China's economy is on the path to recovery

China update

In March, onshore China equities were rangebound, while their offshore counterparts saw positive gains as foreign investors were carefully examining China's economic recovery.

The MSCI China A Onshore and MSCI China indices were up 0.1% and 4.5%, respectively. Globally, major markets remained stable despite the failures of several regional banks in the US followed by Credit Suisse which raised concerns about liquidity in the banking sector. The failures highlighted why central banks will need to be more cautious when trying to reduce inflation to preserve financial stability.

From a macro perspective, recent data from China suggests the economy is on a path to recovery, albeit unevenly. GDP grew by 4.5% for the first quarter and retail sales rose by 10.6% in March, both beating consensus forecasts. Exports also saw a positive surprise at 14.8% year-on-year growth in March. However, the manufacturing Purchasing Managers' Index missed estimates and fell to 50 from 51.6 in February. In the area of geopolitics, despite the ongoing rhetoric, US-China business relations continue to thrive as evidenced by record high bilateral trades in 2022 and Tesla's announcement of building a new Megapack factory in Shanghai. China's relations with other regions, such as the Middle East, ASEAN and Europe, appear to be improving with new trade deals and leadership visits.

The market performance was mainly driven by the big tech stocks, which rallied after news about Jack Ma returning to China and Alibaba's plan to split into six independently run companies.

Shares of state-owned enterprises (SOEs) in the Telecom, Energy and Financials sectors also outperformed. They have been boosted by price/earnings multiple expansion, as the value style was in favour and there was positive news about SOE reforms.

Most of our managers are structurally underweight to the SOE segment for ESG and sanctions compliance reasons. They believe that the recent rerating was likely a one-off as the long-term growth prospects of these companies remain muted.

GDP grew by 4.5% for the first quarter and retail sales rose by 10.6% in March

Exports also saw a positive surprise at 14.8% year-on-year growth in March

In the first quarter of 2023, domestic sales of air conditioners grew by 16% from a year ago

In the A-share market, local investors continued to chase momentum on artificial intelligence stocks despite their lofty valuation levels. For a few days, the Technology, Media and Telecom sector accounted for half of the A-share market's total trading value, despite it only representing about 16% of the aggregate market cap. Our underweight to all these areas, together with negative stock selection effect in the Information Technology and Communication Services sectors, contributed to the poor relative performance in the month. The underperformance was across the board, although managers with a mid-cap growth bias were particularly under pressure. Despite this month's setback, on a longer-term basis, the Fund's performance remains impressive, having delivered an annualised return of 9.8% versus a benchmark return of 6.9%, resulting in an outperformance of 2.9% per annum.

Overall, the managers we work with remain overweight to high-quality companies in the Consumption, Advanced Manufacturing and New Energy sectors. Their businesses will benefit from structural growth themes in the domestic economy, such as consumption upgrades, import substitution and the green economy transition. The home appliances industry is an example. The year 2022 was challenging for the industry, given a downturn in the Property sector, where new home sales fell 40% year on year. However, the top two players, Gree and Midea, were able to achieve positive growth thanks to resilient replacement/upgrade demand and product mix improvement. In the first quarter of 2023, domestic sales of air conditioners grew by 16% from a year ago , and this is expected to accelerate further as the property market recovers in the coming quarters. Yet Gree and Midea are only trading at around four to six times EV to EBITDA on an ex-cash basis, which is very undemanding for their growth potential. We are confident that companies like these will outperform over the medium to long term as the market focus returns to fundamentals and earnings growth.

Overall, the managers we work with remain overweight to high-quality companies in the Consumption, Advanced Manufacturing and New Energy sectors.