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INVESTMENT NOTE

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Andrew Parry, CEO Hermes Sourcecap, explains how European companies can exploit China's vibrant transformation:

If you read any of the recent press on China it would be difficult to make a case for the benefits of investing in the country. However, scratch below the surface of some of the myths about China's current fragility and you will find a vibrant and growing small-to-mid capitalisation section of the market. It is a far more diverse and complex economy than the normal superficial generalisations would lead one to expect.

What does this have to do with European equities? European companies benefit from China's growth in a number of ways, such as the outsourcing of production – think H&M, Adidas and Sports Direct. Expertise and technical know-how is another, perhaps less obvious benefit, which companies like Bureau Veritas, VW and Renault benefit from directly and which also offers protection from competition from China.

A lot has been made of the risk to intellectual property from China and the developing world imitating established products, but this appears to be overblown. We were surprised to hear at a recent meeting with Valeo that the Chinese government has started a crack-down on companies that violate intellectual property rights. This is entirely due to China wanting to protect its own intellectual property and, while there will inevitably be some losers from innovation in China, a company such as Valeo stands to benefit from China's protection of its own innovation.

The Chinese economy is still expanding and, while the pace of growth is moderating, it still represents a huge structural opportunity for those companies with the right products and commitment to invest for the long term. The sources of growth in China will evolve over time as the economy becomes more mature and sophisticated, just as Japan did in its development from 1950 to 1990.

Although increased competition from China will result in some firms losing out in Europe, there will be real beneficiaries too, as the rebalancing of the economy leads to the development of new markets. A selective approach to identifying the winners from the growth in China is required and it is important not to just buy the 'China effect'. While the headlines on China are often dire, and some of the challenges for the economy are immense, the same was said to be true for the eurozone a couple of years ago when stock prices were much lower and sentiment depressed. China will remain a source of opportunity and threat for many European companies for a long time still.

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Notes to Editors:

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