AS AT 31.05.2024

Market Review

Chinese equities performed strongly in the first half of May but then went through some corrections, with offshore and onshore equities ending the month at +2.4% and -1.0%, respectively. Markets were cheered by solid holiday travel data and further policy rollouts for the property market in the first half of May, while soft credit and domestic demand data led to profit-taking in the second half. From a sector perspective, energy and utilities stood out on the back of the continued strength of the state-owned enterprise (SOE) reform/dividend theme. The real estate sector also recovered amid supportive policy rollouts at the central and local government level.

On the macroeconomic front, target indicators showed a slight slowdown in economic growth in April, with significant divergences. Industrial production continued to recover, growing by 6.7% year-on-year (YoY). In contrast, retail sales growth slowed to 2.3% YoY, and the contraction in real estate investment continued. Property transactions remain depressed but are deteriorating at a somewhat less sustained pace.

The official manufacturing Purchasing Managers' Index (PMI) fell to 49.5 in May from 50.4 in April, with the breakdown showing a deterioration in most sub-components, including production and new orders. However, the Caixin manufacturing PMI improved to 51.7 from 51.4, led by the output sub-component. The official non-manufacturing PMI edged down to 51.1 from 51.2, whilst the services sector PMI recovered slightly, propped up by strong activity in transport services, likely helped by greater travel activity during the Labour Day holiday in early May.

Exports in US dollar terms surprised to the upside in May, accelerating to 7.6% YoY. In product terms, the pick-up was broad based, with exports of furniture, toys and plastic goods being the exceptions. By contrast, import growth slowed to 1.8% YoY in May, underperforming expectations. The breakdown of the data in volume terms showed the latest decline was driven mainly by a slowdown in energy imports. Other categories, in particular industrial metals, performed better.

Consumer price index (CPI) inflation remained at 0.3% YoY in May, while producer price index (PPI) deflation improved to -1.4% YoY from -2.5% in April.

Labour market conditions appeared broadly stable, with both the national and 31-major cities surveyed unemployment rates falling to 5.0% from 5.2% and 5.1%, respectively.

Over the month, the People's Bank of China indicated that it will set up a loan mechanism of RMB 300 billion at a subsidised rate to help local state-owned enterprises to buy unsold homes (which should stimulate bank loans). The PBoC will also issue a loan facility to support housing construction projects.

Issuance of very long-dated Chinese government bonds, designed to boost the economy, started in May. They are expected to total RMB 1 000 billion (around USD 140 billion) between May and November, for maturities

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of 20, 30 and 50 years (Source: Chinese Ministry of Finance Website, 13 May 2024).

Fund Performance & Portfolio Activity

Fund Performance

The fund BNP Paribas China Equity returned +1.81% in May underperformed the benchmark by 20bps (Classic, Capitalisation share class, net of fees, NAV-to-NAV with dividends reinvested, in USD).

Main Contributors

Stock selection in consumer discretionary and our underweight in consumer staples contributed to the relative performance.

Within our holdings, Lenovo had a nice rally in May amid global optimism around Artificial Intelligence Personal Computer (AI PC), with Microsoft and Dell both unveiling new AI PC lineups. Lenovo is a global leading IT hardware vendor, and its businesses span across PC, mobile, servers and software & services. In May, the company reported a beat on 1Q24 earnings, and the management guided higher order pipeline for AI-related revenue to USD 7bn, strengthening the thesis on AI PC and servers as growth drivers for the PC maker. Going forward, we continue to like the company for the reacceleration of PC revenue growth on the back of PC shipment's cyclical rebound and structural growth drivers, including AI PC.

Great Wall Motor, a leading pickup truck and SUV maker in China, continued to outperform for another month and was among the top contributors in May. We added back this name into the portfolio in Q4 2023 to capture the recovery in automotive market. We like the company for its leadership position within the industry and expect it to benefit from better product mix with higher-end products and margin expansion driven by overseas business, where gross profit margin is higher compared with domestic business. Going forward, we expect the company to achieve robust revenue and profit growth through strong execution of its overseas strategy and sales momentum from the new product cycle.

Main Detractors

Stock selection in communication services, industrials and health care mainly detracted from the relative performance.

Within our portfolio, Akeso was among the top detractors in May. The company is a clinical-stage biotech company engaged in the discovery and development of innovative biologic therapies for the treatment of cancers and autoimmune diseases. The company's stock got sold off post the release of its AK112's first pivotal trial results, where the detailed mPFS (median progression free survival) turns out weaker than expected. We adjusted our holdings within the health care space back in Q1 and initiated Akeso to shy away from US sanction risk. Unfortunately, given the negative trail result undermining investment thesis, we decided to fully exit the position in May. We will continue monitoring and looking for opportunities within Chinese biotech space.

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Portfolio Activity

Over the month, we exited from China Lesso, China Mengniu Dairy, Huatai Securities, Xinyi Glass, Semiconductor Manufacturing International, Baidu, and Akeso. Meanwhile, we introduced Xiaomi, China Life Insurance, Bilibili and Pop Mart to the portfolio.

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 after global risk sentiment took a hit from the higher- for-longer US interest rates narrative.

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.

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,

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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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