



## China A

### Market context

Chinese equities navigated a turbulent second quarter, ultimately finishing in the black. In April, the US imposed tariffs of up to 145% on Chinese imports, provoking retaliatory tariffs of 125% from Beijing. These actions hurt investor sentiment, especially towards technology and manufacturing. Though a temporary truce was announced in May to allow for fresh trade negotiations, by June Chinese shipments to the US had plunged by 35% year-on-year, putting export-driven sectors under pressure. Nevertheless, the MSCI China All Shares Index rose 2.3% in the quarter overall.

However, macroeconomic indicators in Q2 showed ongoing domestic and external weakness. Industrial production data, while still relatively strong, remained on a downward trajectory, slipping from a 7.7% year-on-year increase in March to 5.8% in May. Retail sales remained subdued, highlighting the fragility of consumer demand. Export data was mixed as US tariffs came into effect, with May growth slowing to 4.8% year-on-year, down from 8.1% in April. Mixed manufacturing data confirmed patchy industrial momentum and a weak recovery.

The People's Bank of China (PBoC) adopted a measured response to the tariff war. In May, it cut the reserve requirement ratio (RRR) and reverse repo rate to boost liquidity, while in June it held loan prime rates steady.

Though investor sentiment remained fragile amid policy uncertainty and geopolitical risks, mainland equities delivered positive returns. However, Hong Kong's equity benchmark outperformed as international investors continued to favour the large tech names.

### Performance

In a modestly positive quarter for Chinese equities, the Strategy underperformed the MSCI China A Index, gross and net of fees\*, held back by stock selection and positioning in financials in a period when Chinese banks did well. However, China Construction Bank and Ping An Insurance were among the top contributors to performance as stable dividends, solid earnings, and sector rotation supported favourable relative performance.

A number of stocks suffered as a consequence of the US tariff storm and subsequent trade and recession concerns. Electronics component supplier Electric Connector Technology underperformed as the sector was impacted by global supply chain and trade tensions. Uncertainty over US tariff impacts hurt Zhejiang Dingli Machinery and Hangzhou GreatStar Industrial, given that both have a large US revenue base. In contrast, industrial valve maker Neway Valve gained after reporting strong sales growth, successful international expansion, and robust sector demand. In a volatile period for technology stocks, telecommunications equipment business Zhongji Innolight retreated after previous strong performance. Electronics manufacturer Universal Scientific Industrial underperformed as the sector was hit by global trade tensions, weak demand, and broad technology stock declines early in the quarter. A number of consumer-related stocks also suffered, as domestic demand remains lacklustre. These included spirit business Kweichow Moutai, which retreated after the Chinese government implemented further 'anti-extravagance' measures which are perceived as likely to impact the sales of premium spirits.

Nonetheless, stock selection in consumer staples proved positive thanks to a strong performance from drinks business Eastroo Beverages which benefited from continued strong sales and brand expansion, reflected in encouraging results. Stock selection in the healthcare sector was also helpful. Hansoh Pharmaceutical rallied after it announced an exclusive licensing deal with Regeneron

\*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.

Pharmaceuticals for its new obesity and diabetes treatment HS-20094, alongside an earnings upgrade for the existing portfolio. In technology, electronics and EV business Xiaomi performed well following strong orders for the YU7, the company's recent mid-size SUV launch.

## Outlook

China's macro outlook for the second half of the year is mixed, as domestic consumption remains weak, while the positive impact from trade-in subsidy programme, which started a year ago, will start to worsen, as the initial uptake and pent-up demand has been filled.

Looming geopolitical uncertainty, especially around tariffs, will remain a swing factor to drive stock market volatility and valuations. The potential offset to these headwinds would be further government stimulus. The upcoming 15th Five-Year Plan provides another catalyst for markets to interpret China's policy priorities in the longer term. Chinese stock market valuations remain attractive vs long-term history and other major markets. In addition, improving shareholder paybacks are capturing interest from the domestic market, in this reducing interest rate environment.

China's road to reflation is proving to be anything but smooth. 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. 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.

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.

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