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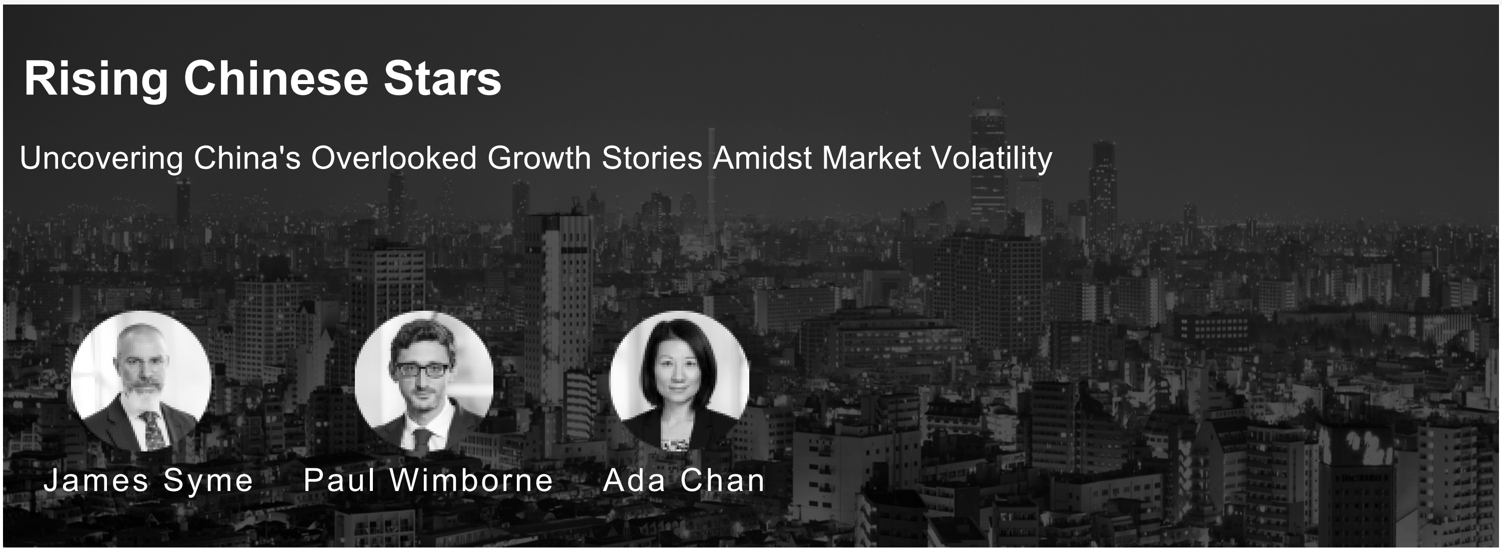
News



13 Nov 2023

One of our core conceptions about the exploitable opportunities within emerging market equities is that the asset class is dominated by bottom-up investors who, in the aggregate, alternatively underreact and then overreact to top-down developments. Sometimes, that over-reaction function can occur to the downside when groups of stocks within markets sell off indiscriminately on top-down concerns to levels that are unjustified. We believe that is happening within parts of the Chinese equity market and that real opportunities are being presented at these price levels.

To be clear, this is not a view that the China equity index is set to outperform the broader emerging market benchmark. The country’s core problems, where politically driven decisions have materially negative economic effects, remain. The property sector continues to struggle, and the loss of market share in US imports will not easily be regained.

However, our process is designed to be alert to top-down opportunities within countries as well as the top-down opportunities of countries. Chinese retail sales in September were 5.5% YoY, but that broad measure hides some real strength in particular segments: restaurant/catering sales were 13.8% YoY and tobacco/alcohol sales were 23.1%.

Tsingtao Brewery is held in the portfolio. The company is China’s second largest brewer, with a 15% domestic market share. As well as benefiting from the cyclical recovery, Tsingtao is a beneficiary of the down shifting of Chinese consumers away from more expensive foreign brands into the company’s own premium brands, and also of a political preference for domestic brands. In recent results, the company showed strong growth in average selling prices and margins. In the first nine months of 2023, the consensus forecast for the company's forward earnings rose 30.5%, but the stock itself declined 16.8%, putting the stock at an all-time low P/E ratio.

Another example would be Trip.com. This company is China's dominant domestic online travel agency, providing full travel booking services domestically but also internationally. Again, the company is performing very strongly. Chinese Valentine's Day in late August saw booked hotel room nights reach a record high, the third quarter of 2023 saw profitable results from all listed Chinese airlines and revenue per room reach a record high for Chinese hotels. The shift online was hugely accelerated during the pandemic, helping Trip.com gain market share and achieve economies of scale reflected in rising margins. As well as domestic and international tourism, recovery in China in music festivals, business conferences and exhibitions should remain supportive. Yet, in the first nine months of 2023, the consensus forecast for the company's forward earnings more than doubled, but the stock itself declined slightly.

Elsewhere in the consumer e-commerce space, Meituan's continued success as a business seems to be being ignored by equity markets. The pattern is the same at online giant Tencent. Tencent's underperformance is particularly stark given the current global investor enthusiasm for stocks with AI exposure. Tencent is likely to be a global leader in the space, combining its existing technological strengths with a major investment program in a Chat-GPT-style Large Language Model. You wouldn't know that from the share price though.

This is not a 'buy-the-dip' argument – we do not trade price signals. It is not a deep value argument – we remain growth-at-reasonable-price investors. But what we are seeing within the Chinese equity market are stocks with supportive top-down conditions, strong and steady earnings growth, upbeat results and guidance from management, and valuations that look attractive relative to peers and to the stocks' own valuation histories. As always with our process, it is crucial for the top-down and bottom-up investment cases to align.

Source: JOHCM/Bloomberg

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