MONTHLY INVESTMENT *brief*

November 8th, 2024

Laurent Denize
Global Co-CIO ODDO BHF

China's bazooka versus Trump's victory

> *As the world's second-largest economy, China has much to offer and should be included in any globally diversified portfolio. Short-term complexities do not rule out building positions in Chinese quality stocks with strong potential.*

On November 6, the U.S. election saw a sweeping victory for Trump, implying rising uncertainties for China and the world. On Friday, November 8, 2024, China' s National People's Congress Standing Committee concluded in Beijing and unveiled a 10-trillion-yuan ($1.4 trillion) stimulus to aid local governments, the boldest one since the pandemic. Is this level of support sufficient?

Trump 2.0 – Implications for China

Trump's return to the White House signals the potential restart of the U.S.-China trade war. Higher tariffs and more trade restrictions could impact Chinese export-oriented sectors. The yuan may also face depreciation pressure to counter reduced external demand.

However, the effects of this round of tariffs hike might differ from the disruption seen in 2018. First, the U.S. share of China's exports has dropped from 19% in 2017 to around 14% by the end of 2023, with China actively expanding markets outside the U.S. and relocating production lines to other countries to mitigate tariff impacts. Second, China will more proactively deploy counter-cyclical fiscal and monetary policies to cushion the economic blow. November 8th, 2024, China's Finance Minister Lan Fo'an promised a "more forceful" fiscal policy for next year, signaling bolder steps may follow Trump's inauguration in January. Third, Trump's approach tends to be "transactional". Thus, the extent of tariff increases could well be the result of negotiations between the two nations.

The November 6 election result is only the first step. The situation will become clearer once the new president assumes office in January 2025 and selects key members for the policy team.

Chinese government is unpacking its bazooka.

China's policy attitudes shifted visibly in late September, shortly after the U.S. Federal Reserve made its first rate cut in years. Since July, economists had been steadily downgrading growth forecasts for the current year. At the end of September, the central bank responded to China's persistently weak growth with a series of measures. Key interest rates were cut, including those for existing mortgage loans. Extraordinary measures were also taken to stabilize the stock markets.

For example, a "facility" of 800 billion renminbi was set up to lend to corporates and non-bank financial institutions to buy shares. The Politburo meeting, originally set for October, was also advanced unusually to late September, calling for stronger and more effective counter-cyclical measures to boost economic growth and stabilize the real estate market.

In October, the Ministry of Finance announced further fiscal measures to stimulate growth, including a program to help local governments address their hidden debts. The Ministry emphasized that the central government still has considerable room to raise debt levels and expand the deficit. Although no figures were given at the time, on November 8, the National People's Congress Standing Committee unveiled a 10-trillion-yuan stimulus package to resolve hidden debt issues — better than the market has expected. The increased debt limit will allow local governments to issue an additional 6 trillion yuan in special bonds over three years to swap hidden debt, explained Finance Minister Lan. He added that regional authorities will be able to tap another total of 4 trillion yuan in special local bond quota to be granted each year over five years, including 2024, for the same purpose. The extraordinary size and rhetoric of these measures show how seriously the government takes the economic slowdown.

But is this enough?

Many investors are hoping for more concrete and direct consumer stimulus policies. However, the importance of local debt resolution is, in our opinion, underestimated by international investors. These debts are invisible clots in the bloodstream of China's economy. Due to local governments' fiscal stress, payments to their suppliers (mainly private companies) have been overdue, salaries of local officials have been delayed, private enterprises are charged "fines" as compensations of shrinking tax revenues and land sales revenues for local governments. Minister Lan estimates that this 10-trillion-yuan debt swap could save around 600 billion yuan in interest payments over five years, freeing up resources to boost investment and consumption. The total amount of hidden debts shall be reduced significantly from 14.3 trillion yuan to 2.3 trillion yuan by 2028. Additional stimulus are likely to respond to a potential trade war when Trump takes office.

Just a short-term price boost?

Understandably, after a long dry spell, equity markets reacted enthusiastically in September to the prospect of economic stimulus. In just one month, from the low for the year in September 2024 to the high in October 2024, the Chinese stock market rose by almost 30% (as measured by the MSCI China Index). Although valuations have improved very quickly, the Chinese stock market still trades at a discount to other major equity markets. This is partly because large international long-term investors are still on the sidelines.

Given the particularly attractive valuations and the prospect of further government support, investors seeking exposure to China should focus on quality equities with healthy balance sheets and strong earnings momentum.

Europe's dependence on China

The Chinese economy is not just an issue for Chinese equities. Many European companies (Industrials, Luxury…) are heavily dependent on China. As a result, stocks in such export-dependent industries have rallied. However, according to a survey by Morgan Stanley, only a minority of investors believe that a sustainable recovery is underway. Here too, the Chinese government has some convincing to do.

A sustained economic recovery in China could also lead to rising stock markets in Europe. For Luxury, China remains the most important market (>30% Sales), ahead of the US (>20% Sales) and the European domestic market (c. 15% of Sales). But the reluctance of Chinese consumers to part with their money, due to falling property prices and economic uncertainty, will continue to slow the growth of the major luxury goods manufacturers in 2025. In the European car industry, German carmakers are still very dependent on China.

But even a growth program here will not lead to a return to the good old days, as German car makers have been losing market shares to Chinese car brands in this important market since 2021. As for the European chemical industry, the impact of these policies is limited, as China has become more and more self-sufficient in chemicals over the past two decades.

Invest in China – "A-shares" must be considered

In the near term, geopolitical uncertainties could weigh on investors' sentiment over Chinese equities again. However, compared to offshore Chinese equities, domestic A-shares may outperform as they are less impacted by "geopolitical uncertainty" risks, with only around 3% owned by foreign investors, but they are direct beneficiaries of the country's stimulus, especially those dedicated to the stock market. The defensive sectors, domestic-oriented sectors, and those supported by the Chinese policies—such as Consumer Goods and Capital Goods — could outperform amid heightened uncertainty.

If Chinese stocks are to close the valuation gap with other global markets over the long term, the government must show a clear path to address structural weaknesses in the economy. The leadership has already taken the first steps in this direction. As the world's second-largest economy, China has much to offer and should be included in any globally diversified portfolio. Short-term complexities do not rule out building positions in Chinese quality stocks with strong potential.

READ THE PRESENTATION

OUR CURRENT CONVICTIONS FOR EACH ASSET CLASS

Equities	OVERALL EQUITIES			1	
	Large cap Eurozone			1	
	Mid cap Eurozone				2
	Small cap Eurozone				2
	UK			1	
	USA			1	
	Emerging markets			1	
	Japan			1	
	China			1	
Currencies	USD/€ (Direction of the USD)		-1		
	YEN/€ (Direction of the YEN)			1	
	GBP/€ (Direction of the GBP)		-1		
	CHF / € (Direction of the CHF)			1	
Commodities	Gold		-1		
	Crude oil		-1		
Government bonds	OVERALL GOVERNMENT BONDS			→ 1	
	Core Europe			→ 1	
	Semi Core Europe		-1		
	Peripheral Europe			1	
	USA			→ 1	
Corporate bonds	OVERALL CORPORATE BONDS			1	
	Investment grade Europe				→ 2
	Investment grade short duration				→ 2
	High yield credit short duration				→ 2
	High yield Europe			1	
	High Yield USA			1	
	Emerging markets			1	
Money Market	Developed markets	2 ←			

Source: ODDO BHF AM, data as of 11/10/2024

Changes vs previous Global Investment Committee meeting

Past performance is not a reliable indicator of future returns and is subject to fluctuation over time. Performance may rise or fall for investments with foreign currency exposure due to exchange rate fluctuations. Emerging markets may be subject to more political, economic or structural challenges than developed markets, which may result in a higher risk

ODDO BHF Asset Management SAS (France)
A portfolio management firm certified by the French Financial Markets Authority (AMF) under n° GP 99011.
Established in the form of a simplified joint-stock company with authorised capital of €21,500,000.
Entered into the Paris Register of Trade and Companies under number 340 902 857.
12. boulevard de la Madeleine - 75440 Paris Cedex 09, France - Tel. : 33 (0)1 44 51 85 00
am.oddo-bhf.com