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CAPITAL MANAGEMENT

ALTERNATIVE THINKING ABOUT INVESTMENTS

New Asia Perspectives

Welcome to Morgan Creek's New Asia Perspectives, an open forum where we share our proprietary research together with curated articles of interest. We seek to offer a variant interpretation of important political and economic events through an Asian lens by leveraging our team's "on the ground" insights and decades-long experience in covering the region. We disseminate our research through newsletters, webinars and periodic whitepapers. Feel free to forward our research to colleagues you think might be interested and please share any interesting research you come across as well. To offer comments, share research, or learn more about our team and investment offerings, please email chinateam@morgancreekcap.com.

Best Regards,

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NOTES FROM THE BUND[1]

In recent years, RMB-denominated assets have been significantly undervalued due to the currency's depreciation and the assets themselves. However, current Chinese government policies and evolving global economic conditions indicate that a correction is imminent. As investor sentiment shifts and market stability returns, we expect these assets to regain their appeal.

To understand this phenomenon, it is essential to first explore the concept of the carry trade, a favored investment strategy for global capital flows. Between 2010 and 2014, the United States maintained a 0% interest rate while China's average commercial bank savings rate was approximately 6%. Such spread attracted significant capital inflows and contributed to the RMB's appreciation, averaging 3% annually and yielding a total return of about 10%. In contrast, from March 2022 to September 2024, the US Federal Reserve initiated a rate-tightening cycle, raising the federal funds rate to 5.25%-5.5%, while Japan maintained a 0% interest rate and China's interest rate was at 2%. During this period, China and Japan emerged as key markets for carry trade, leading to substantial depreciation pressures on the JPY and RMB, peaking at exchange rates of 169:1 and 7.3:1, respectively. Consequently, we believe the RMB has been undervalued compared to the currencies of major global economies in recent years.

By 2025, China's PPP[2] is projected to be 3.658 RMB per USD[3], significantly lower than the current market exchange rate of 7.2. Furthermore, China's lower PPI[4] indicates that Chinese goods are more competitively priced internationally, suggesting that the RMB's real purchasing power is undervalued. If the interest rate spread between the US and China continues to narrow, we believe this rate convergence should facilitate global capital inflows and further drive the appreciation of the RMB.

Moreover, RMB-dominated assets remain significantly undervalued as evidenced by the chart below.

Index	P/E Ratio	P/B Ratio
Dow Jones	29.5x	7.0x
S&P 500	27.2x	4.7x
NASDAQ	27.6x	6.0x
Shanghai Composite Index	12.7x	1.3x
Shenzhen Component Index	20.8x	2.2x
CSI300	12.3x	1.4x
Hang Seng Index	9.7x	1.0x

Figure 1: Major index PE and PB ratio (Oct 16th, 2024)[5]

The instruments discussed previously are expected to address the current undervaluation in the long run. The relending rate for listed companies is set at 2.25%, while the market capitalization-weighted dividend yield of the Shanghai Composite Index stands at 3.35%.[6] This creates a potential 1% spread for profit, not taking into account any potential capital gains along the process. Consequently, we think these newly introduced instruments will enable local listed companies, as the primary force in the short term, to inject liquidity and correct pricing effectively. Additionally, the Politburo has indicated the possibility of a rate cut before year-end, which would further widen the spread and attract additional domestic and foreign capital to facilitate pricing correction.

In sum, we believe the current environment presents a compelling case for the potential long-term bull market in RMB-dominated assets. As domestic and foreign capital flows respond to recent changes, we think RMB-dominated assets are poised to benefit.

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ASIA NEWS SPOTLIGHT

Asia's Factory Activity Stagnates, Taking Shine Off Rebound in China: Asia's manufacturing activity stagnated in October as a rebound in China failed to give much of a boost to regional factories, private surveys showed, a discouraging sign for policymakers bracing for a potential escalation of U.S.-China trade tensions. The readings come as the International Monetary Fund (IMF) warned of rising risks to Asia's economic outlook from trade fragmentation, China's property sector woes and the potential for further market turbulence. *Read More.*

Saudi Arabia May Cut December Oil Prices for Asia, Sources Say: Top oil exporter Saudi Arabia may cut prices for most of the crude grades it sells to Asia in December, tracking weakness in Middle East benchmark Dubai, trade sources said. Price cuts for Saudi oil would signal weak demand and provide more evidence for the Organization of the Petroleum Exporting Countries, led by Saudi Arabia, and its allies including Russia, a group known as OPEC+, to potentially delay plans to increase production from December. *Read More.*

China Stimulus Gives Manufacturing a Shot in the Arm: China's first major economic indicators after authorities unveiled their recent stimulus push suggest the economy has stabilized somewhat, with manufacturing and housing sectors showing tentative signs of recovery. Both official and private measures of factory activity in October exceeded analyst expectations, while home sales saw their first rise this year. The data were the first to capture a full month's activity following Beijing's largest efforts to boost the economy since the pandemic. *Read More.*

Asia Overtakes North America as Leading Crypto Development Hub: Asia has become the top region for crypto and digital assets developers after increasing its share to 32%, up from 13% in less than a decade. At the same time, the number of North American developers was cut in half, according to an X post by Maria Shen, a general partner at Electric Capita. Though more blockchain developers are moving beyond America's borders, the U.S. still has the highest number of developers of any country. *Read More.*

Asian Self-driving Unicorns Horizon Robotics and WeRide Go Public in Big IPOs: Autonomous driving has been the future for some time, but we are only now seeing the first IPOs in the field coming through. And boy have they come through—with two listings this week. Horizon Robotics held Hong Kong's largest IPO of the year, raising nearly $700 million while in the US, China-based WeRide finally went public after months of delay—it raised $119 million. WeRide also represented a rare Chinese tech IPO in the US, potentially opening a door for others to follow, albeit that there's a lot more scrutiny on such a listing compared to the past. *Read More.*

SK Innovation-SK E&S Merger Creates Asia's No. 1 Energy Supplier: SK Group on Friday launched the merged entity between SK Innovation Co. and liquefied natural gas supplier SK E&S Co., a key step in the energy-to-telecom conglomerate's ongoing restructuring amid a slowdown in electric vehicle demand and rising geopolitical uncertainties. SK Innovation, the parent of South Korea's largest oil refiner SK Energy Co. and battery maker SK On Co., absorbed the country's top city gas supplier to create Asia's largest energy company, excluding state-run utilities, with 105 trillion won ($76.3 billion) in assets as of the end of June**.** *Read More.*

China Takes Aim at Energy Replacement with Plan to Rely on Renewables, Reduce Coal Use: China has unveiled a 17-point renewable-energy-substitution plan that spans multiple industries, aiming to accelerate the nation's clean-energy transition while taking a gradual approach to phasing out fossil fuels in a bid to avoid crippling power disruptions like those seen in recent years. The country's top economic planner, the National Development and Reform Commission (NDRC), is urging industries to carry out their energy transition in a "safe", "orderly" and "diverse" manner. *Read More.*

Opinion: Grid Interconnectivity is Critical to Asean's Energy Transition: The Asean region stands at a crossroads in its energy journey. Amid growing demand from industry, rising carbon emissions from fossil fuel reliance, and the pressing need for sustainable growth, the region has an opportunity to redefine its energy future. Enhanced power cooperation, resource sharing and grid connectivity can pave the way to more inclusive approaches to energy sector development. Our recent analysis for Ember – the energy thinktank we represent – conveys the need for a robust regional energy supply. *Read More.*

[1] The Bund is a historic waterfront area in central Shanghai, where Morgan Creek's office is located. From the 1860s to the 1930s, it was the rich and powerful center of the foreign establishment in Shanghai, operating as a legally protected treaty port. The picture above is part of the historical waterfront.

[2] PPP stands for purchasing power parity.

[3] Source: CEIC database

[4] PPI stands for producer price index.

[5] Source: The latest A-share valuation table, https://finance.eastmoney.com/; Oct 16, 2024

[6] Note: The data is as of Oct 16, 2024; Source: Lixingren database

Important Disclosures