AS AT 29.02.2024

Market Review

Chinese markets had a good start to the Year of the Wood Dragon, with offshore and onshore equities up by 8.4% and 10.8%, respectively. Better-than-expected Chinese New Year travel, a larger-than-expected cut of the 5-year Loan Prime Rate (LPR), and stepped-up market- supportive measures from Beijing lifted market sentiment, allowing the indices to recover most of the losses from January.

On the macroeconomic front, January's credit report and high-frequency new year data turned out to be better than expected. The official purchasing managers' indices (PMIs) were mixed in February due to Chinese New Year distortions: The manufacturing PMI edged down to 49.1, while the non-manufacturing PMI posted a decent gain to 51.4, driven by a seasonal pick-up in services activity.

The People's Bank of China (PBoC)'s 25bp cut of the 5-year LPR, which is a benchmark for ultra-long lending such as mortgages, is another incremental step towards targeted policy support for the property sector. High-frequency data readings were better than expected during the new year festival (10-17 Feb). Domestic tourist trips and total tourism spending were up by 34% and 47% year-on-year (YoY), or up by 19% and 8%, respectively from the comparable period in 2019 (before Covid).

Exports in USD terms rose by 7.1% YoY in January-February from 2.3% in December, while import growth increased to 3.5% YoY in January- February from 0.2% in December. The strength in exports was mainly led by robust exports to selected EM trade partners such as Africa, India, and Russia.

Credit expansion beat market expectations in January: New aggregate financing (AF) jumped to RMB 6.5 trillion in January, well above the RMB 1.1 trillion in December, and was mainly driven by new RMB loans. Broad credit growth (outstanding aggregate financing growth) remained at 9.5% YoY.

The consumer price index (CPI) fell -0.8% YoY in January, while the producer price index (PPI) recovered slightly to -2.5% YoY. However, the YoY readings were less relevant due to the distortion from the new year celebrations.

Over the month, coupled with national team's buying (equity purchases by Chinese government-led funds), China's Securities Regulatory Commission (CSRC) tightened the rules for margin financing/short selling and enhanced the regulation on Direct Market Access (DMA) products and other over-the-counter (OTC) derivatives business.

Moving into March, China's annual National Committee of the Chinese People's Political Consultative Conference and the National People's Congress kicked off. Details on economic targets, the fiscal budget, policy priorities are due to be revealed.

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Fund Performance & Portfolio Activity

Fund Performance

The fund BNP Paribas China Equity returned +7.91% in February underperformed the benchmark by 86bps (Classic, Capitalisation share class, net of fees, NAV-to-NAV with dividends reinvested, in USD). From a sectorial perspective, sector allocation contributed positively whilst our stock selection slightly detracted from relative performance.

Main Contributors

Our stock selection in industrials and communication services, as well as overweight in information technology and underweight in financials, contributed the most to the relative performance.
Consumer discretionary led the rally on the back of strong travel readings during the Chinese New Year holidays and earnings beats. Within our portfolio, New Oriental Education & Technology, Trip.com and MGM China were all among the top contributors in February. Trip.com, the largest online travel agency in China, delivered strong bottom-line beat in 4Q23. The company is expected to continue gaining market share as the leading player while delivering structural margin expansion driven by outbound travel recovery. Despite uncertainties around overall consumption environment in China, we noticed the change in consumer preference, namely consumption shift towards travel and experience- based activities. We continue to like the firm as we believe it is uniquely positioned in the market's structural growth and remains attractive from risk-reward angle.

Main Detractors

Stock picks in information technology and our overweight in communication services held back some return.

In February's market rebound, SOE dividend yield play such as Yangtze Power lagged the overall market amid style rotation. The company is the largest hydropower generation company in China and its share price recorded good performance in the market sell-off in 2023 and in January when investors favouring dividend play. Looking ahead, we believe it is helpful to add greater macro top-down considerations to our portfolio construction process on top of the alpha-driven stock picking process to navigate near-term volatility within Chinese equities. Therefore, we continue to like some defensive stocks, like Yangtze Power, which have attractive dividend yields and which will likely to provide steady growth benefitting from SOE reform. Meanwhile, we remain constructive on our long-term investment themes, and we believe that once the macroeconomic environment stabilises, structural growth drivers like industry upgrades are expected to recover and be sustained.

Portfolio Activity

Over the month, we introduced Innovent Biologics to our portfolio, and exited from Jiangsu Cnano Technology.

Fund Outlook and Positioning

Market sentiment towards Chinese equities remains cautious despite a more encouraging outlook and more

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supportive economic policies. China's weak macroeconomic momentum is partly cyclical (patchy and uneven recovery after long Covid), partly structural (local government debt, property). With the government's actions of late, policymakers are putting a floor under the cyclical issues. While the structural issues are still works in progress, China has the tools to manoeuvre and be more proactive in managing the risk (e.g., central government leveraging up, innovation and upgrade of its industrial sectors).

Structural transformation is renewing investment growth in high-value manufacturing and high-tech industries. The most exciting aspect of investing in China in the mid to long term is the upgrade in the industry value chain. Once the macroeconomic environment stabilises, structural growth drivers like industry upgrades are expected to recover and be sustained. 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.

To help stabilise China's GDP growth and ultimately restore market confidence, fiscal stimulus may play a more significant role. In our view, potential positive catalysts for China include: 1) central government leverages up and takes on a larger share of the fiscal burden; 2) relaxation of household registration system and further accelerate urbanization; 3) reviving 'animal spirits' and restoring private sector confidence with more concrete plans to further protect private owned enterprises' (POEs) assets and rights. China's headline inflation remains low. Compared to the developed markets and the other emerging economies, the central bank has more leeway for further liquidity stimulus.

Resolving structural issues require decisive, forceful, and predictable policies. Looking ahead, the regulatory environment is stabilising in China (compared to 2020-2021) as the government reiterated its focus on taking a pro-growth and pro-business policy stance. Over the long run, debt reduction, reducing carbon emissions and implementing further reforms remain key priorities on the policy agenda.

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 technology areas such as semiconductors. 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. The divergence in stock performance looks set to continue to widen, and the recovery in China will likely remain patchy and uneven. Modest valuations, light investor positioning, good fundamentals and structural long-term growth opportunities should help Chinese assets withstand near-term volatility. Our China equities team prefers to focus on names likely to benefit from policy moves and domestically focused names and avoid

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those that are subject to higher geopolitical risk. We believe China's equity markets are increasingly led more by structural growth factors than cyclical factors. We identify long-term investment opportunities in the themes that are well positioned to benefit from structural changes: 1) technology & green innovation; 2) consumption upgrading; and 3) industry consolidation. These themes are the guiding stars in our long-term portfolio strategy.

At the stock level, we remain opportunistic, and we rebalanced our portfolio with a focus of 'next generation' champions benefiting from the technology & innovation boom, and a mix of steady growth & turnaround tactical opportunities from the valuation angle to balance the portfolio risk. More targeted easing measures to support property and more investment on infrastructure and manufacturing are critical to achieve the growth target. On the consumption side, the trend of changing consumption priority is likely to continue with travel, leisure, and services-related purchasing outperforming durable goods consumption.

We continue to focus on our bottom-up stock selection approach, identifying the highest-quality growth companies delivering sustainable earnings growth in the long run and with sound or improving environmental, social and governance (ESG) profiles. The divergence in stock performance looks set to continue to widen. We continue to be selective, and we are closely monitoring the Chinese macroeconomic outlook and the latest developments.

DISCLAIMER

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