Investing for a world of change

Navigating the Year of the Snake

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As we look ahead to 2025, the Year of the Snake, we explore the evolving opportunities and challenges in the China market. Jennifer Ford, Portfolio Specialist at Ninety One, sits down with Wenchang Ma, China Equity Portfolio Manager, and Alan Siow, Co-Head of Emerging Market Corporate Debt, to discuss how investors can navigate this landscape. From policy shifts and geopolitical developments to equity and fixed-income strategies, they share insights into what the year may hold for the world's second-largest economy.

What were the key events of 2024?

In quite a volatile year for risk assets, Chinese government bonds have delivered strong returns relative to other fixed-income asset classes. The total return for Chinese government bonds was 6.2% as at end December. This compares favourably to the equivalent US treasuries benchmark, which ended the year up 1.6%, with the euro benchmark at 2.6%. These figures demonstrate the value of including Chinese bonds in a diversified fixed-income portfolio.

In contrast, the equity market began 2024 on a muted note. Sentiment improved in February when the Chinese regulators intervened to support the market, sparking a rally of about 20% over the following three months. However, this momentum quickly faded as China's macroeconomic data deteriorated through Q2 and Q3, highlighting continued deflationary pressures and weakening retail activity.

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In response, the Chinese government introduced a series of monetary and fiscal measures in late September, interpreted by the market as a strong signal of its commitment to stabilise the property market and support economic growth. This led to a sharp reversal in market momentum, although some gains have since retreated. The MSCI China All Shares Index ended the year up 16.4% — a respectable performance, though not as strong as the rally seen in US markets.

Policy action clearly plays a significant role in shaping market sentiment. What can investors anticipate from policymakers in the coming year?

The policy environment is likely to remain pro-growth in 2025. Policymakers are expected to introduce further measures, such as increasing quotas to address local government debt, easing property purchase restrictions and mobilising government funds to tackle property inventory issues. The market also expects an expansion of consumption-focused stimulus measures, such as extending and expanding the home appliance replacement programme and potentially increasing spending on social benefits.

From a fixed-income perspective, reflecting on 2024, it's important to recognise that these policy announcements often serve two audiences, one domestic, the other international. Domestic interpretations may differ significantly from those of global investors. For bond markets, the key takeaway is that we are witnessing a shift in posture. Like the US Federal Reserve, which signalled a turn by cutting interest rates after a period of increases, China's policy focus has transitioned toward supporting and stabilising the economy, if not outright stimulating it. This shift is a significant development for investors, signalling a potentially more supportive environment in 2025.

However, the market continues to look for a more substantial, fiscally driven stimulus package, particularly around consumption. Whether such a package will materialise remains uncertain, as it would represent a notable departure from past policy norms. For context, during COVID, China was one of the few major economies that did not issue direct stimulus payments to its population—no 'cheques in the mail', so to speak. This cautious approach is consistent with historical practice and not inherently negative, but it does shape market expectations. Investors will need to carefully evaluate the fiscal measures unveiled later in the year within this broader framework.

The election of Donald Trump to the US presidency has been top of mind for clients, particularly regarding its potential implications for the China market. How do we evaluate its likely near-term and long-term impact on shaping the market and the opportunities it may create?

During the 2018 trade war, the tariffs that were ultimately implemented were smaller in both rate and scope than originally announced by Donald Trump. Much of the impact was absorbed through RMB depreciation, with the remaining effects passed downstream. Looking back over the past six years, China's global export share has remained relatively stable, suggesting resilience in its competitive position. This dynamic is likely to persist, as the broader competitive tension between China and the US continues to shape the economic landscape.

Chinese companies have adapted over the years by moving up the value chain, increasing self-sufficiency, and becoming more resilient to potential supply chain disruptions. Even before Trump's re-election, Chinese firms had already started to establish production bases closer to end markets, such as in South America and Southeast Asia. These moves could provide a buffer against potential new tariffs or trade frictions.

From the perspective of emerging markets, the primary adjustment mechanism during Trump's first term was through the FX channel, and this is likely to play a central role again. Interestingly, following Trump's victory on 5 November, the hardest-hit asset class was US treasuries, while the euro was the weakest-performing currency. Meanwhile, currencies of countries most exposed to potential tariffs, like Mexico and China, were relatively resilient.

This leads us to conclude, at least from the perspective of emerging markets, that much of the potential risk is already priced in. The devil will be in the detail, but reflecting on the previous trade war, while the headlines were often alarming, the reality was that the fundamental shape of global trade remained largely unchanged. Although China's direct exports to the US declined by 30% over the last decade, this shift was accompanied by a significant increase in exports to intermediate countries like Vietnam and Mexico. These countries, in turn, boosted their exports to the US, effectively reshaping trade flows in a way that mitigated disruption and underscored the resilience of global trade networks.

Looking at the broader asset class, where do you see the most exciting opportunities as we head into 2025?

On the fixed income front this year has underlined the value of a diversified fixed income portfolio, where Chinese government bonds and Chinese credit have played a critical role. They have outperformed their large G3 counterparts – US and euro bonds – in a year marked by significant global events, including more than half the world going to elections and a momentous US election.

The role of Chinese bonds as a portfolio diversifier cannot be overstated. We see value in US dollar-denominated Chinese corporate credit, particularly in investment-grade names, and in selective high-yield opportunities.

In the equity space, we continue to find a variety of stocks with idiosyncratic investment drivers. For example, we have identified high-quality, high-growth opportunities in sectors like technology and healthcare. At the same time, we see value in stocks offering attractive cash returns to shareholders, particularly in areas like raw materials and the financial sector. Crucially, we focus on companies with strong earnings power and positive earnings momentum relative to market expectations. These opportunities span both the onshore and offshore segments of the China market.

Currently, we are taking advantage of opportunities in areas such as power grid investments, construction machinery within the industrial sector, and consumer-focused companies that are either gaining domestic market share or are competitive in the export market. In the export space we are particularly selective, favouring companies with exposure to non-US markets for growth. Additionally, we see potential along the electric vehicle (EV) supply chain, an area poised for sustained structural growth in China and globally, with the Chinese equity market offering a wealth of names to choose from.

Ultimately, our approach is focused on bottom-up stock picking to build our holdings. We believe this strategy is the best way to capture the opportunities, both onshore and offshore.

The Year of the Snake, also known as the Little Dragon, seems full of interesting opportunities. From a client perspective, are there any concerns that keep you up at night – risks that you are balancing alongside the opportunities you're seeing?

China's road to reflation is proving to be anything but smooth, as we've already seen. Deflationary pressures persist, and the duration of this trend is difficult to predict. For the recovery to take hold, we need to see companies face less pricing pressure and improved profitability. Broadly, growth in the Chinese corporate sector needs to regain momentum, and earnings revisions among listed companies must stabilise and shift towards a positive trend.

In addition, 2025 is likely to bring heightened geopolitical uncertainty, with headline risks creating volatility in equity markets. Sentiment remains fragile, making it crucial to stay mindful of these risks. This is why we believe in maintaining a blended investment style and focusing on bottom-up, individual stock selection as the best strategy for driving long-term performance.

On the fixed-income side, we are cognisant of the potential for headline-driven volatility. As in Trump's first presidency, we expect market reactions to be significant, though much of the risk may already be priced in. Based on experience, the impact may be less severe than initial concerns suggest. We plan to use market dips as opportunities to add exposure, focusing on local currency and dollar-denominated instruments. Our ability to target both investment-grade and high-yield segments allows us to take advantage of the dispersion caused by this environment.

In conclusion, China presents immense opportunities, but realising its full potential requires a thoughtful and intentional approach.

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