Resilience through a challenging macro environment

China update

Chinese equity markets experienced a dynamic month in July, but all indices ultimately ended down. While most major sectors performed better than the previous month, the cyclical sector lagged, revealing clear differences among various sub-sectors. Among all sectors, non-bank financials ranked first, while national defence also did relatively well. In contrast, the energy and consumer sectors, particularly coal, textiles, petrochemicals, light manufacturing, and non-ferrous metals, contributed to the overall downtrend.

- **The MSCI China, MSCI China All Shares, and MSCI China A Onshore Indices ended the month down, with declines ranging between -0.24% and -2.26%.**
- **Non-bank financials led sector performance, with national defence also showed relative strength.**
- **The real estate market showed signs of improvement. Most notably, second-hand home transactions in first-tier cities surged, with growth increasing from +35% in June to +61% in July.**

The real estate market showed some positive signals in July. Following the unveiling of a real estate policy package in mid-May, real estate transactions have begun a modest recovery. Year-on-year (YoY) growth rates of new home transactions in 60 cities and second-hand home transactions in 26 cities rebounded to -21% and +25% respectively, from -25% and +12% in June. Notably, the YoY growth rate of second-hand home transactions in first-tier cities rose sharply to +61%, up from +35% in June.

China has undertaken significant policy actions to promote economic and social development. The Third Plenum Session, held in mid-July, introduced various reforms, including those related to urbanisation, land, the fiscal and tax systems, technological innovation, and expanding high-level opening-up.

On 30 July, the Central Political Bureau emphasised the importance of steadfastly achieving annual development goals, highlighting the need for stronger and more effective macroeconomic policies. Additionally, the National Development and Reform Commission (NDRC) and the Ministry of Finance allocated around 300 billion yuan in special bonds to support large-scale equipment upgrades and the renewal of consumer goods.

Since July, the central bank has also introduced several monetary policy measures, including government bond borrowing, temporary repo and reverse repo operations, and phased exemptions for medium-term loan financing collateral.

Subdued growth amid policy support

GDP growth in Q2 registered at 4.7%, falling short of expectations due to the prolonged downturn in the property sector and lacklustre retail sales, though exports remained robust.

In other economic activity, the manufacturing Purchasing Managers' Index (PMI) for June stood at 49.5, unchanged from the previous month and broadly in line with market forecasts. Whilst overall manufacturing activity remains sluggish, there are bright spots in emerging growth sectors. The PMIs for equipment manufacturing and high-tech manufacturing reached 51.0 and 52.3, respectively, marking a slight improvement from the previous month.

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This adjustment, along with other recent monetary policy measures, aims to reinforce a financial backing for the real economy.

The recently concluded Third Plenum meeting of the Chinese Communist Party yielded no significant surprises or unexpected policy shifts, reiterating the policy priorities outlined in recent years. Nonetheless, it emphasised that government officials must "steadfastly strive to achieve this year's growth targets," hinting at potential future policy support. Notably, China's central bank made an unexpected move in late July by lowering its one-year medium-term lending facility (MLF) rate from 2.5% to 2.3%, marking the first cut in nearly a year.

Double-digit growth in Chinese company earnings

Despite a weak macroeconomic backdrop, various Chinese companies have shown remarkable resilience. Many of them have not only weathered the storm but have excelled through strategic initiatives such as launching innovative products, increasing market share, expanding globally, and in some cases, experiencing a sharp recovery from Covid-related lockdowns, particularly in the travel sector. Perhaps most importantly, private sector companies across the board have become far more efficient in cost management and are increasing earnings at a faster pace than revenues.

We collated the 2023 results and expected earnings growth for the top 10 positions from a selected group of prominent China-focused global asset managers and Chinese specialists. The average increases in revenues and earnings of the underlying companies were +17% and +57%, respectively. Remarkably, earnings grew on average more than three times the increase in revenues. Looking ahead, managers anticipate another strong year for corporate earnings with projected growth of 30%. Furthermore, on a valuation basis, these companies are trading at a modest forward PE ratio of 14x. If we use the PEG ratio (a multiple measuring growth relative to valuations), this comes in at 0.5x, demonstrating the attractiveness of these shares.

Despite a weak macroeconomic backdrop, corporate China has shown remarkable resilience, demonstrating substantial growth in both revenue and earnings.

Name	Revenue growth (2023)	EPS growth (2023)	EPS growth (2024e)	Fwd P/E (2025e)
Tencent Holdings Ltd	10%	-38%	53%	16.8
Kweichow Moutai Co Ltd	18%	19%	23%	18.2
Wanhua Chemical Group Co Ltd	6%	4%	13%	11.0
PDD Holdings Inc	80%	78%	173%	9.2
China Merchants Bank Co Ltd	4%	7%	3%	5.2
Beijing New Building Materials Group Co Ltd	11%	12%	17%	9.0
Contemporary Amperex Technology Co Ltd	22%	64%	14%	13.0
Satellite Chemical Co Ltd	12%	55%	22%	8.6
Trip.com Group Ltd	122%	600%	29%	14.0
S.F. Holding Co Ltd	-3%	34%	15%	15.0
Average - Top 10 positions	30%	84%	34%	11.5
Median - Top 10 positions	12%	27%	17%	11.0
Average – Top 10 of all funds	**18%**	**57%**	**30%**	**14.4**
Median – Top 10 of all funds	**11%**	**20%**	**23%**	**13.1**

"Top 10 of all funds" is for the top 10 positions of the selected group of China focused global asset managers and Chinese specialists.

Source: Bloomberg, consensus estimates or various asset managers' internal estimates.

Several Chinese companies, including Kweichow Moutai, Trip.com, and Contemporary Amperex Technology Co., have continued to deliver impressive business performance and growth, as outlined below.

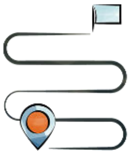
Kweichow Moutai

Moutai remains China's most iconic luxury brand, benefiting from an increasingly affluent population that aspires to consume, gift, and store its sought-after products. One of Moutai's attractive features is their youth-focused brand-building initiatives, such as launching Moutai ice cream and collaborating with Luckin Coffee on coffee and with Mars on chocolate.

Despite the slowing economy, Moutai's revenue and EPS grew +18% and +19%, respectively, last year. Its flagship product, Feitian Moutai, enjoyed a 3% price hike and 11% volume growth. Furthermore, the company raised the price it charges distributors by 20%. For the second consecutive year, Moutai paid out the bulk of its earnings as dividends.

Moutai remains China's most iconic luxury brand, with youth-focused brand-building initiatives.

Trip.com dominates domestic market with 70%+ flight bookings and 50% of hotel reservations.



These companies' prospects are encouraging, as is the value they will continue to create.

Global luxury brands, with few exceptions like Hermès, have experienced slowing growth in recent quarters due to stalling demand from Chinese consumers. Moutai, as a luxury product, has managed to maintain its high growth, with its stock trading at a valuation discount compared to most global luxury brands.

With domestic travel rebounding post-pandemic and rapid overseas expansion, the company's Q1 2024 net profit exceeded expectations by 40%, driven by robust volume growth, market share gains and cost efficiencies.

Our sample group of managers foresee significant profit growth potential driven by the overseas business, which is projected to constitute 50-60% of revenue by 2030 (up from 30% in 2023), leveraging the company's substantial supply chain advantages and customer-centric services. Trading at 14x forward P/E, the company expects 29% EPS growth in 2024, despite its share price already appreciating by more than 2.5 times from its lows in 2022. The stock has been a top performer for many of our managers.

Contemporary Amperex Technology Co. (CATL)

CATL is a global leader in power batteries and energy storage systems. The company stands out for its scale, vertical integration, robust R&D, and ability to maintain healthy margins, while competitors struggle with profitability; some are already looking to exit the market permanently.

CATL's technological prowess mitigates the impact of oversupply, as downstream customers continue to prioritise quality and safety over price. Recent quarters have seen earnings surpass expectations, fuelled by enhanced value and cost efficiencies. Trading at 13x forward P/E, the company is forecasting a 14% YoY EPS growth in 2024.

To manage the geopolitics associated with onshoring, CATL has multiple initiatives with global companies such as Stellantis and GM to build factories outside of China, including in Europe and North America.

In conclusion, the robust performance of these examples showcases their resilience and ability to navigate challenging economic landscapes. The companies have demonstrated substantial growth in revenue and earnings. With a clear focus on innovation, global expansion, cost efficiency, and capital allocation, we remain optimistic about their prospects.

Companies across the board have become far more efficient in cost management and are increasing earnings at a faster pace than revenues.