EMERGING MARKETS

Chinese Tech Stocks Are in Hot Water. It May Not Last.

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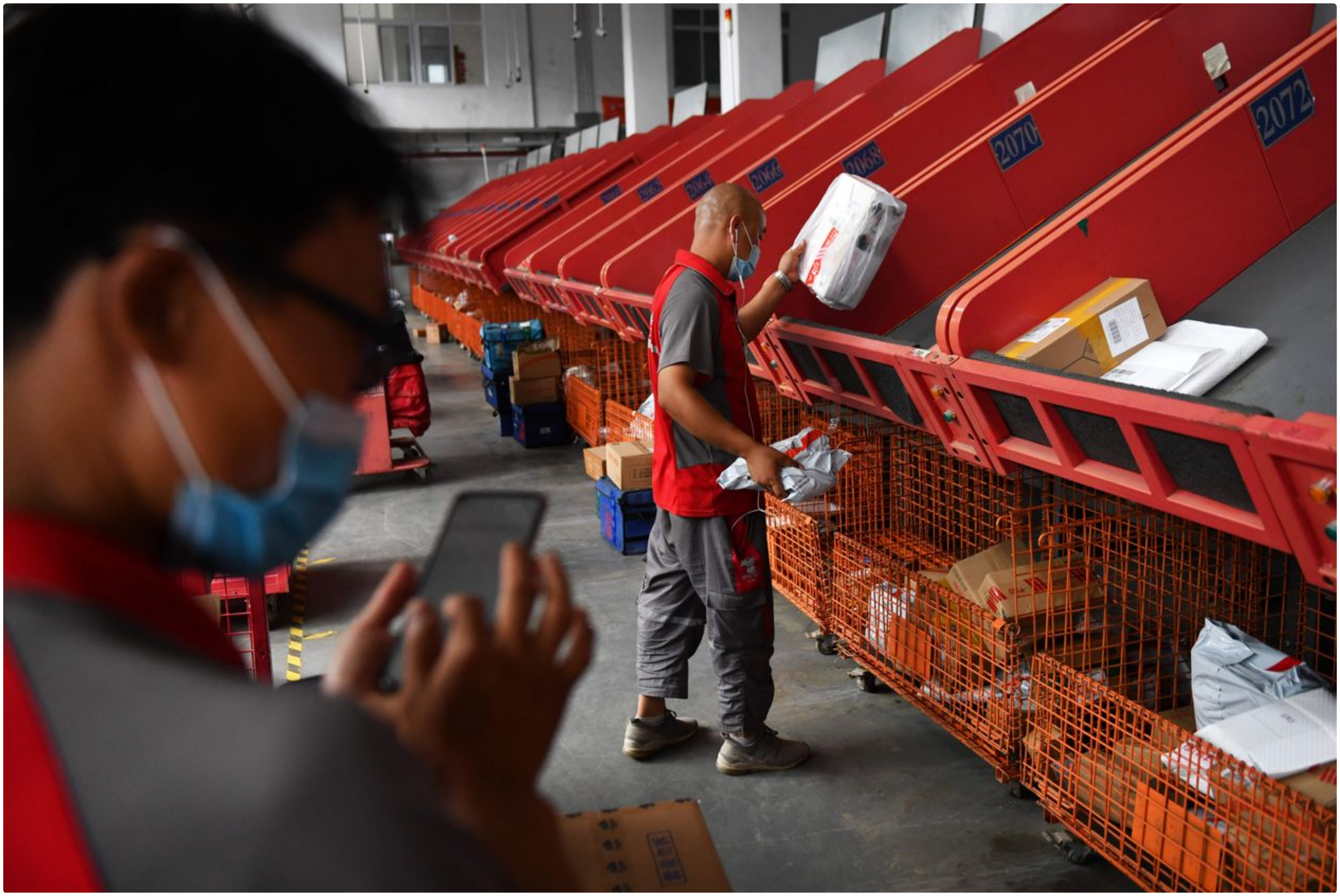
Dec. 31, 2020 5:30 am ET



A worker collects a package delivered by an automated conveyer belt at a JD.com distribution center in Beijing on July 16, 2020.
GREG BAKER/AFP/Getty Images

It's not just Jack Ma's problem. China's regulatory salvos at the Chinese billionaire's companies, Alibaba Group Holding (ticker: BABA) and Ant Group, may look like a personal vendetta after Ma likened the state banking establishment to pawn brokers.

But they likely mark the start of a broader campaign to rein in China's e-commerce and fintech industries, home to many of the biggest and hottest emerging markets stocks. Investor favorites like social media giant Tencent Holdings (700:Hong Kong) and food delivery hero Meituan

(3690:Hong Kong) could be in for a wing clipping in 2021.

“There are a lot of unknown unknowns,” says Zoe Zuo, a global equity analyst at Ivy Investments. “It could take a few quarters to understand what the government’s new tack really means.”

The tack in question was signaled in November, when authorities issued Guidelines for Anti-Monopoly in the Platform Economy. The vague principles therein took some shape last week with an investigation of Alibaba for leaning on merchants to sell exclusively through its sites.

Also in November, China’s bosses slammed the brakes on the fintechs growing out of the internet platform companies. They canceled Ant Group’s IPO days before it was poised to become the world’s most valuable financial company.

Tencent founder Pony Ma (no relation to Jack) has avoided his rival’s lese majeste. But his firm’s financial services arm is nearly as big as Ant, and likely to attract its own official scrutiny, says Vivian Lin Thurston, portfolio manager of the China A shares growth strategy at William Blair.

Meituan, whose threefold stock surge this year has made it the No. 5 name in global emerging markets, may draw regulators’ ire for gaining customers at loss-making prices, another practice regulators have flagged as monopolistic, says Brian Bandsma, an emerging markets portfolio manager at Vontobel Quality Growth. “It sounds like they may put limits on companies using their balance sheets to compete,” he says.

Markets are also picking some winners from China’s crackdown on the platform economy, namely Alibaba’s smaller e-commerce competitors JD.com (JD) and Pinduoduo (PDD). Both stocks have surged while Alibaba’s slid 7% over the past week. That’s a shaky bet, Zuo thinks. “What’s happening will have implications for every company,” she says.

All the more so as China’s online growth juggernaut shows signs of decelerating. China’s apparent quelling of Covid-19 has been (relatively) bad for internet business. Goods sales, which were surging near 25% year-on-year over the summer, have subsided to 16% since August. With Chinese online sales approaching one quarter of all retail, the curve will flatten further, Thurston predicts. “E-commerce growth is peaking,” she says. “The bigger opportunity was online financial services.” Until it wasn’t.

The good news is investors have a rough playbook at this point for Chinese regulatory offensives. Beijing overhauled the rules on internet gaming in 2018 and online education in 2019, stunting some stocks' growth but leaving flourishing industries basically intact.

The government's concern over Alibaba or Tencent's power is tempered by pride in their achievements, Thurston says. "They want to use the industry to leapfrog in financial services, but the Ant Group IPO made them realize how huge it had gotten," she says. "It's a balancing act."

There should still be juice left

in the stocks, too. "We've seen this happen before in different shapes and forms," says Danton Goei, global portfolio manager at Davis Advisors. "The shares are still attractive." Just mind the bumps.
