China: Charting the Course in 2024

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China has long term structural economic issues, namely the ‘3 Ds’ Debt, deflation, and demographics. These are topics that are well understood and frequently discussed, however it is worth remembering that they are not unique to China. Most Western governments are also having to manage these same issues. China’s economy is clearly in transition and the current deleveraging process is a painful part of that journey.

The government's challenge is to navigate this transition and strike a balance to achieve the goal of deleveraging the economy without destroying the economy. The economic recovery since the removal of the zero covid policies late last year has been underwhelming and in response we have seen a marked increase in policies aimed to support the economy. With the expectation of incremental policy support to continue, most sell-side outlooks for 2024 are cautiously optimistic, anticipating an improvement in GDP growth within a range of 4.2% to 5.3%.

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To date, the government’s response to the weak economy has fallen short of expectations but with every policy there will be a lag before their impact materializes. We feel that we are beginning to see an upturn in economic data and recent data points have beaten the, admittedly, modest consensus expectations. Stimulus efforts have intensified, particularly in regards to the property and capital markets. These measures include the easing of home purchase restrictions in several major cities, prime rates cut, and demands to banks to increase lending to private sectors.

FIGURE 1: 2024 Real GDP Growth Forecast

Actual outcomes may differ materially from estimates.
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Source: T. Rowe Price. As of 6 December 2023.

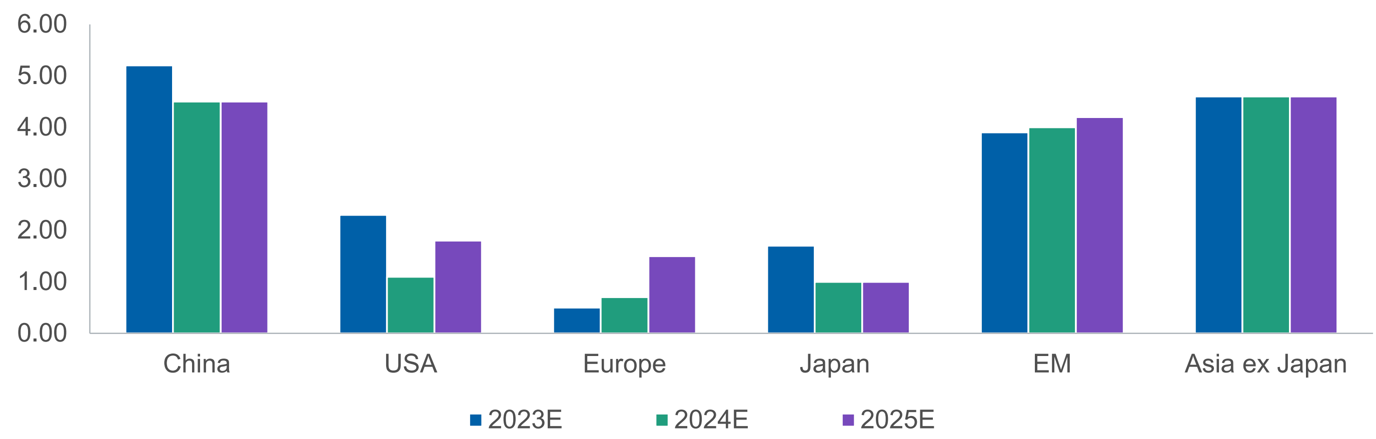
China's experience of the pandemic was unique and as a consequence their economic cycle has meaningfully diverged from the rest of the world. China's post-COVID reopening coinciding with a period where the majority of the world was struggling to contain inflation and avoid a recession which undoubtedly has impacted China's economic recovery through this year. Looking out, China's growth is projected to be higher compared to other global counterparts.

Chinese macro newsflow is closely followed and hard to ignore under the current environment, but over a longer term, the correlation between GDP growth and stock market performance tends to be very low, which is the case across most markets. As an equity investor, the focus is not about the entire economies; instead, we invest into individual companies. And what drive the returns in the equity market are fundamentally grounded in: Profits, Prospects and Price (valuations).

The expected earnings growth in China is stronger than developed markets, albeit below the broader emerging markets universe where a handful of heavyweight tech stocks are forecast to experience a significant upturn. The largest companies in China remain highly profitable. Recent years have been challenging for businesses with the twin headwinds of regulatory oversight and an economic slowdown, both of which have put pressure on their profitability. We see regulatory pressures easing in most sectors and a government clearly focused on economic growth. Furthermore, cyclicality in certain industries is showing signs of improvement. We also hear messages from company management teams that they are focusing heavily on capital discipline and profit maximisation. Certain industries that previously struggled with overcapacity are showing signs of recovery.

While market volatility may still lie ahead, sentiment towards China currently appears

FIGURE 2: GDP Growth YoY%



E= Estimated. **Actual outcomes may differ materially from estimates.**
Source: Bloomberg Finance L.P. As of 6 December 2023

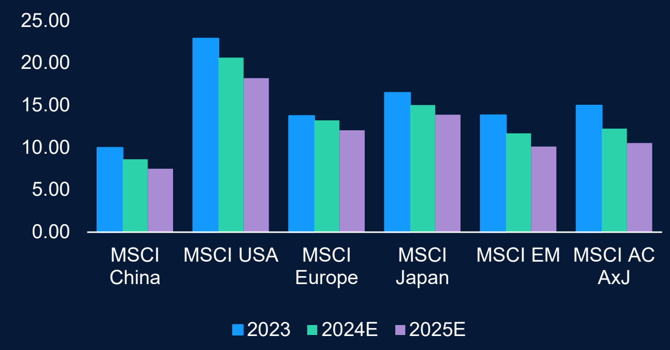
EPS Growth YoY%

(Fig. 3)

E= Estimated. Actual outcomes may differ materially from estimates.
Source: Bloomberg Finance L.P. As of 31 January 2024.

EST P/E Ratio (x)

(Fig. 4)



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Source: Bloomberg Finance L.P. As of 31 January 2024.

predominantly pessimistic, causing a disconnection between fundamentals and subdued valuations. China's economy has moved in a different cycle to the rest of the world and it feels so too has its stock market. The overall index has pulled back to valuation levels last seen during the Zero-Covid lockdowns in the last summer, yet the situation in China has significantly improved since that point.

Our portfolio managers act cautiously and control our exposure to China market, but we do not share the view that the Chinese market is inherently uninvestable. There are many good companies generating significant earnings growth. The past few years have been entirely dominated by top-down macro factors; including the COVID on/off, QE/QT, and inventory de-stocking/re-stocking, all within the context of heightened geopolitical events. We believe that we have passed the moment of peak uncertainty for all of these events. Looking ahead to 2024, we foresee the influence of macro forces reducing and China moving back towards a stock picker's market.

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