.4%**	**11.1%**	**+7.4%**
Middle East	3.9%	7.9%	-4.0%	3.9%	Consumer Non-durables	1.5%	5.9%	-4.4%
Africa	0.0%	4.1%	-4.1%	vs. 13.2%	Healthcare Services	1.9%	3.8%	-1.9%
Global Emerging Companies	**11.8%**		+11.8%		Utilities	0.0%	2.6%	-2.6%
Cash	3.1%			OTHERS	Cash	3.1%		
Source : Gemway Assets	100%	100%		4.1%		100%	100%	

Main convictions (Country/Sector)			Matrix Active Share (Σ of country/sector overweights) :		45.8%
Positive Convictions	Fund	+/-	Negative Convictions	Fund	+/-
China Industrials	7.8%	+5.9%	China Financial Services	1.0%	-4.1%
Global Emerging Companies Financial Services	4.3%	+4.3%	Taiwan Financial Services	0.0%	-2.3%
Korea Technology	9.9%	+3.7%	China Property	0.0%	-1.3%
Global Emerging Companies Industrials	3.5%	+3.5%	India Basic Materials	0.0%	-1.3%
Brazil Consumer Durables	2.8%	+2.5%	China Basic Materials	0.0%	-1.2%

Also, our China exposure in mainly **focused on A-shares (17% of GemEquity)**. Nonetheless, we are slightly overweight in the Chinese internet/e-commerce sector and suffer accordingly. Our exposure is as follows for our funds: GemEquity at 11.5% (vs. 10% for the EM index); GemAsia 13.6% (vs. 13% for Asia ex Japan index); and GemChina 20.2% (vs. 20% for the China index). Our holdings consist of: Tencent, Netease, Alibaba, JD.com, Meituan and Pinduoduo (this latter only in GemChina).

As of now, we have not increased our exposure to the sector. The bull-case on Alibaba/Tencent/Meituan has been that regulatory cycle has peaked and share price has over corrected. However, if we assume regulations have not peaked, then there is a risk that analysts will further adjust their earnings forecast downwards. Furthermore, if China macro continues to worsen, then dominant platforms are going to have to do even more margin-compressing national service for SMEs and consumers. There is no doubt that the level of current uncertainty remains at an unprecedented level. There is also no doubt that the present level of valuation looks very attractive. In the short term, the situation is undoubtedly uncertain. However, once volatility settles down in the next couple of weeks, we believe coming back to the sector will be a fruitful strategy in the long run.

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