INVESTMENT STRATEGIES

Ask an advisor: Should I divest from China?

By Nathan Place   October 3, 2023 5:46 PM

Welcome back to "Ask an Advisor," the advice column where real financial professionals answer questions from real people. The topic can be anything in the world of finance, from retirement to taxes to wealth management — or even advice on advising.

Over the past two years, countless American investors have worried about a potential recession in the United States. Fewer people have worried about a recession in China.

But maybe they should. For decades, China's economy seemed unstoppable — the country's GDP grew at 14.2% in 2007, according to the World Bank, and by 2010 it had become the world's second-largest economy. But in recent years, that dizzying growth has begun to falter — in 2022, China's GDP grew by only 3%.

In addition, China's real estate market is in crisis. After the country's second-largest developer, the China Evergrande Group, defaulted on its debts, dozens of other developers followed suit. And as the *New York Times* has reported, almost 40% of China's bank loans are tied to real estate, which means the crisis could spread to the banking system.

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All of this is more than enough to spook many Western investors, who have been fleeing the Chinese market in record numbers. Now a magazine editor in New York is wondering if she should do the same. Here's what she wrote:

Dear advisors,

Ten or 15 years ago, investing in China seemed like a no-brainer, but today I'm getting the opposite feeling. Should I divest from Chinese stocks?

These days I keep seeing headlines about China's increasingly authoritarian government, lack of transparency and a real estate bubble that might wreck its economy. And to top it all off, the country's famous growth has slowed to a crawl, raising fears that it may enter a recession.

Should I pull my money out while I still can? Right now I have about $20,000 invested in an international index fund. I don't know how much of that is in Chinese stocks, but I'm wondering if I should sell that part and invest it somewhere safer. What should I do?

Sincerely,

And here's what financial advisors wrote back:

Stay diversified

Jay Zigmont, certified financial planner and founder of Childfree Wealth in Water Valley, Mississippi

I've had a few clients ask questions about investing in China, just as you have. The answer may depend on why you want to divest from China. There are those who don't want to invest in China due to their policies, and see it as a conflict with their own values. If it is a conflict of values, then it becomes just like any other ESG investing and you need to decide which is more important.

From a financial standpoint, I don't recommend divesting from China for the same reason I don't try to time the market or invest in individual stocks. When you buy an international ETF, you get diversification by buying a bit of everything. Taking out China may help, or hurt, but the reality is that it is no different from picking an individual stock to buy or not.

Divest away

John Bovard, CFP and owner of Incline Wealth Advisors in Cincinnati

I agree that the risks are real when it comes to the Chinese economy, and it does not seem like a market that will flourish. Experts are also saying that birth rates are dropping in China and the long-term growth and innovation isn't there.

My suggestion would be to relocate that $20,000 into an emerging-markets-ex-China fund. That way you can still have international diversification but eliminate the investment in Chinese stocks.

What about India?

Jeremy Eppley, CFP and founder of Silverstone Financial in Owings Mills, Maryland

I recommend that my clients not invest deeply into China. If China invades Taiwan, I expect most U.S. investments in China would be cut in half or more. A little bit of exposure from an international ETF or Mutual Fund is nothing to worry about, but being overly concentrated in the country is worrisome to me.

Divesting your assets really depends on the tax implications of the sales. If you have net losses or insignificant gains, I would get out of China. If you have large capital gains, it might be worth coming up with a multiyear plan to slowly unwind some of those investments without causing a large tax bill for yourself.

If you are looking for other large international emerging markets ("BRICs") to replace your China exposure, I would look at Brazil or India. Personally, I am bullish on India; it reminds me of what China's economy looked like 15 or 20 years ago. Seeing many multinational companies (e.g., Apple, etc.) diversify their supply chains out of China and into neighboring countries makes me excited to see what India's economy will look like in the next decade.

Make it in America

Kashif Ahmed, CFP and president of American Private Wealth in Bedford, Massachusetts

In my opinion, investing in Chinese stocks was never a no-brainer. Yes, I know they had sizzling returns for a while, and everyone was infatuated (I wasn't, and I'm proud to never fall into the FOMO nonsense. The herd seldom has wisdom). But people forget it is a communist, authoritarian country, and one cannot trust the numbers that come out of there. I never did.

Yes, it is a giant economy (if you believe the numbers), and yes, global trade is intertwined with it. I do not touch Chinese, or even other international stocks. Why bother when the greatest companies are right here? Keep in mind that investing in U.S. multinationals gains you significant, albeit indirect, exposure to China's economy. Also, domiciles can be misleading. Many U.S. companies get the majority of their revenues from China and elsewhere, whereas some international companies get almost all of their revenue from sales in America. So, one could say they are in fact American companies.

Think long-term

Trent Porter, CFP and CEO of Priority Financial Partners in Durango, Colorado

Recent regulatory shifts, especially in the technology and education sectors, combined with concerns about the transparency of some Chinese firms, have introduced a degree of unpredictability.

However, viewing these changes within the broader context of investment strategy is vital. Diversification is a fundamental principle of investing, and one trap many investors fall into is attempting to out-guess the market, often reacting impulsively to short-term events and headlines, many times leading to suboptimal results.