China Equity Opportunity

As of July 31, 2024, monthly performance commentary and review

Global economy

Global equities managed to end the month of July higher yet again, making it eight of the last nine calendar months that equities have provided positive returns. That said, there was considerable volatility with a drawdown of almost 5% in the S&P 500 in the middle of the month, and a marked change of sectoral leadership away from expensive tech stocks to some of the cheaper parts of the equity complex. Lower U.S. Inflation readings and some slowing labor market data generated optimism regarding a soft landing, and pushed bond yields to move considerably lower as fixed incomes returns were also positive globally.

Market review

MSCI Asia ex Japan ended the month flat in July in USD terms, with tech names pulling back in end July, with the momentum continuing into early August. This was due to Artificial Intelligence (AI) cautiousness partially sparked by rumours about Nvidia's product delay, and worse-than-expected macro data out of the US fuelling concerns that the Fed may be behind the curve. Investors rotated from stocks that had done well. Taiwan and Korea fell as the Information Technology (IT) sector weighed on those markets. Chinese equities saw negative returns, driven by fluctuating expectations for policy support during the 3rd Plenum and Politburo meetings. Mixed economic activity data and rising US election risks further pressured the market. At a sector level, IT and Materials fell most while Health Care rose most.

China Market review

Chinese equities experienced volatility in July, driven by fluctuating expectations for policy support during the 3rd Plenum and Politburo meetings, ending the month slightly negative. Mixed economic activity data and rising US election risks further pressured the market. The 3rd Plenum was generally in line with market's muted expectations. As these are mostly high-level guidance, investors are monitoring closely for follow-on execution. The end-July Politburo meeting vowed to achieve the full year growth target and reinforced their pro-growth policy by highlighting the focus on domestic consumption and reiterating boosting development of emerging sectors and tech self-sufficiency. On the economic front, macro data sent mixed signals. China's trade surplus hit a record high with strength of export remained as a bright spot. Fixed Asset Investment expanded by 3.9% year-on-year (yoy) from January to June, supported by solid manufacturing investment year-to-date in spite of continued contraction in real estate investment. Meanwhile, retail sales showed a subdued pace compared to the previous month, suggesting weak domestic demand. From a sector perspective, Financials and Health Care led gains in July, while Energy was the key market detractor, facing profit-taking pressure.

Performance summary

July 2024

The China Opp strategy underperformed the benchmark in July. Stock selection in Health Care and Financials dragged performance, while it was positive in Materials. Underweight in Energy also helped. On a stock level, Far East Horizon was the key contributors, together with underweight in PetroChina and Trip.com. Meanwhile, China Resources Land, Anhui Gujing Distillery and underweight in Alibaba were among the detractors.

Key stock comments

Key contributor:

Far East Horizon (Financials):
Despite weakness in earnings growth, Far East Horizon continues to improve shareholders returns at around 10% yield with a hike in dividend payout and special dividend.

PetroChina <Underweight> (Energy):
Market concern on oil price volatility ahead impacted share price performance. Underweight in PetroChina added value in relative terms.

Trip.com <Underweight> (Consumer Discretionary):
Not holding Trip.com contributed as the stock fell on lower expectations of domestic demand travel, as reflected in the Chinese hotel industry's weak performance at the beginning of summer holidays. Valuation looked full and expectation was set high.

Key detractors:

China Resources Land (Real Estate):
Stock declined as developers' sales for the month remained weak. Despite some supportive policy measures, outlook for the property sector remains weak and market sentiments will take time to recover.

Anhui Gujing (Consumer Staples):
Anhui Gujing underperformed due to weaker demand amid the lackluster economic situation in China.

Alibaba <Underweight> (Consumer Discretionary):
Our underweight in Alibaba detracted as the stock rose. The company is raising payment and service fees and market share appears to be stabilizing after declining for the past year and more.

Investment thesis for top holdings

Tencent

Tencent is the leading company in China's personal computer/ mobile internet market, engaged in the provision of services such as instant messaging, online gaming, social community, news and online music. Tencent has established several powerful online service platforms and accumulated huge number of loyal customers. We believe the company is well-positioned in China Internet and will benefit from "2B" (services to businesses) business growth and game expansion to overseas markets.

Kweichow Moutai

Kweichow Moutai is the market leader in ultra-premium Baijiu (local spirit) in China. Its key drivers are its strong brand, distribution, and pricing. It enjoys double-digit growth for premium Baijiu demand in China, aided by favorable demographics for their segment and rising incomes. Moutai also has high barriers to entry, given deep linkages to local "heritage", local sourcing requirements and long maturity period for premium spirit.

NetEase

NetEase is a leading online game company in China. It has a good track record for delivering blockbuster games and has had healthy growth for more than ten years. We believe that the company continues to have a strong moat in the China gaming industry, supported by its large research & development (R&D) development capacity, streamlined process, as well as shared supporting platforms.

China Merchants Bank

China Merchants Bank has the leading retail banking franchise in China. This was built up over many years due to an early focus on the segment while large state-owned enterprise (SOE) banks were focusing on corporates. China Merchants Bank is also well positioned to benefit from China's growing wealth which would drive demand for wealth management products and financial advice could rise to become a significant contributor as the industry matures.

Alibaba

We invest in Alibaba on the back of attractive valuations, normalization of sector regulations, and an stablizing outlook on discretionary spending. We believe Alibaba's core commerce could see some stabilization with ecommerce industry recovery. On top of that, Alibaba is restructuring into six units and some are scheduled to be spun off in initial public offerings (IPOs).

Outlook and strategy

2024 kicked off with the China market sharply undershooting expectations and we believe that market was overly pessimistic on Chinese equities, which has played out well for our strategies. Since then, Chinese equities have rerated significantly. At this juncture, China's economic recovery is still a patchy one. As the property sector still plays an outsized role and a stabilization of new home sales is key to watch, consumption and manufacturing are also strong growth engines for the country. We believe that China is at a different growth stage, and we maintain our focus on identifying industry leaders in different industries. Furthermore, even when policy intensity has picked up, we still think that there is room for further policy support when the US economy showed signs of weaknesses and the presidential elections is looming nearer.

China is home to a large number of high-quality companies which are still under appreciated by the market. They offer attractive opportunities in light of improving shareholder returns, earnings quality and undemanding valuation. We invest in fundamentally solid companies with strong cash flow and emphasize on investor returns, including decent dividend payout and share buybacks. Some companies have made breakthroughs in expanding their businesses overseas. These companies are no longer producing low end processing trade products or primary processed goods, but successfully competing with well-established global brands in international markets. They are adapting to the various external challenges in this volatile environment, and continue to invest in technology and R&D, control costs and grow their market share. As bottom-up investors, we continue to believe that Chinese equity markets hold significant opportunities for active investing.

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