

MORGAN CREEK

CAPITAL MANAGEMENT

ALTERNATIVE THINKING ABOUT INVESTMENTS

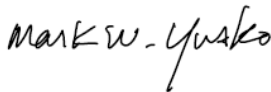
New China Perspectives



Welcome to the latest issue of Morgan Creek's **New China Perspectives**. This issue is comprised of research from Morgan Creek's China-based investment team together with curated articles of interest. In addition to timely political and economic news covering greater China, Morgan Creek's China team seeks to provide in-depth perspectives on investing in the technology, consumer and healthcare sectors in the region. Our research leverages the "on the ground" insights of our team together with

Morgan Creek's decades-long experience in covering the region. To learn more about our team and investment offerings, please email chinateam@morgancreekcip.com.

Best Regards,



Mark W. Yusko
CEO & CIO

NOTES FROM THE BUND¹

There has been a lot of concern around China's decelerating economy, with many pointing to significantly slowing exports whereas outbound shipments slumped 12.4% year on year in June, following a drop of 7.5% in May.² Reasons provided by observers range from the re/friend-shoring phenomenon to a faltering global economy. In prior newsletters, we discussed China's economic transition as being a driving factor behind many of the challenges it is currently facing, and we believe it is a significant factor behind these new statistics as well. We will also explore the recent status of re/friend-shoring trend.

1. China exports are normalizing after Covid disruptions

China Merchandise Trade Balance

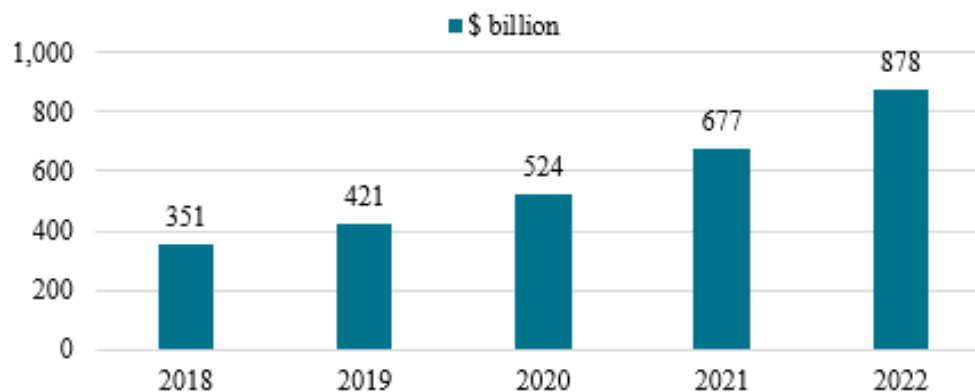


Figure 1: China’s trade balance was steadily increasing even during the Covid pandemic

Despite many criticisms over China’s handling of Covid, China’s economy was the least damaged amongst all major peers. Due to its stringent lockdowns, China was able to continue producing goods for the world while many other countries became paralyzed. The chart above shows China’s increasing merchandise trade balance – where all-time records were surpassed year after year; even during 2022 when Shanghai had to wrestle with lockdowns. With Covid now becoming endemic, demand for goods has dropped as people now begin to consume more services, and supply has also increased with factories in other parts of the world coming back online. A decrease in Chinese exports given the above factors is to be expected.

2. China is undergoing a structural change in its exports

There are significant underlying changes that are occurring, both with the composition of exports and with customers.

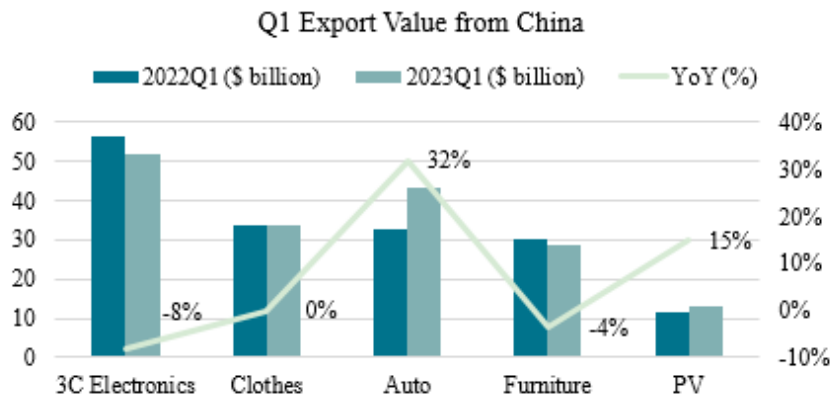


Figure 2: China is optimizing its export structure

As illustrated from the chart above, and in line with our observations in prior newsletters, China is seeking to upgrade its economy – moving away from low end manufacturing/assembly and exports of clothes/textiles and PCs to clean energy technologies and EVs. In fact, China overtook Germany last year to become the 2nd largest car exporter' and in the first quarter of 2023, it overtook Japan to become the largest in the world. We believe there remains significant upside for China to continue scaling in these markets given it achieved this success on the back of exporting its EVs to emerging markets with limited purchasing power and is only just beginning to make inroads in the large consumer markets of³ the US and Europe.⁴

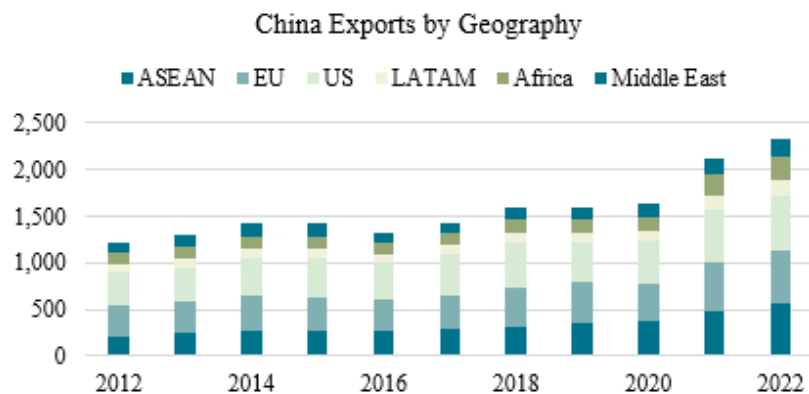


Figure 3: Evolution of China’s major trading partners

China is also transitioning its export markets: the chart above illustrates that regions including the

Middle East and ASEAN have almost doubled imports from China over the last few years, with the latter now becoming the largest trading partner for China.⁵ China continues to cultivate new markets along its one belt, one road initiative, increasing trade in regions like LATAM (which grew from \$12 billion in 2001 to \$430 billion in 2021⁶) and Africa (which also reached a record \$254 billion in 2021⁷).

Update on global re/friend-shoring

On the other hand, there is also significant concern around China's position in the global supply chain due to diversification of manufacturing back into the US or into other regions including India. While still early to determine ultimate success, results thus far have been mixed.

The headline numbers indeed show China's market share of US imports declining since 2018 when the trade war began, from 22% to 15%. Over the same period of time, China's overall exports actually increased, from \$2.49 trillion to \$3.59 trillion, including to geographies identified as key western allies. The charts below show Chinese exports to third party countries increasing in tandem to their exports to the US - implying that it is cost effective to still re-export goods from China.



Figure 4: Vietnam, Mexico and India Re-exports from China to US

Furthermore, in technologically advanced sectors where China leads global manufacturing with no cost effective substitutes, China's market share increased. Examples include the EV battery segments, where China's share of US imports doubled to 35% during the same period.



Figure 5: China still dominates certain sectors despite an overall export decrease

There has also been some recent developments of multinational corporations attempting to relocate their production out of China that might be informative, albeit anecdotal:

- Foxconn, Apple's largest supplier, led this reshoring wave in 2017 when it announced a \$10 billion display panel manufacturing factory in Wisconsin. The project was supposed to create 13,000 jobs and Foxconn would receive \$3 billion in subsidies.⁸ Six years later,

Foxconn is now eligible for only \$80 million in tax incentives, having revised down its investment to \$672 million and commitment to create 1,454 jobs by 2024. The most recent available headcount, reported by Foxconn in December 2020 as part of its tax arrangement with Wisconsin is 600 employees.⁹ It is still unclear what those employees are doing.¹⁰

- One year after Foxconn's Wisconsin factory project announcement, TSMC unveiled plans for a \$12 billion factory in Arizona which was expected to create 1,600 jobs targeting a start date in 2024. Five years in, TSMC has reportedly demanded twice the subsidies¹¹ initially offered given cost over-runs¹², with construction at least 6 months behind schedule. TSMC had also announced that opening would be further delayed another 12 months due to a shortage of skilled labor.¹³
- Foxconn had also announced a \$19.5 billion deal with Vedanta, an Indian conglomerate, to set up semiconductor and display production plants in India. A little over a year later, Foxconn pulled out of the deal.

[Click here](#) to see back issues of New China Perspectives

CHINA NEWS SPOTLIGHT

China Central Bank Unexpectedly Cuts Rates to Support Sputtering Economy: China's central bank unexpectedly cut key policy rates for the second time in three months on Tuesday, in a fresh sign that the authorities are ramping up monetary easing efforts to boost a sputtering economic recovery. Analysts said the move opened the door to a potential cut in China's lending benchmark loan prime rate (LPR) next week. [Read More.](#)

China Cuts Interest rates of MLF, reverse repos: China's central bank on Tuesday cut the interest rates of the medium-term lending facility and reverse repos, as part of efforts to strengthen counter-cyclical adjustment and stabilize market expectations. The move aims to maintain reasonable and ample liquidity in the banking system to fully satisfy the needs of financial institutions, according to the People's Bank of China. [Read More.](#)

NIO-backed LiDAR Maker Innovusion Files for US IPO : Innovusion, the LiDAR supplier for electric vehicle manufacturer NIO, is making plans for a potential initial public offering (IPO) in the US. LiDAR, which stands for Light Detection and Ranging, is a remote sensing method that uses laser light to measure distances and create detailed 3D maps of the surroundings. It's a crucial technology for achieving safer and more reliable autonomous driving. [Read More.](#)

Xiaomi Bolsters High-end Push with Latest AI and Foldables: Chinese tech company Xiaomi Corp said on Monday night that it will invest 20 billion yuan into research and development this year, as CEO Lei Jun sees the efforts to crack the high-end market as "the only way for Xiaomi to grow and as a battle of life and death". Lei Jun, CEO of Xiaomi, said at a speech in Beijing that the company will beef up R&D push to grow its presence in the premium segment, after years of hard work in exploring how to better sharpen its technological strengths in areas such as mobile imaging. [Read More.](#)

China's NMPA Accepts and Grants Priority Review Designation to the New Drug Application for Luye Pharma's Rotigotine Extended-Release Microspheres: Luye Pharma Group today announced that the New Drug Application (NDA) of its weekly-dosed Rotigotine Extended-Release Microspheres for Injection (LY03003) for the treatment of Parkinson's disease (PD) has been accepted and granted priority review by the Center for Drug Evaluation (CDE) of China's National Medical Products Administration (NMPA). Developed on the company's industry-leading microsphere platform, LY03003 is the world's first long-acting extended-release microsphere formulation for the treatment of PD. This drug is also being developed in the U.S. and Japan. [Read More.](#)

Jiangsu Hengrui Inks Deal with One Bio for ex-China Rights to SHR-1905: Jiangsu Hengrui Pharmaceuticals has out-licensed global rights, excluding China, for its anti-TSLP monoclonal antibody SHR-1905 to One Bio. The deal comes with a \$21.5-million upfront payment, but Jiangsu Hengrui could be entitled to over \$1 billion in development and sales milestones if the drug is approved in the US, Japan and select European countries. It is also eligible for double-digit tiered royalties. [Read More.](#)

¹The 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[China's exports fall most in three years as global economy falters | Reuters](#)

³[China became the world's largest vehicle exporter in Q1 2023, surpassing Japan \(carnewschina.com\)](#)

⁴[China starts shipping electric vehicles to Europe – DW – 10/20/2022](#)

⁵[Trade between China and ASEAN grows 15% in 2022, first year of RCEP's enforcement - Global Times](#)

⁶[U.S., China vie for trade dominance in Latin America \(gisreportsonline.com\)](#)

⁷[China to Deepen Influence Over Africa by Building Trade, Investing in Resources - Bloomberg](#)

⁸[Foxconn pulls back on its \\$10 billion factory commitment | TechCrunch](#)

⁹[Foxconn in Wisconsin: tech mega-deal faces reality check | Financial Times \(ft.com\)](#)

¹⁰[Foxconn employs more than 1,000 in Wisconsin. But what are they doing? \(jonline.com\)](#)

¹¹[TSMC Arizona plants: US rules 'unacceptable': more cash needed \(9to5mac.com\)](#)

¹²[TSMC to send hundreds more workers to speed U.S. plant construction - Nikkei Asia](#)

¹³[Apple supplier TSMC delays start of Arizona chip factory \(cnbc.com\)](#)

Important Disclosures

The above information reflects opinions of Morgan Creek Capital Management, LLC (“Morgan Creek”) as of the date it is written and, as such, all such opinions are subject to change. No representation or warranty, express or implied, is given by Morgan Creek as to the accuracy of such opinions and no liability is accepted by such persons for the accuracy or completeness of any such opinions. Further, Morgan Creek does not warrant the accuracy, adequacy, completeness, timeliness or availability of any information provided by non-Morgan Creek sources.

Morgan Creek Capital Management | 301 W. Barbee Chapel Road, Suite 200, Chapel Hill, NC
27517

[Unsubscribe ljacob@morgancreekcap.com](mailto:ljacob@morgancreekcap.com)

[Constant Contact Data Notice](#)

Sent by myusko@morgancreekcap.com