China A Share

Market context

Hope returned to China's equity markets in September after the government unveiled its most substantial stimulus package since the pandemic to boost its ailing economy. This helped the country's equity market post its best quarterly performance since 2009. The monetary policy component of the package, aimed at boosting capital markets, was well received by investors. The People's Bank of China (PBoC) announced a RMB800 billion injection to entice companies to buy back their own stock and to encourage asset managers, brokers and insurers to invest in domestic equities. It also reduced the main policy rate from 1.7% to 1.5% and announced cuts to the reserve requirement ratio for lenders.

The dramatic change in expectations for the market lifted stocks almost across the board. Consumer discretionary and healthcare stocks produced impressive returns, although energy stocks struggled against a background of weak oil prices. Helped by efforts by the authorities to stabilise the property sector, real estate and financial stocks outperformed.

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Performance

The Strategy underperformed the MSCI China A Onshore Index over the month, gross and net of fees*.

In light of the broad-based rally in Chinese equities towards the end of the month, the more defensive healthcare companies lagged the market, in particular Hansoh Pharmaceutical, which gave back some of its previous outperformance. In technology, as part of Apple's supply chain, the disappointing new iPhone launch impacted the share price of Universal Scientific Industrial. Other IT stocks we hold, which performed well in August, lagged the market rally in September, and detracted from relative performance, including smart meter company Hexing Electrical. The largest detractor from performance was PetroChina, which suffered from the weaker oil price and rotation into sectors thought to benefit more from government stimulus.

More positively, large parts of the portfolio participated well in the strong market rally. Zhongji Innolight has recovered well since late August following strong Q2 results, where management reiterated the strong demand outlook. Home appliance manufacturer Hisense recovered on the back of domestic trade-in policy driving demand recovery and strong overseas growth. Not owning China Yangtze Power helped relative performance as utilities lagged the rally.

In financials such as GF Securities and Ping An Insurance also added to performance. The former benefited from increased trading volumes, while Ping An reported strong Q2 results in late August, ahead of analyst expectations and China's stimulus policy on properties and capital market further reinforced investor sentiment.

*Where performance is gross of fees, returns will be reduced by management fees and other expenses incurred. Net performance is net of highest institutional segregated portfolio management fee.
Not all securities held have been discussed. For further information on how the overall strategy performed during the period covered, please reference the relative performance noted in the Performance review section.

Past performance does not predict future returns; losses may be made.

Outlook

The Chinese markets have de-rated significantly from the peak and, despite the recent rally, the valuation gap versus developed markets remains wide, and international investors' allocation close to trough. Most of the planned initiatives are monetary in nature, and in our view those alone are likely to prove insufficient to address China's structural issues. The market expects a fiscal package to follow after the September Politburo announcement, providing potential uplift to domestic demand in the near to medium term. More importantly, for the positive momentum to sustain, we will likely need to see better economic datapoints coming through and more policy support to continue, particularly those that address structural challenges such as local government financing and fiscal reform.

While valuations are depressed, on a more granular level, companies and industries that are backed by clear structural tailwinds are well positioned for returns. Companies that align with social and economic values are able to deliver more sustainable growth in the long run. Export and technology driven businesses, for example, are the bright spots, thanks to strong demand and competitive advantages in pricing and R&D. This has fed through to corporate earnings revisions. While headline results remain muted, some sectors are showing better earnings delivery such as internet and industrials, although real estate and materials continue to see a downward revision trend in earnings. Additionally, capital management has improved, with shareholder buybacks and dividend payouts at record levels, for both state-owned enterprises and privately-owned enterprises. Investment sentiment is weak, but household savings are high, and a large portion of savings are parked in risk-free assets.

The market is positioned for more upside, which could materialise if the property industry starts to stabilise and consumer sentiment improves. In the meantime, the asset class offers compelling value and rich bottom-up opportunities, despite the uncertainty around the recovery. We remain focused on bottom-up opportunities where pricing anomalies are the most pronounced and selective towards companies that are exceeding on operational performance relative to expectations, while avoiding those that are seeing fundamental deterioration. We maintain our style agnostic approach by focusing on the breadth in investment opportunities to drive consistent long term performance outcomes.

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