China: the new investment frontier.

For many companies, doing business in China is getting trickier by the day. But western banks and asset managers are more than willing to up their bets on the world's second biggest economy, convinced that the opportunities remain too good to pass up.

Major banks in recent weeks have inked deals to expand their footprint in China — or are otherwise attempting to take greater control of their businesses there — after years of being forced to enter the market via joint ventures. Late last month, HSBC received approval from Chinese regulators to take full control of its life insurance joint venture, which was created in 2009 in equal partnership with a Chinese company, under rules that were rolled back in 2020. The bank said the move underscored its "commitment to expanding business in China." The British banking giant is also seeking a greater stake in HSBC Qianhai, its joint securities venture in China, according to Reuters, which cited an anonymous source. HSBC declined to comment to CNN Business. HSBC isn't the only one. The state-owned China Securities Journal reported Wednesday that Deutsche Bank wants to establish its own wealth management joint venture in the country. The German bank declined to comment. "The sheer size of China's virtually untapped equity and bond market is irresistible to the world's large financial institutions, especially since Beijing is finally allowing them to operate wholly owned mutual funds," said Alex Capri, a research fellow at the Hinrich Foundation. China is the world's second biggest market for stocks and bonds. But it's largely untapped by foreign investors: International holdings account for about 5% of the $14 trillion stock market, and less than 4% of the $17 trillion onshore bond market, according to stock exchange and central bank data. That started to change last year, after BlackRock — the world's largest asset manager — in June became the first global firm to gain approval for a wholly owned Chinese mutual fund business. Two months later, BlackRock launched its first mutual fund in the country, and quickly raised $1 billion from more than 111,000 investors. Then, in August, JP Morgan became the first US bank to gain full ownership of its securities unit. CEO Jamie Dimon said back then that China represents "one of the largest opportunities in the world" for the firm. In October, Goldman Sachs, received the green light to fully take over its securities venture. And Morgan Stanley followed suit with a victory of its own in December, when its Chinese partner said the American bank planned to boost its stake in a brokerage venture to 94%. Earlier this week, China's securities regulator said it accepted an application from BNP Paribas to establish a securities firm, bringing the company a step closer to broadening its presence in the country."

While progress was slow for a while, the country in 2019 announced that it would entirely remove foreign ownership limits for financial firms the following year, shortly after Chinese President Xi Jinping and former US President Donald Trump agreed to restart trade talks. The enthusiasm from global banks and asset managers also comes with risks, as there is growing uncertainty about China's political and regulatory climate — as well as Beijing's rising tensions with other countries. In late 2020, Beijing launched an unprecedented regulatory squeeze on private enterprise, worried that such firms had become too powerful. The ensuing crackdown has extended to major Chinese financial players. "There is a sense, broadly, that Xi may moderate some of his more aggressive rhetoric after this year's 20th Party Congress, having assured his political position," said Craig Singleton, an adjunct China fellow at the Foundation for the Defense of Democracies, referring to the widespread expectation that Xi will use an important political gathering to cement a historic third term in office.

Some American politicians also called on Wall Street to stop "enabling Communist China" and take a tougher stance against Beijing. The squeeze has continued in recent weeks. Last month, US President Joe Biden signed the Uyghur Forced Labor Prevention Act, a law that bans imports from Xinjiang over concerns about forced labor. It sent a clear message that his administration and Congress are looking to ratchet up the pressure on Beijing. China's decision to let more foreign firms into the country is "aimed at shoring up collateral damage in the international community," according to Capri, who added that allowing western companies to take larger stakes in China also gives Beijing "leverage" over Washington and Brussels." This will increase tensions between the big financial firms in the US and Europe, and their home governments," he said. The moneymaking potential in China seems to outweigh any political headaches, though. "While China is facing huge economic headwinds, the country has defied bearish predictions in the past," Singleton said, adding that Western banks have continued to generate billions of dollars in revenue from China, even with the recent regulatory crackdown. "In other words, western banks are playing the long game under the guise of portfolio diversification," he added. And even as Beijing tightens its grip over parts of its economy, there are reasons why the country is eager to open its financial industry to foreign investors. The government wants to utilize global expertise as it builds a strong and diverse financial service industry, which it needs to manage its looming demographic crisis. A rapidly aging population and shrinking workforce have increased the burden on the country's inadequate pension system and put tremendous pressure on the government to provide enough financial resources for the elderly." One of the Chinese Communist Party's key attributes has been its adaptability and its pragmatism," Singleton said. He added that China understands it needs to maintain access to foreign markets, technology, and capital, necessitating those continued partnerships with western firms. "In other words, the CCP must integrate to survive, which means that it cannot completely eschew existing global norms or systems even as it tries to alter them to suit Beijing's needs," Singleton said.

On a more pragmatic side, where would that lead us on future investments in China? China’s domestic sector has grown significantly and now forms a dominant share of the economy, which should stage a recovery following the disruptions caused by Covid. Digital trend is supported by improving infrastructure spending and innovative corporate strategies. The best strategy should therefore be directed to private, fast-growing enterprises because they are highly innovative and competitive. But beware, because large Chinese Hi tech companies have already reached high levels and their prices reflect that.

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