RISCURA

China commentary for February 2024

Are we at an inflexion point for Chinese equities?

China update

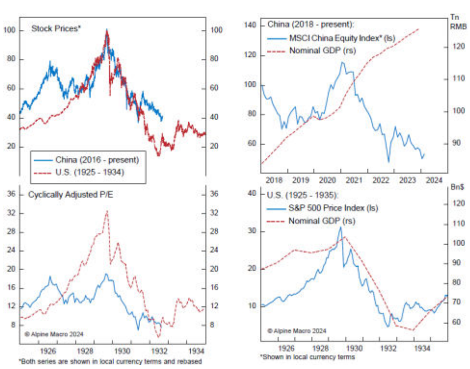
China’s equity market rebound in February can be attributed to the government's stepped-up rescue efforts, including interest rate cuts, stricter regulations on short selling, expanded investment scope of the state funds through ETF purchases, and the appointment of a new chairman at the CSRC, the country's stock market regulator.

- **In February, the Chinese equity market experienced a significant rebound, with the MSCI China and MSCI China A Onshore indices recording gains of 8.4% and 10.8% respectively.**
- **This growth effectively recovered the losses incurred in January and could mark the beginning of a long-awaited turnaround.**
- **Positive momentum continued after the Lunar New Year holiday, as travel and spending activities surpassed projections.**

After a prolonged three-year downturn in the Chinese markets, it appears that the worst is now behind us. A recent research report from Alpine Macro argues that a more favourable environment is emerging for Chinese equities. We have summarised some key points, along with our own observations:

Chinese equities are currently trading at depressed valuation levels

These price levels already factor in various risk factors (arguably more than adequately) and imply a significant decline in growth. It may come as a surprise to readers that cyclically adjusted P/E multiples in China have fallen to levels similar to those of US equities during the Great Depression. However, the economic conditions were vastly different, with the US economy nearly halving between 1930 and 1933, and the banking system almost fully collapsing. China's current situation is nothing like that. We believe Chinese stocks have overly discounted an extremely negative outcome that is highly unlikely to materialise.



Source: Alpine Macro

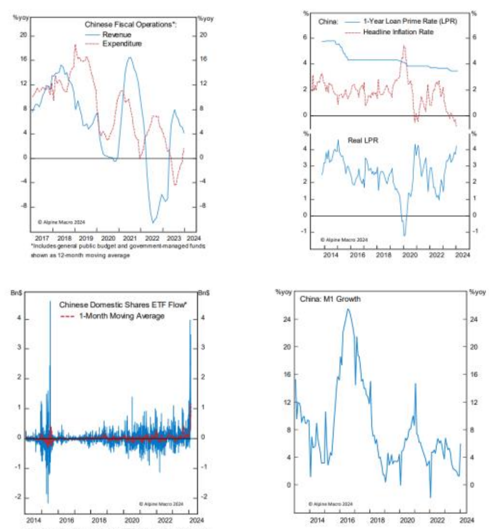
Chinese equities have been undervalued despite bright spots in varied sectors.

Further policy actions might bolster the targeted 5.2% economic growth rate for 2024.

Government taking action

China's growth issues are largely self-imposed, as the Chinese government initially refrained from adopting aggressive stimulus measures to promote economic transformation. However, following the market sell-off in January, authorities have acknowledged the importance of stimulating both the stock market and the broader economy.

In recent weeks, we have observed a coordinated effort to rescue the stock market, purchase China ETFs, alongside balance sheet expansion, unexpected cuts to reserve ratio requirements, and a key lending rate by the central bank. We anticipate further policy actions aimed at supporting the targeted economic growth rate of 5.2% for this year.



Source: Alpine Macro

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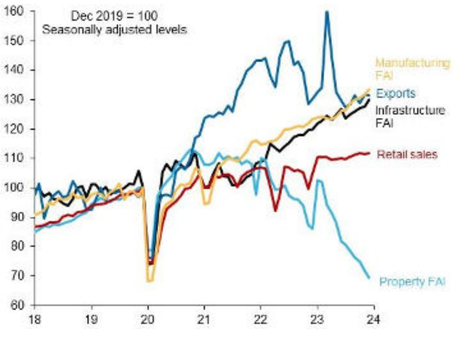
Economic growth hasn't really been that bad (outside of real estate)

The Chinese economy continues to grow at a moderate pace, despite weaknesses in the property sector, and is not as dire as often portrayed in Western media. Notably, there are structural bright spots within the Chinese economy, such as the new energy and semiconductor sectors; we have also recently witnessed positive surprises in some other parts of the economy, including consumer credit demand, industrial output, and exports. It's important to remember that much of the commentary focuses on relative growth – that is growth relative to China's own history or relative to targets – whereas in absolute terms, the GDP expansion, even at current levels, is enviable for many countries.



Source: Macquarie

Commentary refers to relative growth, forgetting China's comparably strong GDP expansion.

Investor sentiment saw an upward trend amidst increased foreign interest and inflows.

Is investor sentiment changing?

Investor sentiment is showing signs of improvement. At a recent hedge fund event we attended in Hong Kong, most managers expressed a more positive outlook on Chinese equities compared to a year ago. Foreign investor interest picked up in February, as evidenced by robust inflows through the Northbound Stock Connect (Hong Kong → Mainland exchanges). This marked a significant turnaround after six consecutive months of net selling. Notably, the average daily inflow of over $560 million in February was the second highest since December 2021. The total year-to-date Northbound net inflows have surpassed $6.4 billion, exceeding the full-year net inflows of 2023. However, it is still early days, and recent fund managers' surveys indicate that shorting Chinese equities remains a popular trade.

In conclusion, with Chinese equities trading at depressed valuations, a more supportive policy environment, signs of economic resilience, and improving investor sentiment, we believe the stage is set for a sustained rebound in the China markets.

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