



# China: Time to revisit an unloved asset class

From the Field  
December 2023



## Key Insights

- We believe China’s muted post-COVID reopening recovery is largely cyclical in nature.
- Structural opportunities exist in a number of areas: industrial upgrading, rising consumption, and companies gaining market share via consolidation.
- We believe this downturn provides opportunities to own great Chinese businesses at attractive prices.



**Weni Zheng**  
Portfolio Manager, China  
Evolution Equity Strategy

Chinese equities have been disappointing since early 2021, with the MSCI China Index more than halving. It has continued to underperform even as the country emerged from the pandemic late last year. Most other economies enjoyed a consumption boom following the

post-COVID reopening. However, this failed to materialize in China.

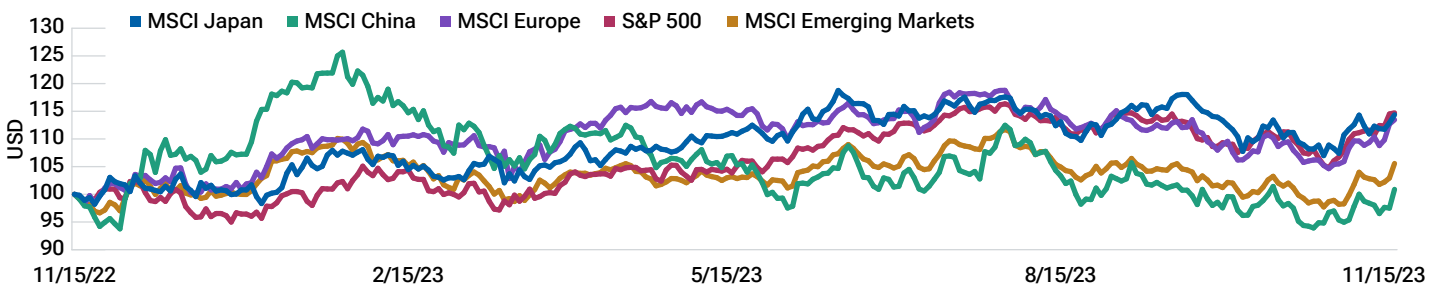
During the pandemic, the government balance sheets of many countries expanded substantially as they pushed through extensive support packages. The Chinese

government, in contrast, did not provide any meaningful consumption stimulus. Instead, the country is going through a major financial deleveraging phase.

This is best reflected in China’s troubled property sector. The property supply chain

## Performance

(Fig. 1) 12-month performance by region

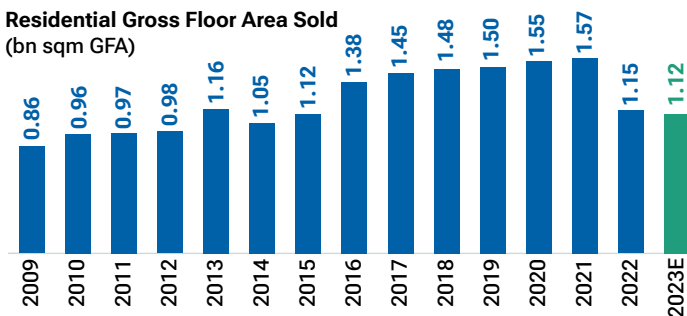


As of November 15, 2023. Past performance is not a reliable indicator of future performance. Performance is indexed to 100. Sources: FactSet, MSCI. Total return in USD.

## Deleveraging

(Fig. 2) The property sector remains depressed

**Residential Gross Floor Area Sold**  
(bn sqm GFA)



**Property De-stocking**

(% change CY 2023 Estimate with CY 2020 base)



As of November 20, 2023. E=Estimated. **Actual outcomes may differ materially from estimates.**

Sources: Left-hand chart: Haver Analytics/China National Bureau of Statistics/Markit. Please see Additional Disclosures page for information about this Markit information. Right-hand chart: Haver Analytics/China National Bureau of Statistics.

contributes over 20% to China's gross domestic product (GDP)<sup>1</sup>. However, since the tightening process began in early 2021, property transaction volumes have declined 30%–40% from their peak and are back to levels last seen a decade ago. Property new starts have fallen 60% from the peak. This has been a major drag on the economy.

Exports, another growth engine for China during 2020–2022, have declined this year with the weaker global economic backdrop. There are also longer-term concerns resulting from the efforts of multinational corporations to diversify supply chains away from China. Since U.S.-China trade tensions started in 2018, China's share of U.S. imports has come down from over 20% to below 15%. However, at a global level, China's export share continued to increase as Chinese

exporters made greater inroads into emerging markets.

China does undoubtedly face structural challenges, such as the high levels of leverage in the property sector and at local government level, ongoing geopolitical uncertainties, and demographic headwinds. However, to a large extent the current slowdown we are seeing is cyclical. This period is not unique from a historical perspective. Every three to four years, China has gone through mini economic cycles. The last time China experienced a large deleveraging cycle was in 2012–2015, which resulted in sharp declines in Chinese equities. This downcycle was followed by five years of strong market performance with the MSCI China Index gaining 160% during that period,

outperforming major markets, including the S&P 500<sup>2</sup>.

## Structural and unique opportunities exist amid China's economic transition

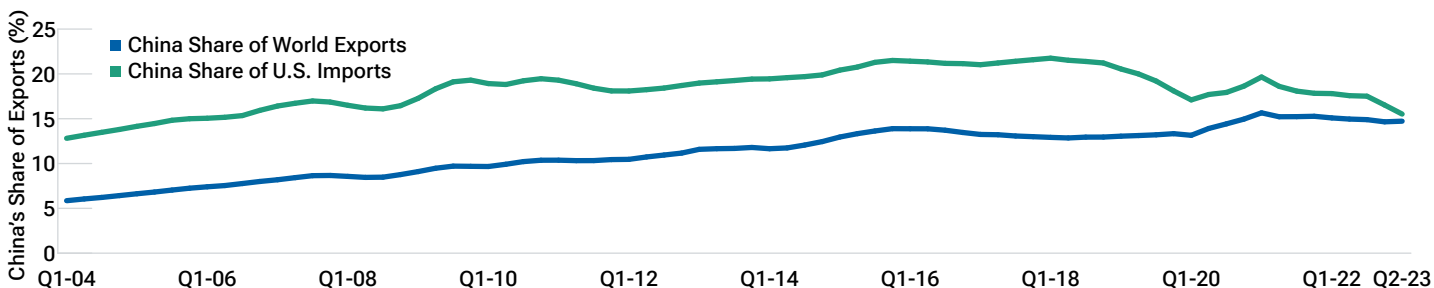
China is making rapid progress in manufacturing and moving up the value chain. China's R&D (research & development) spending as a percentage of GDP is now higher than that of European Union countries. This has helped China achieve strong leadership positions in many fast-emerging industries. China is well known for mobile phone and PC assembly. However, this year, China's exports of autos and renewable energy are expected to overtake PCs and mobile phones.

<sup>1</sup>Source: K. Rogoff, Project Syndicate, August 17, 2023.

<sup>2</sup>From February 29, 2016 to January 29, 2021. **Past performance is not a reliable indicator of future performance.**

## Diversification

(Fig. 3) China gains export share outside the U.S.

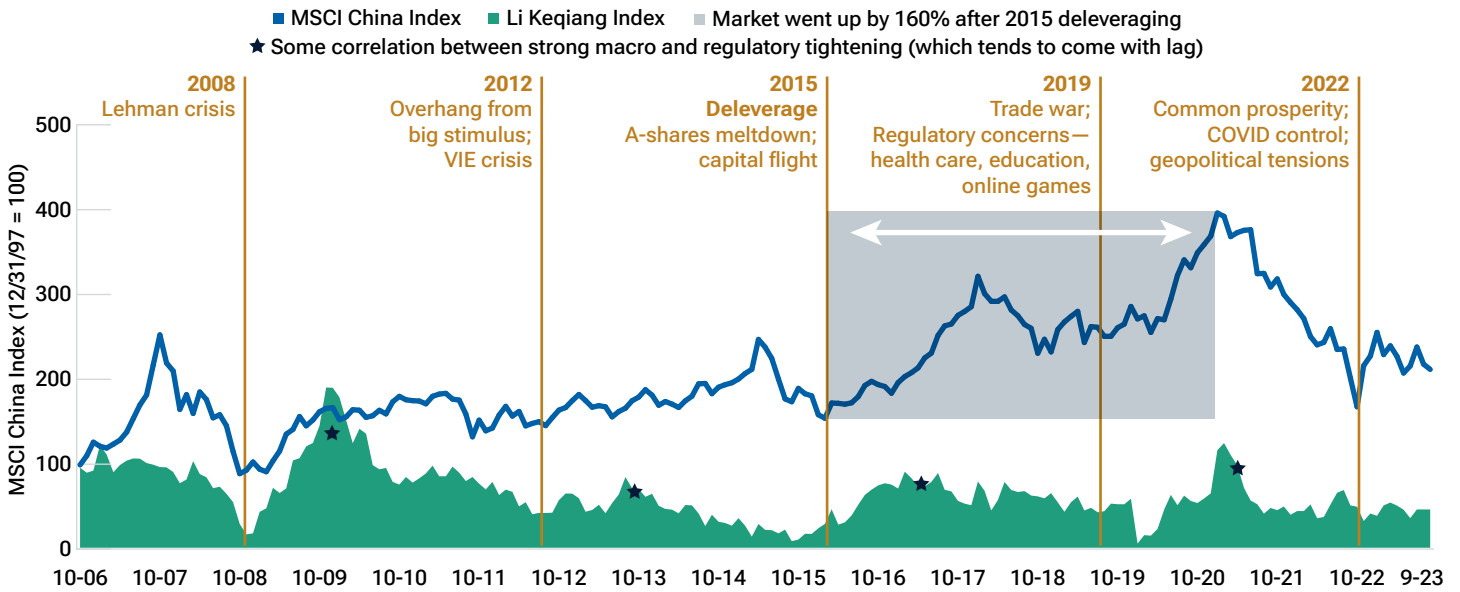


As of June 30, 2023.

Sources: China Customs, NBS, Wind, Citi Research.

## We have been here before

(Fig. 4) MSCI China Index vs. Li Keqiang Index (a mix of real economic activities in China)



As of September 29, 2023. Past performance is not a reliable indicator of future performance.

VIE = variable interest entities.

Sources: Bloomberg Finance L.P., MSCI. Please see Additional Disclosures page for more information about this MSCI information.

China is widely expected to become the No.1 auto exporter globally in 2023. This is a huge turnaround as only three to four years ago Chinese auto original equipment manufacturers were struggling for success in their own domestic market. The EV (electric vehicle) transformation has changed the dynamic, turning Chinese automakers' weakness in internal combustion engines into a strength in battery powertrains. This transformation doesn't stop at autos. We have seen

similar patterns playing out in construction machinery and outdoor power equipment, where Chinese firms are gaining market share on the back of electrification.

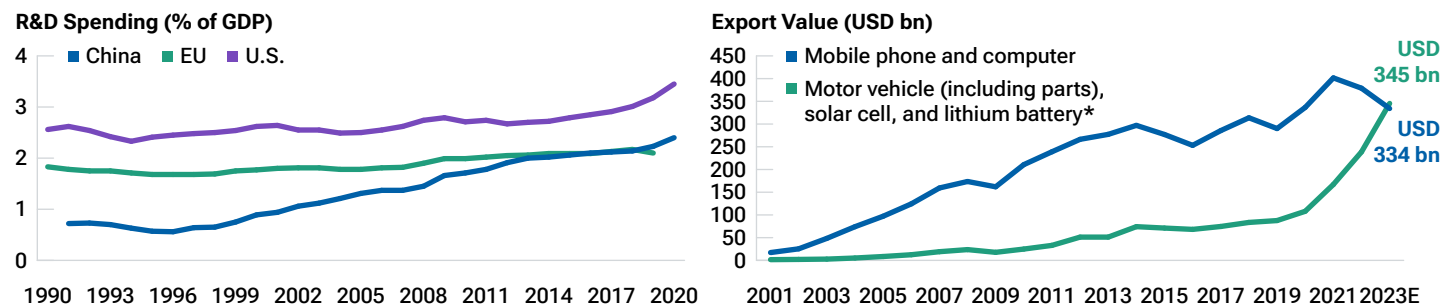
The trend toward supply chain diversification and realignment does create challenges for many Chinese industries, especially those that are highly dependent on U.S. demand or U.S. technology. However, in many emerging industries, including green tech, biotech, and mobile

internet, Chinese firms have established both scale and technological leadership. While they may face uncertainties in certain developed markets, we think that their global competitiveness and footprint will continue to rise.

A byproduct of supply chain realignment is local substitution, where we have seen meaningful acceleration. China is the largest market for many products. It accounts for 60% of global demand for

## Areas of opportunity: industrial upgrade

(Fig. 5) Increased R&D spending has raised China's competitiveness



As of June 30, 2023.

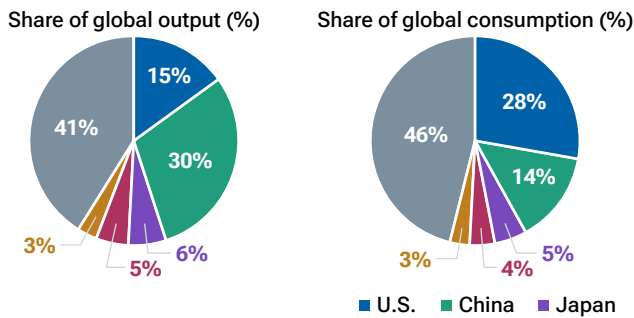
\* Solar cell data are not available before 2012, and lithium battery data are not available before 2020.

Sources: General Administration of Customs, Morgan Stanley Research Estimates (E).

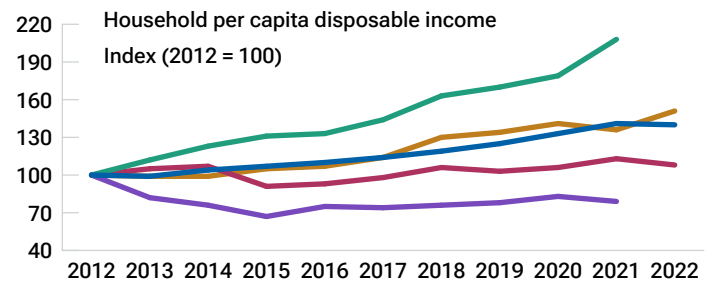
## Areas of opportunity

(Fig. 6) From exports to consumption

### Manufacturing vs. Consumption



### Disposable Income Growth



As of September 30, 2023.

Sources: World Bank, NBS, BEA, CAO, Deutsche Bundesbank, Ministry of Statistics and Programme Implementation (India), Haver Analytics, CEIC.

industrial robots, for example, and 30%–40% of analog semiconductor demand.<sup>3</sup> Those markets used to be highly dependent on foreign suppliers. However, local leaders are now emerging and quickly narrowing the gap versus their foreign peers.

In many traditional industries, we've seen better capex discipline and industry consolidation. China has a reputation for exporting overcapacity. This may still be true for some emerging industries, but in more mature sectors, things have changed. Since the supply side reforms in 2016, capex investment in areas like coal, steel, LCD panels, beer, etc., has come down substantially, leading to improving returns and profitability for those industries. These businesses are entering into what we term the "harvest stage," where the investment phase has passed and margins and cash flows have rebounded strongly.

While China's consumption recovery post-COVID is more muted than expected, the structural trend is not broken, but rather remains intact. Chinese consumers' purchasing power has been rising. The per capita household income has more than doubled over the past 10 years. Even in a relatively weak macro environment, household income grew 6.5% year-to-date (as of September 2023). Consumption contributed 95% of China's GDP growth in the third quarter of 2023.

China generated 30% of global industrial output but only 14% of global consumption demand. China's consumption-to-GDP ratio is only 38% versus 50%–70% for other major economies. The geopolitical tensions today might serve to accelerate China's transition to a more consumption-driven economy, which we believe will help generate more balanced trade relationships in the future.

### Compelling opportunities from the downturn and market inefficiencies<sup>4</sup>

Despite the muted economic backdrop, investors should focus on finding businesses that can consistently increase their earnings power. These opportunities could be found, for example, in the technology and industrials sectors which leverage the industrial upgrade and green transition. In traditional industries, including shipbuilding, offshore oil service, copper, etc., we expect improving return on invested capital driven by favorable supply/demand dynamics.

We'd also encourage investors to distinguish the index-level performance from true return potential in Chinese equities. While the MSCI China Index hasn't done much over the past 10 years, the top 20 A-share stocks with highest foreign ownership have outperformed

the index by over significantly. China remains a highly inefficient market, with retail investors accounting for around 70% of trading volume. Their average holding period is approximately 16 days. This can lead to high velocity and ample mispricing opportunities.

Another disconnect for Chinese equities is between the opportunity set and investors' asset allocation. China has over 6,000 stocks, but only around 1% are mega-caps with a market cap of USD 30 billion plus. However, that 1% of stocks have a weighting of over 50% in the MSCI China Index. Mainstream China funds, on average, put over half of their assets under management into just 1% of stocks. The remaining 98%–99% of the China stock universe is arguably underexplored. We believe there are tremendous alpha opportunities beyond the well-discovered large-cap consensus names.

With Chinese equities in a third consecutive year of decline, it is a test of investors' conviction and patience. However, the prolonged downturn provides the opportunity to own some great Chinese businesses at attractive prices. It is often said that the best investment opportunities occur during the most uncomfortable periods. We believe that we are currently in such a period for Chinese equities.

<sup>3</sup> T. Rowe Price estimate as of September 30, 2023. **Actual outcomes may differ materially from estimates.**

<sup>4</sup> All statistics in this section are T. Rowe Price estimates, as of September 30, 2023. **Actual outcomes may differ materially from estimates.**

## INVEST WITH CONFIDENCE™

T. Rowe Price identifies and actively invests in opportunities to help people thrive in an evolving world, bringing our dynamic perspective and meaningful partnership to clients so they can feel more confident.

---

### Additional Disclosure

Unless otherwise noted, numbers may not total due to rounding.

T. Rowe Price cautions that economic estimates and forward-looking statements are subject to numerous assumptions, risks, and uncertainties, which change over time. Actual outcomes could differ materially from those anticipated in estimates and forward-looking statements, and future results could differ materially from any historical performance. The information presented herein is shown for illustrative, informational purposes only. Forecasts are based on subjective estimates about market environments that may never occur. Any historical data used as a basis for this analysis are based on information gathered by T. Rowe Price and from third-party sources and have not been independently verified. Forward-looking statements speak only as of the date they are made, and T. Rowe Price assumes no duty to and does not undertake to update forward-looking statements.

MSCI and its affiliates and third party sources and providers (collectively, "MSCI") makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed, or produced by MSCI. Historical MSCI data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such.

---

### Important Information

**This material is being furnished for general informational and/or marketing purposes only.** The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, nor is it intended to serve as the primary basis for an investment decision. Prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. T. Rowe Price group of companies including T. Rowe Price Associates, Inc. and/or its affiliates receive revenue from T. Rowe Price investment products and services. **Past performance is not a reliable indicator of future performance.** The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources' accuracy or completeness. There is no guarantee that any forecasts made will come to pass. The views contained herein are as of the date written and are subject to change without notice; these views may differ from those of other T. Rowe Price group companies and/or associates. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request. It is not intended for distribution to retail investors in any jurisdiction.

**DISCLOSURE CONTINUES ON THE FOLLOWING PAGE.**

---

## Important Information (cont.)

**Australia**—Issued by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 28, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000, Australia. For Wholesale Clients only.

**Brunei**—This material can only be delivered to certain specific institutional investors for informational purpose only. Any strategy and/or any products associated with the strategy discussed herein has not been authorised for distribution in Brunei. No distribution of this material to any member of the public in Brunei is permitted.

**Canada**—Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc.'s investment management services are only available to Accredited Investors as defined under National Instrument 45-106. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services.

**Colombia, Chile, Mexico, Perú, Uruguay**—This material is prepared by T. Rowe Price International Ltd - Warwick Court, 5 Paternoster Square, London, EC4M 7DX which is authorised and regulated by the UK Financial Conduct Authority - and issued and distributed by locally authorized distributors only. For professional investors only.

**DIFC**—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd which is regulated by the Dubai Financial Services Authority as a Representative Office. For Professional Clients only.

**EEA**—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à.r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

**Hong Kong**—Issued in Hong Kong by T. Rowe Price Hong Kong Limited, 6/F, Chater House, 8 Connaught Road Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

**Indonesia**—This material is intended to be used only by the designated recipient to whom T. Rowe Price delivered; it is for institutional use only. Under no circumstances should the material, in whole or in part, be copied, redistributed or shared, in any medium, without prior written consent from T. Rowe Price. No distribution of this material to members of the public in any jurisdiction is permitted.

**Korea**—This material is intended only to Qualified Professional Investors. Not for further distribution.

**Mainland China**—This material is provided to qualified investors only. No invitation to offer, or offer for, or sale of, the shares will be made in the mainland of the People's Republic of China ("Mainland China", not including the Hong Kong or Macau Special Administrative Regions or Taiwan) or by any means that would be deemed public under the laws of the Mainland China. The information relating to the strategy contained in this material has not been submitted to or approved by the China Securities Regulatory Commission or any other relevant governmental authority in the Mainland China. The strategy and/or any product associated with the strategy may only be offered or sold to investors in the Mainland China that are expressly authorized under the laws and regulations of the Mainland China to buy and sell securities denominated in a currency other than the Renminbi (or RMB), which is the official currency of the Mainland China. Potential investors who are resident in the Mainland China are responsible for obtaining the required approvals from all relevant government authorities in the Mainland China, including, but not limited to, the State Administration of Foreign Exchange, before purchasing the shares. This document further does not constitute any securities or investment advice to citizens of the Mainland China, or nationals with permanent residence in the Mainland China, or to any corporation, partnership, or other entity incorporated or established in the Mainland China.

**Malaysia**—This material can only be delivered to specific institutional investor. This material is solely for institutional use and for informational purposes only. This material does not provide investment advice or an offering to make, or an inducement or attempted inducement of any person to enter into or to offer to enter into, an agreement for or with a view to acquiring, disposing of, subscribing for or underwriting securities. Nothing in this material shall be considered a making available of, solicitation to buy, an offering for subscription or purchase or an invitation to subscribe for or purchase any securities, or any other product or service, to any person in any jurisdiction where such offer, solicitation, purchase or sale would be unlawful under the laws of Malaysia.

**New Zealand**—Issued by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 28, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000, Australia. No Interests are offered to the public. Accordingly, the Interests may not, directly or indirectly, be offered, sold or delivered in New Zealand, nor may any offering document or advertisement in relation to any offer of the Interests be distributed in New Zealand, other than in circumstances where there is no contravention of the Financial Markets Conduct Act 2013.

**Philippines**—ANY STRATEGY AND/ OR ANY SECURITIES ASSOCIATED WITH THE STRATEGY BEING DISCUSSED HEREIN HAVE NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES REGULATION CODE. ANY FUTURE OFFER OR SALE OF THE STRATEGY AND/ OR ANY SECURITIES IS SUBJECT TO REGISTRATION REQUIREMENTS UNDER THE CODE, UNLESS SUCH OFFER OR SALE QUALIFIES AS AN EXEMPT TRANSACTION.

**Singapore**—Issued by T. Rowe Price Singapore Private Ltd. (UEN: 201021137E), 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. T. Rowe Price Singapore Private Ltd. is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

**South Africa**—Issued in South Africa by T. Rowe Price International Ltd (TRPIL), Warwick Court, 5 Paternoster Square, London EC4M 7DX, is an authorised financial services provider under the Financial Advisory and Intermediary Services Act, 2002 (Financial Services Provider (FSP) Licence Number 31935), authorised to provide "intermediary services" to South African Investors. TRPIL's Complaint Handling Procedures are available to clients upon request. The Financial Advisory and Intermediary Services Act Ombud in South Africa deals with complaints from clients against FSPs in relation to the specific services rendered by FSPs. The contact details are noted below: Telephone: +27 12 762 5000, Web: [www.faisombud.co.za](http://www.faisombud.co.za), Email: [info@faisombud.co.za](mailto:info@faisombud.co.za)

**Switzerland**—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

**Taiwan**—This does not provide investment advice or recommendations. Nothing in this material shall be considered a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person in the Republic of China.

**Thailand**—This material has not been and will not be filed with or approved by the Securities Exchange Commission of Thailand or any other regulatory authority in Thailand. The material is provided solely to "institutional investors" as defined under relevant Thai laws and regulations. No distribution of this material to any member of the public in Thailand is permitted. Nothing in this material shall be considered a provision of service, or a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person where such provision, offer, solicitation, purchase or sale would be unlawful under relevant Thai laws and regulations.

**UK**—This material is issued and approved by T. Rowe Price International Ltd, Warwick Court, 5 Paternoster Square, London EC4M 7DX which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

**USA**—Issued in the USA by T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, MD, 21202, which is regulated by the U.S. Securities and Exchange Commission. For Institutional Investors only.

© 2023 T. Rowe Price. All Rights Reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the Bighorn Sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc.