Ninety One

Investing for a world of change

Navigating a volatile Chinese equity market

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Investors in the Chinese equity market have had a challenging 2022. What were the main headwinds?

Over the past year, China's equity market faced enormous challenges, most notably in its domestic economy. The property market experienced a very sharp slowdown after the government tightened measures to deleverage the sector and curb property speculation.

COVID restrictions were another major driver of market weakness, with the second quarter of 2022 seeing the biggest impact. This was when areas responsible for a quarter of China's GDP, including Shanghai, were in partial or full lockdown.

Geopolitics was also a headwind. There were spill-over effects from the Russia-Ukraine war and from Nancy Pelosi's visit to Taiwan. Additionally, the US CHIPS Act and export prohibition are expected to impact China's ability to access leading semiconductor technology.

Where have you been able to find opportunities?

Even during such a challenging time, we found attractive entry points in areas that were being ignored by the market, especially those businesses that generate consistent, but not ultra-high levels of growth. Sectors including communication services, consumer and utilities are full of companies delivering stable profits and cash flow, while trading at heavily discounted valuations.

What were the key takeaways and implications for equity investors from the Chinese Communist Party Congress?

The 20th Party Congress report published in October contained no major surprises for investors. The most important takeaway was that economic development remains a priority, which was confirmed by the long-term growth target being reiterated. This should offset concerns in the market that economic growth is no longer important for China.

Regarding Taiwan, the report maintained the official line calling for a peaceful reunification without promising to abandon the use of force. It also reiterated its commitment to “one country, two systems” in Hong Kong and Macau for the long term.

Additionally, the Party Congress unveiled the new Politburo and Standing Committee. The market was initially unsettled by the reshuffling of China’s top leadership team. With the dust now settling, policy uncertainty should be reduced and allow the new leadership team to focus on economic development. More pro-growth policy measures may be rolled out as the country still needs to maintain a reasonable growth level to meet the Party's long-term targets and we hope for better policy coordination and implementation.

Looking out to 2023, where are you seeing risk and opportunities across the spectrum for Chinese equities?

Chinese equities are trading at a discounted valuation level relative to both their own long-term history and global markets. From a price momentum perspective, valuation could rebound if there are positive headlines. However, for a more sustainable rally to happen, corporate earnings need to bottom.

There are also a number of key events to note where the market can get some idea of the direction of policy for the coming year. Namely, the Central Economic Work Conference in mid-December and, in March 2023, the annual sessions of the National People's Congress (NPC) and the National Committee of the Chinese People's Political Consultative Conference (CPPCC).

Overall, the predominant risk for China equities stems from the domestic environment, specifically from prolonged COVID restrictions and property market weakness. Given continued geopolitical tensions and broader global economic weakness, we expect the market to remain volatile.

There are reasons to remain positive, however. A gradual exit from the strict COVID restrictions would provide a positive catalyst for manufacturing and consumption activities to recover, in addition to lifting property demand. Increasing high-level international dialogue should also be helpful to alleviate some of the geopolitical tension, although it remains unlikely to change the competitive stance between Beijing and Washington.

Against this backdrop, the frequent style rotation seen through 2022 may persist. We believe maintaining a flexible investment approach and building a balanced portfolio will be supportive for investors. This can be achieved through bottom-up stock selection, adhering to a disciplined and balanced investment framework that combines quality, valuation and momentum for both earnings and technical considerations.

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