East Capital China

Chinese stocks are currently trading at very attractive valuations and paying generous dividend yields, despite solid earnings growth, following several years of poor investor sentiment and relentless selling by international investors. The East Capital China Fund aims to take advantage of this by investing in exciting but unloved companies across the Chinese investment universe, both onshore and offshore. The fund offers a uniquely strong combination of growth and value, with a P/E ratio of 7.3x for 2024 and 18% earnings growth implying a PEG ratio (price/earnings to growth) of 0.4x. The corresponding PEG ratio for the S&P500 is 2.2x.

The path to China's turnaround

China has had a few difficult years, following covid lockdowns, geopolitics and problems in the real estate sector, which has long been a key driver for the economy. However, this has more than been reflected in market prices. While the MSCI China is up 23% from its lows, it is still down 18% from recent highs in 2023 and 50% below its highs in 2021. Importantly, the fundamentals of most Chinese companies remain strong, with free cash flow and buybacks at record levels and earnings growth at 14%.

Performance of MSCI China over last three years

Source: Refinitiv, accessed 01.07.24

A unique combination of value and growth

	EPS Growth		PE		PEG		Average PEG
	2024	2025	2024	2025	2024	2025	24/25
Fund	18%	14%	7.3	6.5	0.4	0.5	0.4
MSCI China	13%	12%	9.3	8.3	0.7	0.7	0.7
MSCI China A	15%	11%	11.6	10.4	0.8	0.8	0.8
S&P 500	14%	12%	19.5	17.4	2.2	1.4	1.8

For the economy and stock market to make a sustained recovery, it will be important to see a stabilisation of the real estate sector – for the time being prices are still falling (around 4% YoY for new homes as of June 2024). The government has been drip-feeding a large number of small measures to support the sector, such as a recently announced USD 69 billion programme for state-owned enterprises to buy housing stock and rent it out as affordable housing. We believe these measures will start to have an impact by the end of 2024, which would significantly improve consumer and investor sentiment in the country.

Regulatory support for China's financial markets is growing, underlining the increasing strategic importance of the stock market to the economy. The China Securities Regulatory Commission (CSRC) has intensified efforts to stabilise the market and restore investor confidence, with the national team, including the sovereign wealth fund, stepping in to buy during sharp sell-offs, but also encouraging dividends / buybacks and limiting equity issuance.

Fund benefits

- Chinese equity exposure (all shares)
- Focus on high-quality, mid-cap companies with strong growth and free cash flow generation /shareholder distribution
- Highly unique and differentiated fund with over 80% active share
- On-the-ground experienced investment management team

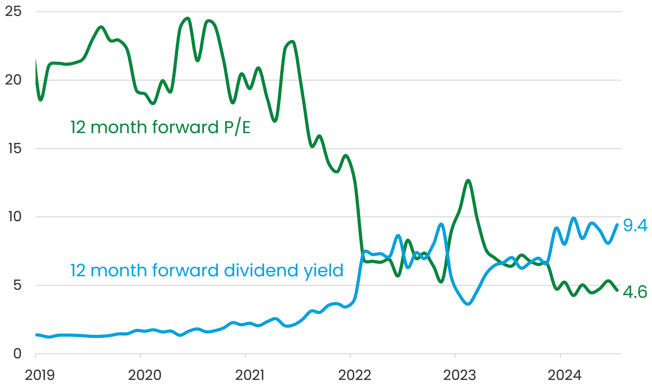
Case study : China Education

While it is easy to talk about the market / economy in general terms, we of course invest in companies rather than the economy in general.

As an example, we can take China Education Group, which is the largest private university provider in the country. This is a high-quality company that was trading at around 20-25x forward P/E before 2022. It is now trading at less than 5x P/E despite solid growth and a 9% dividend yield. This is the type of name that we believe investors would want to buy if there was an improvement in sentiment.

There are many more examples of similar companies – for example one of the larger microfinance companies is now trading at 1.5x 2025 P/E with a 13% dividend yield.

Valuation of China Education Group since 2019



Source: Refinitiv, accessed 01.07.24

Why East Capital?

Our team of highly experienced emerging markets specialists is on-the-ground, based in Hong Kong. We have a long track record, with the core team having a combined 39 years of regional and industry experience. We were the first Nordic manager to invest in China A-shares back in 2014, and the first manager globally to invest through Stock Connect.

We have a dynamic and high-conviction approach to portfolio construction, meaning that we remove holdings as soon as our conviction falls. This means we have higher turnover than many of peers, but also that we avoid the biases that plague most investors (such as inertia bias).

Core investment team

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