C WORLDWIDE
ASSET MANAGEMENT

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China is too important to ignore

Key Insights

- Some investors have written China off. Some even consider the country uninvestable. However, many Chinese companies now lead their global sectors with promising prospects.
- A disastrous handling of the COVID-19 pandemic and a collapse in the Chinese real estate sector have caused consumer confidence in China to plummet, prompting investors to flee the Chinese stock market.
- The Chinese government, led by President Xi Jinping, has acknowledged the problems and is ready with bailout packages to turn the tide. If successful, a significant upside could await Chinese equities.
- A rising tide will not lift all boats; selectivity remains key. Emphasising stock picks with thematic and regulatory tailwinds remains the most appropriate investment mindset.

Marketing

For quite a long time, the dominant view of China among investors in the West has been negative. There are many valid reasons for that.

- Prolonged lockdowns and restrictions during the COVID-19 pandemic, combined with an uneven economic recovery, have reduced consumer spending and over–all optimism, dampening the outlook for businesses targeting the Chinese market.

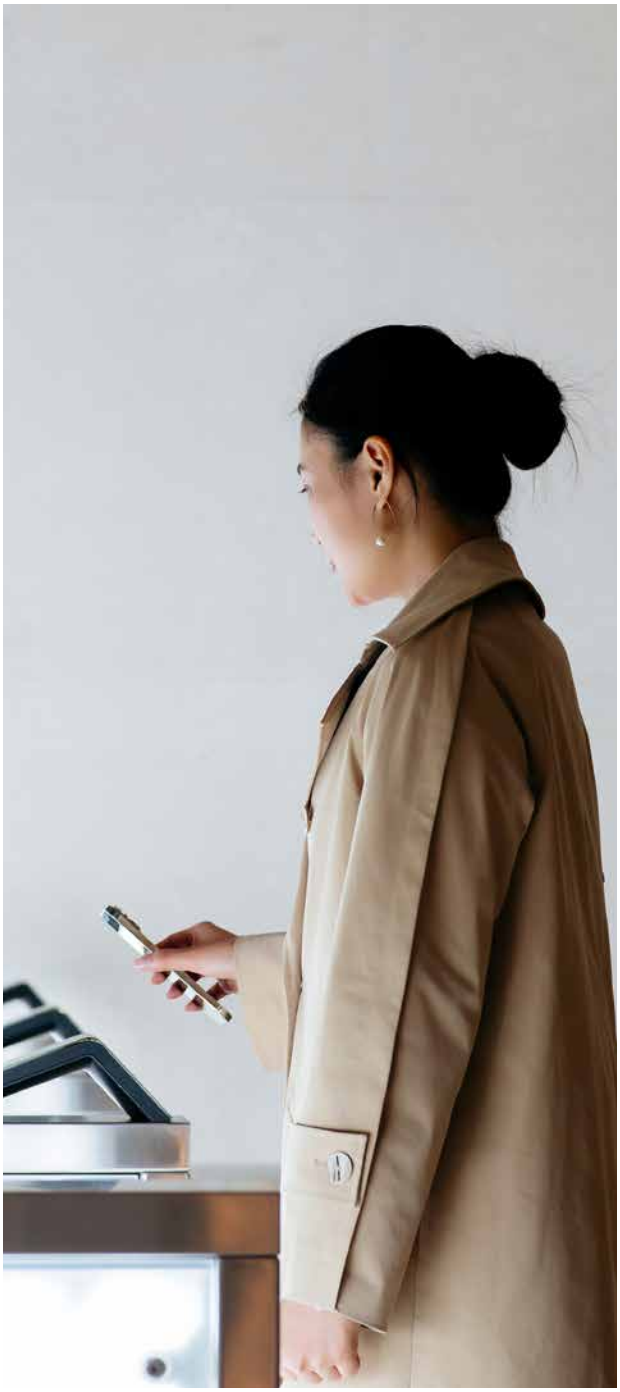
- The collapse of major property developers like Evergrande has exposed systemic risks in China's real estate sector, a critical part of the economy. This has shaken the stability of the financial system.

- Overall, China's economy has faced significant headwinds, including slower GDP growth, declining prices, and challenges in boosting domestic consumption.

However, it is essential to note that there is also a completely different story of corporate innovation in the shadow of all the negative stories. These are significant advancements that politicians and investors in the West almost entirely ignore. Indeed, it might even be too late, as Western markets could be flooded with new technology and innovative industrial products.

Decision-makers, business owners, and investors in the West consistently underestimate specific sectors where China is now a global leader. For example, in developing and producing wind turbines, solar panels, batteries, nuclear power plants, high-speed trains, drones, specialised materials, and, not least, electric vehicles. 70 % of the world's production of electric cars comes from China (11 million units in 2024 alone). These are complicated industries that require an advanced industrial economy. And China is far ahead in development and a leader in several fields.

Where do China's current industrial advancements come from? They rise, among other things, from a vast pool of a highly educated labour force com-



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bined with a well-consolidated banking system that can provide loans and finance new projects (Fig. 1). Japan, Korea, and Taiwan adopted a similar model decades ago during their rise to prosperity. The chart below illustrates that the surge in loans to industry over the past few years lies at the heart of China's booming industrial productivity.

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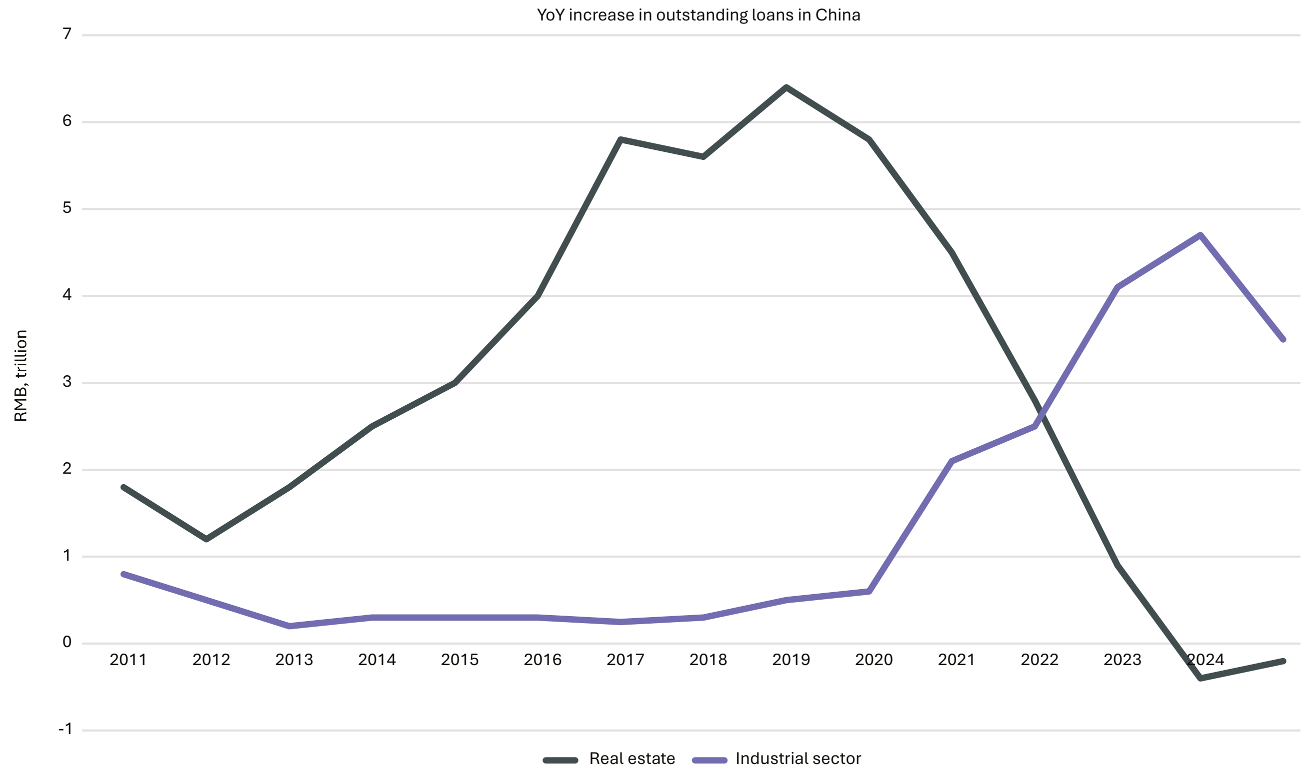
The Australian Strategic Policy Institute (ASPI), an independent think tank based in Canberra, has extensively researched global advancements in critical technologies. Their findings indicate that China has established a significant lead in numerous fields.

In March 2023, ASPI's Critical Technology Tracker reported that China was leading in 37 of 44 critical and emerging technologies. These include electric batteries, hypersonics, and advanced radio-frequency communications such as 5G and 6G. The United States was leading in seven, and Europe in none.

In August 2024, ASPI expanded its dataset from five years (2018–2022) to 21 years (2003–2023), now covering 64 critical technologies spanning defence, space, energy, the environment, artifi-

Figure 1

China's banks have dramatically increased their lending to industry



Source: Gavekal Research, October 2024

cial intelligence, biotechnology, robotics, cyber, computing, advanced materials, and key quantum technology areas.

China's development gained momentum in the mid-2010s (Fig. 2). In 2014, China surpassed Europe, and in 2016, it overtook the United States, continuing its rapid ascent while Europe and the United States moved in the opposite direction. We believe that this trend will continue.

China has also made new gains in quantum sensors, high-performance computing, gravitational sensors, space launch and advanced integrated circuit design and fabrication (semiconductor chip making). The development speaks for itself – China is way too important to ignore.

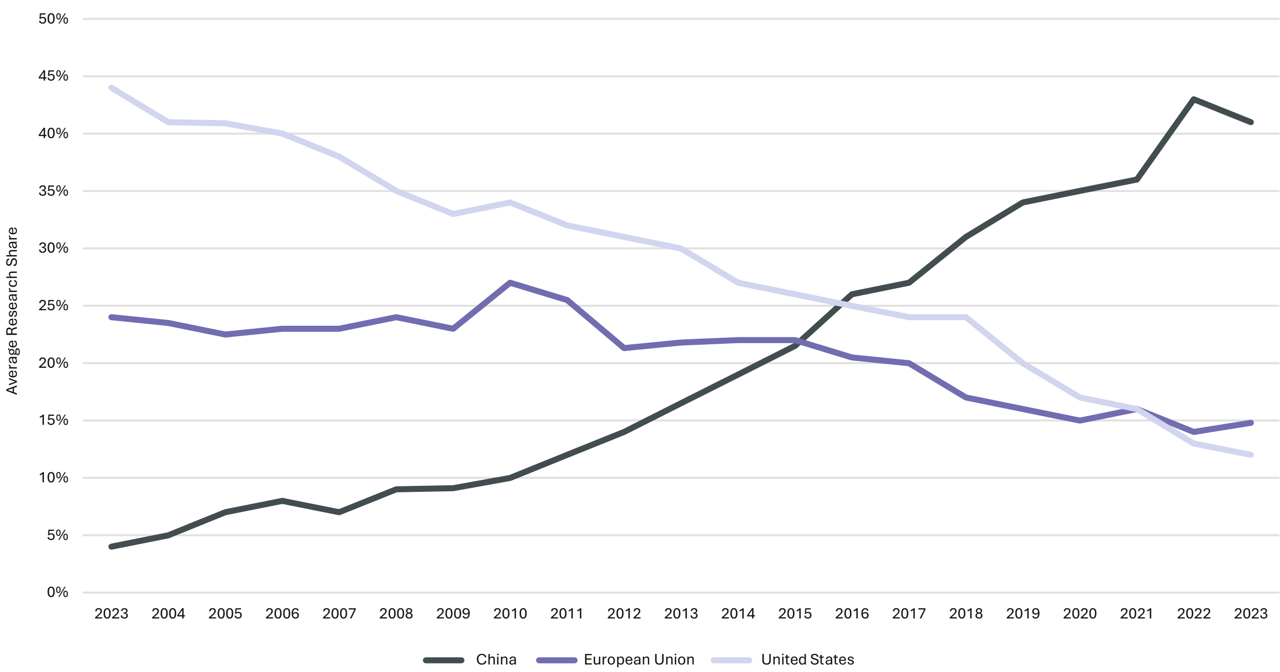
> **"DeepSeek's success story underscores China's growing technological prowess and ability to adapt to challenging circumstances.**

Necessity is the mother of invention

The rise of DeepSeek exemplifies China's remarkable ability to innovate and circumvent Western technology export restrictions, embodying the age-old adage that necessity is the mother of invention. Despite facing significant hurdles in accessing cutting-edge AI chips, Chinese engineers have demonstrated their ingenuity by developing advanced AI models that rival Silicon Valley giants but at a fraction of the cost. DeepSeek's success story underscores China's growing technological prowess and ability to adapt to challenging circumstances. This achievement showcases China's technological resilience and raises questions about the effectiveness of US export controls to hinder China's AI advancements. Its robust STEM education system further bolsters China's ability to innovate in adversity.

Figure 2

Research Leadership Inversion over 21 years



Source: ASPI Critical Technology Tracker, September 2024

China is projected to produce over 77,000 STEM PhD graduates annually by 2025, compared to approximately 40,000 in the United States[1]. This significant disparity in STEM talent production highlights China's long-term strategy to dominate the global technology landscape. As DeepSeek and other Chinese tech companies continue to push the boundaries of innovation, it is becoming increasingly clear that external restrictions will not easily constrain China's technological advancement.

Challenges along the road

As the introduction mentions, the Chinese economy has faced significant headwinds in recent years. In the fall of 2024, the Chinese government introduced a series of stimulus packages to jumpstart the economy, briefly boosting optimism. However, it has not been enough—consumer confidence in the country remains low, and far too many Chinese prefer saving over spending.

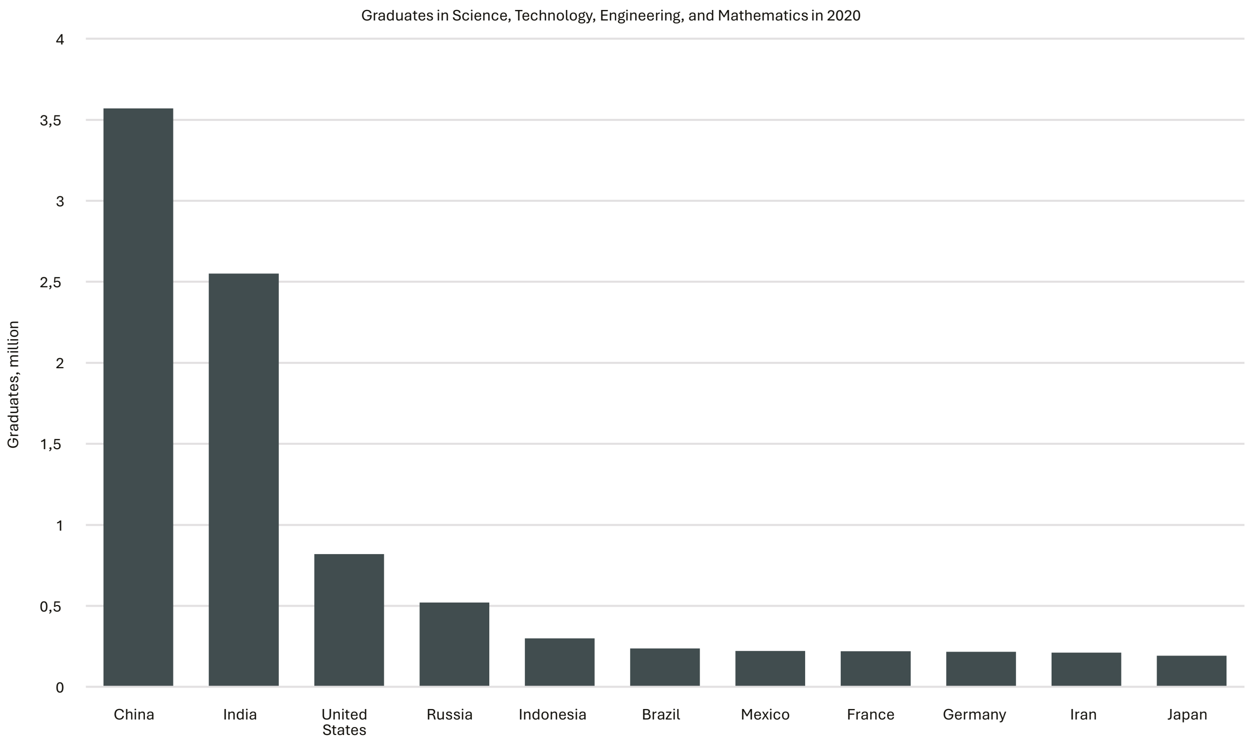
Therefore, the government, led by President Xi Jinping, is now focused on deploying more substantial measures to reverse the trend. Efforts are being made to create better conditions for entrepreneurs and private businesses. The government also aims to support urbanisation, as potentially 110 million households could move from rural to urban areas in the coming decades. This shift would also help stabilise the housing market, which has been in a significant crisis.

To boost domestic consumption, the efforts should include social reforms to support the long-term confidence of Chinese consumers:

- Expanding access to healthcare, pensions, and unemployment benefits to reduce

Figure 3

China produces as many STEM graduates as the next four countries



Source: OECD and the statistical yearbooks of Russia, Indonesia, Iran, India, and China

1 China is Fast Outpacing U.S. STEM PhD Growth

the need for excessive personal savings.

- Improving education subsidies and social insurance systems to increase a sense of financial security.

China's transformation aims to grow through high-tech investments, "smart" infrastructure, exports of high-quality goods, and a more potent domestic consumption engine. For Xi Jinping and his government, 2025 will be a decisive year when the tide must ideally begin to turn. Otherwise, Xi Jinping and the communist party will lose further credibility among the populace.

Trump as an unknown factor

Although there are many obvious investment opportunities in China, many investors in the West consider the geopolitical risks too high. One big issue is Taiwan. China considers Taiwan a Chinese province, while Taiwan, on the other hand, is fighting for its independence and sovereignty.

Additionally, many have excluded China from their investment universe due to ESG considerations. In particular, when discussing governance, there are concerns about the government's influence over corporations.

The election of Donald Trump as president of the United States has introduced yet another unpredictable factor. During Trump's previous presidency, a geopolitical clash emerged between the two superpowers. And already now, a new trade war has been announced.

It is too early to predict the consequences of a trade war between the United States and China, which will affect businesses and consumers in both countries, as Trump's policy actions are still unfolding.

However, China is prepared this time and has strengthened its alliances with its partners and many countries in the Global South. As a result, China is less vulnerable to potential actions or attempts at a full-scale trade war emanating from Trump.

Conclusion: Too important to ignore

The Chinese stock market has underperformed the US and MSCI indexes over the past 20 years. Government crackdowns on big tech, education, and financial firms have created turbulence and unpredictable risks.

On the other hand, Chinese stocks are now historically cheap (P/E close to 10-11x next year's earnings), and the country has undergone a significant transformation. China is no longer only a low-cost manufacturer but a global leader in AI, semiconductors, Electric Vehicles EVs), and fintech. Companies like BYD (EVs), Tencent (tech/gaming), Alibaba (e-commerce), and CATL (battery tech) are shaping the global market.

Large-cap Chinese companies, particularly in the tech and consumer sectors, have room to rebound as regulatory uncertainty increases. After years of regulatory crackdowns, many Chinese equities are trading at a discount compared to their US peers, making entry points attractive for long-term investors.

We consider China investable—too large and important to ignore, although sustained market performance depends on vital Chinese consumers and unfolding geopolitical events. Our stock selection approach, as always, remains very selective. We favour sectors and themes that align with government priorities and avoid those prone to sudden regulatory shifts.

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