FUND MANAGEMENT DIARY
Meeting held on 21st August 2018

How deep are China's ties with Africa?

- The blossoming relationship between China and Africa has been driven by pronounced synergies between the two economies – China needs to invest abroad to recycle its large current account surplus and Africa has huge unmet investment needs

- China is an important trading and investment partner but, with the exception of the construction industry, has not displaced traditional western partners yet

- Economic ties between China and Africa are expected to grow closer over the coming years as Chinese investors expand into new sectors of the economy. This will disrupt existing industries, but should boost productivity and stimulate economic diversification

Pronounced synergies between the Chinese and African economies have led to closer ties

Increased economic engagement with China has had a huge effect on economies across Africa. The blossoming relationship is, indeed, one of the key developments affecting the region. This is largely the result of pronounced synergies between the Chinese and African economies. China needs to invest abroad in order to recycle its large current account surplus. The country also has a large construction and infrastructure sector which is suffering from overcapacity at home. Over the longer term, rising wages in China are encouraging the relocation of labour-intensive sectors, such as clothing, textiles and low-level electronics. And Africa is rich in mineral resources that China lacks, such as copper and oil.

Africa, on the other hand, has huge unmet investment needs. The World Bank has estimated that the continent needs $90 billion of additional investment each year in order to close its infrastructure gap. China is a natural partner. And, unlike more developed markets, Africa is a relatively open market for Chinese firms. For one thing, the region has few national champions to protect from foreign competition. For another, it is much easier, for example, for a Chinese firm to get a contract to build and run a railway in Kenya than in Germany.

One implication of this is that economic integration between China and Africa cannot be suddenly shut off if political priorities in Beijing change. The relationship now has its own momentum.

But while China is a key trading partner for Africa, it isn't the largest
China-Africa economic relations are indisputably important, but reports of Chinese economic dominance on the continent are greatly exaggerated. Often, the rapid intensification of China-Africa ties has obscured the continuing importance of links with traditional partners, which are less newsworthy.

Merchandise trade provides an instructive example. The value of imports and exports between China and Sub-Saharan Africa increased by almost 1,300 per cent between 2000 and 2016. Some of this increase was due to higher commodity prices (comparable volume measures are not available). The growth of China-Africa trade dwarfed the increase in trade between Sub-Saharan Africa and its other major trading partners. By 2016, the latest date for which comparable figures are available, trade with China made up fifteen per cent of Sub-Saharan Africa's total trade. Indeed, China has been Sub-Saharan Africa's biggest single trade partner since 2011 when it overtook the United States.

But there are two important caveats to this. First, while China is now the region's largest single trading partner, its influence is still smaller than the European Union's when the bloc is counted as a whole. While the European Union's share of Sub-Saharan trade declined from 43 per cent in 1990 to 23 per cent in 2010, it has remained steady since then.

Second, China overtaking the United States was as much the result of falling American-African trade as it was due to Chinese growth. The pace of Sino-African trade growth has slowed in recent years, whereas African exports to the United States fell sharply following the development of the American shale oil industry, which cut energy imports.

And although China is a key investment partner, it is far from dominant
It is important to distinguish between investment flows (the money moved into Africa each year) from investment stocks (the value of foreigners' assets in Africa). While investment flows from China to Africa have risen rapidly in recent years, the long history of investment from western countries mean that they remain key partners.

Figures are neither timely nor exact, but the latest United Nations data suggest that China's total investment in Africa lags behind that of the United States, United Kingdom or France. The country is, admittedly, catching up quickly. In the five years to 2015, China's foreign direct investment stock on the continent jumped from $13 billion to $35 billion. Even so, Chinese investments in Africa are smaller than key western states of the United States ($64 billion), United Kingdom ($58 billion) and France ($54 billion).

In the infrastructure sector, however, China does play an unmatched role in Africa. If funding from the Chinese state, Chinese state owned enterprises and Chinese policy banks is added together, the country invested $6.4 billion in 2016, the largest of any foreign partner. This dwarfed the investments of countries such as France ($2.9 billion), Saudi Arabia ($2.3 billion) and Japan ($1.9 billion). Indeed, the country spent more on African infrastructure than the African Development Bank or World Bank.

Indeed, China's key role in this high profile sector is one of the key reasons why it is seen as being so dominant in Africa. Infrastructure spending by Chinese firms is much more visible to the average African (or the average Western journalist) than European investment in intangible financial services or off-shore oil platforms. Even within infrastructure, most Chinese investment targets big, high-profile sectors, such as flagship projects building new railway lines, while investment Western governments and multilateral donors devote a larger share of their investment to lower-profile projects in the water sector.

The visibility of Chinese involvement in infrastructure is further boosted by the success of Chinese-owned construction firms, which often execute projects funded by local governments or western donors. Researchers at McKinsey estimate that Chinese-owned firms control about half of the entire construction and real estate market across Sub-Saharan Africa.

China hasn't yet displaced traditional economic partners in Africa

In short, China is a key player in Africa, but – with the exception of the infrastructure sector – it has not displaced traditional economic partners. China's rise is notable, but its 'dominance' is often overestimated.

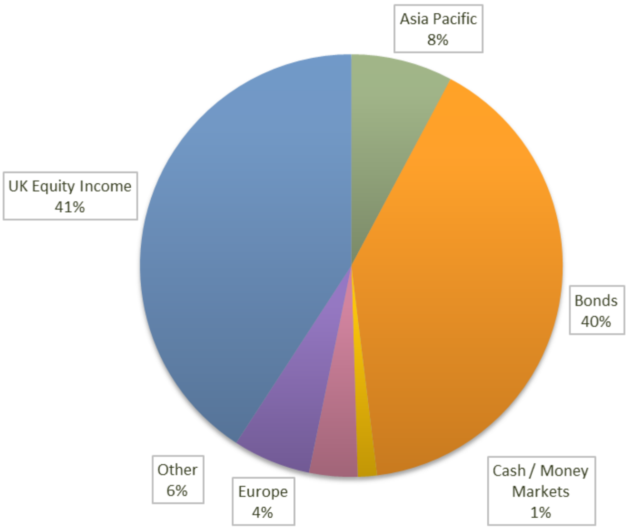
The economic relationship between China and Africa is complex and rapidly-developing. The poor quality of African data (and the inaccuracy of Chinese ones) make it difficult to fully account for this relationship. But it is likely that ties between the two will grow closer over the coming years as Chinese investors expand into new sectors of the economy. This will disrupt existing industries, but should boost productivity and stimulate economic diversification. Indeed, the increased presence of Chinese firms in non-resource sectors will provide a more stable source of investment, which may cushion the effect on Africa of future commodity price shocks.

Strategy

We believe that China's investment into Africa is a sign that China is maturing and becoming a more developed economy, which is good news. The Future Money portfolios do not invest in specialist China or Africa based funds, however our fund range has exposure to China through our Asia Pacific and Emerging Markets holdings, and a smaller exposure to South Africa through some of our Emerging Markets funds. Overall, we have positive expectations for Emerging Markets, and think that they offer good value compared to developed markets.

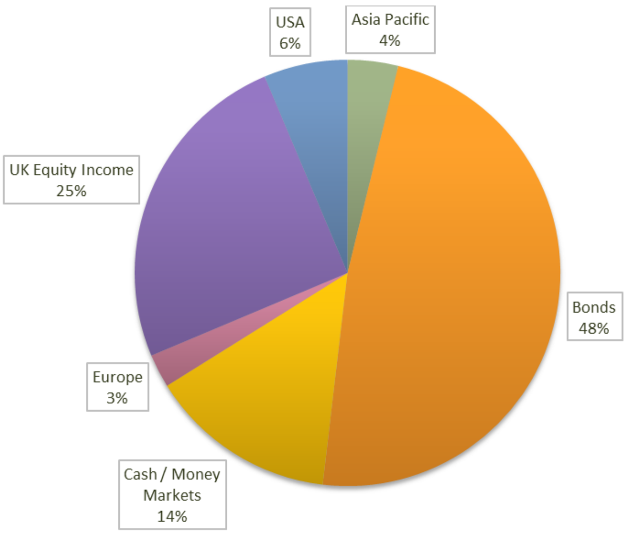
Income

A new position is being opened in the M&G Emerging Markets Bond fund, this will be funded with the removal of Smith & Williamson Short Dated Corporate Bond. Yields in the sector are very attractive relative to developed market bonds and given widespread negativity towards the Emerging Markets over recent months, valuations are now at attractive levels.



Real Value

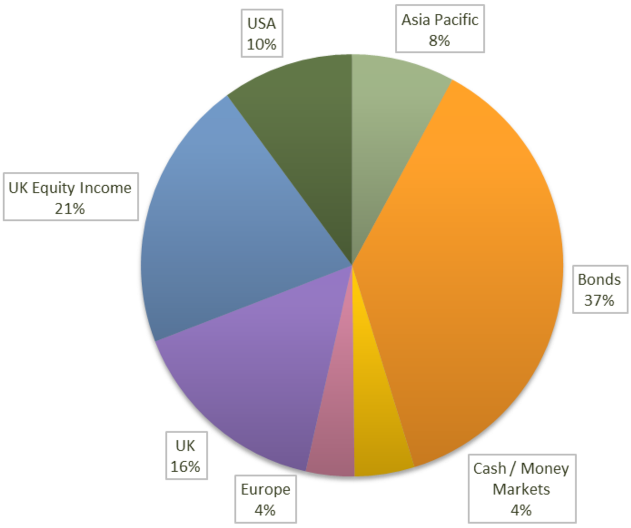
The Schroder European Alpha Income fund has experienced a slightly disappointing performance relative to its peer group. This position will be monitored closely over the coming weeks with the cause of the underperformance investigated.



Real Growth

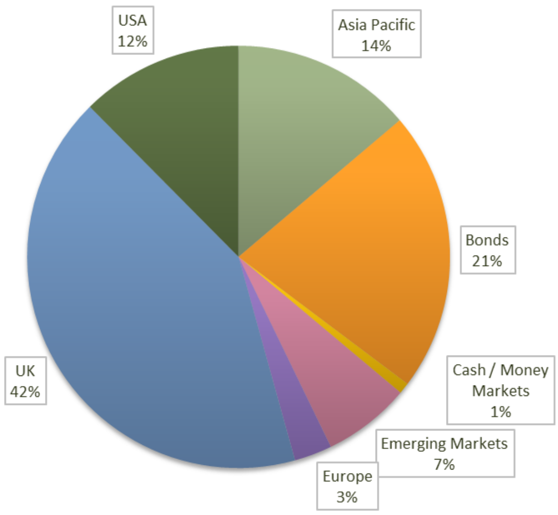
The Schroder European Alpha Plus fund has experienced a slightly disappointing performance relative to its peer group. This position will be monitored closely over the coming weeks with the cause of the underperformance investigated.

Threadneedle UK Growth & Income continues its recent strong performance, with the fund now in the top quartile of its peers over the past year.



Dynamic Growth

Threadneedle UK Growth & Income continues its recent strong performance, with the fund now in the top quartile of its peers over the past year. The portfolio's US and European allocations are also performing well currently, while fund selection in the Asia Pacific and Emerging Markets regions has been slightly disappointing. No changes are currently being considered.



Important Information

Please note that the contents are based on the author's opinion and are not intended as investment advice. This information is aimed at professional advisers and should not be relied upon by any other persons.

Any research is for information only, does not constitute financial advice or necessarily reflect the views of the author and is subject to change.

It remains the responsibility of the financial adviser to verify the accuracy of the information and assess whether the fund is suitable and appropriate for their customer.

Past performance is not a reliable indicator of future performance. The value of investments and the income derived from them can fall as well as rise and investors may get back less than they invested.

Important information about the funds can be found in the Supplementary Information Document and NURS-KII Document which are available on our website or on request.

For any information about the Future Money funds please contact the authorised corporate director, Margetts Fund Management Ltd, on 0121 236 2380, admin@margetts.com or at 1 Sovereign Court, Graham Street, Birmingham B1 3JR. A copy of their Terms of Business which relates to investments into the funds can also be obtained using these contact details.

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