AS AT 31.08.2024

Market Review

Chinese onshore and offshore equities saw a divergence in performance in August: offshore equities gained 1.0%, outperforming their onshore peers, which dropped by 1.9%. Resilient second quarter earnings from offshore Internet names, a weaker US dollar, and relatively higher yields collectively lent support to the offshore market. The energy and financials sectors outperformed as investors shifted back to high yielders on lingering macroeconomic concerns and fading US hard-landing risks, while materials continued to lag on concerns over the demand outlook. In August, the LPR (loan prime rate) was kept unchanged as expected. Bloomberg reported that Beijing may allow local governments to use funds raised from special bond issuance for home inventory purchases. Near month-end, media reports of a potential mortgage rate cut aiming at reducing borrowing costs and boosting consumptions weighed on banks.

On the macroeconomic front, activity and spending data for July came in mixed: retail sales rose by 2.7% YoY, up from 2.0% in June, while industrial production remained resilient too, only edging down to 5.1% from 5.3%. However, these areas of relative strength were counterbalanced by weaker investment, dragged down by the infrastructure and manufacturing sectors.

The August purchasing managers' index (PMI) surveys pointed to broadly stable growth. Specifically, the two manufacturing PMIs diverged again last month, with the official PMI edging down to 49.1 (in August 24) from 49.4 (in July 24), but the more export-oriented Caixin index rising to 50.4 (in August 24) from 49.8 (July 24). The breakdown of the official survey also showed a deterioration in both output and new domestic orders, but with the new export orders sub-index rising. The official non-manufacturing PMI edged up to 50.3 (in August 24) from 50.2 (July 24), driven by a rebound in the services sector as strong transport activity outweighed weakness in finance and real estate.

Export growth in US dollar terms picked up to 8.7% YoY in August, with broad-based growth across major developed markets and emerging markets. Shipments of motor vehicles and electrical products contributed the most to export growth among the different categories. On the other side, imports slowed to 0.5% YoY from 7.2% in July amid sluggish domestic demand.

Broad credit growth edged up to 8.2% YoY in July from 8.1% in June but remained low. The breakdown of the data showed a further slowdown in bank lending growth, but growth in other forms of credit mostly picked up, driven by faster bond issuance (both government and corporate) and with the contraction in shadow financing easing further.

Labour market data remained strong overall in July despite finally showing some deterioration. The national unemployment rate edged up to 5.2% (July 24) from 5.0% (June 24) and the 31-major cities rate rose to 5.3% (July 24) from 4.9% (June 24), both still below the annual target.

Consumer price index (CPI) inflation edged up to 0.6% YoY in August due to higher costs of food due to high

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temperatures and rainy weather, while the producer price index (PPI) slipped by 1.8% YoY.

Fund Performance & Portfolio Activity

Fund Performance

The fund BNP Paribas China Equity returned +0.11% in August underperformed the benchmark by 57bps (Classic, Capitalisation share class, net of fees, NAV-to-NAV with dividends reinvested, in USD).

Main Contributors

Stock selection in financials and consumer discretionary contributed to the relative performance, along with our overweight allocation in information technology.
Pop Mart, a leading IP-creator in the toy and blind-box market, was the top contributor over the month. We initiated the name back in 2024 Q2 to capture the company's moat growth stemming from its strong bargaining power across value chain, from upstream artists and manufactures to downstream consumers. The company released a strong set of 24H1 results in August, with revenue and profit growing at 62% YoY and 103% YoY, respectively. Despite macro weakness and consumption slowdown, the company delivered accelerated growth in domestic market in Q2, showcasing its resilience and alpha characteristic. Going forward, we continue to like the name as a good fit of our 'Lifestyle Change' investment theme: consumers are buying Pop Mart products for the 'little joy' type of emotional value. Meanwhile, the foreign market ramp-up and expansion of product types is expected to lend further support to the company's sustainable growth in the long run.

Fuyao Glass, the world's largest auto glass manufacture, was among the top contributors in August. The company has a vertically integrated business model that covers the whole value chain from upstream sand to downstream finished products. Apart from being a dominant player in the domestic auto Original Equipment Manufactured (OEM) glass market, Fuyao also has good presence in Europe and the US, where the manufacturing facilities are set close to customers. The stock was sold off in late July upon the news on US factory probe. The share price recovered in August as concerns on the investigation faded as the management reiterated the target of the investigation is a third-party labor supplier rather than Fuyao. We remain positive on the company's revenue growth and margin competitiveness through consistent market share gain and proven cost leadership. We believe Fuyao's continuous innovation in high value-added products such as HUD and panoramic glass will lead to sustainable ASP growth in the long run.

Main Detractors

Stock selection in information technology and industrials detracted from the relative performance.
Within our holdings, PDD (Pinduoduo) was a top detractor in August. The company is the third-largest e-commerce platform by gross merchandise volume (GMV) and the largest platform by active buyer in China. PDD's share price plunged post 2Q earnings release in late August. The topline growth in Q2 slightly missed consensus but bottom line was a clear beat. What truly hurt the sentiment was the management's conservative guidance as well as the lack of shareholder return enhancement. Given current price level, we

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believe the damage is overdone as current price implies attractive valuation on both domestic and overseas side despite a healthy Gross Merchandise Value (GMV) growth outlook. Over the past a few years, PDD has been grabbing market shares domestically from traditional e-commerce giants, while ramping up overseas business under the 'Temu' brand. We remain confident in PDD's strong execution and value-for-money position, which should cater to the consumer trade-down trends both in domestic and overseas markets. With the rollouts of PDD's merchant-friendly initiatives ahead, we will keep monitoring the impacts on e-commerce competitive landscape.

Within our holdings, Zhuzhou CRRC Times Electric (CRRC Times), an emerging leader in IGBT (Insulated Gate Bipolar Transistor) and China's leading locomotive propulsion and control system supplier, was among the top detractors in August. The year-to-date rally in share price took a pause and the stock suffered from profit-taking after the release of a set of strong earnings in August. CRRC Times used to be seen as an old industrial name but has been actively expanding their business segment from railway equipment to other areas such as vehicles and solar inverter. In the latest H1 results, the company delivered solid profit growth helped by margin expansion. Despite near-term volatility, we continue to like the name as the railway equipment business enjoys high visibility helped by the high-speed train replacement cycle. As for the IGBT semi business, CRRC Times also delivered strong earnings growth and margin expansion in Q2 despite concerns around overcapacity and softness in EV demand. By leveraging on its IDM (integrated design and manufacturing) model, capacity expansion and proven manufacturing expertise, CRRC Times moves fast in product iterations and has been gaining market share from global competitors within the EV IGBT space over the past a few years.

Portfolio Activity

We fully exited from MGM China and introduced Jiangsu Hengli Hydraulic over the month.

Fund Outlook and Positioning

Market sentiment towards Chinese equities has trended weaker in the third quarter of 2024 due to the slowdown in the macroeconomic recovery and insufficient policy stimulus. In the near term, the pace and the strength of additional policy supports are crucial to shore up growth and revive momentum. While the recovery is likely to remain patchy and uneven, high-quality development and market-based reforms are key for China to maintain sustainable growth in the longer run. Chinese equities, deeply discounted, may also benefit from a global re- allocation of fund flows and its low correlation with the rest of the Asian and DM indices.

Policy support is likely to be stepped up in the coming months in order to hit this year's key economic targets (e.g., 5% Gross Domestic Product (GDP) growth). On the fiscal policy side, the main tools include front-loading support via early issuance of special CGBs (central government bonds) and accelerating the issuance of special LGBs (local government bonds). On the monetary policy front, China's central bank also has more leeway for further liquidity stimulus, such as further policy rate and RRR (reserve requirement ratio) cuts, compared to developed markets and the other emerging economies.

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China is going through a structural transformation. To boost future economic growth, officials have called for state-led investment to stimulate private investment and to support the new initiatives such as 'new quality productive forces'. Structural transformation is renewing investment growth in innovation and upgrades in the industry value chain. The new infrastructure sector (e.g., IT, artificial intelligence, data hub, hard tech development, environmental projects, electric vehicles, transport, etc.) are likely to benefit more than traditional infrastructure from future investment growth. We expect to see increasing opportunities to pick up fundamentally solid long-term market winners at more reasonable valuations.

Risk prevention remains near the top of the policy agenda, with a particular focus on stabilising the property sector. Insufficient domestic demand, pressures on private firms and a more complex external environment are hidden risks in key areas. Resolving these structural issues requires decisive, forceful and predictable policies. Looking ahead, the regulatory environment is stabilising in China (compared to 2020-2021), with Beijing reiterating its focus on taking a pro-growth and pro-business policy stance.

We believe China's relationship with the US will remain challenging in 2024 and beyond, with geopolitical risks remaining high as both economies increasingly see each other as competitors. In some areas where both parties have common interests worth compromising on, we are seeing progress. However, risks remain, especially in specific areas such as semiconductors, AI development and sectors chosen as China's new growth engines. Over recent years, western multinational companies have been diversifying their supply chain to southeast Asia and India to mitigate Sino-US trade tensions. That said, the diversification and/or relocation of supply chains is a slow process, given China's scale, capacity and efficiency as well as its strong manufacturing ecosystem. This can be seen from the increased market share of China's global exports in the past few years despite tariffs, as well as from the increased intra-regional trade between China and other Asian countries.

For 2024, we believe the risk-reward is turning more positive even though China is not fully out of the woods yet. Re-rating prompts investor focus to shift towards individual company fundamentals. This may result in a greater divergence in stock performance. Year-to-date at the portfolio level, we have added macroeconomic top-down and cyclical factors into greater account to select steady growth companies with an attractive dividend. We also reduced our exposure to companies which are more sensitive to geopolitical risks while increasing the number of holdings in sectors/themes in which we still see long-term growth potential for the purpose of diversification. We continue to focus on our bottom-up stock-picking process, identifying the highest-quality growth companies with sound or improving environmental, social and governance (ESG) profiles.

Modest valuations, light investor positioning, good fundamentals and structural long-term growth opportunities should help Chinese assets withstand near-term volatility. We believe China's equity markets are increasingly led more by structural growth factors than cyclical factors. Our China equities team identifies investment opportunities in the themes that are well positioned to benefit from structural changes: 1) innovation; 2) industrial upgrade; and 3) lifestyle change. These themes are the guiding stars in our long-term portfolio strategy.

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DISCLAIMER

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