

China Q1 investment update

April 2025

Investment manager Sophie Earnshaw and investment specialist Qian Zhang give an update on the China Strategy covering Q1 2025.

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Qian Zhang (QZ): Hello everybody and welcome to the quarterly update for our China Strategy. My name is Qian Zhang, I'm an investment specialist and I'm joined by Sophie Earnshaw, lead portfolio manager.

Sophie just returned from a research trip to China recently, so we will discuss about her takeaways from the trip. As usual, we'll also review the market developments over the past quarter and the changes we made in the portfolio. We'll also discuss performance and our outlook.

So, Sophie, let's first start with the market backdrop. The Chinese equity market has outperformed all the other major markets, including the US, both last year and this year, so far year to date. That is perhaps quite surprising to many market participants. Can you share with us more context here?

Sophie Earnshaw (SE): Sure. I mean, first of all, we are happy to see a performance recovery in the asset class, especially during this period of US market volatility. And also, we're really happy that the strategy outperformed its reference index last quarter.

So, you know, while many of the audience will know, about our long-term approach and the fact that we don't judge ourselves over shorter time periods, I think it's worth noting probably three things that are happening in the background recently and that are important for the direction of travel for the asset class going forward.

So, number one, I think it's clear that growth is back on the table in terms of domestic policy in China. We saw this shift to a pro-growth stance at the extraordinary meeting of the Politburo in September last year, and then again at numerous economic meetings towards the end of the year.

Most dramatically, we saw this at the meeting of President Xi with China's leading entrepreneurs, including Jack Ma, and that happened in February of this year. So a clear indication, I think, from

the top that growth is back on the table and that the private sector is absolutely crucial to the government's long-term growth agenda.

Second point I'd make, [is] the emergence of DeepSeek. So I think the global reaction to DeepSeek and the dent that this caused in this kind of narrative of US AI exceptionalism, is a really fantastic reminder that China's innovation ability remains deeply underappreciated in the western world. So, for context, DeepSeek is a Chinese startup, which came up with a large language model, which is much cheaper than global competitors, but of a similar, very high-quality standard.

The third point I'd make is geopolitics. The on-off tariff imposition from the US remains a key source of disruption for exporters globally, not only for China, and actually perhaps for some US producers themselves. The key question is really how this will shape the redistribution of value and trading among partners. This will probably take time to unfold but is a source of continued sort of volatility.

So overall, I'd say despite these external uncertainties, we've actually become a bit more confident that the domestic economy is seeing some policy support, growth is back on the table, while actually the scale effect in innovation seems to be gathering pace in a number of industries. So these factors are clearly supportive.

QZ: Well, thank you. That's helpful context. Can you comment on the recent related changes that you've made in the portfolio as well?

SE: So as mentioned in the last quarterly update, we reduced exposure to companies that have larger revenue exposure to the US. So, an example here would be Anker, a consumer electronics brand, its main distribution partner is Amazon.

Or a company called Shenzhen Megmeet, this makes electric automation parts. Megmeet recently announced that it had become a supplier to Tesla and NVIDIA. It's a very, very strong share price reaction. We thought that reaction was too much, actually, the market reaction had overshot the likely operational impact, so we decided to trim that position.

On the other hand, I think we've become more optimistic at the margin about domestic consumption. So, despite aggregate consumption numbers remaining quite weak, we think it's only a matter of time before stimulus measures begin to bear fruit. So Chinese households accumulated huge amounts of savings during the pandemic, almost as high as 15 per cent of total consumption. So, when the sentiment does turn, we think the opportunity is likely to be extremely attractive. So recent additions to the portfolio, HaiDiLao, a restaurant chain specialising in hot pot cuisine in China, and Anta, a sportswear brand.

QZ: Right, so looks like at the margin, the portfolio is more domestic-oriented than a few quarters back. So, did you do some onsite due diligence of visiting HaiDiLao's hotpot restaurants when you were there?

SE: We did indeed. We visited HaiDiLao with some of our Shanghai colleagues. HaiDiLao is very well known for its excellent customer service and it did not disappoint. The food was also fantastic, so it was a great experience.

QZ: Good, right, so that's the consumption sector. What other holding companies did you meet in your trip and anything interesting to highlight?

SE: So we met a few platform and technology companies, including the CFO of Alibaba, the CFO of Meituan. Almost all of the technology and private companies that we met shared that actually President Xi's recent meeting with leading entrepreneurs was a real, a significant boost to confidence domestically. And that really reinforced the narrative that we've mentioned in previous updates that China has made it very clear that they do want to support innovation, technology and the private sector.

So that episode of regulatory crackdown on platform companies, we think is firmly behind us. And as you know, that was one of the strongest headwinds to performance over the past couple of years. We think that has now turned into a tailwind and actually our portfolio retains significant exposure to these platform companies. And we actually added to that exposure at the beginning of 2024.

QZ: Is everyone on the ground quite excited about DeepSeek?

SE: Yep, there's quite a lot of excitement there. I mean, I think the key point with DeepSeek, as I sort of said in the introductory remarks, is that it's a real example of, again, innovation really being overlooked in China by a Western audience. It's just a fantastic example of that, in addition to more well-known breakthroughs such as China's battery technology or solar technology.

QZ: What are the implications for portfolio holdings and perhaps some new ideas from that as well?

SE: Yeah, so the reduction in cost of AI we think could have quite far-reaching consequences. So the most immediate outcome is likely to be, we think, an explosion in user cases for AI and then a potential explosion in demand for related infrastructure.

A number of our portfolio holdings saw their share prices respond very strongly to the DeepSeek news. For example, SAS players, Kingdee and Yonyo, both of those companies were top 10 contributors to performance in the most recent quarter.

We take a fundamental view – we go back to basics, back to operational performance – and actually, for those companies, we struggle to see how AI integration will meaningfully benefit them operationally in the short- to medium-term. So, we decided to take advantage of the share price appreciation to reduce our exposures there.

On the other hand, however, we think the most likely impact from DeepSeek will probably be in areas such as cloud, gaming, advertising, social media. So, we kept our exposure to, for example,

cloud provider, Kingsoft, and we're very happy with our existing holdings in the platform companies who we think are in a great position to monetise AI of their sort of consumer-facing apps.

QZ: I also heard you had a test autonomous drive in Beijing, was it?

SE: Yeah. So that was with Horizon Robotics, a company in the portfolio. They make cutting-edge autonomous driving chips. We've known the founder, Dr. Yu, for many years and followed the company from when it was still private. We took a holding in its recent IPO. There's been strong performance since then, and that name is also a top 10 contributor to performance. The test drive that I took was very, very smooth, and I was pretty impressed.

QZ: We also mentioned in previous videos that the portfolio has gradually increased its exposures to China's domestic semiconductor supply chain, so Horizon Robotics is a new addition here. But on the other hand, the portfolio also has exposures to [the] energy sector. They perhaps have detracted in the most recent quarters. How about your views there?

SE: Yeah, so we're still comfortable with the long-term growth case for our holdings in energy. Strategically, energy security is incredibly important for China, probably equally as important as tech self-sufficiency. China is still a net oil importer. Our energy holdings have been weak in share price terms as investors have repositioned at the margin into consumption names and some AI-related names.

So, we actually took the opportunity recently to add to our energy holdings, given good operational performance and very low valuations.

QZ: Yeah, right. Okay, so we've covered the main themes: AI and semiconductors, consumption, energy and platform companies. Any final remarks on the outlook at the asset-class level?

SE: Yeah, so I'd say we are cautiously optimistic about the direction of travel for the Chinese market. Despite the recent rally, the index is still trading at somewhere around a 10-15 per cent discount to its long-term average, and around a 40-45 per cent discount to global equities.

There are still risks, so real estate only really appears to be improving in tier-one cities so far. Geopolitics, as I said, continues to be a source of significant volatility. However, growth is back on the table in terms of government policy. The regulatory crackdown is behind us and our holdings are performing well operationally and are still, we think, very attractively valued. So, on balance, I'd say we are cautiously optimistic.

QZ: Thank you. That's a quite comprehensive review. Thank you for joining us and see you next quarter.

China

Annual past performance to 31 March each year (net%)

	2021	2022	2023	2024	2025
China Composite	77.7	-32.0	-10.1	-24.6	33.1
MSCI China All Shares*	46.0	-24.1	-6.3	-16.5	28.8

Annualised returns to 31 March 2025 (net%)

	1 year	5 years	10 years
China Composite	33.1	1.7	4.8
MSCI China All Shares*	28.8	2.3	3.4

*(MSCI All China prior to 27/11/19, MSCI Golden Dragon Prior to 02/05/19)

Source: Revolution, MSCI. US dollars. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite. 1 year figures are not annualised.

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