Investor interest in China equities is rising

April 2025

Regional Asia Equity Investment Team

Capitalizing on China's stock market potential
Investor interest in Chinese equities is increasing, with indices such as the Hang Seng China Enterprises Index and CSI 300 rallying significantly since the start of the year. This rally has been backed by the DeepSeek moment, supportive policies, and substantial southbound flows. We are seeing a favorable re-rating of China stocks and have also seen renewed interest from global investors.

The MSCI China Index provides a balanced mix, with approximately 85% offshore equities and 15% onshore equities.[1] The emphasis on offshore equities underscores their attractiveness from an investment trend standpoint, while the inclusion of onshore equities providing unique opportunities.

Offshore China equities are poised for growth
We believe the offshore China equity market has an abundance of high-quality names and can offer attractive opportunities to investors considering this asset class.

A large selection of opportunities with growth potential
We are seeing ample investment opportunities in the offshore China equity market in structural growth areas namely the internet, consumer, services, and technology sectors. The growth prospects of these sectors are being boosted as China's economy transitions toward a more consumption- and services-led model and technological innovation progresses. We expect companies in these sectors to register faster growth, thanks to industry innovation and new listings, and thus providing investors with unique investment opportunities.

Industry-leading companies in the internet, consumer, services, and technology sectors already comprise the top 10 holdings of the MSCI China Index (Figure 1). We believe these industry leaders are in a good position to expand their market share and further solidify their leadership positions going forward.

Figure 1: Market leaders in consumer and internet sectors are mostly listed offshore

MSCI China	
Company	**Sector**
Tencent	Communication Services
Alibaba Group	Consumer Discretionary
Meituan	Consumer Discretionary
Xiaomi Corp	Information Technology
China Construction Bank	Financials
PDD Holdings	Consumer Discretionary
JD.com	Consumer Discretionary
BYD Company	Consumer Discretionary
Industrial and Commercial Bank of China	Financials
Bank of China	Financials

Source: MSCI, data as of 28 February 2025

1. Factset, data as of 25 March 2025.

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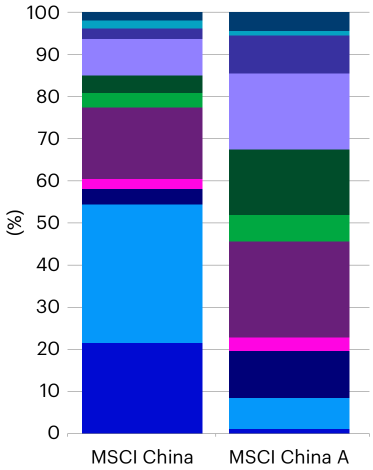
Offshore China equities benefit from DeepSeek moment
Prominent Chinese tech giants listed in Hong Kong have reported robust earnings in recent years and have strong earnings visibility underpinned by their diverse and well-established businesses. We expect the potential integration of advanced artificial intelligence (AI) interfaces, such as those developed by DeepSeek, to lead to an upgrade in the earnings of these Hong Kong-listed internet giants. The positive sentiment around AI advancements have led to a re-rating of valuations for offshore Big Tech companies. We believe Investors are optimistic about the long-term potential of AI to drive growth, which has led to increased investment in these stocks.

We believe offshore Big Tech companies are well-positioned to reflect earnings growth through the expansion of their AI tools and applications. The established market position and strong financial performance of these companies may provide investors with better visibility into their future earnings, thus making these stocks more attractive.

Offshore Big Tech companies also typically have a global presence, allowing them to tap into a broader market for their AI products and services. We believe this global reach enhances their ability to generate higher earnings and attract international investors.

Onshore China equities post unique opportunities
The onshore China equities market may also presents investment opportunities amid the ongoing AI rally. As AI continues to revolutionize various industries, onshore Chinese equities may well-positioned to benefit from this technological advancement, given its breadth and depth. We believe that several sectors, including autonomous driving, robotics, semiconductors, sensors, cloud platform services and telecommunications, stand to gain significantly from China's technological progress. These industries are experiencing rapid growth and transformation, driven by AI's ability to enhance efficiency, optimize processes, and create new business models. Investors could capitalize on these tech-driven sectors, that are supported by strong government initiatives, substantial R&D investments, and a robust talent pool. As the AI landscape in China continues to evolve, the onshore equities market may offer a compelling avenue for investors seeking to participate in the next wave of technological innovation.

Figure 2: Sector comparison between MSCI China Index and MSCI China A Index



	MSCI China (%)	MSCI China A(%)
Utilities	2.0	4.4
Real Estate	1.9	1.1
Materials	2.5	9.1
Information Technology	8.6	18.0
Industrials	4.2	15.6
Health Care	3.4	6.2
Financials	17.0	22.9
Energy	2.5	3.1
Consumer Staples	3.6	11.2
Consumer Discretionary	32.9	7.3
Communication Services	21.6	1.2

Source: Factset, Invesco. Datat as of Feb 2025.

2. Source: CEIC, Morgan Stanley Research; data as of 7 March 2025.

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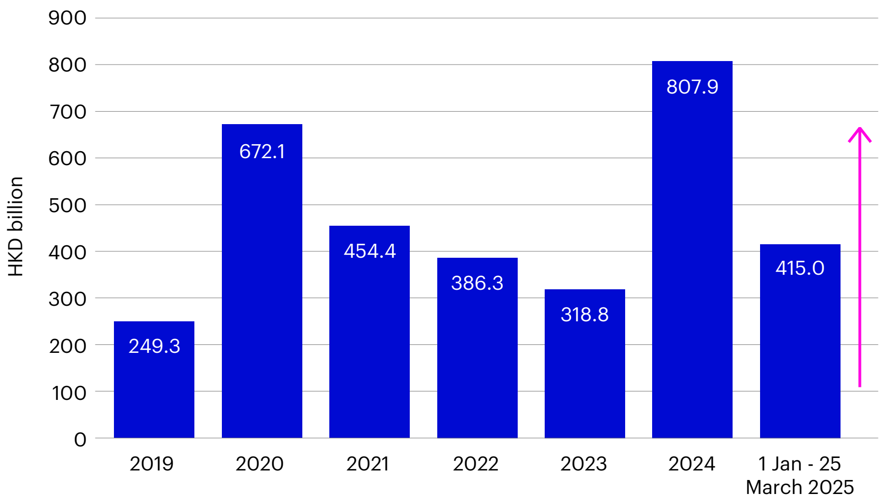
Equity market dynamics are favorable

Strong southbound flows driven by domestic liquidity
The increased participation of mainland investors, particularly through domestic channels, is driving strong southbound flows. This robust domestic liquidity is supported by the growing diversification needs of mainland investors and attractive investment opportunities, creating a favorable environment for continued inflows into offshore China equities.

Southbound flows have been very strong since 2024 and even stronger year-to-date in 2025. In February 2025 alone, net inflows reached US$19.6 billion, bringing the total for the first two months of 2025 to US$35 billion, compared to US$103 billion for all of 2024. (Figure 3). We expect this momentum to continue.

Figure 3: Southbound net flows (2019 – 2025 YTD)



Source: HSBC; data as of 25 March 2025.

MSCI China Index showed earnings stabilization and upward trend
We have seen earnings of stocks listed on the MSCI China Index stabilize and trend upward recently. This shift has been driven by strong performance in key sectors, including technology, consumer discretionary, and financials. The technology sector has benefited from increased innovation and investment in AI and digital infrastructure, leading to robust revenue growth. Meanwhile, the consumer discretionary sector has seen gradual recovery due to improving domestic consumption and a steady rise in consumer confidence. Investors are drawn to China's financial sector due to its potential for more stable earnings. These factors collectively underscore the resilience and growth potential of China equities.

Valuations are appealing
We believe China equities remain attractive even after the recent rally has brought valuations back to their long-term average. Currently, China equities are trading at relatively low valuations both historically and compared to developed markets (Figure 4). Notably, the MSCI China Index is trading at a significant discount of almost half relative to the MSCI US Index. This substantial valuation gap presents a compelling investment opportunity. Furthermore, we believe that the ongoing AI trend will continue to support the re-rating of China equities, attracting further investments. The combination of attractive valuations and strong growth prospects driven by technological advancements may make China equities an appealing choice for investors.

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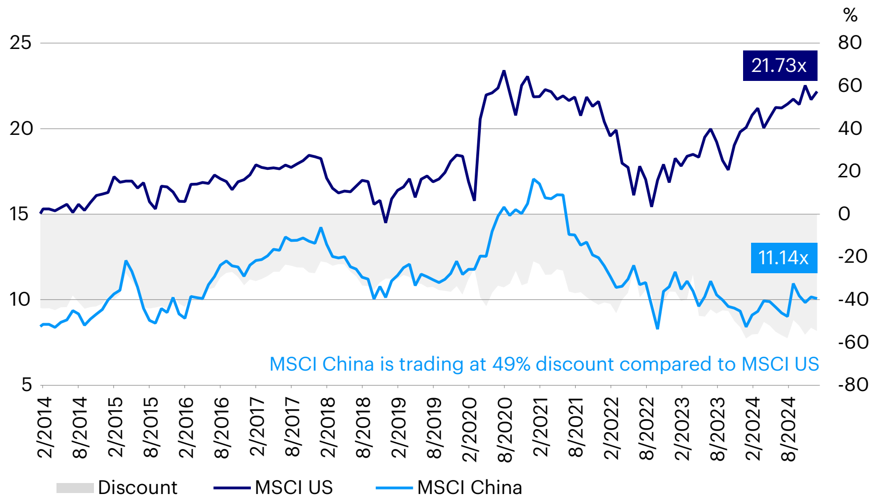
Figure 4: Forward 12M P/E of MSCI China vs MSCI US



Source: Factset, Invesco. Datat as of Feb 2025.

External factors to consider

While we are positive on this asset class, we still believe there are several factors to watch out for in China equities, including external market volatility and evolving supply-demand dynamics. Tariff policies and geopolitical uncertainties worldwide may affect the growth of China's economy and the sentiment towards China investment. However, we believe these risks are already priced into the current valuations of Chinese equity market. Domestically, recent policy announcements have focused on increasing consumption. We think the extent of the recovery in consumer sentiment will depend on effectiveness and speed of policy implementation by the local government as well as policy coordination. Consumer confidence in China is gradually picking up, and the market is still assessing the effectiveness of recent policies in stimulating economic activity and consumer sentiment.

Our outlook for China equities

In conclusion, we think China equities may present a compelling investment opportunity, driven by strong domestic liquidity, favorable valuations, and robust earnings growth. The MSCI China Index has recently seen a stabilization and upward trend in earnings, particularly in key sectors like technology, consumer discretionary, and financials. The substantial valuation gap between China equities and developed market equities, coupled with the ongoing AI trend, underscores the potential for further re-rating and investment inflows. As China's economy continues to transition towards a consumption and services-led model with a focus on technological innovation, we believe the China market offers significant growth opportunities.

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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.

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