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Western Portfolio Managers' Asset Allocations: Substantially Underweight China and Other High-growth Economies, Depriving of Investment Performance and Diversification from Investors

Executive Summary

China's potential in the global equity market is currently overlooked in particular considering its relatively low weight in terms of asset allocation in western investment portfolios. Though still regarded as a developing country, China's GDP and market capitalization of companies listed on its stock exchanges are both second to those of the U.S. However, China's economic achievements have not been entirely reflected in investment portfolios managed by asset managers in the west in general, with the Organization for Economic Co-operation and Development ("OECD") being the representative. We believe bias is the primary underlying reason for underweighting Chinese assets.

OECD is one of the most influential international organizations consisting mainly of developed countries in Europe and North America with some of the members being the world's wealthiest nations. All members of the Group of Seven ("G7") are part of OECD, but none of the high-growth developing economies such as China, India and Indonesia is a member. In 2022, the combined GDP of all the 38 OECD countries totaled USD59.62 trillion, representing about 60% of the world's total. This organization impacts the world in many ways by working with governments to establish international standards. Due to the sheer size of capital under management, OECD-based portfolio managers have the power to significantly influence the performance of equity markets.

Obviously, emerging markets especially China and India have surpassed many OECD countries in economic performance. Despite U.S. is still the world's largest economy, with 2022 GDP topping USD25 trillion, OECD's total GDP has been on a downward trajectory. It is because many OECD members have been lagging behind the high-growth countries. For example, the average GDP growth rate for OECD and Japan was 1.72% and 0.63% during 2001-2022, well below the 8.43% and 6.19% for China and India respectively for the same period. Importantly, China and India are projected to maintain the leadership position in respect of GDP expansion with respective growth rate of 5.4% and 6.0% in 2023 and 5.1% and 7.0% in 2024, according to the OECD Economic Outlook issued in June 2023.

According to a non-exhaustive search, there are more than 30,933 hedge funds and mutual funds based in OECD countries. Since diversification is one of the most critical factors in reducing investment risks, it is stunning to discover that **36% of those funds' capital is concentrated solely on U.S. assets, while only 2.4% of the money is invested in assets in China**.

MSCI All Country World Index Investable Market Index ("MSCI ACWI IMI"), the widely used global index as a performance benchmark, underweights assets in China and emerging markets, not in sync with actual economic performance. As at 30 June 2023, China's weight in the index was merely 2.89%, much smaller than its share of 2022 global GDP of approximately 18%. On the contrary, U.S. assets represented 60.94%, way above its around 25% share of the world's GDP in 2022. The wide disparity in the percentage of asset allocation between these two countries is not reasonable given the fact that China's 2022 GDP was 71% of that of the U.S., but the difference between their weights in MSCI ACWI IMI was slightly more than 21 times. Importantly, the GDP gap between China and the U.S. has been closing, and some scholars have declared that China could replace the U.S. to become the largest economic entity globally by 2035 or earlier. Nevertheless, the

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