Fidelity INTERNATIONAL

Understanding China's recent market volatility

Martin Dropkin, Head of Equities, Asia Pacific

It's been a weak start to the year for China and Hong Kong stocks, with the CSI 300 delivering a 6.2 per cent decline and the Hang Seng index down by 12.2 per cent in January 2024. This is after the People's Bank of China decision to maintain current prime loan rates, indicating a reluctance to inject additional stimulus into the economy amid further concerning economic data.

The fast-paced sell-off has led to a sense of panic, prompting investors to rush into selling more to maintain their underweight position in China and adhere to volatility controls, further undermining confidence.

A slow and steady policy response, no stimulus measure

Considering the broader context is crucial. China's economic cycle diverges from the West, where inflation concerns lead central banks to maintain high interest rates constraining growth momentum. In contrast, the Chinese government is slowly but surely stimulating investment and consumption to achieve stable GDP growth of around 5 per cent.

Today there are discussions over a stabilisation fund for stocks, but the significant stimulus of the past is unlikely since it would undermine the government's long-term economic objectives. But despite ongoing economic challenges, targeted support for the property market and a shift in policy orientation more towards growth, sets the stage for potential recovery.

Moreover, the substantial amount of household savings, accumulated for security during these uncertain times, creates the potential for an upswing in consumer spending once confidence is restored.

Compelling valuations, but it pays to be selective and focus on corporate fundamentals

While it's too early to declare an end to this period of elevated volatility, amid the alarming headlines, opportunities for long-term investors lie in the resilience and adaptability of Chinese companies and can be identified by focusing on discerning corporate fundamentals.

Chinese companies' commitment to innovation and high-end manufacturing is evident in measures of research and development spend or their share of global patent applications. Good quality companies are expected to profit from gaining market share in fragmented industries like building materials, which are poised for further consolidation. Urbanisation and a growing middle class persist in strengthening consumer purchasing power, offering structural growth for those under-penetrated products and services industries.

Healthcare also presents opportunities, especially in areas with low penetration like medical devices or core pharmaceuticals. In emerging sectors, opportunities can be found in the electric vehicle (EV) value chain, particularly those providing key components and services, such as battery manufacturers or auto parts suppliers. Many businesses are also benefitting from the re-orientation of global supply chains and an increasing focus on self-sufficiency and local suppliers.

Investors can now buy into these opportunities at what we believe to be compelling valuations. A wide range of measures look favourable, for example the 1-year forward price-to-earnings (PE) ratio for MSCI China is 9 times versus it's 10-year average of 11.4 times - not far from its lowest level in the past 20 years.

But as always with investing in China, it pays to be selective. Our confidence in these appealing valuations is anchored in on-the-ground research, which is currently uncovering resilience among many companies, and the belief that stock prices follow earnings in the long term.

Current market moves may be unsettling even for experienced investors, but corporate China has proven time and again its ability to innovate and create opportunities even in the toughest of markets.

Important Information

All information is current as at 24 January 2024 unless otherwise stated. Not for use by or distribution to retail investors. Only available to a person who is a "wholesale client" under section 761G of the Corporations Act 2001 (Commonwealth of Australia) ("Corporations Act").

This document is issued by FIL Responsible Entity (Australia) Limited ABN 33 148 059 009, AFSL No. 409340 ('Fidelity Australia'). Fidelity Australia is a member of the FIL Limited group of companies commonly known as Fidelity International. **Prior to making any investment decision, investors should consider seeking independent legal, taxation, financial or other relevant professional advice.** This document is intended as general information only and has been prepared without taking into account any person's objectives, financial situation or needs. You should also consider the relevant Product Disclosure Statements ('PDS') for any Fidelity Australia product mentioned in this document before making any decision about whether to acquire the product. The PDS can be obtained by contacting Fidelity Australia on 1800 044 922 or by downloading it from our website at www.fidelity.com.au. The relevant Target Market Determination (TMD) is available via www.fidelity.com.au. This document may include general commentary on market activity, sector trends or other broad-based economic or political conditions that should not be taken as investment advice. Information stated about specific securities may change. Any reference to specific securities should not be taken as a recommendation to buy, sell or hold these securities. You should consider these matters and seeking professional advice before acting on any information. Any forward-looking statements, opinions, projections and estimates in this document may be based on market conditions, beliefs, expectations, assumptions, interpretations, circumstances and contingencies which can change without notice, and may not be correct. Any forward-looking statements are provided as a general guide only and there can be no assurance that actual results or outcomes will not be unfavourable, worse than or materially different to those indicated by these forward-looking statements. Any graphs, examples or case studies included are for illustrative purposes only and may be specific to the context and circumstances and based on specific factual and other assumptions. They are not and do not represent forecasts or guides regarding future returns or any other future matters and are not intended to be considered in a broader context. While the information contained in this document has been prepared with reasonable care, to the maximum extent permitted by law, no responsibility or liability is accepted for any errors or omissions or misstatements however caused. Past performance information provided in this document is not a reliable indicator of future performance. The document may not be reproduced, transmitted or otherwise made available without the prior written permission of Fidelity Australia. The issuer of Fidelity's managed investment schemes is Fidelity Australia.

© 2024 FIL Responsible Entity (Australia) Limited. Fidelity, Fidelity International and the Fidelity International logo and F symbol are trademarks of FIL Limited.