# New Capital China Equity Fund

Quarterly Commentary | As of 30 September 2024

## Market overview

The third quarter of 2024 experienced a sustained rally in global equity markets, despite occasional volatility and economic uncertainties. The MSCI World Index and the MSCI All Countries Index showed consistent gains, with year-to-date returns of 19.1% by the end of September.

The quarter opened with a change in investor sentiment in July. Soft US CPI inflation numbers led to the anticipation of a Federal Reserve funds rate cut, prompting a move from mega-cap tech stocks to US small-cap stocks. Reflecting a weakening in the US economy, bond markets rallied, with yields on US Treasury bonds falling to the lowest in more than a year.

August witnessed a continuation of the equity rally, but volatility increased due to fears of a looming US recession and changes in Japanese monetary policy. These concerns added to geopolitical tensions and the prospect of monetary easing and contributed to extending the gold price rally.

September brought new all-time highs for global stock markets. The Federal Reserve started easing interest rates, shifting its focus from inflation control to supporting the labour market and economic growth. Chinese authorities announced measures to stimulate their economy and declining oil prices provided further market support. Throughout the quarter, all major developed market currencies and the yuan renminbi recovered against the US dollar.

The outlook at the end of the quarter is supported by the expectation of a prolonged period of monetary policy easing and moderate bond yields.

In the third quarter of 2024, the MSCI China All Shares Index rebounded by 23.2%. As of September 24, the index was roughly flat quarter-to-date, with a rapid rally in the last week following unprecedented stimulus policies from the People's Bank of China (PBOC) on February 24 and a pivotal policy shift signaled by the September Politburo meeting. This marked the first such shift since 2022, aimed at restoring economic growth.

The divergence between A shares and H shares persisted, with the CSI 300 up 16% for onshore markets and the Hang Seng Index rising 20% offshore. Notably, onshore performance was capped by a technical shutdown of the Shanghai exchange due to trading volume overload and pricing limits. There is potential for onshore performances to catch up following the National Day holiday in October.

The offshore Renminbi depreciated to the critical level of 7.3 in July, driven by weakening economic fundamentals and a strong US dollar. It appreciated quickly to 7.0 after a 50 basis points Fed rate cut and China's policy pivot in the last week. Similarly, the yield on 10-year Chinese government bonds hit an unprecedented low of below 2% due to weak fundamentals and lack of policy visibility in early October but surged to 2.3% after Beijing's policy shift. This quarter was notably marked by China's surprising policy pivot in late September.

As of mid September, high-frequency data suggests a rising probability of missing the 2024 GDP growth target, with a significant fiscal budget gap highlighting economic distress. Onshore markets have declined for three consecutive months since May, with the CSI 300 returning to levels seen in February. On September 24, the PBOC (People's Bank of China) announced unprecedented policy support, including comprehensive monetary stimuli and new tools for stock market support. These measures exceeded market expectations and signaled improved communication and coordination among government departments.

Politburo's strong signal of support for economic growth further underscores the urgency of the situation. The meeting's timing and focus on economic issues highlight Beijing's prioritization of economic stability and growth, with expectations for additional fiscal and demand-side policies in the near term. The follow-up execution of these policy pivots has been impressive, with clear directives and coordination across departments to support economic recovery.

## Fund performance and positioning

In the third quarter of 2024, the Fund underperformed the benchmark by 9.6 percentage points. Until mid-September, the Fund's performance was roughly in line with the index. However, the major drag during the market reversal stemmed from several factors:

1. Market dynamics: In sharp market rebounds, high-quality companies tend to underperform in comparison to lower-quality ones. Similarly, companies with relatively strong fundamental trends and visibility, which we overweighted, underperformed those with weakening fundamentals, which we underweighted.
2. Cash holdings: Our cash holdings also contributed to underperformance during the rally.
3. Defensive positioning in Financials: We maintained a defensive stance, with no exposure to brokers - the best-performing industry. Instead, we were overweight in high-yield major banks. We also overweight property and casualty insurance, which offer more long-term structural opportunities and higher quality than life insurance, which is more sensitive to capital market movements.

Recognizing the positive policy pivot since September 24, we began to reduce cash holdings and increased our positions in companies we think will benefit from policy changes. We also adjusted our strategy in the financial sector and by the end of September, we were comfortable with our positioning. The market began to show some recovery in the relative performance of quality and fundamentals. By the first week of October, we had recovered over 2 percentage points of relative performance.

Looking ahead, we will continue to closely monitor policy details, fundamental developments and the valuation of our holdings and market opportunities. We acknowledge that this is a pivotal and rapidly evolving period for the China market.

| | New Capital China Equity Fund | MSCI China All Shares Net Total Return | Difference |
|---|---|---|---|
| 1 Month | +19.45% | +23.19% | -3.74% |
| 3 Months | +12.74% | +22.30% | -9.56% |
| 6 Months | +19.37% | +26.80% | -7.43% |
| YTD | +15.50% | +25.09% | -9.59% |
| 1 Year | +13.57% | +21.79% | -8.22% |
| 3 Years | -44.16% | -20.50% | -23.66% |
| 5 Years | -3.44% | +0.57% | -4.01% |
| 10 Years | +11.07% | +30.47% | -19.40% |
| Since Inception Annualised | +3.53% | +3.88% | -0.35% |
| Since Inception (20/08/2012) | +52.30% | +58.60% | -6.30% |

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## Outlook

The recent policy pivot is a significant positive for the valuation of Chinese equities. For the first time since 2022, we are witnessing meaningful policy stimulus from Beijing, highlighted by a clear statement of support from the Politburo and the PBOC's unprecedented move to include equity on its balance sheet. Despite these developments, Chinese equities continue to trade at a historically high discount compared to the US and other emerging markets.

This development reinforces our long-held view that while long-term structural issues, such as the property market, are well-known, there remains room for policy improvement. As the world's second-largest economy, China's growth continues to play a critical role in global demand and supply chains, making it a focal point for investors.

In the near term, our attention is on the specifics of fiscal policies and the injection of Tier 1 capital into major banks. Although the size and application of these funds have yet to be confirmed, they hold significant implications for the divergence of investment opportunities.

We also observe notable differences from previous cycles. Unlike prior stimulus efforts in China, the property sector is expected to play a smaller role, while other areas, particularly consumption, are likely to take on greater significance. We believe these differences will present new investment opportunities for investors.

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