Prescient
CHINA

PRESCIENT CHINA QUARTERLY COMMENTARY

2024 Q3

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THE TURNING POINT WE'VE BEEN WAITING FOR

Thinking back to events in China during the third quarter of 2024, no one could have expected how different the market would have been before and after September 24th, when the Chinese central bank, the People's Bank of China (PBoC), introduced substantial monetary stimulus.

It took the markets a few hours to digest the news before equities experienced the quickest and most significant rally, even for a market as volatile as China. The CSI 300 Total Return Index rallied 25.8% in US dollar terms between 24 and 30 September, a mere five trading days. The five-day rally helped the index deliver a robust 21.9% US dollar return for the quarter. Offshore Chinese equities also rallied, with Hong Kong's Hang Seng China Enterprises (HSCE) Total Return index similarly returning 21.8% in US dollars over the same five trading days.

Our flagship Prescient China Balanced Fund continued its robust performance during the quarter, returning 23.1% net of fees, 7.6% ahead of the reference 65/35 equity/bonds index, and an annualised outperformance of 34.0%.

After 3.5 years of painful declines in the Chinese markets, this past quarter reminded us how quickly China can recover once investor sentiment changes. We had been saying for many months that fundamentals were extremely attractive, with policy supportive; all we needed was a shift in overall sentiment. The markets remain volatile, but the clear policy shift from the Chinese authorities and focused efforts to revive both local and global investor sentiment has been a very solid first step in China's recovery journey.

CHINA IS BACK - FINALLY

CHINA'S "WHATEVER IT TAKES" MOMENT?

On September 24, 2024, the PBoC unveiled a broad monetary stimulus package to invigorate the Chinese economy and stock markets. Individually, none of the newly announced monetary stimulus measures were particularly groundbreaking. However, the simultaneous introduction of multiple initiatives, combined with the assurance of further support, if necessary, made a significant impact. While the PBoC may not have the same monetary arsenal as the US Federal Reserve, the measures are probably as close to "whatever it takes" as we have seen.

Key stimulus measures announced by the PBoC Governor included:

- Lowering mortgage rates: Commercial banks are guided to reduce interest rates on existing mortgages by an average of 0.5%, expected to save CNY 150 billion (ZAR 367 billion) annually.

- Funding unsold properties: The PBOC will fully fund local governments and state-owned enterprises (SOEs) to buy unsold properties up to CNY 300 billion (ZAR 734 billion).

- Boosting market liquidity: A 0.5% cut in the reserve requirement ratio (RRR) is expected to inject CNY 1 trillion (ZAR 2.5 trillion) into the financial system, with the potential for further cuts.

- Interest rate adjustments: The seven-day reverse repo rate has been reduced by 0.2%, bringing it to 1.5%, while the one-year rate has been cut by 0.3% and is now standing at 2%.

- Stock market support: Financial institutions will receive CNY 500 billion (ZAR 1.2 trillion) in funding to purchase stocks, along with CNY 300 billion (ZAR 734 billion) in low-cost financing (around 2.25%) for listed companies and shareholders to buy back shares.

    - Commitment to further support: If the initial round proves effective, additional rounds of CNY 500 billion + 300 billion are promised.

During the same press conference, the China Securities Regulatory Commission (CSRC) chief confirmed that state-backed financial institutions will also increase long-term investments in the stock market. Further details will follow.

Investors reacted positively and strongly, driving both the onshore CSI300 and offshore HSCE indices up by more than 4% on the day, with gains continuing during the week as rumours of further fiscal support for both the property and retail sectors did the rounds. Between Tuesday, 24 September, and Monday, 30 September, the CSI300 Total Return index gained a total of 25.8% in US dollars before closing for the Chinese National Day holidays until October 8th. While onshore A-share markets were closed, the Hong Kong markets continued to rally, and by October 7th, the HSCE Total Return index had gained 30.7% since September 24th, a mere nine trading days. These moves marked the fastest rally in Chinese equity markets since before the 2008 global financial crisis, reflecting renewed market confidence in the effectiveness of the stimulus measures – surpassing the impact of previous supportive efforts since the end of China's strict zero-Covid policies

WHAT ABOUT FISCAL STIMULUS?

During the same week, the PBoC's monetary stimulus measures were announced, and rumours of fiscal stimulus of a similar magnitude were widely reported. Numbers ranged between CNY 2-3 trillion (ZAR 5-7.5 trillion) of long-term sovereign bond funding to support local government debt issues, recapitalise large banks and stimulate retail consumption. These rumours fuelled the rally alongside the confirmed monetary measures until the onshore A-share markets re-opened on October 8th. On the morning of October 8th, markets turned up their volatility dial after the highly anticipated National Development and Reform Commission (NDRC) announced a mere CNY 200 billion support package. Investors were hugely disappointed because the NDRC announced only the initial details of fiscal support measures rather than the "full package". Volatility ensued until the Ministry of Finance (MoF) managed to help calm the markets with more clarity on policy direction on the weekend of October 12th.

Although details were still lacking, there was specific mention of CNY2.3 trillion of local bond funding available for the rest of 2024, which was seen as positive. Emphasis was placed on the central government's "relatively large" capacity to increase the government budget deficit and issue more long-term debt to stabilise the bond and property markets and recapitalise the banking sector.

Measures to stabilise the property sector and recapitalise banks are largely in line with reported rumours in terms of policy direction. The latest rumours, as reported by highly respected financial media outlet Caixin in mid-October, puts treasury bond issuance over the next three years at CNY 6 trillion to support the economy, higher than all previous estimates. Regardless, we expect fiscal support to be significant enough not to disappoint the markets over the cycle.

With much speculation surrounding possible fiscal support figures, markets keenly await the NPC Standing Committee meeting later in October because it was at this event last year that additional sovereign debt was approved, and we are expecting similar announcements this year.

STEADY & SUSTAINED

Spectacular rallies like the one we saw in China in late September and early October are almost always unsustainable. An average daily gain of around 4% (a daily increase China averaged over almost 2 weeks) will bring about a return of 128% in a month with 21 trading days. There is a reason why we don't see such monthly returns. We believe markets got too optimistic too quickly, and the minor correction experienced so far in October will be healthy for the long-term sustained recovery of the Chinese equity markets. The last thing investors need now is a 2015-style boom and bust where most participants in the rally eventually ended up losing significant amounts of money.

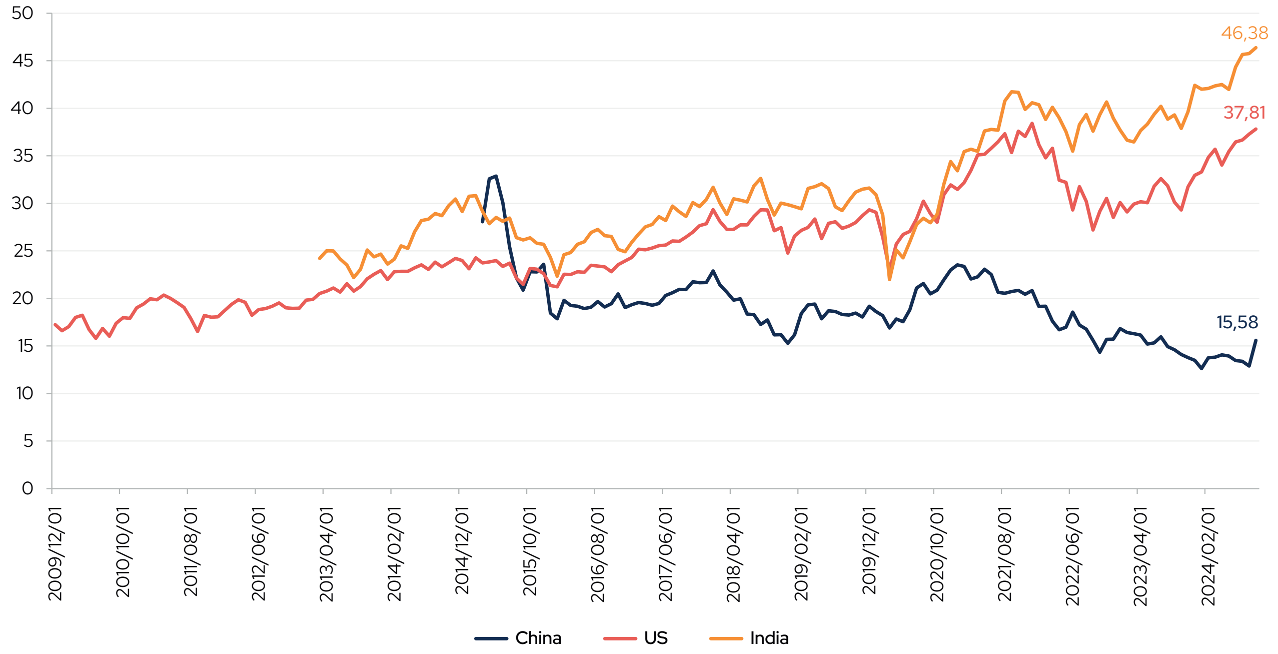
The policymakers appear to want the same; they have repeatedly communicated the need for high-quality economic and market growth, focusing on attracting long-term investors rather than short-term speculators. Policy direction has taken a significant positive shift, with all policymaking departments now combining efforts to support a more sustained economic and financial market recovery. As follow-up fiscal support measures are announced, likely on a pre-planned schedule, we expect to see reduced market volatility followed by steady and sustained growth in both the onshore and offshore Chinese stock markets.

IS IT TOO LATE TO INVEST?

The noise around China's prospects continues to preoccupy global media outlets, many of which suggest the prospects of China as a nation depend entirely on the momentum of the Chinese stock market. Extreme narratives varied from China being uninvestable and being too expensive as the rally has "gone too far" to China being the "go-to" market after the recent rally and the best opportunity in a decade.

Many investment banks upgraded China after the September rally, only to see it start falling again. While market views may be subjective, data points are not. We continue to believe it is now a once-in-a-decade, if not a once-in-a-lifetime opportunity to allocate to China. On a cyclically adjusted basis, Chinese onshore A share valuation multiples are not only close to their historical lows, but they are also trading at more than a 60% discount to US and Indian equities on average, AFTER the most recent mini-rally.

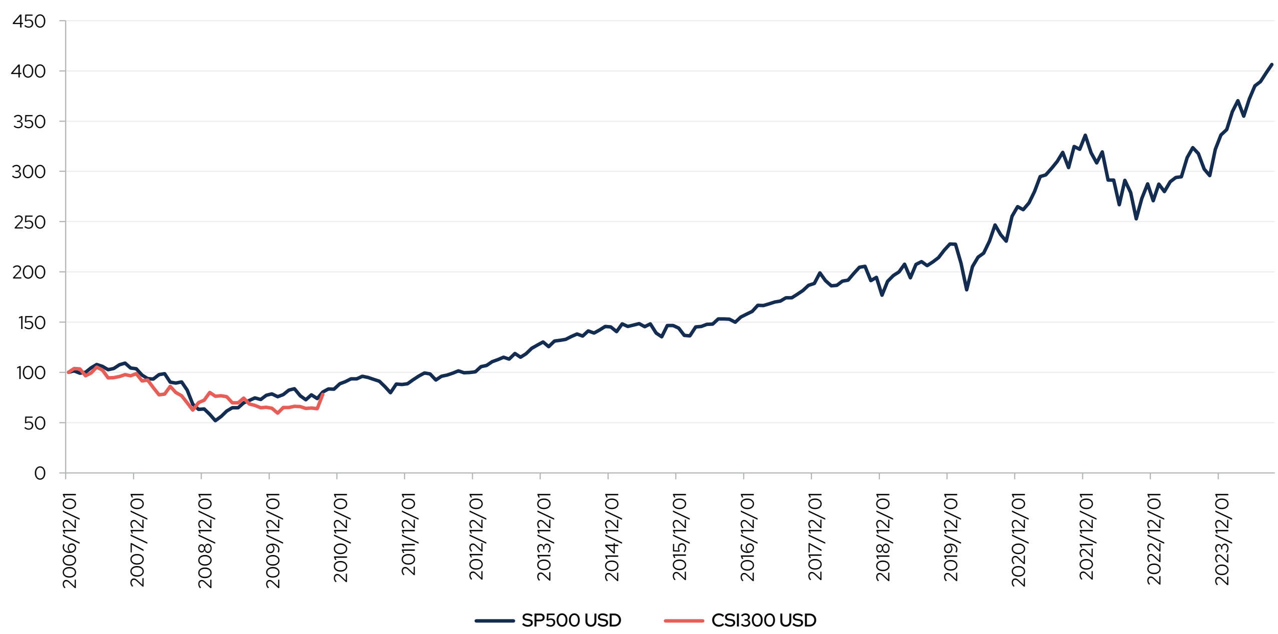
Figure 1: Cape Ratio China vs Peers



Source: Prescient, Bloomberg (as at 30 September 2024)

For those still worried they have missed the rally, Figure 2 shows an interesting comparison between the CSI300 Index since 2021 and the S&P500 Index of 2007's crash and recovery.

Figure 2: CSI300 since Dec 2020 vs S&P500 since Dec 2006 - USD rebased



Sources: Prescient, Bloomberg (as at 30 September 2024)

Rewinding back to the S&P500's post-global financial crisis recovery from 2009 onwards, the QE program was quite controversial at the time, with strong opponents saying it would not work. By early 2010, there were fears that the S&P500 had recovered too quickly, and the economic costs of QE would be painful, including experiencing significant bouts of inflation. With the benefit of hindsight, those who continued to hold onto US equities continued to receive spectacular returns. QE not only buoyed sentiment but also improved the real economy.

Once the real economy bounced back, earnings came through, resulting in a decade-long bull market. Inflation only arrived a decade later, with the help of a global pandemic. The CSI300's bear market over the past 3.5 years and its recent mini-rally look strikingly similar to the S&P500's 2007 to 2010 journey during a once-in-a-century property collapse. Consistent, supportive policies and economic improvements are leading us into a virtuous cycle. The Chinese government's latest actions demonstrate that they understand the importance of boosting spending and lifting sentiment within the economy.

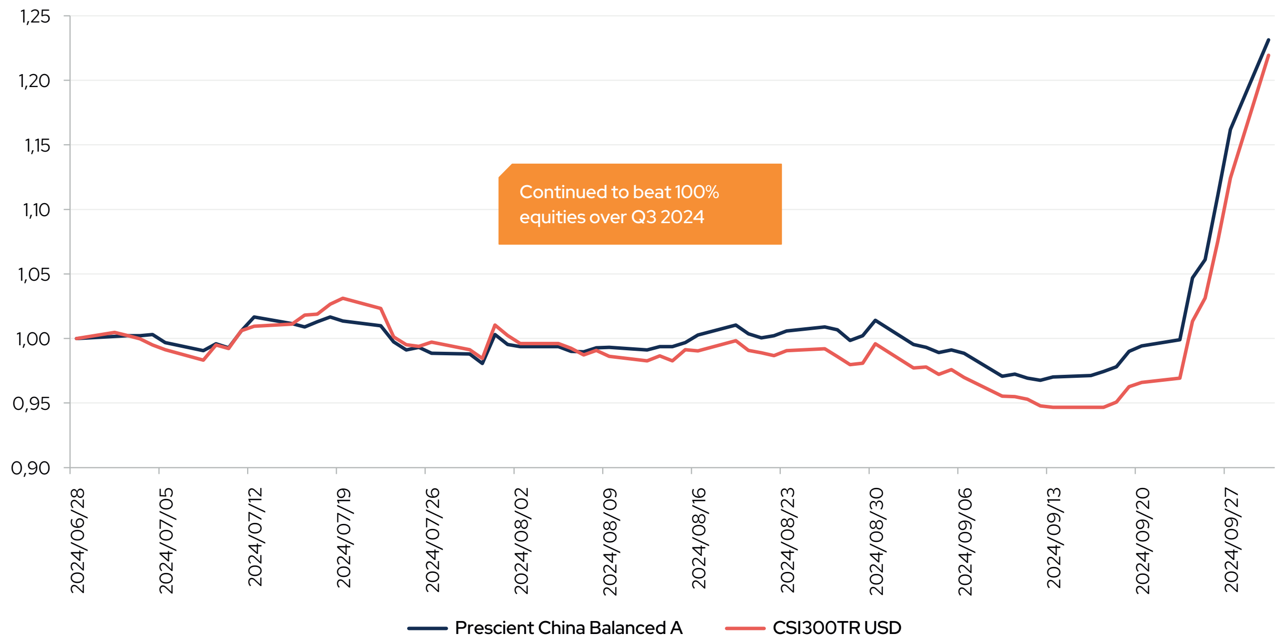
Policymakers in China are focused on not repeating the errors of Japan three decades ago. With a Fed cutting cycle expected to decrease pressure on both interest and exchange rates, supportive fiscal and monetary policies will only add fuel to a recovering economy. While caution is always advised, we believe there is a strong case for additional allocations to Chinese equities at this time.

PRESCIENT POSITIONING & PERFORMANCE

PRESCIENT CHINA BALANCED FUND

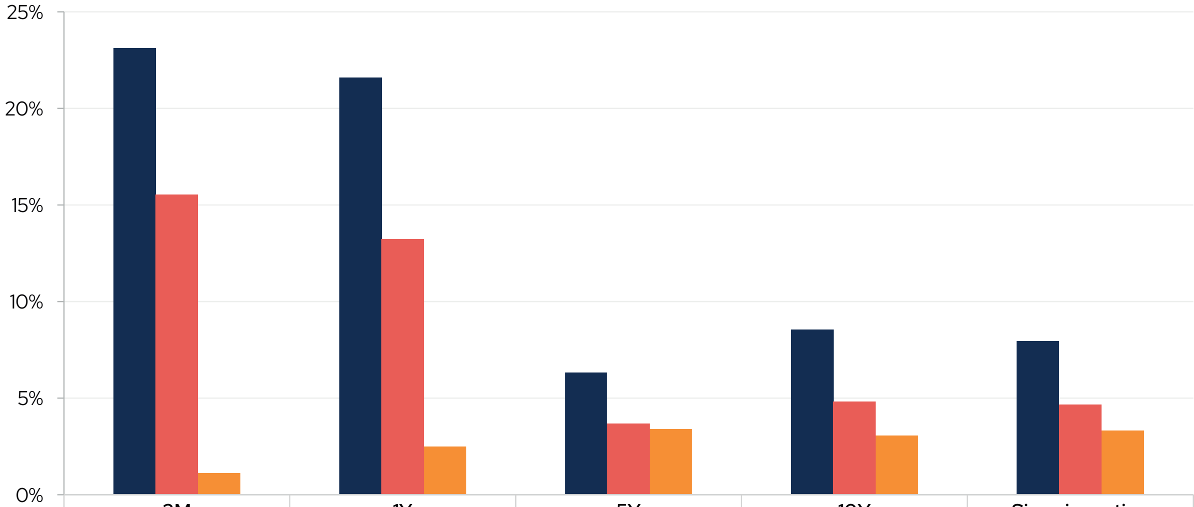
Our flagship Prescient China Balanced Fund continues to be our star performer. Over the quarter, we continued to manage our asset allocation and protection structures dynamically to maximise upside exposure while strictly managing downside risk and overall portfolio volatility. The fund returned 23.1% in USD terms, a full 7.6% ahead of the reference 65/35 Equity/Bonds index. Compared to 100% equities, the fund not only managed to keep up but outperformed with over 100% of equity market upside, exceeding the returns of the CSI300 Total Return index by 1.2% over the 3-month period as demonstrated in Figures 3 & 4 below.

Figure 3: Prescient China Balanced Fund - USD A Class Net



Sources: Prescient, Bloomberg (as at 30 September 2024)

Figure 4: Prescient China Balanced Fund - USD A Class Net



	3M	1Y	5Y	10Y	Since inception
Fund	23,13%	21,61%	6,33%	8,56%	7,97%
Composite 65/35	15,54%	13,24%	3,68%	4,82%	4,68%
CPI+3	1,14%	2,50%	3,39%	3,08%	3,34%

Fund   Composite 65/35   CPI+3

Sources: Prescient, Bloomberg (as at 30 September 2024)

Composite: 65% CSI300 and 35% CSI1Bond

Inception date: 31 March 2013

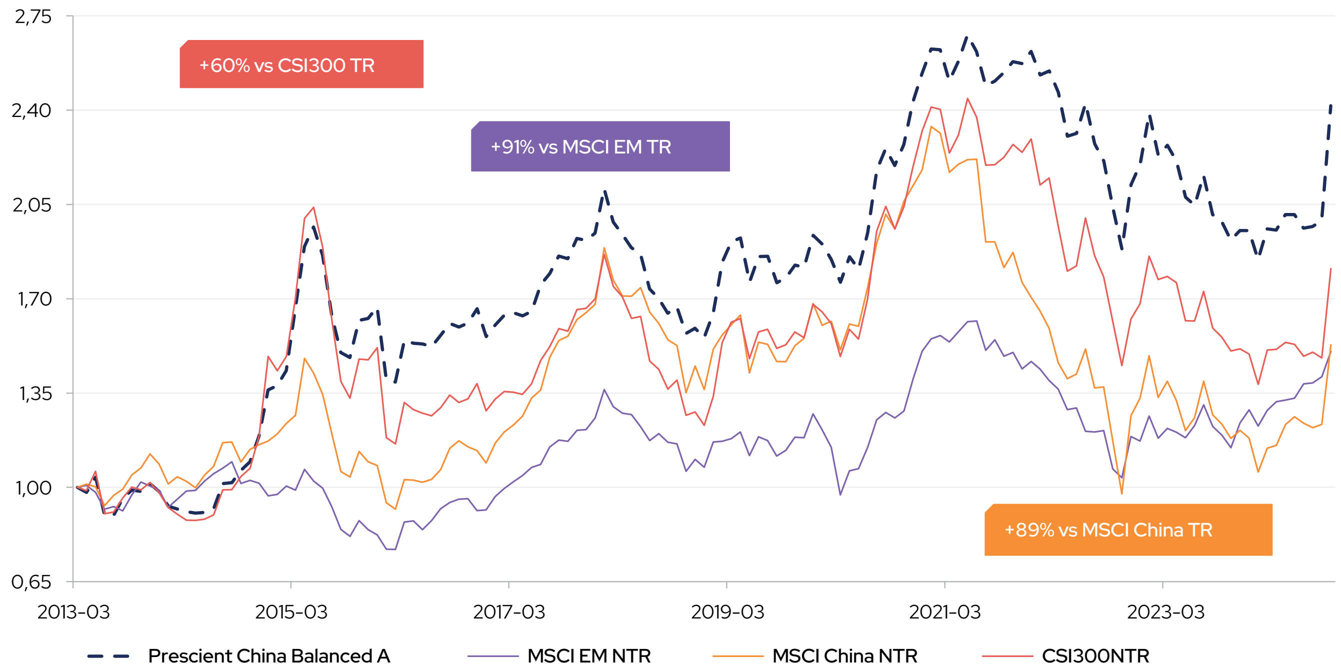
Note: Figures may differ from MDD due t o rounding.

	Fund	Benchmark
Highest rolling 1 year	116.81	17.08
Lowest rolling 1 year	-26.97	-7.82

Over the long term, our track record remains consistent in achieving strong real returns for investors throughout the cycle. In doing so, we have also managed to outperform the main equity indices in the region by wide margins, all net of fees. Since inception in March 2013, we have outperformed:

- the CSI300 Total Return Index by 60%
- the MSCI Emerging Markets Total Return Index by 91%, and
- the MSCI China Total Return Index by 89% as of the end of September 2024

Figure 5: Prescient China Balanced Fund - USD A Class net



Sources: Prescient, Bloomberg (as at 30 September 2024)

Given that valuations remain extremely attractive, even after the recent mini-rally, and that the overall policy stance has clearly shifted from "mildly positive" to "aggressively positive" in our view, we are maintaining our aggressive positions in our Prescient China Balanced Fund. We expect sentiment to continue to be volatile in the short term. As a result, we continue to hold derivative structures in the fund to reduce downside volatility. As more fiscal and general economic support measures are announced, we expect sentiment volatility to reduce and turn sustainably positive. A steady and sustained market recovery is looking more and more likely. Regardless, we continue to maintain our robust investment process in navigating the Chinese financial markets for our clients.

IN OTHER NEWS

With all eyes on Chinese stimulus policies, some of us might have lost track of how the Chinese economy is actually performing. Recent numbers have continued to be in lukewarm territory:

- CPI and PPI figures continue to be a concern, with CPI up +0.4% YoY in September and PPI down -2.8% YoY
- Consumer sentiment remains low, but the recovery is steady. October 1st National Day holiday tourism revenue figures continued to beat pre-pandemic levels. Total tourism spend/revenue reached CNY701 billion, 6.3% higher than 2023 and 7.9% higher than 2019.
- PMI numbers are marginally deteriorating, with the latest (pre-stimulus) private sector-weighted Caixin Services PMI dropping to 50.3

The significant positive shift in policy support from the Chinese authorities has been hugely welcomed. Our previous concerns that mediocre economic numbers were not “bad enough” to warrant massive stimulus have dissipated. Recent events in China have proven again how quickly and firmly investor sentiment can turn in the country. The cost of waiting on the sidelines can easily result in lost upside in the double digits.

With valuations remaining extremely attractive even after the recent rally, the latest mini-correction offers investors a window of opportunity to begin buying or adding to their China allocation. Of course, we would always advise against taking the concentrated large bets on China we have seen in the market recently, even if the potential upside may be huge. A better approach is a managed and risk-controlled allocation process to add to China’s exposure in a portfolio.

We are excited that the much-anticipated turnaround in the Chinese markets finally appears to be here, and we will continue to work relentlessly to help our clients navigate them confidently.

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A schedule of fees, charges and maximum comissions is available on request from the Manager. A CIS may be closed to new investors in order for it to be managed more efficiently in accordance with its mandate. There is no guarantee in respect of capital or returns in a portfolio. Performance has been calculated using net NAV to NAV numbers with income reinvested. The performance for each period shown reflects the return for investors who have been fully invested for that period. Individual investor performance may differ as a result of initial fees, the actual investment date, the date of reinvestments and dividend withholding tax. Full performance calculations are available from the manager on request.

Annualised performance shows longer-term performance rescaled to a one-year period. Annualised performance is the average return per year over the period. Actual annual figures are available to the investor on request. Highest and lowest is returns for any one year over the period since inception have been shown. NAV is the net asset value represents the assets of a Fund less its liabilities.

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