GIC Insights 2018: The New China Economy

Speech by Lim Chow Kiat, CEO, GIC

Delivered at GIC Insights Forum, 18 October 2018

Good morning.

Dr Tony Tan, GIC Board Director and Special Advisor, and Former President of Singapore

Dr Zhou Xiaochuan, President of China Banking and Finance Society and Former Governor of People's Bank of China

Dr Yin Yong, Vice-Mayor of Beijing Municipal Government

GIC Board Directors, Honoured Guests, Ladies and Gentlemen, welcome to the third GIC Insights. 欢迎! This event would not be possible without each and every one of you taking the time to be here. Many of you have come from faraway places. I thank you for your support and friendships.

Purpose of Insights

We organise this forum to bring together our most valued partners from across asset classes, sectors and geographies to engage with GIC, connect with one another and share perspectives. This primarily benefits GIC, but I hope you too will bring home useful insights.

The sharing of ideas is all the more important in an investment environment where the global recovery is aging, asset valuations are high, and uncertainty is elevated and climbing.

A key risk is excessive monetary tightening. For the first time in over 10 years, after 463 interest rate cuts in 31 countries, we are experiencing some reversals, importantly by the Fed.

Added to this is heightened political uncertainty in many parts of the world, with populism mixing with nationalistic politics, leading to both domestic tensions and global divisions. The ongoing conflicts between China and the US have already rattled markets. These developments have very profound and long-term implications for the world.

In the meantime, technological disruption continues to rapidly change businesses, industries and societies.

For investors, the compensation for taking risk now looks very low and the outlook highly uncertain.

GIC Insights in China

It's with this backdrop that we planned this forum. Specifically, we are holding Insights forum here in Beijing, for 2 reasons:

First, to mark the 20th anniversary of our first China office, here in Beijing. In 1998, having invested in China for a number of years and seeing opportunities arising from the Asian Financial Crisis, we decided to set up our ground presence. Subsequently, in 2007, we set up a second China office in Shanghai as we expanded our activities. Today, China account for a meaningful share of our Asia ex-Japan portfolio which was 19% on 31 March 2018. We expect over time to see China featuring more in global investment portfolios, as more of its markets open e.g. its bond market currently has only less than 2% of foreign participation, vs about 30% in the US.

The second reason is to focus on the developments in China, on both its economy and technological innovation:

- China's economy is important to all investors. It's already 16% of world GDP (on market exchange rate basis, 19% on PPP basis), and accounts for about one-third of world GDP growth. Many of our portfolio holdings are directly affected by what happen here.

- China's technological innovation too is important for all investors. As we have seen, in just a few years, China has rapidly developed a whole new ecosystem of technology enabled businesses and industries.

GIC Insights 2018 - 2 Key Themes

Let me elaborate more and set the stage for the discussions later:

Theme 1 : China's economy

On China's economy, even as she marks 40 years of reform and opening up (改革开放), there are significant challenges. Internally, the credit excesses built up since the Global Financial Crisis need to be reduced and the potential property market bubble needs to be contained. Progress has been made, but problems remain large, especially in ensuring that growth is not derailed.

Externally, the trade and perhaps more accurately strategic conflicts with the US seem to be worsening. The issues appear to have moved beyond short-term political posturing and into long-term geopolitical competition. This complicates internal economy management. But this may also provide additional impetus for deepening reforms.

Other key challenges include the ongoing shifting of economic composition from investment to consumption, improving corporate governance, controlling pollution, further reducing poverty, etc.

Any one of these is no easy task for such a large and diverse economy that is also aging rapidly.

Our approach has been to stay invested in China. Through the ups and downs, we have stayed invested because this is the way to benefit from the compounding effects on our investments. We don't have a crystal ball to know what Shanghai Composite will do tomorrow or next year. What we do know is China leaders has met all sorts of challenges before. And each time, they have faced up to them, analysed them carefully, and found ways to deal with them. Over a long period of time, a basket of the top companies in China would be worth significantly more than what they are worth today. By staying invested through cycles, we have a better chance than most at identifying what those companies are or will be.

We also see the positive effects of change in China. As China transitions to a 'new era' of economic development, their needs and aspirations will continue to evolve. This will drive growth in many sectors such as consumer goods, healthcare, education, financial services and technology.

Financial sector reforms in particular and opening up of the capital markets represent an attractive window to merge the best practices of China with the rest of the world. A globally connected Chinese market would be a powerful funding source to take growth to the next level, even as China exports more capital to the world. China's anti-corruption campaign and reforms will also be a key driver in improving corporate governance, capital efficiencies and shareholder alignment.

A long-term orientation does not mean blind faith or rigid position. There are challenges and risks which could knock us off this expected trajectory. Hence it is important to examine the issues closely and from different perspectives, which is what we plan to do today.

Theme 2: Technology & Disruption

China is also very much about technology. Technological disruption has been an area of focus for GIC for some years now. Allow me to briefly share some of our observations.

First, we are fast reaching a point where every or many companies are becoming technology companies. Rather than looking at traditional classifications and labels, we need to look deeper into the actual technological capabilities of each company. We have found traditional companies with such capabilities but trading at "old economy" valuations. They are good investments and we want to keep looking for more of them.

Second, true business moats are getting fewer. Today these are found in "ecosystem" businesses, where cross-selling, rich data, high customer switching costs and scale are reinforcing one another. This creates a powerful network effect, producing high and sustainable returns on capital, much like an "investor surplus". Those who do this well should form the core of our portfolio.

Third, some of the best investments in the tech space are not the first movers, but the fast followers and good executors. Often, it's not the technology invention but providing goods and services at scale, with the right quality and at a low enough price point for the consumer that matters. Businesses ultimately succeed or fail on whether they deliver customer value - better, faster, cheaper.

Fourth, emerging markets have become major hubs for innovation and technology adoption. This is due to their greater openness to experiment, less mature industries and fewer legacy arrangements. Technological disruption can be even more powerful in these economies, as they have even more unmet and undiscovered needs and hence, more leap-frogging opportunities. Today we focus on China which is leading the global frontier in many areas including smart technology, drones, e-commerce, and mobile payment systems.

Lastly, while technology can do a lot of good, the pervasiveness, speed of change, concentration of power and degree of intimacy also make the downsides more severe. From privacy issues to cyber theft to fake news to addiction, the list goes on. With more advancement comes even more risks, some unknown yet today. All parties need to make responsible choices.

Speakers

This morning, we are deeply honoured to have 7 very distinguished speakers to share their insights on these themes. They are Governor Zhou Xiaochuan (周行长), Vice Mayor Yin Yong （殷勇市长）, Ray Dalio, Ng Kok Song, Joseph Tsai and Yuri Milner - all legends in their fields and long-time friends and supporters of GIC.

In the afternoon, we have curated a very special showcase of 6 exciting tech companies. Each will present on industries they are impacting, giving us information and food-for-thought as we assess their wider implications.

Conclusion

Ladies and gentlemen, it's our good fortune to be part of China's reform story over the decades. By being an early and steady investor in China, we have benefitted financially, learned valuable lessons and built many strong partnerships. We hope to continue on this journey, with many of you here.

We are very privileged to have you join us here today.

Let me also thank our organizing team for putting in many hours to make this possible.

谢谢大家.

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