Monthly commentary / 30.8.2024

Vontobel Fund II – mtx China A-Shares Leaders

Marketing document for institutional investors in: AT, CH, DE, ES, FI, FR, GB, IT, LI, LU, NO, SE, SG (Professional Investors only).

Market developments

Despite a very difficult start, August turned out to be a relatively good month for global equities with the MSCI World Index finishing up approx. +2.7%. Emerging market (EM) equities trailed developed markets during the month but managed to return a respectable +1.6% for the month. Volatility spiked at the beginning of the month, with weak US unemployment data sparking fears that the US Federal Reserve (Fed) has held interest rates at too high a level for too long, and that the world's largest economy is heading for a harder landing than was previously anticipated. In addition, a surprise rate hike by the Bank of Japan (BOJ) added to the market volatility at the beginning of the month. These macro events led the market to significantly sell off during the first two trading days of August before staging a rebound following the publication of more positive US economic data and reassuring comments from BOJ officials regarding future rate-hike decisions.

Chinese offshore equities have fared much better than their onshore counterparts during the year to date, and this is a trend we saw continue during August. The MSCI China Index returned +1.1% for the month compared to the MSCI China A Onshore Index, which was down -1.9%. The MSCI China A Onshore Index, eight sectors finished the month in negative territory. The worst performing sectors were information technology/IT, materials and industrials. Energy, financials and communication services were the three sectors to finish the month in positive territory.

Portfolio review

The mtx China A-Shares Leaders fund returned -0.1% for August, outperforming the benchmark by +1.8% for the month (gross of fees). Positive stock selection was the key driver of this outperformance, particularly within industrials and consumer discretionary. Allocation impact was also positive for the month, particularly due to our underweight position to IT.

The number of companies in the portfolio remained unchanged at 33 as of the end of August. We did not sell any existing holdings or initiate any new positions during the month.

Some of the salient points for performance in August are summarized below.

Performance analysis

Industrials: Following a difficult month in July, our industrials holdings had a much better month, outperforming the benchmark sector return by over +4%. Shandong Himile was the best performing stock in the sector.

Outlook

Despite the recent rally, sentiment towards China remains subdued due to its troubled real estate sector, lackluster real economic growth, and geopolitical and regulatory uncertainties. Policy and stimulus measures that resonate with the market appear vital before investor confidence in a sustained rally can increase.

Operations

Chinese corporates are estimated to post earnings growth of +12% in 2024, which compares favorably with earnings growth expectations in the developed world of +13%. However, this level of estimated earnings growth for Chinese corporates falls behind many of its EM (emerging markets) Asia peers with expectations of +25% earnings growth for South Korean corporates and +18% in Taiwan.

Earnings estimates for Chinese corporates remain unchanged at +12% in 2025, which is in line with estimates for both broader EM and developed markets. Once again, this estimate of earnings growth places China behind many peers in EM Asia such as Taiwan (+15%) and India (+15%).

Profitability margins, such as return on equity (ROE), are predicted to grow only slightly in 2024 and 2025 for the average company in the MSCI China index. We see a similar trend for companies in the China A Onshore Index, with estimated ROE for the average onshore company estimated to be +11.4% in 2024 and 11.8% in 2025.

Momentum

During the past three months, analyst earnings expectations for Chinese corporates have been pared back slightly for 2024 by -0.3%. This contrasts with the developed world where earnings expectations were revised upwards by +1.4%.

Valuation

Chinese equities continue to look relatively attractive compared to developed market equities, with 2024 earnings trading on a multiple of 9.2x and 2025 earnings trading at 8.2x. In comparison, developed market equities are trading at 17.3x for 2024 earnings and 15.6x for 2025 earnings.

On a Shiller P/E basis (the cyclically adjusted price-to-earnings ratio that adjusts 10 years of earnings for inflation), Chinese equities continue to trade at a significant discount to developed market equities. We believe this is a powerful signal that long-term investors should consider.

Growth

Real gross domestic product (GDP) expectations for EM economies are strong with consensus estimating that EM economies will grow by +4.3% in both 2024 and 2025. In comparison, expected real GDP growth in the developed world is +1.7% in both 2024 and 2025.

The biggest growth in real GDP expectations for 2024 continues to come from EM Asia with economies such as India (+6.8%), Indonesia (+5%) and China (+4.9%) expected to grow the fastest. This trend is expected to continue into 2025 with India once again predicted to be one of the fastest-growing economies in the world at +6.5%. Notably real GDP growth in China is expected to fall back to +4.5% in 2025.

Risk

Geopolitics and global trade: The US presidential election in November could be a significant event in terms of investor sentiment towards EM. A Trump victory could potentially bring substantial hikes in tariffs on Chinese imports and add to the simmering tensions surrounding global trade, as was recently highlighted by the EU's decision to hike tariffs on the import of Chinese electric vehicles.

Policy direction: The market has become used to piecemeal stimulus measures, with most believing significantly more is needed to shore up the confidence of the Chinese consumer. In particular, the issues in the real estate sector are not going away and need to be addressed in a meaningful way.

Fed up with inflation: Expectations for cuts in US interest rates have been significantly dialed back throughout the year, with many in the market now only expecting one to two cuts during 2024. While equity markets have performed well despite this setback, further upward pressure when it comes to inflation could prove to be a significant headwind for risky asset classes such as EM equities.

Recession on the cards? With US interest rates at a 20-year high, many have been surprised at how resilient the US economy has been. However, we know that the effects of monetary policy are lagged, and it is very conceivable that the US economy could fall into recession at some point. A deep recession in the US would be bad news for the earnings of EM corporates.

Regulation: The risk of unexpected regulatory changes remains a significant risk when investing in Chinese equities.

Flows

During the second quarter of 2024, “northbound” equity flows (i.e., flows into “onshore” equities, Shenzhen/Shanghai-listed stocks) were negative at approx. -29bn RMB (-$4bn). In the opposite direction, “southbound” equity flows (i.e., Hong Kong-listed stocks) were much stronger with flows of approx. +219bn RMB (+$30bn), according to flows data compiled by JP Morgan.

Looking at 2023, southbound flows finished the year at approx. +290bn RMB while northbound flows were much smaller at approx. +40bn RMB ($41bn versus $6bn). To put these figures into context, the median annual southbound/northbound net inflows since 2016 has been +292bn RMB / +204bn RMB. These figures, which are calculated by JP Morgan, show how much negative sentiment there has been towards domestic Chinese equities.

Fund characteristics

Fund name	Vontobel Fund II – mtx China A-Shares Leaders
ISIN	LU2262960185
Share class	I USD
Reference index	MSCI China A Onshore TR net
Inception date	31.5.2021

Historical performance (net returns, in %)

Time period	Fund	Ref. index
MTD	-0.4%	-1.9%
YTD	-4.9%	-4.5%
1 yr	-14.2%	-9.2%
3 yrs p.a.	-16.8%	-14.0%
5 yrs p.a.	–	–
10 yrs p.a.	–	–
ITD p.a.	-18.2%	-14.6%

Time period	Fund	Ref. index
2023	-17.8%	-11.7%
2022	-31.8%	-27.2%
2021	–	–
2020	–	–
2019	–	–
2018	–	–
2017	–	–
2016	–	–
2015	–	–
2014	–	–

Past performance is not a reliable indicator of current or future performance. Performance data does not consider any commissions and costs charged when shares of the fund are issued and redeemed, if applicable. The return of the fund may go down as well as up due to changes in the rates of exchange between currencies.

Investment risks

— The sub-fund's investments may be subject to sustainability risks. Information on how sustainability risks are managed in this sub-fund may be obtained from vontobel.com/sfdr.

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