2024 Mid-Year Investment Outlook – China equities

June 2024

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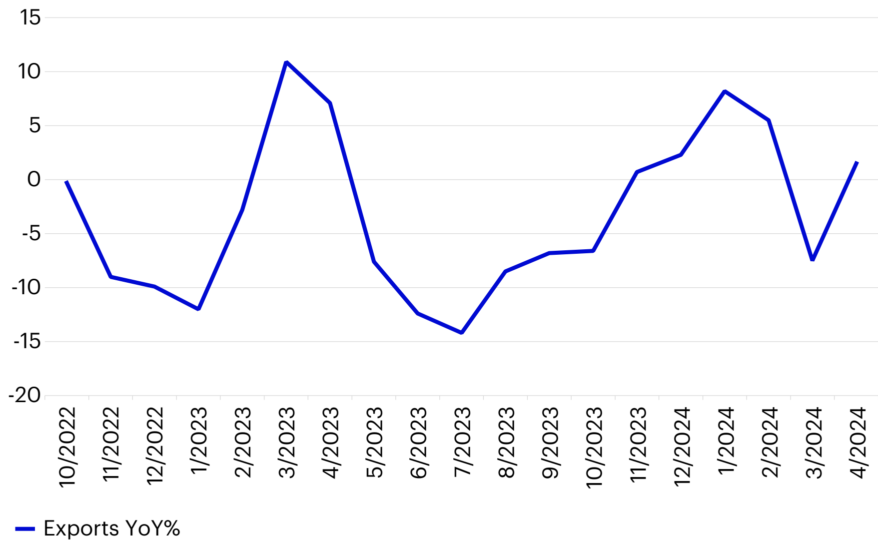
China's equity market has seen positive momentum so far this year, rebounding by over 30% since the trough in January. Both onshore and offshore Chinese equities have recorded positive returns year-to-date, with materials, industrials, and communication services sectors in positive territory.

China's economy has also shown resilience. The country's GDP grew by 5.3% year-over-year in Q1[1], surpassing market expectations. We expect the recovery to continue through to Q2 and are seeing ongoing signs of this from economic data and travel indicators. Industrial production has had robust growth year-to-date, and exports have returned to positive territory. The positive factors that drove economic stabilization and upward momentum in the first half of 2024 are expected to continue into the second half.

China's economic recovery

Looking ahead, we anticipate a continued recovery in China's exports and domestic demand over the second half of the year. On the manufacturing side, there was a positive year-on-year change in exports in the first quarter of 2024, reflecting the increased business activity and production momentum of Chinese companies. Exports to ASEAN, Latin America, and Africa have risen, suggesting that Chinese companies have been expanding their global market reach. We believe the increase in exports marks an encouraging improvement in both domestic and overseas demand.

Figure 1 - China YoY change in exports (October 2022 - April 2024)



Source: General Administration of Customs, data as of April 2024.

1. Goldman Sachs Global Investment Research, April 2024.

In terms of consumption, key indicators are moving in the right direction, including retail sales, travel data, and automotive sector performance. Consumer confidence is also rising and retail sales in China have had a close to 5% year-on-year increase [2]. The e-commerce sector in particular has expanded rapidly. We expect this consumption momentum to continue for the rest of the year. After China's reopening, we've seen robust holiday and travel spending data, including a 13.5% year-on-year increase in tourism revenue [3] during the recent Labor Day holiday, compared to pre-pandemic levels. Looking ahead, we expect a steady increase in consumption for the upcoming holiday season.

The government's monetary policy stance has been supportive, and we expect further cuts to the reserve requirement ratio (RRR), as well as interest rate cuts to accommodate faster government bond issuance. We believe these measures will provide additional stimulus to help revitalize China's economy.

Potential investment opportunities

Going forward, we see ample investment opportunities in China equities centered around the themes of reorganization of the global supply chain and the electrification and energy revolution. We continue to expect these trends to benefit Chinese companies in 2H 2024.

Chinese corporates are poised to benefit significantly by expanding their supply chain and global footprint. In doing so companies can benefit from sustained local demand in overseas markets to capture a larger share of the worldwide customer base. Chinese firms currently enjoy a cost advantage stemming from their large domestic market and economies of scale. We anticipate that these companies will have stronger earnings growth and overall growth prospects in the years ahead. We believe China's ongoing efforts to strengthen its global market presence will unlock opportunities for investors to engage in the country's expanding international trade and investment landscape.

Chinese companies are also benefitting from the global transition towards clean energy and are likely to play a key role in electrification and energy transformation trends. This is due to their strong presence across the entire green supply chain as well as the cost efficiencies gained from their large domestic market base. An example of one such opportunity lies in a tap changer manufacturer with ongoing overseas expansion plans that aims to build a full-scale industry supply chain. Currently, there are two major tap changer manufacturers globally that account for a large proportion of the overall market share. One is a privately-owned German company, and the other is the Chinese manufacturer. As tap changers are a crucial component in transformers that are seeing rising demand, investing in these companies could allow investors to capitalize on the anticipated surge in interest. We expect companies like this to emerge as key beneficiaries of the power grid upgrade trend.

Despite challenges, more clarity lies ahead

We believe investors considering China should also be mindful about potential challenges. The property sector set back in the past few years has put pressure on economic growth. We are seeing policies being put forward to stabilize the property market on a gradual basis and need to wait for some time before we see the impact of these measures. Such policies include guaranteeing the delivery of pre-sold homes, cutting mortgage rates, and enacting minimum downpayment requirements. We anticipate further policy stimulus for the property sector going forward. In terms of the external macro environment, with the highly anticipated US presidential election approaching before the year's end, we believe the market can expect more headline news that could result in short-term volatility.

2. Retail sales jump 4.7% year-on-year in Q1, showing a stable consumption expansion, Global Times, April 2024.
3. China May Day holiday spending shows mixed picture on post-COVID recovery, Reuters, May 2024.

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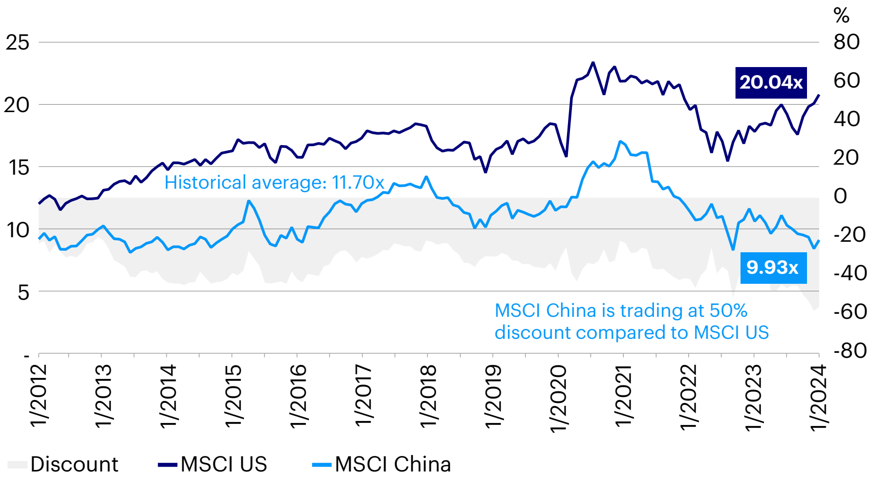
China equities are trading at attractive valuations

At present, China's equity market valuations are trading at relatively low levels both in historical terms and compared to developed markets. In fact, the MSCI China Index is currently trading at a significant discount of around 50% relative to the MSCI US Index. We believe this presents an attractive opportunity for investors to potentially capitalize on.

Figure 2 - Sizeable valuation discounts of MSCI China Index against global comps



Source: Factset, Invesco, data as of April 2024.

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Investment risks
The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

When investing in less developed countries, you should be prepared to accept significantly large fluctuations in value.

Investment in certain securities listed in China can involve significant regulatory constraints that may affect liquidity and/or investment performance.

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