

T. Rowe Price Funds OEIC

# China Evolution Equity Fund

A unique approach to investing in China

## Fund snapshot

- An actively managed, style agnostic, unconstrained portfolio investing across onshore and offshore China equity markets
- Focuses on areas of the market that may be overlooked by some investors, investing outside of the 100 largest, well-owned mega caps
- Seeks to uncover stocks where change and durability of growth are underappreciated or undiscovered by the market

<b>Asset class</b>	China equities
<b>Benchmark*</b>	MSCI China All Shares Index Net
<b>Inception</b>	December 2021
<b>Portfolio Manager</b>	Wenli Zheng
<b>Style</b>	Agnostic, but with growth bias
<b>No of holdings</b>	40-80
<b>ISIN</b>	GB00BMHRML25 (C Acc)

## Fund overview



*"Investing beyond the mainstream holdings in China sets us apart. We believe this fund can play a key role in complementing investors' existing China exposure while capturing the exciting potential for grass-roots growth in their portfolios."*

**Wenli Zheng** | Portfolio Manager

The China Evolution Equity Fund is designed to focus on areas of the market that are being largely overlooked by most investors. Our approach is to go beyond the top 100 largest companies in the China universe by market cap – ie those companies that dominate the index and many investor portfolios – to invest where change and growth are underappreciated or undiscovered by the market, in our view.

As well as avoiding the stocks which most investors already own, historically it is this area of the market that has been home to the outlier companies we seek – that small percentage of exceptional companies which drive the majority of market returns. Finding those future outliers is critical for sustainable returns and alpha generation.

## Reasons to consider this fund



### Alpha Opportunity

A portfolio of idiosyncratic ideas with relatively low correlation to macro influences and mainstream equity markets that seeks to exploit the inefficiencies and ample mispricing opportunities across the full extent of China's large, liquid equity markets.



### Unique Exposure

A high active share fund that we believe offers a truly differentiated exposure to China's exciting growth potential and which can complement investor portfolios by avoiding the widely-owned mega caps and focusing on the vast overlooked segments of the market.



### Asia-based Investment Team

With a long history of investing in China and with one of the largest and most experienced Asia-based analyst teams in region since 1987, we have built extensive local knowledge and long-term relationships which are essential to uncovering the future winners.

\* The manager is not constrained by the fund's benchmark, which is used for performance comparison purposes only.

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# The Active Opportunity in China



## Quick takeaways

- China is a dynamic economy reflected in a large and constantly evolving equity market of over 6,500 companies
- Mainstream China indices are concentrated into a small subset of companies and do not reflect the true opportunity set
- The equity market is vast, dynamic and inefficient – an active stock picker's paradise

## An inefficient and under-explored market

Whilst China's share of global gross domestic product (GDP) has more than doubled over the past decade from 9% in 2010 to over 20% today, its expansion has not been matched in global equity indices. China exposure in the MSCI AC World Index expanded from 2% to just over 4% during the same period.

On the other hand, China's equity market capitalisation has increased by approximately 25 times since 2002 and it is now the second largest stock market globally, by market cap. China is a fast-evolving market, with new companies coming to the market across a range of innovative sectors. The total universe comprises more than 6,500 onshore- and offshore-listed stocks.

However, mainstream indices are not an accurate representation of the opportunity set. For example, the MSCI China Index comprises just over 700 listed companies – with the largest 100 stocks having a weighting of over 70%. The remaining 6,400+ companies – some 98% of the investable market – are being largely ignored.

While many of China's mega caps will have rewarded investors and remain sound companies, it is the overlooked areas of the market where we believe many of the investable success stories of tomorrow lie.

## China A shares: accessible and under owned

China's domestic A-shares are by far the biggest investment universe by both number of companies and market cap, yet this dynamic, fast evolving segment is greatly underrepresented in both the index and, consequently, many China funds.

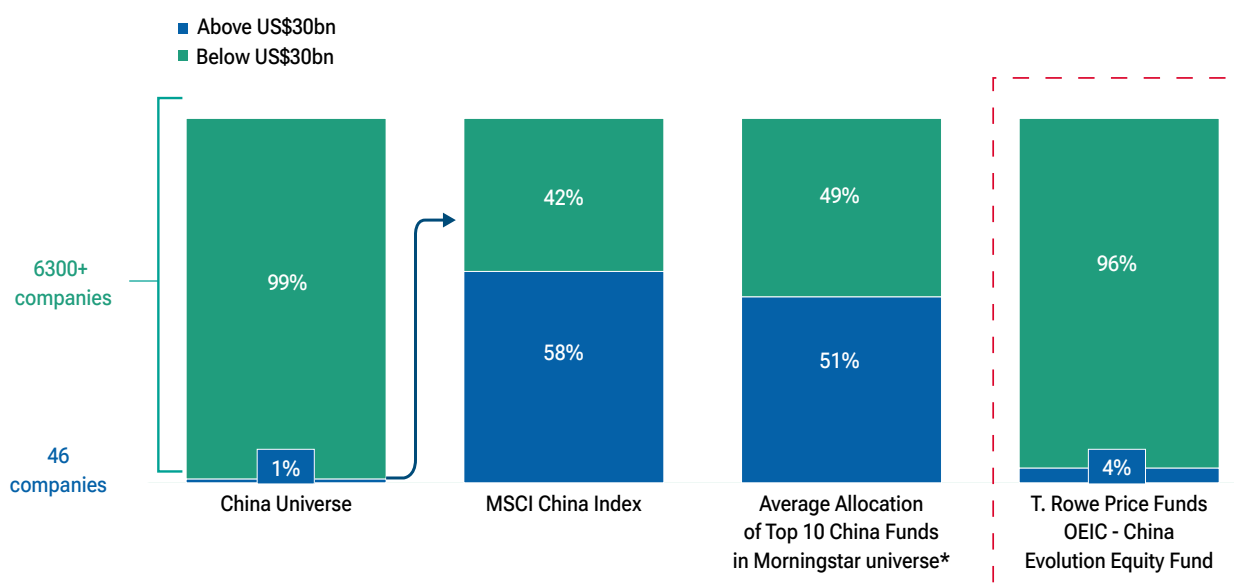
The underrepresentation of A-shares in the index is important, not only because of the broad range of investable opportunities A-shares have to offer, but also because the A-share market remains highly inefficient given its retail-driven investor base. It is a high liquid, high velocity market, with local retail investors accounting for 70% of market turnover and an average holding period of just 15 days.

Furthermore, a lack of sell-side coverage outside of a handful of A-share companies serves only to exacerbate these inefficiencies and creates mispricing opportunities. A-share companies with a sizeable market capitalisation of between US\$5-US\$30 billion are covered, on average, by five analysts. For smaller companies, the average falls to just one.

As such, we believe the A-share market presents an attractive opportunity set for skilled fundamental, active investors to invest in potentially mispriced assets.

**Fig. 1: The opportunity set is much more than the mega caps**

Market cap breakdown by stock count (%), as at 31 December 2023



Sources: MSCI, HKex, FactSet, Wind, Morningstar. Financial data and analytics provider FactSet. Copyright 2024 FactSet. All Rights Reserved.

Please see Additional Disclosures for information about this MSCI and Morningstar information.

<sup>1</sup> The Top 10 China funds refer to the funds in the Morningstar China Equity universe, measured by AUM.

# Our Investment Approach



## Quick takeaways

- Fundamental approach based upon a large, local and experienced investment team
- A framework designed to find tomorrow's winners that lie outside of the 100 largest companies
- A portfolio that is concentrated, style agnostic and unconstrained

The China Evolution Equity Fund is designed to give clients a highly differentiated exposure to China's opportunity set. By excluding the mega caps and looking to invest in the future winners we take a truly active approach to stock selection in China across both on- and offshore markets. The ability to identify future winners in areas of the market overlooked by others relies on proprietary, forward-looking fundamental research. To that end, we have one of the industry's strongest commitments to in-house research dedicated to China.

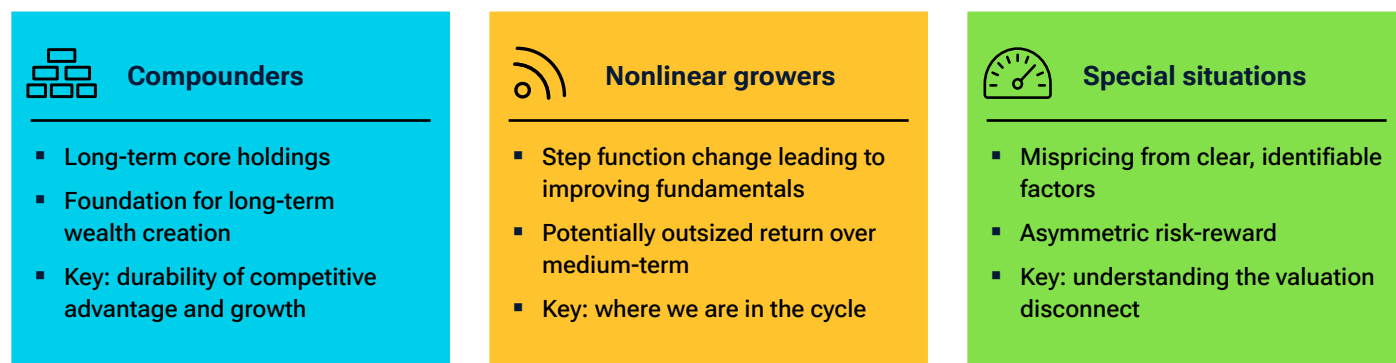
## Investing beyond the mainstream mega caps

Based in Hong Kong, Portfolio Manager Wenli Zheng and our team of dedicated China analysts have close proximity to companies and extensive local market knowledge.

They are supported by teams of emerging market debt analysts, ESG specialists and over 100 globally based sector and regional specialists who can provide a broader perspective on what is happening in other countries and can help evaluate the potential impact for companies in China.

Our bottom-up approach seeks to identify outlier companies, beyond the well-understood mega-cap stocks, that potentially offer durable growth that can compound over multiple years; accelerating growth from a new product or industry cycle; or rerating opportunities as we look beyond short-term challenges or concerns to the longer-term prospects of the company.

Fig. 2: Future winners and mispricing opportunities - the types of stocks we want to own



## A balanced portfolio unconstrained by any index, sector or style

Going beyond the top 100 largest companies by market cap means that we invest in stocks with a market cap that translates to roughly US\$30bn or below under current market conditions (although we are not compelled to sell should a stock go above this threshold provided our investment thesis remains intact).

When constructing the portfolio, the primary focus is on the idiosyncratic fundamental factors of each holding. Position sizes are determined by the potential upside and downside of an individual stock.

We are unconstrained by index, style or sector with the portfolio driven by bottom-up considerations where we believe we have unique insights beyond the consensus names. The result is a portfolio that is very different from both the MSCI China Index and our peers, that can, in our view, complement most investors' existing exposure to China equities. A portfolio that, we believe, stands out from the crowd.

<b>Holdings</b>	40-80
<b>Position size range</b>	Typically 1%-10% with an average of 2%-4%
<b>Benchmark*</b>	MSCI China All Shares Index Net
<b>Cash level</b>	Max 8%; typically < 5%
<b>Expected turnover</b>	20%-100%
<b>Sectors</b>	All industries with emphasis on technology, healthcare, consumer, industrials, and services
<b>Countries</b>	Minimum 80% invested in China; selective investment in global companies levered to Chinese consumer or supply chain

\* The manager is not constrained by the fund's benchmark, which is used for performance comparison purposes only.

## Risks - the following risks are materially relevant to the fund:

**Country risk (China)** – Chinese investments may be subject to higher levels of risks such as liquidity, currency, regulatory and legal risks due to the structure of the local market.

**Currency risk** – Currency exchange rate movements could reduce investment gains or increase investment losses.

**Emerging markets risk** – Emerging markets are less established than developed markets and therefore involve higher risks.

**Issuer concentration risk** – Issuer concentration risk may result in performance being more strongly affected by any business, industry, economic, financial or market conditions affecting those issuers in which the fund's assets are concentrated.

**Small and mid-cap risk** – Stocks of small and mid-size companies can be more volatile than stocks of larger companies.

## General Fund Risks

**Equity risk** – Equities can lose value rapidly for a variety of reasons and can remain at low prices indefinitely.

**Geographic concentration risk** – Geographic concentration risk may result in performance being more strongly affected by any social, political, economic, environmental or market conditions affecting those countries or regions in which the fund's assets are concentrated.

**Investment fund risk** – Investing in funds involves certain risks an investor would not face if investing in markets directly.

**Management risk** – Management risk may result in potential conflicts of interest relating to the obligations of the investment manager.

**Market risk** – Market risk may subject the fund to experience losses caused by unexpected changes in a wide variety of factors.

**Operational risk** – Operational risk may cause losses as a result of incidents caused by people, systems, and/or processes.

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## Important information

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