Baillie Gifford™

Manager insights: China Growth Trust

May 2024

Investment manager Sophie Earnshaw discusses the trust's journey through 2023, addressing market challenges, portfolio updates, and future opportunities.

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

Sophie Earnshaw (SE): Hello, and welcome to this annual update for the China Growth Trust. I'm Sophie Earnshaw, one of the managers of the trust, alongside Linda Lin.

In this short update, I'll talk a bit about performance, provide an update on what we've been doing in the portfolio, and leave you with our outlook on China and how the trust is positioned.

Performance

The portfolio's performance in 2023 was disappointing in both absolute and relative terms. It underperformed against a falling benchmark.

Stock markets were impacted by a mix of challenges, including domestic economic difficulties, as well as rising geopolitical and regulatory risks.

A lack of confidence in the domestic markets has led local investors to seek stability in sectors such as energy, financials and utilities which performed strongest. These sectors are often state-dominated and offer very little growth, which is why they have limited representation in the trust's portfolio – not owning them was one cause of our underperformance.

At the stock level, we were hit by weakness in various consumer and construction names including local sportswear brand Li-Ning (which saw growth and profits hurt by the slower consumption environment which led to inventory write-downs), Beijing United (which had a concern about revenue recognition that led to regulatory investigations), and Glodon (a leading construction software company whose end markets were hit by weakness in property - this has now been sold).

This was partially offset by stock-specific strength at ByteDance (the largest holding and the only private company in the trust). Though this company has challenges with TikTok in the US, it is both

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very cheap and growing quickly. We also saw relative strength at engine maker, Weichai Power and BMW's onshore JV partner, Brilliance Auto.

It's fair to say that the extent of the drawdown and the persistence of negative sentiment and weak confidence has surprised us all, though we've recently begun to see signs of optimism return.

The authorities stepped in with a raft of policy measures aimed at shoring up sentiment prior to Chinese New Year, which led to a more recent rebound in stock markets. That's a helpful start, but we still think that the sustainability of any recovery is dependent on further stimulus and reforms.

Portfolio Update

While we understand that poor performance has been painful, we can offer a degree of encouragement based on what the portfolio has actually been doing. A return to fundamentals shows that the environment for growth and innovation in China remains strong.

While headline GDP continues to slow, there are ample structural opportunities in a variety of industries that continue to excite us. Indeed, because of our ability to avoid vast swathes of the index, our portfolio holdings delivered double-digit earnings growth in 2023 despite China's economic woes.

As examples from the trust's portfolio, eCommerce company, PDD, reported revenue and earnings growth of 90 per cent in 2023. CATL, the world's leading battery manufacturer, reported 44 per cent growth. Anker Innovations, best known for their wireless charging devices, grew 55 per cent.

But given the macro environment that China has been through, valuations have come down. China is now at valuation levels that are as low as we've seen in decades both in absolute and relative terms.

So the starting point from here is that we have a portfolio of companies that, in the main, are performing very well, and are now on far lower valuations than we've seen for years.

As a result of market volatility, operational developments and low valuations, we've recently seen a pickup in transactions as we look to take advantage of various opportunities.

We've been able to make additions to companies whose valuations have fallen despite them reporting strong growth. Companies like CATL, Meituan and Tencent.

We have also made a new purchase of Luckin Coffee, where new management has built a strong mass-market brand but whose valuation reflects its history not its future, and Shanxi Fenjiu, a regional baijiu brand (baijiu is a white spirit) with scope for further development.

We believe the overall shape of the portfolio is exposed to a more positive macroeconomic scenario via overweight positions in both consumer discretionary and industrials. At the margin, we have

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been reducing our exposure to ecommerce given slowing industry-level growth and intense competition.

We have also sold holdings in pharma contract research and development organisations, Wuxi AppTec and Asymchem Laboratories, which have been hurt by a bill being debated in Congress that could significantly reduce their ability to win future contracts in the US.

There is clearly a groundswell of noise around US protectionism and national security concerns in areas ranging from TikTok to genetic data to electric vehicles to Chinese-built cranes in ports. We should expect continued pressure given the elections this year, particularly when related to technology and national security.

However, we should also recognise that the vast bulk of the portfolio is focused on China's domestic revenue opportunity. This opportunity remains very significant and the companies exposed to it on very low valuations.

Outlook

China's economy continues to transition away from its old model of property-led growth to a new model of innovation-led growth. There is clearly a risk that the government fails to manage this transition successfully. However, we are cautiously optimistic.

Policy support to stabilise the property sector continues to build. Any improvement here could be very meaningful for consumer confidence and domestic demand.

In addition, the government continues to offer support to the 'new productive forces' that are vital for the country's long-term transition; areas such as new materials, the climate transition, and industrial automation. Both domestic demand and 'new productive forces' are well represented in the trust.

Looking forward, we are encouraged by the operational growth exhibited by companies held in the trust and by the government's growing support for the economy.

While we acknowledge that geopolitics is likely to remain a long-term headwind, we believe very low relative and absolute valuations compensate us for this risk. As such, we continue to be excited by the opportunities that China presents for long-term, patient investors.

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

	2020	2021	2022	2023	2024
Baillie Gifford China Growth Trust	-3.2	53.0	-32.7	-12.8	-26.0
MSCI China All Shares Index*	-7.3	27.3	-20.5	-0.2	-18.2

Source: Morningstar and MSCI. Share price, total return, sterling.

*Changed from MSCI AC Asia ex Pacific index to MSCI China All Shares Index on 16/09/20. Data chain-linked from this date to form a single comparative index.

Please note, Baillie Gifford was appointed by the board to manage what was the Witan Pacific Investment Trust as of September 2020

Past performance is not a guide to future returns.

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- The Trust invests in overseas securities. Changes in the rates of exchange may also cause the value of your investment (and any income it may pay) to go down or up.
- Baillie Gifford China Growth Trust invests in China, where potential issues with market volatility, political and economic instability including the risk of market shutdown, trading, liquidity, settlement, corporate governance, regulation, legislation and taxation could arise, resulting in a negative impact on the value of your investment. Investments in China are often through contractual structures that are complex and could be open to challenge.

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- Unlisted investments such as private companies can increase risk. These assets may be more difficult to sell, so changes in their prices may be greater.
- The Trust can borrow money to make further investments (sometimes known as "gearing" or "leverage"). The risk is that when this money is repaid by the Trust, the value of the investments may not be enough to cover the borrowing and interest costs, and the Trust will make a loss. If the Trust's investments fall in value, any invested borrowings will increase the amount of this loss.
- Market values for securities which have become difficult to trade may not be readily available and there can be no assurance that any value assigned to such securities will accurately reflect the price the Trust might receive upon their sale.
- The Trust can make use of derivatives which may impact on its performance.
- Investment in smaller companies is generally considered higher risk as changes in their share prices may be greater and the shares may be harder to sell. Smaller companies may do less well in periods of unfavourable economic conditions.
- The Trust's exposure to a single market and currency may increase risk.
- Share prices may either be below (at a discount) or above (at a premium) the net asset value (NAV). The Company may issue new shares when the price is at a premium which may reduce the share price. Shares bought at a premium may have a greater risk of loss than those bought at a discount.
- The Trust can buy back its own shares. The risks from borrowing, referred to above, are increased when a trust buys back its own shares.
- The aim of the Trust is to achieve capital growth and it is unlikely that the Trust will provide a steady, or indeed any, income.
- The Trust is listed on the London Stock Exchange and is not authorised or regulated by the Financial Conduct Authority

Further details of the risks associated with investing in the Trust, including a Key Information Document and how charges are applied, can be found in the Trust specific pages at **www.bailliegifford.com**, or by calling Baillie Gifford on 0800 917 2112.

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