

ASPOMA China Opportunities Fund semi-annual report

The Chinese stock market performed slightly positive overall in the first half of the year. A certain catch-up effect was expected for the Chinese market as the late effects of Covid on overall economic demand eased. This also took place in the first quarter, but was then quickly overshadowed by overriding factors, above all the effects of the property crisis, which slowed economic development considerably. Despite the rather weak economic development, fiscal and monetary policy focused on selective measures; a broader stimulus programme has not yet been launched and is not expected.

In this environment, large caps rose by 4.8%, while mid-caps and small caps fell by 3.2% and 4.8% respectively. State-owned companies, which often have low growth potential but high dividend yields, outperformed the market in this environment, not least because various government-related market players ("national team") presumably supported the market with targeted purchases. The ASPOMA China Opportunities Fund rose by 0.8% in the same period, reflecting its focus on private companies, which are often also located in the mid- and small-cap segment.

China is expected to achieve the growth target of around 5% for 2024. In macroeconomic terms, China's growth was stronger than expected in the first quarter as investment and manufacturing output accelerated and export growth improved. Domestic demand, on the other hand, remains weak and is expected to recover only slowly and with a time lag. The figures for the second quarter are currently only partially published, but the data for April and May indicate that growth in the second quarter will be around 4.7%. From today's perspective, the government's growth target for this year of around 5% should be achieved.

Property sector will burden the economy for the foreseeable future, but Beijing is focussing on forward-looking issues. The main negative factor for the Chinese economy continues to be the clean-up of the property sector, which has grown out of control in recent years. The property sector remains an important part of the Chinese economy and accounts for around 25% of gross domestic product and around 70% of private household assets.

According to China's National Bureau of Statistics, residential property sales in China (living space) fell by 23.8% in the January-April period. Prices for new houses in 70 cities fell by 0.6% month-on-month in April. The sale of building land, an important source of income for regional governments, also fell significantly. Even though the government managed to achieve a certain stabilisation of developments in the property sector over the course of the second quarter, the high number of unsold completed or nearly completed residential units will continue to weigh on the property market and the economy as a whole for several years to come.

This development is weighing on domestic demand. Even if household balance sheets are robust and by no means over-indebted - the purchase of property in China has always required a considerable amount of equity - the loss of assets due to falling property prices is nevertheless depressing the tendency to consume and leading to increased savings efforts on the part of households. Regional governments, which have often already exhausted their debt potential, are being forced by falling income from land sales to adopt a restrictive spending behaviour.

However, the recent plenary session of the Central Committee of the Communist Party of China, which traditionally focuses on economic issues and took place from 15 to 18 July, barely mentioned the real estate sector. The government seems to take the view that working through the distortion will be gradual and will simply take time. Attempts to accelerate the clean-up with substantial public

funds are rejected as a backward-looking policy that will not achieve its objectives.

Focus on China's transformation from a property and investment-orientated economy to an "advanced manufacturing economy". The plenary session of the Central Committee, on the other hand, clearly focused on *innovation, research and development* in key sectors such as *semiconductors, digitalisation, batteries and electric vehicles* and *biotechnology*. Productivity advances and *environmental and digital upgrades* of China's huge manufacturing sector, which accounts for 28% of GDP (compared to 10.7% in the US), is seen by the government as the key lever to create wealth. The *manufacturing sector*, with wide and rapid *availability of components, manufacturing capabilities* of all kinds and *strong engineering expertise*, is unrivalled in Asia and the world.

The automotive sector is a good example of the fact that this is not just a futuristic dream but already a reality in many cases. Foreign brands are under enormous pressure in China and have lost significant market share in recent years. For example, Honda and Toyota sales in China have fallen by 11% and 13% respectively since the beginning of 2024 compared to the previous year. GM, Stellantis and Hyundai are struggling in a similar way. Chinese manufacturers, on the other hand, have greatly improved the quality and equipment of their vehicles during the pandemic. The quality and attractiveness of the prices of electric vehicles manufactured in China are far higher than those offered by foreign brands. Given the high-quality, well-engineered products now coming out of China, it is questionable whether there is any reason for Chinese consumers to return to foreign brands. In May, Toyota's CFO Yoichi Miyazaki expressed how seriously foreign manufacturers are taking the competition from China when he admitted that his company was lagging far behind its Chinese rivals in some areas.

Accelerated energy transition with sustainable concepts another cornerstone of Chinese policy. China is also in the process of accelerating its energy transition. The country is likely to reach "peak coal" in 2025 and "peak oil" in the 15th Five-Year Plan by 2030. Renewable energy, nuclear power, gas and batteries will be the main energy sources and carriers driving this phase.

Successful development of export markets and production facilities in the "global south". Another development that has become increasingly apparent in recent quarters and is particularly relevant in view of the increasing protectionism in Europe and especially in the USA, is the *strength of Chinese exports*, especially to middle and low-income countries ("*global south*"). This is a deliberate policy to *reduce export dependence on Europe and the US in particular*. However, China's export performance varies greatly within the emerging economies. *Exports to the ASEAN countries are growing the fastest*, although these economies have not yet been large enough to act as regional demand drivers. In the twelve months to May, China's exports to ASEAN countries grew by 22%, faster than exports to any other major destination. In addition to *developing alternative export markets* to the US, there is also anecdotal evidence that Chinese companies are shifting final assembly of products to ASEAN countries, either to mitigate the impact of current and expected US and European sanctions or because China's comparative advantage has shifted away from final assembly to upstream areas.

The implications of the US import data from the time of the first Trump administration are interesting regarding the intensification of potential trade conflicts. On the one hand, they show the rapid increase in Vietnam's market share; on the other hand, they also show that, despite this first trade war between the US and China, China's market share in the US has not fallen if the value added by third parties is taken into account.

Historically low valuation levels

Valuation levels at historic lows suggest that *investors* have their *eyes* firmly set *on the challenges China is currently facing* and have *priced* them into their investment decisions. The *valuation parameters for Chinese equities* are currently at a *price/earnings ratio of 9.6x* and a *price/book ratio of 1.15x* for 2024.

China's internet sector illustrates the fundamentally attractive valuation levels. The sector recovered from its low in January and outperformed the CSI 300 and Hang Seng indices. As the sector's valuation remains de-

pressed, there is a good chance that this trend will continue. The fundamentals of the internet sector look attractive: Many companies are achieving record profits and also have attractive growth opportunities for the coming years in terms of sales and adjusted EBIT. The sector also offers a total return of over 5% through share buybacks and dividends.

Changes in the portfolio

There were no changes to the portfolio in the reporting period.

Portfolio positioning: unchanged focus of the fund on forward-looking sectors and companies with above-average quality

In view of these developments, the ASPOMA China Opportunities Fund investment strategy remains unchanged: focussing on future-oriented sectors such as consumer goods, healthcare, software, internet and e-commerce, which are very strongly positioned and will benefit from structural developments in the long term. At the same time, the fund invests exclusively in companies that we consider to be above average in terms of aspects such as the quality of management, IT systems and internal processes, a focus on research and development and sustainable brand building in the Chinese market.

Outlook

Even with slower growth than in previous decades, **China is continuing its transformation process with a policy characterised by caution and continuity.** What has already been achieved in many areas of the economy is remarkable, as is the potential that still exists.

At the same time, issues such as the authoritarian political course, the unresolved tensions with the USA, the Taiwan issue and the long-term consequences of the property crisis remain. In our opinion, the valuation levels of the Chinese market reflect these risks.

For investors with a medium investment horizon, China's companies offer attractive potential returns based on current valuation levels.

All information on the ASPOMA China Opportunities Fund can be found here: <https://www.aspoma.com/fonds>

Investment philosophy of the ASPOMA China Opportunities Fund

The investment objective of the fund is to offer investors the opportunity to participate in the increasing importance and high growth potential of the Chinese economy and its companies. The fund's investment focus is on companies in the private sector in China that are characterised by the fact that they operate primarily in industries that stand to benefit more than average from China's future development. These include the consumer goods, healthcare and service sectors as well as the IT and software sector and modern industrial companies.

Our stock selection pursues a value-oriented investment philosophy that aims to invest in undervalued but high-quality companies with a strong competitive position and above-average returns on capital employed whose medium-term potential is not yet reflected by the capital market. In addition to structural, process and corporate governance aspects, for us quality always means that a company must have a sustainable competitive advantage, be it due to leading technologies, strong brands, dominant market shares or economies of scale and network advantages, which is reflected in sustainable above-average earnings and cash flow growth.

In our opinion, the Chinese capital market offers the necessary conditions for this approach, as it is in a phase where leading or even dominant companies are emerging in many sectors that fulfil these conditions. Given the below-average performance of the Chinese stock market over the past decade, these companies can generally be acquired at prices that are significantly below their long-term value potential.

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Additional information

The investment fund ASPOMA China Opportunities Fund (hereinafter: UCITS) was established on 20 August 2010 as an undertaking for collective investment in transferable securities (UCITS) under the law of the Principality of Liechtenstein. The UCITS is a legally dependent undertaking for collective investment in transferable securities of the open-ended type and is subject to the Law of 28 June 2011 on certain undertakings for collective investment in transferable securities (hereinafter: UCITSG). The prospectus, the Key Investor Information Document (KIID), the trust agreement and Annex A "Overview of the Fund" as well as the latest annual and semi-annual reports, if already published, are available free of charge on a durable medium from the management company, the depositary, the paying agents and all authorised distributors in Liechtenstein and abroad as well as on the website of the LAFV Liechtenstein Investment Fund Association at www.lafv.li. The units of the UCITS are not authorised for distribution in all countries of the world. This information does not constitute an offer or solicitation to subscribe for units of the UCITS by any person in any jurisdiction in which such an offer or solicitation is unlawful or in which the person making such an offer or solicitation is not qualified to do so or to any person to whom it is unlawful to make such an offer or solicitation. Information not contained in the Prospectus and Trust Agreement or documents available to the public is deemed to be unauthorised and unreliable. In particular, the units have not been registered in the United States of America (USA) in accordance with the United States Securities Act of 1933 and may therefore not be offered or sold in the USA or to US citizens. In general, units of the UCITS may not be offered in jurisdictions and to persons in which or to whom this is not permitted. Potential investors should be aware of the risks associated with an investment in the units and should only make an investment decision once they have obtained comprehensive advice from their legal, tax and financial advisors, auditors or other experts on the suitability of an investment in units of the UCITS, taking into account their personal financial and tax situation and other circumstances, the information contained in the prospectus and trust agreement and the investment policy of the UCITS.