

# Dividend-focused investing in China — a winning strategy

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Successful investing in China has been about more than harnessing growth. Historically, dividend-paying stocks in the A-share market have outperformed their broader peers, making a dividend-focused investment strategy superior (see Figure 1).



The appeal of China’s dividend stocks will likely remain, given the country’s low interest rate environment, which has resulted in low yields from bank deposits and bonds. Interest rates are also expected to decline and remain low for the foreseeable future, which should boost further the appeal of dividend stocks.

We believe other conditions are becoming even more favourable for dividend-focused investors. These include ongoing policy measures to improve returns on equity (ROE), payout ratios and overall shareholder returns and supportive long-term structural trends that should boost demand for dividend stocks. Collectively, these should provide strong support for dividend-driven investing in China now and in the decades ahead.

## **Policy support**

The government has rolled out various efforts to improve corporate governance and shareholder returns, which should support dividend stocks in the long term.

An example is China's "nine-point guideline", published in April of this year, which aims to promote the high-quality development of China's capital markets. Besides strengthening regulation and improving investor protection, the new guidelines also aim to improve the quality of listed companies, such as encouraging dividend payouts.

Besides recent regulations, the government's ongoing state-owned enterprise (SOE) reforms, which are now well into its fifth decade and ongoing efforts by the securities regulator to encourage higher dividends have also supported the overall market.

One recent reform is the move by the State-owned Assets Supervision and Administration Commission (SASAC) to set new key performance indicators (KPIs), which include operating revenue and return on equity (ROE).

The new set of KPIs should improve the operating efficiency of SOEs and lead to higher shareholder returns. Following the introduction of these KPIs, there have been sustained efforts by both SOEs and the Shenzhen and Shanghai stock exchanges to improve their investor relations.

These efforts have led numerous companies to lift their dividend payout ratios and improve shareholder returns. While the measures pave the way for a more conducive climate for the local stock market, they also create a more diverse and deep universe for dividend investing.

In China, out of more than 4,500 A-share stocks in the country, around 550 stocks have a yield of over 3%. Those stocks span the full spectrum of sectors and this market opportunity is certainly not just a 'defensive' story (ss Figure 2).

The opportunity is also not confined to SOEs, as dividend payouts have increased at state-owned and private enterprises in recent years, thanks to policy support.

Many sector leaders in China have entered the stable-growth phase of their development, with strong cash flows and balance sheets. Many more companies will enter this phase in the years ahead, ensuring a sustained supply of listed firms that can pay attractive dividends, further expanding China's A-share dividend universe.

### **Favourable long-term structural trends to boost demand**

Several long-term structural trends in China are set to boost the demand for dividend stocks. Due to China's ongoing rhetoric that "houses are built to be inhabited, not for speculation" and related regulations, the appetite for property investment has been subdued in recent years. Because of that, a great asset reallocation is underway as China's population diversifies investment exposure away from the property market to other investment opportunities.

China's ageing population should also drive demand as an older population seeks alternative sources of income. That goes in tandem with the development of China's private pensions industry. Essentially, the expected huge growth in Chinese private and occupational pensions should ensure that demand for dividend-paying domestic equities remains high.

The country has long-established state pensions (the first pillar) and occupational pensions (the second pillar) since 2004, albeit with limited take-up. Meanwhile, private pensions (the third pillar) are still very much in their infancy.

However, the second and third pillars are set for massive growth shortly, with pension assets expected to grow to RMB15 trillion (\$2.7 trillion) and RMB21 trillion by 2030, representing a near-tripling of China's total pension market, according to joint research by KPMG China and ASIFMA.

There is an urgent need for this huge expansion. China's ageing population will no longer be able to rely on younger generations for the necessary level of support and given the shrinking proportion of working-age people, it is increasingly important that the young start paying into pensions.

Private pension products require assets with stable return profiles. Hence, the forecast surge in pension assets should lead to a further increase in demand for stocks with dependable dividends.

## Weathering market volatility

Although the advantages of a dividend-based approach to investing in China are clear, one of global investors' biggest concerns with China's equities market is its volatility. The domestic Chinese stock market is becoming increasingly institutionalised and we expect this process to accelerate.

Although individual retail investors make up less than a quarter of the market, they still account for most of the trading volumes. This excitable cohort can dramatically influence the market's overall volatility by chasing — and deserting — growth 'stories', which impacts the broader market return.

By contrast, the typically large, mature and stable businesses that are the best candidates for dividend-driven strategies are less likely to be subject to short-term speculative whims.

This combination of strong upside participation in positive market environments and robust downside avoidance in negative market environments has enabled the high-dividend A-share opportunity set to outperform the broader market consistently.

In recent years, the withdrawal of foreign capital from China's equity markets has been dramatic. But, for the reasons we have outlined, we expect the stocks in the A-share dividend universe to be supported and driven by domestic capital, with support from government policy and long-term structural trends.

In our view, capturing headline growth should no longer be the goal for China investors. As the Chinese economy matures and normalises, the best approach to extracting alpha from this vast, deep and diverse market is an actively managed, total-return one driven by dividends.

FACTSET, VALUE PARTNERS, ANALYSIS BASED ON ALL COMPANIES LISTED ON THE A-SHARE MARKET, DATA AS OF DEC 31, 2023

Fig 2: The China A-share dividend universe

