Matthews Asia

Transcript: On-the-Ground Insights: China
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Hi, my name's Hardy Zhu and I'm a portfolio manager with Matthews Asia. I'm a China specialist and I have been following Chinese equities for many years. Currently, I'm working out of the firm's Hong Kong office.

Chinese equities review and outlook

My view on Chinese equities is that they have sold aggressively in January out of concerns of weak property sales, inflationary pressure, and the lack of a strong government stimulus. Sectors such as energy, materials, utilities and communications outperformed due to global commodity price increase, high dividend yield, and exposure to artificial intelligence, as well as defense reasons.

Property and health care are the two sectors that underperformed meaningfully because of steep job or property sales, and the liquidity problems for developers, and the lingering impact from anti-corruption in the health care sector. As a response, the government continued its supportive policies, including a further cut on down payment ratios, mortgage rates, as well as further relaxation on home purchase restrictions to support the property sector. Also, the government has since tightened IPO requirements, and the so-called "national team" also started buying blue-chip Chinese stocks to put a floor on the market. As a result, market has started to recover to end the quarter almost flat.

One surprise is actually industrial names, which normally don't do well in a weakened economy. But some select names performed pretty well due to their export exposure. I would say we are more positive on Chinese equities these days, but I also believe China needs to resolve the problems in the property sector, as the sector is actually in a more structurally downward cycle. But the property sector has very deep implications on many industries in the supply chain as well as on local government finances. Hopefully, we'll see a soft landing on the property sector. Meanwhile, I also feel the property sector and the economy are intertwined and they are not separate issues. Falling property prices have a negative impact on people's willingness to spend, but better economic prospects and a better job market will also help to stabilize the property market as well.

Corporate earnings outlook

Chinese companies are still reporting for 2023 earnings, but consensus has been coming down to about 10% earnings growth for last year. It's expected this year's earnings growth will be faster than 2023, and based on the earnings of the companies that reported for the first quarter, and also based on my communication with corporates, things are actually looking much better this year. I know 10% earnings for last year is not a very high number, but that's a turnaround for earnings growth if we look at the past three years, because of depressed earnings due to COVID. And combined with a very low valuation, about nine times of 2024 earnings, I think the Chinese equities do look attractive.

China's economic health

I do see signs the Chinese economy is improving. If we watch the March PMI number, that's the first time within the past six months, the PMI number is about 50. Also, although the Chinese primary home sales is still pretty weak, the secondary home transactions in China on nationwide basis is finding a better footing.

For instance, a friend of mine in Shanghai has been trying to sell his property for the past few months, and he was finally able to sell the property at the price he's happy with. And, based on my communication with some leading online recruiting agencies, the average number of new job postings rose approximately 20% year-on-year after the Chinese New Year. All these are very positive signs pointing to continuance of economic recovery in China.

On-the-ground observations

I think company executives are more positive than before. I think they acknowledge the economy is tough. A lot of problems are well known to them, so they're doing their best to deal with that. And, with the domestic consumption being weak, many firms are finding opportunities in the global market. As you know, China has many manufacturing firms which are really competitive in the global market, and they are leveraging the weaker renminbi yen.

Also, there are quality products at competitive pricing to export to the overseas market and gaining share from some leading global companies in the world. And, companies, what I realized is, they are trying to focus on more quality growth instead of just focusing on top line growth, or the size of the company. They are focusing more on the return on investments. They're focusing more on the efficiency, and the profit, and the margins et cetera. So, what we are seeing now is a little bit different from before, that people are nimble and people are more focusing on quality growth going forward.

What I want to highlight is that people do want to travel more. In addition to the pent-up demand on travel, I noticed people flock to concerts to listen to their favorite singers. After COVID, people do want to enjoy a quality life.

And, the Chinese government has been more pragmatic as well. As you know, during COVID, many of the practices that were put into place were not very friendly to foreigners, and the Chinese government has been taking steps to correct that by relaxing visas to many foreign countries, and also by allowing foreigners to pay by credit cards and cash. So, we start to see more foreigners in the Chinese cities as well.

And lastly, I noticed many Chinese corporates are increasingly focusing on sustainability by doing more ESG disclosure also. So even though the Chinese economy is still facing a lot of challenges, all these positive steps that were taken, make me more positive on the Chinese equities longer term.

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