AS AT 31.07.2024

Market Review

Chinese onshore and offshore equities saw a divergence in performance in July, with onshore gaining 0.6% and offshore falling by 1.3%. Market sentiment reflected some disappointment over the lack of policy surprises from the Third Plenum, then slightly recovered by the end of July after the Politburo meeting. The Politburo stepped up stimulus with monetary easing and support for domestic consumption and emerging industries. It also reaffirmed its commitment to achieving the 5% Gross Domestic Product (GDP) growth target in 2024. However, the rising odds of a Trump presidency raised concerns over the sustainability of exports' contribution to overall economic growth, leading to some risk-off trades. From a sector perspective, energy and materials underperformed amid profit taking and concerns on the demand outlook, while healthcare outperformed amid outflows from some high-flying sectors, valuation repair and more encouragingly, policy rollouts in support of innovation development within the biopharmaceutical industry.

On the macroeconomic front, second quarter GDP (falling to 4.7% YoY from 5.3% the previous quarter) showed a clear slowdown in momentum and the June activity data pointed to continued divergences across different parts of the economy. Industrial performance remained strong, supported in part by resilient exports, but domestic demand continued to be dragged by the ongoing property downturn and weak confidence. The official and Caixin manufacturing Purchasing Managers' Index (PMIs) both pointed to a further slowdown in growth in July due to weak domestic demand. Specifically, the official manufacturing PMI edged down to 49.4 from 49.5 in June, while the more export-oriented Caixin manufacturing PMI index fell to 49.8 from 51.8 in June. The breakdown was broadly similar, showing a noticeable fall in output and new domestic orders, but with export orders holding up better. The official non-manufacturing PMI also edged down, to 50.2 from 50.5, mainly driven by a further fall in the construction PMI.

Export growth in US dollar terms slowed to 7.0% YoY from 8.6% in June, with declines in exports to ASEAN and Latin America, which have been an important prop to Chinese exports over the past year. Shipments of electronic products held up the best among the different categories. On the other side, imports rose by 7.2% YoY after a 2.3% contraction in June, mainly due to a flattering base from a year ago.

Activity data for June revealed sluggish momentum at the end of the quarter despite healthy industrial production (+5.3% YoY after +5.6% in May). Retail sales slightly edged down (-0.1% MoM) despite a still-solid labour market. Labour market conditions remained strong, with both the national surveyed unemployment rate and the 31-major cities rate stable at 5.0%.

Consumer price index (CPI) inflation improved to 0.5% YoY in July thanks to food prices ending deflation, while the producer price index (PPI) slipped by 0.8% YoY.

The People's Bank of China (PBoC) delivered policy rates cuts in July to support growth. The one-year Loan Prime Rate (LPR) was reduced by 10bp to 3.35% and the five-year LPR was also reduced by 10bp, to 3.85%. This came as a surprise, as did the announcement a few days later of a 20bp cut in the rate of the Medium-

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Term Lending Facility (MLF) to 2.30%.

Fund Performance & Portfolio Activity

Fund Performance

The fund BNP Paribas China Equity detracted by -1.94% in July underperformed the benchmark by 74bps (Classic, Capitalisation share class, net of fees, NAV-to-NAV with dividends reinvested, in USD).

Main Contributors

Stock selection in energy, industrials, and utilities contributed to the relative performance.

China Yangtze Power, the largest hydropower generation company in China, continued to outperform the market and ended the month as a contributor. The stock recorded good performance amid declining yield-to-maturity of long-term central government bonds. China Yangtze Power is a defensive name in our portfolio to navigate near-term volatility within Chinese equities while we remain positioned in China's long- term structural growth drivers. Fundamentally, we continue to like Yangtze Power for its attractive dividend yield and expect it to benefit from SOE reforms and deliver steady growth in the long term.

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 contributors in July. The share price had a nice run on the railway investment theme amid rising odds of a Trump presidency and expectations on policy supports following weaker-than-expected Q2 GDP readings. 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. Apart from the angle of rising policy supports on railway investment, we believe the company will also benefit from the ongoing Electric Vehicle Insulated Gate Bipolar Transistor (EV IGBT) shortage and local substitution driven by China's robust EV adoption. 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. We continue to like this name, which fits our long-term investment focus on technology innovation and industry consolidation.

Main Detractors

Stock selection in consumer discretionary, information technology, communication services and financials detracted from the relative performance.

Within consumer discretionary, New Oriental Education & Technology Group (EDU), the leading private educational service provider in China, was the top detractor in July. Several headlines dampened the sentiment around the stock over the month. East Buy, the live-streaming e- commerce sub-business of EDU, announced the departure of its main celebrity live-streamer, bringing negative impact on East Buy's growth outlook. Also, despite the earnings beat in its latest quarterly results, the company missed consensus on operating profits

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due to a mix of front- loaded expansion costs, reorganization cost from East Buy, and higher bonus payout. In our view, the impact from East Buy on EDU's margin should be mainly felt in the recent quarters, whilst EDU's core educational business remains strong and on track of margin expansion. We continue to like the company in the long run as we believe the key driver to its core business recovery remains to be the demand for children education, which is unlikely to fade in foreseeable future. As the industry is back to more stable regulatory environment, EDU has also fortified the key pillars of future business direction with further lifted industry leadership. We will closely monitor for signs of margin improvement in the coming quarter.

Within our holdings, Shenzhen Mindray Bio Medical Electronics (Mindray) was among the top detractors in July. The company is China's largest medical equipment producer and is specialized in heavy machines such as Computed Tomography (CT) Scanner and testing equipment. The health care sector in general held up relatively well over the month, whilst the valuation repair was mainly concentrated in the pharmaceutical outsourcing services space amid policy rollouts in support of biopharma innovation development. Hence, Mindray did not benefit from the sentiment improvement and continued suffering from the impact from the anti-corruption campaign and delayed equipment purchase ahead of the medical equipment upgrade program. Despite near-term pressure in share price, we are confident in the company's long-term competitive advantages, including strong Research & Development (R&D) and diversified product portfolio. We remain positioned in the name for its undemanding valuation and solid domestic demand outlook with the medical equipment upgrade program materializing ahead.

Portfolio Activity

We fully exited from Maxscend Microelectronics and Chinasoft International over the month.

Fund Outlook and Positioning

Market sentiment towards Chinese equities has started to recover, backed by a more encouraging outlook and more supportive economic policies. In the near term, the authorities' policy focus is shifting to the implementation of existing easing measures to tackle the cyclical issue of an uneven and patchy recovery. In terms of a long-term growth strategy, policymakers are emphasising a commitment to the importance of reforms to boost productivity, economic growth and China's path to modernisation. While the structural issues (i.e. local government debt, property sector woes) are still works in progress, China has the tools to manoeuvre and be more proactive in managing the risk. Chinese equities, deeply discounted, may also benefit from a global re-allocation of fund flows.

Policy support is likely to be stepped up in the coming months, with front-loaded fiscal support doing much of the heavy lifting, backed by monetary easing. 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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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 high-value-added manufacturing 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 other new technology. 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 shift may result in a greater divergence in stock performance. At the portfolio level, while 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, we are also taking macroeconomic top-down and cyclical factors into greater account to help us select the better-performing companies in relative terms. We prefer companies that are likely to benefit from policy moves and domestically focused names and avoid those that are subject to higher geopolitical risk.

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) technology & green innovation; 2) consumption; and 3) industry consolidation. These themes are the guiding stars in our long-term portfolio strategy.

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