AS AT 31.10.2024

Market Review

Chinese equities consolidated in October as the market awaited Beijing's stimulus details and the US election outcome: onshore and offshore equities corrected by 2.8% and 5.9%, respectively. The information technology sector largely outperformed as semiconductor names jumped on the localisation theme amid rising odds of a Trump presidency. While the People's Bank of China (PBoC) is providing monetary stimulus through key rate cuts, there is still little clarity on how fiscal support measures will be put in place. In mid-October, the finance minister mentioned the issue of special government bonds to support public commercial banks as well as other measures for local authorities.

On the macroeconomic front, third quarter GDP growth came in at 4.6% year-on-year (YoY), edging down from 4.7% the previous quarter. Encouragingly, the key September activity and spending data showed some green shots: industrial production (IP) growth rose to 0.6% MoM from 0.3% and retail sales picked up by 0.4% MoM. Investment growth also ticked up to 1.3% MoM as faster growth in manufacturing and infrastructure investment outweighed a further contraction in property investment.

The October purchasing managers' index (PMI) surveys pointed to an improvement in conditions. The official manufacturing PMI rose to 50.1 from 49.8. The breakdown of the official survey showed a pick-up in output and an increase in new domestic orders. The Caixin manufacturing PMI also delivered an upside surprise, rising to 50.3 from 49.3, driven by the improvement in the output and new order components. The official non-manufacturing index rose from 50 to 50.2, led by an improvement in services.

Export growth rebounded to 12.7% YoY in October from 2.4% in September, with broad-based growth across major product categories and major markets except for the US. By contrast, imports contracted by 2.3% YoY after a 0.3% pick-up in September.

Broad credit growth slowed in September to 8.0% from 8.1% in August. New loan creation remained soft at CNY 1 590 billion, with loan growth moderating to 8.1% YoY from 8.5% in August.

The national surveyed unemployment rate improved to 5.1% in September from 5.3% in August, which likely reflected the reversal of distortions caused by an influx of graduates in the preceding months.

Consumer price index (CPI) inflation ticked lower to 0.3% YoY in October from 0.4% in September on falling food prices, while the producer price index (PPI) slipped by -2.9% YoY, down from -2.8% in September.

Fund Performance & Portfolio Activity

Fund Performance

The fund BNP Paribas China Equity detracted by -5.20% in October outperformed the benchmark by 28bps

Source: BNP Paribas Asset Management as at 31 October 2024. **Past performance is not indicative of current or future performance.** The above views represent our judgement as at the date of this report and may be subject to change without notice. Any economic and market trends/forecasts are not a guide to future performance of the fund. The funds/securities mentioned above are for illustration only and shall not constitute any investment advice. Calendar year performance: 2023: -19.53%, 2022: -28.41%, 2021: -18.86%, 2020: 51.03%, 2019: 35.02%. Classic Capitalisation shareclass, net of fees, NAV-to-NAV with dividends reinvested, in USD.

(Classic, Capitalisation share class, net of fees, NAV-to-NAV with dividends reinvested, in USD).

Main Contributors

Stock selection in consumer discretionary, and our overweight exposure to information technology contributed to the excess return. Our underweight exposure to consumer staples also paid off.

Pop Mart, a leading IP-creator in the toy and blind-box market, was the top contributor over the month. The share price jumped on a strong set of 3Q results, where the company delivered accelerated sales growth in both domestic and overseas market. 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. Despite macro weakness and consumption slowdown, the company has been showcasing its resilience and alpha characteristic. 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.

Xiaomi, an upstart in China EV market, was a top contributor in October. The company is a leading smartphone brand with a fully developed ecosystem across IoT hardware and internet services. In March this year, Xiaomi launched its first EV model, SU7. We introduced the name in Q2 upon the initial success of Xiaomi's EV launch, which is disruptive to the China EV market and might accelerate industry consolidation. As of Oct, the monthly delivery number of SU7 has reached 20k, suggesting sustainable customer interest. On top of strong NEV order flows, market rumours about earlier-than-expected launch of next SUV model further lift market sentiment. At the same time, Xiaomi's IoT business stays on the high growth trajectory and is also likely to benefit from the recent subsidy and stimulus policies in China for home appliances and consumer electronics. What's more, smartphone margin is also showing recovery. We remain positive on Xiaomi and will continue monitoring developments in new EV model launches and smartphone shipment.

Main Detractors

At portfolio level, stock selection in information technology, financials, and industrials mainly detracted from the relative performance.
The information technology sector strongly outperformed in October, but the rally was uneven across sub-industries. Semiconductor space was the bright spot backed by the localisation theme amid rising odds of a Trump presidency. However, some other sub-industries witnessed some correction. Our stock selection in information technology cost us some performance as our investment allocation within IT spans beyond semi space.
Within our holdings, New Oriental Education & Technology Group (EDU), the leading private educational service provider in China, was the top detractor over the month. The company's 1QFY25 results triggered a selloff upon earnings release. Despite in-line earnings, 2QFY25 guidance is softer on both topline and margin side. In particular, core education business is guided to slow down to 25+% YoY from 34% YoY in 1Q, while capacity has been expanding at 35+% YoY for a few quarters. Meanwhile, margin for core business is also

guided lower as low seasonality and loss from tourism business leads to operating deleverage. We have turned more cautious on this name months ago when increasing opex trend started to pose pressure on potential EBIT margin miss and have been closely monitoring for signs of margin improvement. Given the margin miss in latest quarterly result, we decided to slice down the position size to control risk. However, we like EDU in the long run as the resilient demand for children education will continue to drive EDU's core business recovery. As the industry returns to more stable regulatory environment, EDU has also fortified the key pillars of future business direction with further lifted industry leadership.

Portfolio Activity

We fully exited from Shengyi Technology, Baidu, Venustech, Kanzhun and Yifeng Pharmacy Chain over the month. In terms of new positions, we introduced KE Holdings, Anta Sports, Anhui Conch Cement, and GDS Holdings into the portfolio.

Fund Outlook and Positioning

Overall, the latest stimulus package announced by Beijing is more aggressive than anticipated, showing not only the officials' determination to hit their 5% GDP growth target this year, but also their new-found priority and urgency in turning around the economy. Looking ahead, additional monetary, fiscal and structural reform policy supports will be key to turning the market rebound from a short-term pop-up to a more sustainable rally. While the economic 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, with undemanding valuations, may also benefit from a global re-allocation of fund flows and its low correlation with the rest of the Asian and DM indices.

For the key areas where we think policy is urgently needed to lift economic growth – property and fiscal – the announcements at the end of September slightly underwhelmed. Monetary easing by itself may not be sufficient to resolve the fundamental issues faced by the Chinese economy. The market needs a '1-2-3 punch' (with current monetary easing as the first action) followed by big fiscal stimulus, and more importantly structural reform to sustain the rally rather than it being a short-term trade. The actual form of stimulus, not only the size, would also matter, as providing a pathway out of the property crisis and transition to consumption are amongst the more urgent issues. Nevertheless, structural reform, especially those addressing private enterprise confidence and safety net of the public, will be the keys in turning the market from a short-term "stabilization trade" into a structural longer term buy in the "next China story".

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 sectors 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.

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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. Local government spending and property inventory purchases have been held back in 2024 mainly by overly stringent rules rather than a lack of funding. We believe it is important for Beijing to provide a pathway forward with better execution plans (e.g. more and cheaper financing support from central government, lower returns requirement, etc). 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.

From an investment perspective, the stimulus (and the expectation of more of it) will support valuations, but the economy and corporate earnings could remain weak for some time. In the first phase of "stabilization trade", everything goes especially the areas previously under the most pressure, e.g., property and consumption. As it may take time for stimulus to pass through and show an impact on the real economy, greater stock diversity will emerge after the initial excitement fades. In this second phase, the market will focus on earnings delivery, or companies with better visibility (such as beneficiaries of government supporting policies). Our increasing allocation to consumer Internet platforms and insurance reflects this outlook.

Modest valuations, light investor positioning, good fundamentals and structural long-term growth opportunities should help Chinese assets withstand near-term volatility. Looking ahead, privately-owned enterprises (POEs), innovation and industrial upgrading companies are favored under Beijing's structural reform tactics. Our China equities team identifies investment opportunities in the themes that are well positioned to benefit from structural changes: 1) innovation; 2) industrial upgrade; 3) lifestyle change; and 4) consolidation. 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.

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