2025 Midyear Investment Outlook – China Equities

May 2025

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Much like the global equity market, China's equity market has been volatile over the past few months. As we reach the midpoint of 2025, we believe global markets will remain uncertain for the rest of the year amid evolving dynamics, while the outlook for China equities may be shaped by an interplay of domestic and international factors.

China and the US have shown a willingness to re-engage in dialogue to reduce tariffs, signaling a potential thaw in trade relations. While this is a positive step, we remain mindful that the broader geopolitical landscape remains fluid. The path to a comprehensive resolution is still uncertain, and we believe investors should be prepared for intermittent volatility as negotiations continue.

Supportive policies are boosting consumption

The Chinese government has reaffirmed its commitment to supporting economic growth, targeting to achieve its GDP growth target for 2025. Policymakers have rolled out a series of measures aimed at stabilizing and stimulating the economy. On the monetary policy front, the People's Bank of China has continued to lower the reserve requirement ratio (RRR) at a moderate pace, ensuring sufficient liquidity in the banking system. At the same time, fiscal policy has remained proactive, with increased investment in infrastructure projects designed to bolster long-term productivity and employment.

Looking forward, a particularly important area of focus is domestic consumption. Recognizing the need to boost consumer confidence and spending, the government is expected to extend and expand last year's successful consumption trade-in policy. This initiative, which incentivizes the replacement of older consumer goods, expanded from white goods and automobiles to include consumer electronics earlier this year. We believe this supportive policy is likely to continue in 2H 2025.

China's recent Labor Day holiday provided a timely snapshot of consumer resilience. Over the five-day break, domestic tourism surged, with 314 million domestic trips recorded, marking a 6.5% year-on-year increase according to the Ministry of Tourism.[1] Sales at key retail and catering enterprises rose 6.3% year-on-year, while inbound and outbound travel surged by 28.7%.[2] These figures may signal the potential for consumption to serve as a key driver of growth in the months ahead.

Global trade dynamics may pose challenges to exports

While China's export data has shown positive year-to-date growth, we believe the exports may face headwinds from both the lingering effects of trade policy and a broader slowdown in global demand. Although the government continues to evaluate and adjust its policy package to lower the impact of risks, the external environment remains challenging. Volatile trading dynamics may hinder China's export growth. We believe the global trade environment is still uncertain and this uncertainty is likely to persist in the near term.

Looking ahead, the upcoming Politburo meeting at the end of July will be worth monitoring. The meeting is expected to assess first-half economic performance and potentially fine-tune the government's policy stance accounting for the evolving dynamics. We believe the timing, scope, and effectiveness of any new policy measures will be critical in shaping the pace of economic recovery, especially as policy transmission to the real economy typically takes time.

1. Reuters, data as of May 2025.
2. HSBC, data as of May 2025.

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Navigating volatility: A bottom-up approach

Amid the macro uncertainty, we believe navigating China equities requires a disciplined and selective approach. Rather than relying on broad sectoral themes, we believe investors may adopt a bottom-up strategy, focusing on individual companies with strong fundamentals, resilient earnings, and limited exposure to external shocks such as tariffs. We believe this approach is particularly well suited to the current environment, where volatility remains elevated, and macro signals are mixed. Adopting this strategy may allow investors to have greater flexibility in navigating market volatility and identifying long-term winners across sectors.

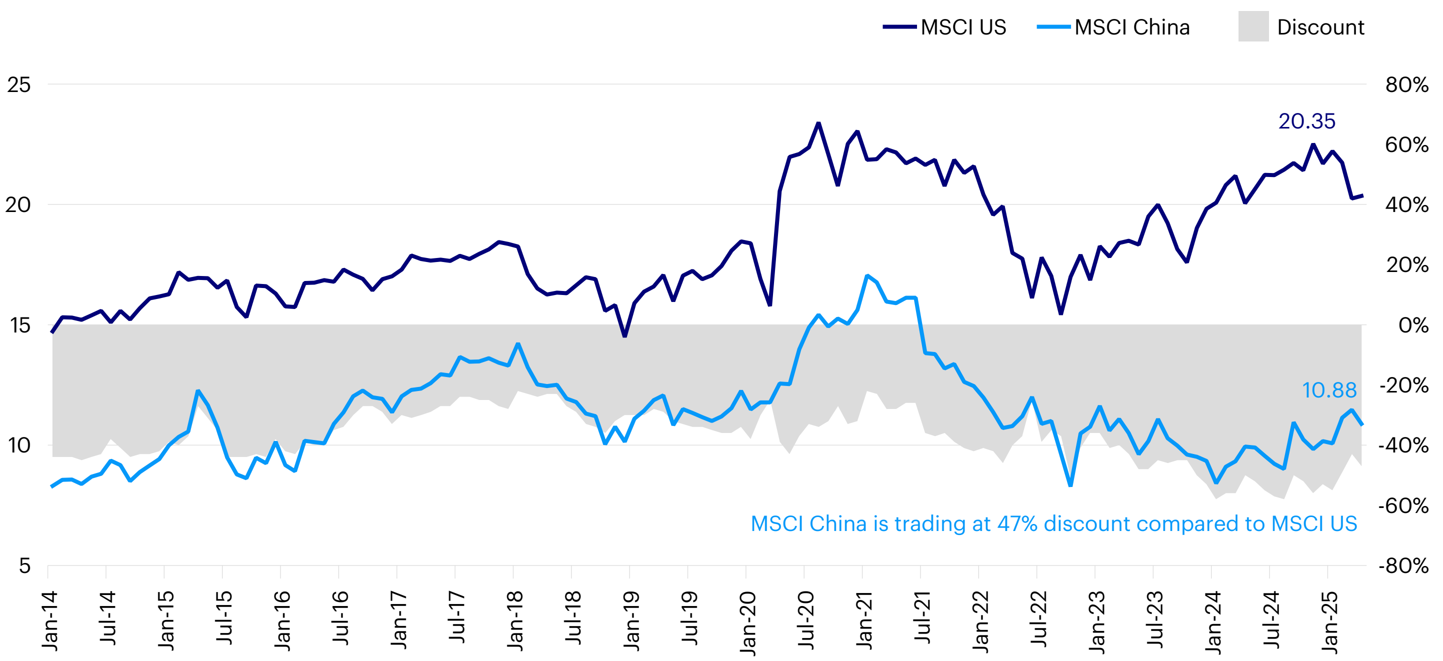
Supportive Southbound liquidity and attractive valuations

Southbound flows through the Stock Connect program remained robust in the first half of the year, reflecting the supportive liquidity environment and strong interest in Hong Kong-listed Chinese companies. Southbound investors account for US $78 billion of net buying year-to-date, 75% of the full-year inflows for 2024. The market predicts Southbound flows in 2025 will reach US $110 billion, a higher level than in recent years.[3]

Although concerns over US-listed China ADRs have resurfaced in recent months, the continued strength of Southbound flows highlights the stabilizing influence of domestic capital, helping to cushion potential outflows and support overall market resilience.

Valuations for Chinese equities remain undemanding, having reverted to their long-term averages. The MSCI China P/E ratio is trading at around 11x as of April 2025,[4] trading at a significant discount of around 47% compared to US equities. This presents a favorable risk-reward profile for long-term investors, making the current valuations of Chinese equities look attractive.

Figure 1: Forward P/E of MSCI China versus MSCI US



Source: FactSet, Invesco, data as of April 2025. **Past performance does not predict future returns.**

3. Goldman Sachs, data as of April 2025.
4. FactSet, data as of April 2025.

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Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

When investing in less developed countries, you should be prepared to accept significantly large fluctuations in value.

Investment in certain securities listed in China can involve significant regulatory constraints that may affect liquidity and/or investment performance.

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