Monthly commentary / 30.9.2024

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

After starting the month in negative territory, Chinese equities (MSCI China) rebounded to track just under +2% higher, spurred by an unexpected wave of stimulus measures from Chinese authorities aimed at boosting the world's second-largest economy. The initial announcement focused on reducing the main policy rate, cutting existing mortgage rates by 0.5%, lowering the down payment requirement for homebuyers from 25% to 15%, and injecting additional funds into local stock markets. Further market optimism was driven by the subsequent Politburo meeting, where officials reviewed the country's economic situation and discussed key policies to achieve its annual economic goals.

The market's reaction to this renewed determination was decisive, with the MSCI China Index jumping almost +24% for the month (China A onshore equities were also up approx. +23%). In comparison, US equities were up approx. +2.1% for the month. By the end of September, the MSCI China Index is approx. +7.5% ahead of the S&P 500 Index (+29.6% versus +22.1%) year-to-date. While Chinese onshore equities are trailing their offshore counterparts, they have still climbed to an impressive absolute return of +17.5%.

In terms of the MSCI China A Onshore Index in September, all sectors finished the month in positive territory, with the strongest performances coming from real estate, financials, and consumer staples. Although positive, utilities and energy were the clear laggards for the month.

Portfolio review

The mtx China A-Shares Leaders fund returned +24.3% for September, outperforming the benchmark by +1.2% for the month (gross of fees). Positive stock selection was the key driver of this outperformance, particularly within financials. Allocation impact was negative for the month, due to our underweight positions to real estate and IT.

As of the end of September, the number of companies in the portfolio was slightly lower at 32. During the month, we sold out of our holding in Wuxi Lead Intelligent Equipment (industrials).

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

Performance analysis

Financials: Our financials holdings enjoyed a very strong month thanks to Ping An Insurance Group and East Money Information. In particular, East Money was up almost +90% for the month given that one of the primary purposes of the stimulus measures is to restore investor confidence in the Chinese stock market. Given East Money's business model, this led to an extraordinary reaction in the share price.

Consumer staples/discretionary: Elsewhere, Kweichow Moutai (staples) and Haier Smart Home (discretionary) also benefitted from the stimulus measures and the possibility of a more confident Chinese consumer. In the case of Haier, the market had renewed optimism that domestic appliance manufacturers would benefit from a more confident Chinese consumer and efforts to restimulate the real estate sector were also beneficial to companies like Haier.

Outlook

The decisive efforts by Chinese authorities to reinvigorate the world's second-largest economy has provided a welcome boost to Chinese equities. While challenges remain and many continue to question how effective the measures will ultimately prove to be when it comes to stimulating demand, Chinese equities continue to stand out in terms of a relative valuation opportunity.

Operations

Chinese corporates are estimated to post earnings growth of +11% 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 +30% earnings growth for South Korean corporates and +17% in Taiwan.

Earnings estimates for Chinese corporates are also at +11% 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 (+16%), Indonesia (+15%) and India (+14%).

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% in 2024 and +11.4% in 2025.

Momentum

During the past three months, analyst earnings expectations for Chinese corporates in 2024 have increased by +0.5%. This contrasts with the developed world where earnings expectations were revised upwards by +1.1% and +0.7% within wider emerging markets.

Valuation

Despite the strong performance during the third quarter, Chinese equities continue to look relatively attractive compared to developed market equities, with 2024 earnings trading on a multiple of 9.6x and 2025 earnings trading at 8.7x. In comparison, developed market equities are trading at 20.6x for 2024 earnings and 18.3x for 2025 earnings.

On a Shiller P/E basis (the cyclically adjusted price to earnings ratio that adjusts ten 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 +3.9% in 2024 and +4.3% in 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 (+6.9%), Indonesia (+5%) and China (+4.8%) 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 +6.6%.

Risk

China stimulus: Chinese authorities positively surprised markets with a bumper stimulus package of measures announced in September. While the initial market reaction has been very positive, there is a risk that this fails to stimulate sufficient demand and return confidence to the Chinese consumer. In such a scenario, the sustainability of a recovery in Chinese equities would be called into question.

Red or blue? The US Presidential election in November will likely play a key role in determining investor sentiment towards EM equities during the final quarter of the year. A potential return of Donald Trump to the White House is generally considered a negative for EM equities, particularly given his policy pledges around hiking tariffs on Chinese imports.

Hard or soft landing? In an extension of the previous risk, a hard landing for the US economy would likely prove to be a negative for the earnings of EM corporates. While the US economy does appear to be slowing but resilient, 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. The magnitude of this slowdown is the key question.

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

Flows

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	24.2%	23.1%
YTD	18.1%	17.5%
1 year	8.9%	13.9%
3 yrs p.a.	-11.0%	-7.9%
5 yrs p.a.	–	–
10 yrs p.a.	–	–
ITD p.a.	-12.3%	-8.8%

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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