

# Crafting the Optimal China Allocation Strategy

## The Asset Owner's Perspective

April 7, 2020

Executive Summary:



Many pension funds, endowments, foundations, and other institutional investors have hesitated about making direct investments in China due to uncertainty about political risks, concerns about governance standards, and, until recently, limited market access. However, as projections suggest that China may soon emerge as the world's biggest national economy, many asset owners and investment consultants have begun to reassess the optimal level of China exposure in their portfolios and how to best achieve this objective.

Because most asset owners today obtain China exposure through investments in global and/or emerging markets products, many of these investors believe - or at least believed - that they have sufficient allocations to the country. However, the indirect nature of these allocations makes it difficult to quantify and manage that exposure. In fact, a large number of asset owners say they don't have a clear understanding of their own exposure to one of the world's most important nations. Among those that do, there is a growing awareness that current exposure levels achieved mostly indirectly through allocations to global and emerging markets strategies are inadequate.

Recognizing this fact, some institutions have begun to consider moving beyond their current approach and start making direct investments in China. Their investment consultants agree: Nearly 40% of consultants doubt that EM managers are effectively allocating to China, suggesting that a new approach is in order.

As asset owners consider ramping up the level of direct investment, they are being forced to confront one of the main factors that caused them to hesitate in the past: China's opaque corporate governance standards that can make it difficult to assess the performance of companies across both financial and increasingly important ESG metrics. (Twenty-one percent of asset owners see the potentially positive ESG impact as a reason to invest in China.)

To overcome this obstacle, and to educate their committees and boards about myriad other perceived risks present in this rapidly developing market, many asset owners are turning to experienced asset managers.

Managers with specific expertise regarding the China market (specifically with an on-the-ground presence), combined with factors such as risk management capabilities and an investment team with long-term success investing in China, can alleviate these concerns, articulate how to appropriately consider and manage the risks and highlight potential benefits of the direct investment approach.

#### Methodology:

During Q3 & Q4 of 2019, Greenwich Associates interviewed 118 institutional investors globally, including public and private pension plans, endowments and foundations, insurance companies, sovereign wealth funds, and 20 investment consultants. Respondents were asked about their goals and objectives with respect to portfolio allocations to China, including their current investment levels, as well as the key factors for either increasing their allocations or not allocating to a dedicated China manager. Other topics included the manager selection process, satisfaction with current managers and expected allocation shifts across asset classes.



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