Baillie Gifford

China Q3 investment update

October 2024

Investment manager Linda Lin and investment specialist Qian Zhang give an update on the China Strategy covering Q3 2024.

Your capital is at risk. Past performance is not a guide to future returns.

Qian Zhang (QZ): Hello everyone, and welcome in joining us for the quarterly update for the China strategy. My name is Qian Zhang. I'm one of the investment specialists for the strategy. Today, I'm joined by Linda Lin, who is head of our China investment team, also one of the decision makers for the China strategy.

Linda and I just came back from Gleneagles last week, where Baillie Gifford held its client conference. This year, we had globally more than 100 clients joining us for two fantastic days. The China breakout session received particular interest, where we discussed a number of big picture questions.

In July, China also held its third plenum, which is perhaps one of the most important meetings for long-term economic policy. Recently, the Beijing government also announced a new series of stimulus measures to support the property market and also the stock market. So, a quite an eventful quarter.

We thought for this quarterly video update, we should first provide a number of updates on our big picture thinking on China before we dive into the recent changes and performance of the portfolio. So, Linda, first of all, can you give us a summary of what has been discussed at the Gleneagles Conference?

Linda Lin (LL): Sure. Thanks, Qian. I think the central debate in our session is still the risk and rewards to invest in China from a global perspective. Because the three major risks are still on the table. The geopolitical risk is likely to continue. I think our global investors also have some concern about the local policies. Certainly, the economy remained weak in the last few quarters. So, I think that's how we are talking about the risk. But I think I got a general feeling that our global clients understood those three risks much better, which I think are mostly priced into this asset class, which is still trading at a 20-year low multiple *[price to earnings ratio]*.

QZ: Can you elaborate a little bit more, why do you feel the risks are perhaps better understood?

LL: Yes, sure. I take domestic policies as an example, because as we know, the internet campaign has peaked in 2021, and we think now it's back to normal. Because I think during the last few months as we've been actively talking to the founders of those companies, they're all thinking about how the policy has shifted to a more supportive side. Because the policymakers are recognizing how important those technologies are to a meaningful Chinese job market and also the technology innovative system.

QZ: I see. Back to the third plenum, many people were quite disappointed at the beginning because they didn't give any more clues on how to tackle the property downturn. But more recently, there were also new measures announced to support the property market and the stock market. Market reaction at the beginning was very positive. How do you think about this? Does it have longer impact?

LL: Yeah, I read the two stories separately. So, the third plenum, that's a very important meeting, as you said, to set up the long-term goal of China. And the long-term goal is very clear. The government wants China to be a tech superpower by 2035. And the high-tech sector is going to drive the future growth of China. That's the high-quality growth that the Chinese government means. That's clear.

And the other side of the story is a lot of stimulus policies have been published in the last few days.

The good thing is the central government is very clear China is back on growth. They have several big monetary policies to boost the economy. But I'm still concerned a bit on the demand side. I'm still waiting for the fiscal policy coming out from that. The most important thing is confidence for private sectors. That is the growth engine of China. We need to see them increasing their R&D, increasing their spending, which means they will provide more jobs to the society and the consumers have more confidence of the future. And when the property price is stable, they will spend more than today. And that's the most important thing.

LL: Let's elaborate a little bit more on the consumption side because it's often asked. The common perception is that Chinese consumers are saving more than spending. Is there a catalyst? How does that consumption story impact your stock picking?

QZ: I think I see China's consumer markets in two ways. Firstly, size matters. I'm talking about the second-largest consumer market globally. Taking cosmetics as an example, China consumes 27% of the global market. So, during this slower growth period of time, there are still many local brands aggressively taking market share from the international ones. For example, Proya, our holding, they're growing significantly in the last few years, when people are talking about consumer sentiment being low. But they are not thinking about aggregate size. They're thinking about creating a new local brand in China, and that matters.

And secondly, the structural trends of a very big consumption shift. So that means, you know, for example, value for good. I think we own a decent size of our portfolio in companies like PDD. Because when consumers get cautious about spending, actually, the value-for-money type of goods are actually getting more popular. So PDD is definitely well set to benefit from that trend. Again, size matters and also the structural trends going-on will excite the stock pickers for growth companies like us.

QZ: I see. That's very clear. The other thing happening in the quarter is that global market had quite a turmoil period. A lot of the AI and semiconductor stocks were impacted. We do have a few holdings in that area as well. How does it impact portfolio performance, etc.?

LL: I think the portfolio performance has been recovering quite meaningfully during this quarter. For our AI and semi play, I personally think this is a long-term trend because China has to be self-sufficient in this technology system. So that means the policy from the top will continuously go to the local leaders, because they are going to displace their international competitors.

So, in our portfolio, we have the leading analog designers like SG Micro and Silergy. And in the new stock- searching perspective, there are two focuses. We are looking at the new hardware opportunities, for example, machines, for example, the foundry, and also we're looking for the opportunity in the domestic AI app perspective. I think we own quite decent exposure in leading companies like Tencent, like Alibaba, but we're still excited to see some new opportunity coming. For example, Horizon Robotics, which is the largest competitor to NVIDIA in the AI autonomous driving perspective. So those companies are going to become the new opportunity for us in the next few years.

QZ: That sounds quite exciting. In the last quarterly video, Sophie, your co-portfolio manager, mentioned one of the team's research focuses was on Chinese companies with global competitiveness. I know you spent the entire summer back in China meeting a lot of companies with our Shanghai colleagues. Any new interesting findings through those meetings?

LL: I think the most interesting part is when I was sitting in Edinburgh reading the western media, which was always talking about how serious the de-coupling between US and China and the de-globalisation. But what we see locally is not the case. Many companies we met in the past few months, they are actually doubling down their overseas spending.

So, for example, Tencent is excited with their gaming opportunity outside of China, CATL, their founder actually emphasized how important it is to encourage their employees to go to their offshore factories. And BYD, actually their new products are not only going to be for China, but they are actually becoming number one leading players in Southeast Asia or global south. And this type of opportunities really sets contrast to the financial news here. Chinese companies are going global.

QZ: Yes, that's quite exciting as well. Any thoughts you want to leave with our audience from an outlook perspective for the asset class itself?

LL: Yes, I think now is a very interesting and important time for investors or for our clients to be thinking about China. Three most important things on the table today: firstly, China is back to growth. There is going to be more supportive policies to support this growth. Secondly, this asset class is trading at a 20-year low multiple, while the earnings in Chinese companies are actually the highest among the global investment universe. Thirdly, we're going to experience an increasing shareholder return period with more buying back from the companies and also dividends. So, this is a special period of time for our clients to rethink China.

QZ: Quite optimistic perhaps from a starting point perspective, especially when you mention valuations. Thank you very much. That's a very good note to end. Thank you for joining us and see you next quarter. Thank you.

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China

Annual past performance to 30 September each year (net%)

	2020	2021	2022	2023	2024
China Composite	51.9	2.5	-38.4	-4.1	14.9
MSCI China All Shares*	32.4	1.4	-31.6	0.6	20.6

Annualised returns to 30 September 2024 (net%)

	1 year	5 years	10 years
China Composite	14.9	1.1	5.2
MSCI China All Shares*	20.6	2.2	4.3

*(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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