

## China A Shares Quarterly Update

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30 September 2024



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**Calton Square, 1 Greenside Row, Edinburgh EH1 3AN  
Telephone +44 (0)131 275 2000 bailliegifford.com**

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## **Potential for Profit and Loss**

All investment strategies have the potential for profit and loss.

## **Stock Examples**

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The commentary relates to the above mentioned strategy and not all stocks mentioned may be held in the portfolio.

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## Product Overview

The China A-shares strategy is a purely stock-driven, unconstrained equity strategy focused on investing in exceptional growth companies listed on the domestic stock markets in China (known as 'A' shares). The companies which we invest in are expected to benefit from, and contribute to, China's economic, societal and cultural development, and be capable of growing to a multiple of their current size. We take a long-term approach with an expected investment horizon of 5+ years.

## Risk Analysis

### Key Statistics

Number of Holdings	32
Typical Number of Holdings	25-40
Active Share	83%*
Rolling One Year Turnover	19%

\*Relative to MSCI China A Onshore Index. Source: Baillie Gifford & Co, MSCI.

## Baillie Gifford Key Facts

Assets under management and advice	US\$293.0bn
Number of clients	633
Number of employees	1708
Number of investment professionals	376

Early in the year, we thought a change at the top of the securities regulator and a raft of pro-market policies may mark a more proactive approach towards markets and growth in the economy, but that sentiment soon faded amid an ongoing cycle of expectation and disappointment. Then came a host of property sector policies designed to stabilise the sector, yet transactions and prices have yet to take heed. A new nine-point set of guidelines released to stimulate the market has led to, amongst other things, a greater focus on shareholder returns and we're seeing an increasing number of companies report dividend increases or higher share buybacks, but this had led to little shift in the index as a whole.

Had this been written in mid-September, it would have focused on a domestic economic backdrop that remained underwhelming, a lack of consumer confidence which continued to weigh on markets, and ongoing challenges in the property sector. A lack of aggressive intervention asked questions of credibility in China's leadership around economic policy. China's bank lending fell to a 15 year low in July and A share turnover fell to its lowest in four years.

This all changed on the 24<sup>th</sup> of September with the coordinated announcement of a policy shift that led to the largest one week move in stock markets since September 2008. The policy response focused on three areas: 1) further easing monetary policy: interest rates and RRR cut (requirement rate for reserves for banks); 2) supporting the property sector: further reducing mortgage rate and downpayment requirement; 3) supporting the stock market/listed companies: setting up a central loan pool to lend to companies to buy back shares and reduce their cost of capital.

This bodes well for stock markets. The fact that the government is coming together with clear, coordinated policy communication has clearly turned sentiment and met the markets hope for action. The immediate response has seen sharp moves in share prices. Market turnover reached Rmb1trn in the first 32 minutes of trading on one day, the fastest ever.

However, we must balance the excitement. China's problems aren't down to high rates, inadequate liquidity or credit supply constraints, and the announced policies remain small in a historic context when related to their likely economic impact. As long-term investors, a one-year GDP target is not a key focus for our stock picking. Most of our holdings are positioned to benefit from long-

term secular trends and China's economic transition, and it's here where our focus remains.

The battle for supremacy in semiconductors is likely to be one of the most important stories in geopolitics, national security and economic prosperity in the coming decade. China spends more money importing semiconductors than it does buying oil. This reliance on foreign chips is a source of significant external vulnerability, particularly in a decoupling world, and explains why China's industrial/tech policy (alongside modernizing the national security system) has risen to top ranks in government. This was made perfectly clear at the Third Plenum held in July.

The world knows much about companies such as Intel, nVidia and Microsoft. But what about their Chinese competitors? Today, China may be struggling in its attempts to commercially manufacture leading edge semiconductors at scale. But there may be cautionary lessons learnt by those who laughed at China's attempts to deliver its own 4G telecoms network in the 2000s, only to now dominate the world at 5/5.5G. Few believed China could make a 7nm chip with its older equipment and production lines once sanctions limited access to world leading TSMC, and yet Huawei made the breakthrough in just four years. Is it possible that top-down policy can drive bottom-up innovation to the point that China leads in semiconductors – or are we just seeing China leading a shift in legacy products as it remains behind the curve at the leading edge?

The challenge is often finding the companies that could benefit most from these big structural growth drivers. In multiple industries, China has excelled at delivering production efficiencies and massive economies of scale, enabling it to sell decent quality products at low prices: telecom equipment, machinery, solar panels and Electric Vehicles (EVs) amongst others. China is potentially now set to repeat the process in mature segment of the semis market. Approximately 75% of global semi production is done at mature nodes (>28nm), where this year, China is forecast to increase capacity by more than the rest of the world combined, growing its global market share towards 40% over the next three years.

But scale and leadership haven't always delivered profitability for shareholders as much as for society. And China's industrial practices are increasingly seeing protectionist responses from the developing world. We're yet to believe that this Pandora's box of technological opportunity brings

overwhelming excitement to us as long-term investors. At this point, and making broad generalisations, the competitive intensity and limited long-term visibility combined with valuations is keeping us on the sideline. However, the tailwind of support for domestic self-sufficiency is one argument for the portfolio holdings in SG Micro and 3Peak, analogue semiconductor manufacturers producing chips to compete with Texas Instruments and Analog Devices on mature nodes where there is less geopolitical focus and yet a significant growth opportunity.

And while the technology space is taking much of the limelight, it is helpful to remind ourselves that the portfolio is deliberately balanced across a number of different forms of growth.

China's consumption story is well represented, and while the short-term outlook is clouded by the economic backdrop, the longer-term opportunity is reflected in positions which include leading domestic cosmetics company, Proya, EV market leader BYD and baijiu brands Kweichow Moutai and Shanxi Xinghuacun Fen Wine. Economic forecasts continue to highlight that Chinese consumption is expected to grow from U\$8trn in 2020 to over U\$14trn in 2030. That growing 'pie' is a large opportunity for the most innovative and relevant companies.

The healthcare space has been a difficult one for investors for a number of years, both with domestic policy and external geopolitics providing challenges, but just as domestic self-sufficiency in technology is driving opportunities, China needs biotech champions to drive innovation, improve efficiencies and lower prices. Whether in contract research for leading pharma companies at Hangzhou Tigermed or in the pharmacies tasked to deliver product to consumers at Yifeng, we believe the portfolio has exposure to this opportunity.

And we shouldn't overlook the industrials in the portfolio – the companies are perhaps not the most widely known, but with Shenzhen Inovance a leading player in industrial automation, Midea as one of the world's largest home appliance businesses, CATL as the global market share leader in EV batteries and Sungrow the leading inverter manufacturer for the solar industry, we have exposure both to companies with large domestic competitiveness, but also increasingly looking overseas.

## Performance

The portfolio outperformed its respective index during the quarter, with the final week of the period seeing a significant swing into positive absolute returns. In stark contrast to recent periods, energy and utilities were the worst performing sectors, although financials continued their strong performance as securities companies rallied with the market and real estate did well on new policy measures. We have little exposure to either sector. Performance was derived mainly for stock specific reasons.

Top contributors to performance were CATL and Centre Testing.

CATL is the world's leading battery manufacturer for electric vehicles and energy storage systems. Following a two-year cyclical downturn in the battery sector, we may now be at a positive inflection point, with domestic industry capex having halved from the peak, and sustainable global battery demand supporting a more favourable backdrop. Despite louder geopolitical noises surrounding its relationship with Ford in the US, the market has focused on CATL's leading competitive edge in technology, reliability and cost.

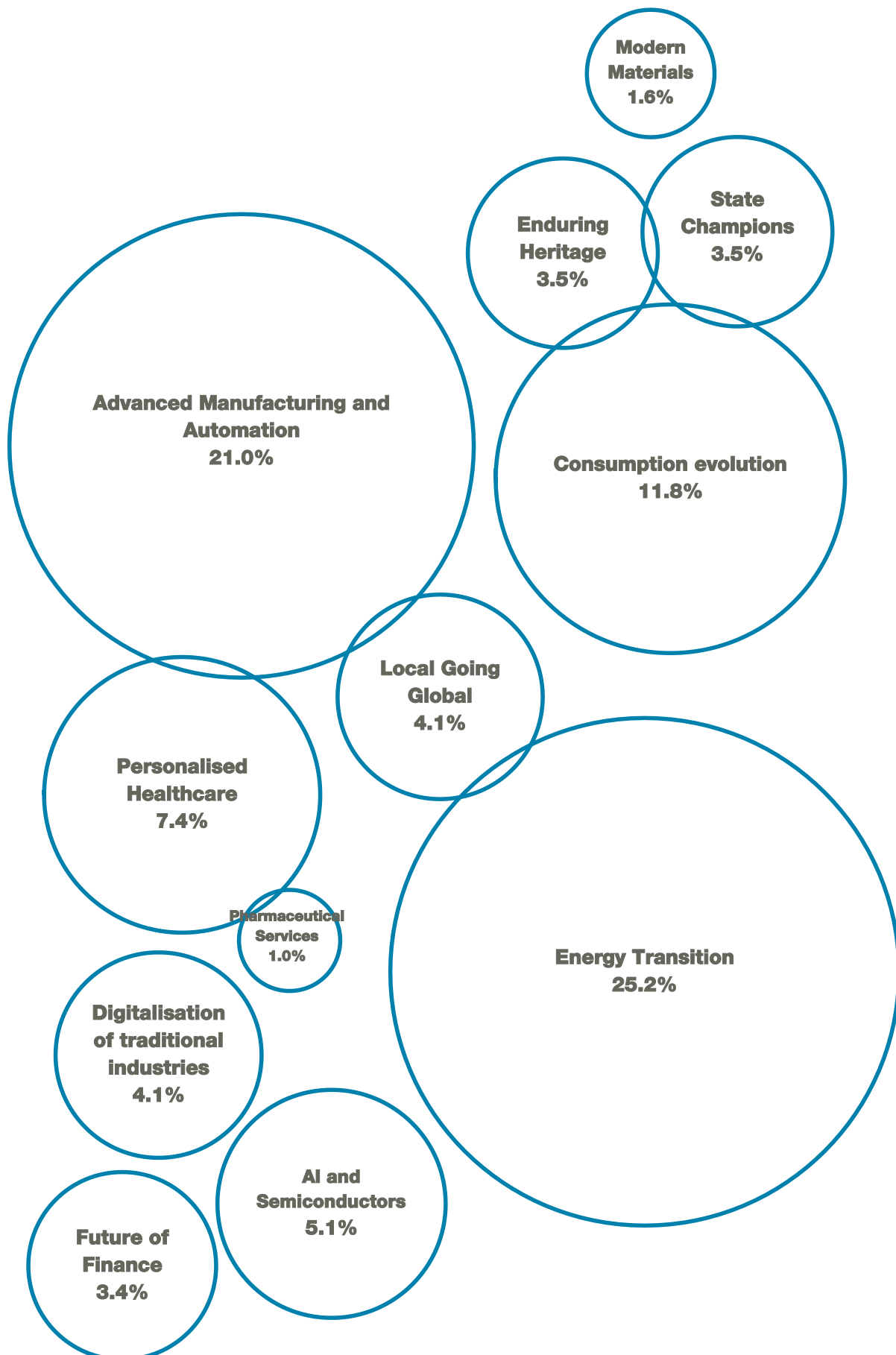
Centre Testing is one of China's leading testing, inspection and certification companies, continuing to grow market share during a difficult economic backdrop. It reported stronger than expected profitability during the quarter, proving their resilience during the downturn, while positioning themselves to benefit from the upswing in the economy and the company's strategic M&A plan.

Top detractors from performance were Proya and Yifeng Pharma.

Proya is a leading domestic skincare company. Weakness in the share price is more likely driven by general concerns about the consumption environment amid a weak domestic economy than anything stock specific. The company reported strong earnings growth in the recent quarter and may actually be a beneficiary of the weaker environment as consumers seeking greater value look to leading domestic brands. Proya has a multi-brand portfolio and leading operations capabilities that should make it more agile and efficient in product development and online sales. While the ongoing transition of management may impact sentiment, we don't believe it alters Proya's competitive position nor growth outlook.

Yifeng Pharma has been impacted by concerns around pressure on prices. Regulation and domestic policy will likely provide a headwind to sentiment, though only a small proportion of revenues are likely to be impacted, and stable margins support the idea that worries are overestimated. The company do however expect the net increase in stores to be lower than previously announced given the regulatory and market backdrop. Our investment thesis is built on the longer-term trend of traffic flowing from hospitals to retail pharmacies, and the offline consolidation of pharmacy chains where leaders such as Yifeng are set to benefit.

If markets are a game of expectations, then China's government has just altered expectations. After what has been a challenging time for China's economy and its stock markets, the response to coordinated pro-growth policy support has, in the short term at least, led to greater optimism and confidence in the government's pragmatism in the face of economic headwinds. We will have to watch closely as to how policy is executed and how the consumer responds. We don't expect geopolitics to go away in a hurry, particularly in a US election year. But a shifting domestic agenda may now shine a light on the strength of individual companies both in the local market and in their increasingly competitive strengths in the global sphere. Our enthusiasm is helped by companies continuing to report good operating results that highlight China's scale and growth, alongside the cheap valuations we're being asked to pay for this growth, and our focus remains on finding those with the most exciting opportunities ahead.





## Performance Objective

Long-term capital appreciation, outperform the Index after fees over rolling five year periods..

The performance objective is aspirational and is not guaranteed. We don't use it to compile the portfolio and returns will vary. A single performance objective may not be appropriate across all vehicles and jurisdictions. We may not meet our investment objectives if, for example, our growth investment style is out of favour, or we misjudge the long-term earnings growth of our holdings.

## Periodic Performance

<b>GBP</b>	<b>Composite Net (%)</b>	<b>Benchmark (%)</b>	<b>Difference (%)</b>
3 Months	18.6	14.6	3.9
1 Year	-13.0	3.9	-16.9
3 Year	-17.2	-7.5	-9.7
5 Year	0.5	2.4	-1.9
Since Inception	3.8	3.5	0.3
<b>USD</b>	<b>Composite Net (%)</b>	<b>Benchmark (%)</b>	<b>Difference (%)</b>
3 Months	25.8	21.6	4.2
1 Year	-4.4	14.2	-18.6
3 Year	-17.4	-7.7	-9.7
5 Year	2.3	4.2	-1.9
Since Inception	4.0	3.7	0.3
<b>EUR</b>	<b>Composite Net (%)</b>	<b>Benchmark (%)</b>	<b>Difference (%)</b>
3 Months	20.8	16.8	4.0
1 Year	-9.3	8.3	-17.6
3 Year	-16.3	-6.5	-9.8
5 Year	1.8	3.7	-1.9
Since Inception	4.4	4.0	0.3
<b>CAD</b>	<b>Composite Net (%)</b>	<b>Benchmark (%)</b>	<b>Difference (%)</b>
3 Months	24.2	20.1	4.1
1 Year	-4.5	14.1	-18.6
3 Year	-15.6	-5.7	-9.9
5 Year	2.7	4.6	-1.9
Since Inception	4.5	4.1	0.3
<b>AUD</b>	<b>Composite Net (%)</b>	<b>Benchmark (%)</b>	<b>Difference (%)</b>
3 Months	21.1	17.1	4.0
1 Year	-11.1	6.2	-17.3
3 Year	-16.2	-6.4	-9.8
5 Year	1.7	3.6	-1.9
Since Inception	4.5	4.1	0.3

Annualised periods ended 30 September 2024. 3 Month & 1 Year figures are not annualised.

Inception date: 28 February 2019

Figures may not sum due to rounding.

Benchmark is MSCI China A Onshore Index.

Source: Revolution, MSCI.

The China A Shares composite is more concentrated than the MSCI China A Onshore Index.

## Discrete Performance

<b>GBP</b>	<b>30/09/19- 30/09/20</b>	<b>30/09/20- 30/09/21</b>	<b>30/09/21- 30/09/22</b>	<b>30/09/22- 30/09/23</b>	<b>30/09/23- 30/09/24</b>
Composite Net (%)	60.9	12.5	-17.5	-20.9	-13.0
Benchmark (%)	25.5	13.5	-12.2	-13.3	3.9
<b>USD</b>	<b>30/09/19- 30/09/20</b>	<b>30/09/20- 30/09/21</b>	<b>30/09/21- 30/09/22</b>	<b>30/09/22- 30/09/23</b>	<b>30/09/23- 30/09/24</b>
Composite Net (%)	68.8	17.4	-31.7	-13.5	-4.4
Benchmark (%)	31.7	18.4	-27.3	-5.2	14.2
<b>EUR</b>	<b>30/09/19- 30/09/20</b>	<b>30/09/20- 30/09/21</b>	<b>30/09/21- 30/09/22</b>	<b>30/09/22- 30/09/23</b>	<b>30/09/23- 30/09/24</b>
Composite Net (%)	56.9	18.8	-19.2	-20.0	-9.3
Benchmark (%)	22.4	19.8	-14.0	-12.3	8.3
<b>CAD</b>	<b>30/09/19- 30/09/20</b>	<b>30/09/20- 30/09/21</b>	<b>30/09/21- 30/09/22</b>	<b>30/09/22- 30/09/23</b>	<b>30/09/23- 30/09/24</b>
Composite Net (%)	70.3	11.3	-26.0	-14.9	-4.5
Benchmark (%)	32.9	12.3	-21.2	-6.7	14.1
<b>AUD</b>	<b>30/09/19- 30/09/20</b>	<b>30/09/20- 30/09/21</b>	<b>30/09/21- 30/09/22</b>	<b>30/09/22- 30/09/23</b>	<b>30/09/23- 30/09/24</b>
Composite Net (%)	58.8	16.5	-23.3	-13.8	-11.1
Benchmark (%)	23.9	17.5	-18.3	-5.6	6.2

Benchmark is MSCI China A Onshore Index.

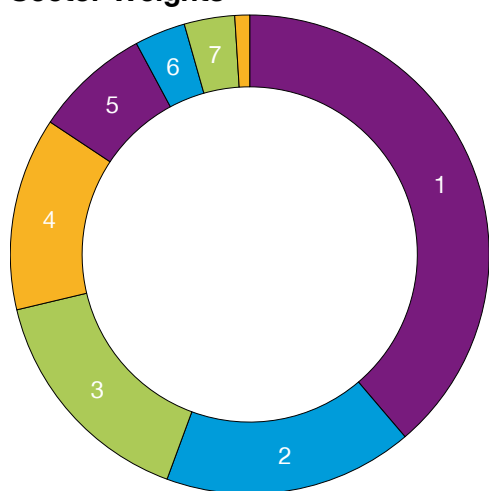
Source: Revolution, MSCI.

The China A Shares composite is more concentrated than the MSCI China A Onshore Index.

**Top Ten Holdings**

Stock Name	Description of Business	% of Portfolio
CATL	Battery manufacturer	10.1
Midea	Household appliance manufacturer	8.5
Kweichow Moutai	Spirits manufacturer	8.3
Shenzhen Inovance Technology	Industrial machinery manufacturer	5.1
Zhejiang Sanhua Intelligent Controls	Appliance part manufacturer	4.9
Anker Innovations	Electronics manufacturer	4.7
Proya Cosmetics	Chinese cosmetics	3.7
Sungrow Power Supply	Develops, produces, sells and provides services for photovoltaic inverters, wind power converters and other power supply	3.5
Centre Testing International	Testing and Inspecting Services	3.5
Ping An Insurance	Chinese insurance	3.4
<b>Total</b>		<b>55.7</b>

**Sector Weights**



	%
1 Industrials	38.8
2 Consumer Staples	16.8
3 Information Technology	15.7
4 Consumer Discretionary	13.0
5 Health Care	7.8
6 Financials	3.4
7 Materials	3.4
8 Cash	1.0

Figures may not sum due to rounding.

Voting Activity

Votes Cast in Favour		Votes Cast Against		Votes Abstained/Withheld	
Companies	15	Companies	3	Companies	2
Resolutions	114	Resolutions	3	Resolutions	3

Company Engagement

Engagement Type	Company
Environmental	BYD Company Limited, Contemporary Amperex Technology Co., Limited, Zijin Mining Group Company Limited
Social	BYD Company Limited, Contemporary Amperex Technology Co., Limited, S.F. Holding Co., Ltd., Zijin Mining Group Company Limited
Governance	BYD Company Limited, Dongguan Yiheda Automation Co., Ltd, Hangzhou Tigermed Consulting Co., Ltd, Midea Group Co., Ltd., Quectel Wireless Solutions Co., Ltd., Shanxi Xinghuacun Fen Wine Factory Co.,Ltd., Sungrow Power Supply Co., Ltd., Zijin Mining Group Company Limited

Company	Engagement Report
CATL	<p><b>Objective:</b> To follow up and learn the company's stance on US lawmakers urging the addition of CATL to the import ban list this June, and to understand its implications on the Ford partnership in the US. We also took the opportunity to gain a greater understanding of the impact of lithium resources on CATL's business operations.</p> <p><b>Discussion:</b> The board secretary and IR confirmed there was no additional update after CATL's public response to the allegations a few months ago. The company reiterated its position that there is no connection to forced labour or any violations of US law and regulations. It labelled some of the accusations as "wrong and misguided." CATL confirmed that its partnership with Ford in the US remains unaffected by these allegations. The discussion also touched on the dynamics of lithium supply and demand. CATL expressed confidence in the long-term demand for lithium and emphasised its strategic positioning to capitalise on this demand. The company's ownership of mines in strategic locations across China, Indonesia and South America, along with its active pursuit of high-quality assets globally, underscores its commitment to securing a stable lithium supply chain.</p> <p><b>Outcome:</b> This situation underscores the complexities businesses face when navigating geopolitical tensions, especially in sectors such as electric vehicles and battery manufacturing, where supply chains are global and subject to regulatory scrutiny. Despite these challenges, the ongoing partnership between CATL and Ford suggests a strong business relationship and confidence in the ability to comply with US regulations.</p>
S.F. Holding Co., Ltd.	<p><b>Objective:</b> To learn about labour management and the deployment of autonomous driving (AD).</p> <p><b>Discussion:</b> We met SF Holding's chief financial officer and Investor Relations in a post-result meeting. SF Holding demonstrates a strong commitment to employee welfare, as evidenced by its decision to increase delivery staff remuneration by 5-10 per cent despite a market-wide decline in salaries. This approach not only reflects the company's value but also contributes to a high employee retention rate, indicating a positive work environment. The company is integrating AD vehicles into its operations to alleviate the burden of labour-intensive and repetitive tasks on employees. Although the current number of AD vehicles is small relative to the total fleet, the anticipated decrease in the cost of AD cars suggests significant potential for productivity improvements. The ability to deploy AD vehicles in specific cities is contingent upon local government, underscoring the importance of navigating local regulations.</p> <p><b>Outcome:</b> The meeting provided valuable insights into SF Holding's strategic emphasis on employee welfare and sustainability. We believe this supports the business case and can be a contributor to future growth. We appreciate the company's proactive measures, such as increasing remuneration and deploying AD vehicles, and we are convinced that it treats sustainability as a priority in business planning.</p>

Company	Engagement Report
Zijin Mining	<p>Objective: As part of a three-year engagement plan with Zijin Mining, we visited its subsidiary, Julong Copper Mine in Tibet, to discuss its occupational safety management and equitable treatment of employees and contractors after a shaft falling accident. It is Zijin's largest mineral copper site in China and the third-largest globally.</p> <p>Discussion: Julong Copper is one of Zijin's most important copper mines. The conversation opened with a candid acknowledgement from Julong Copper's chief executive. The incident led to a comprehensive review and overhaul of safety protocols, including equipment checks, personnel accountability, and enhanced contractor management. A strengthened risk assessment framework now categorises outsourced units to ensure safety standards, with financial incentives tied to safety performance. To prevent such accidents from reoccurring, Julong Copper has partnered with the China Occupational Safety and Health Association to enhance its safety management system. The subsidiary also reiterated its commitment to treating employees and contractors equally, sharing resources, safety training, working conditions, etc. We also visited the tailing ponds and discussed material topics such as ecological restoration, community engagement, and autonomous driving on mine sites.</p> <p>Outcome: The discussion provided an overview of the subsidiary's current ESG practices. The recent improvement in safety protocols suggests that the company has taken steps to address the aftermath of the safety accident and is determined to avoid future occurrences. Efforts towards green mining and community involvement indicate the company's ongoing investment in sustainable operations. We will continue to monitor Zijin's progress to its responsible mining commitment going forward.</p>

## Votes Cast in Favour

Companies	Voting Rationale
Anker Innovations 'A', Guangzhou Kingmed 'A', Hefei Meyer Optoelectronic 'A' - Stock Connect, Iflytek 'A' - Stock Connect, Jiangsu Azure Corp 'A', Longshine Technology 'A' - Stock Connect, Midea Group 'A', Proya Cosmetics 'A', Quectel Wireless Solutions Co 'A' Stock Connect, SG Micro 'A', Sanhua Intelligent Controls 'A', Shenzhen Inovance 'A', Shenzhen Megmeet Electrical 'A', Yifeng Pharmacy Chain 'A' - Stock Connect, Yonyou 'A'	We voted in favour of routine proposals at the aforementioned meeting(s).

## Votes Cast Against

Company	Meeting Details	Resolution(s)	Voting Rationale
Guangzhou Kingmed 'A'	EGM 27/09/24	7.2	We opposed the election of one director because we have concerns over his suitability to serve on the board as he was criticised by Shanghai Stock Exchange.
Hefei Meyer Optoelectronic 'A' - Stock Connect	EGM 10/09/24	3	We opposed amendments to the company's articles of association because of concerns relating to the permanence of an amendment linked to the board's authority to issue shares.
SG Micro 'A'	EGM 19/09/24	2.1	We opposed the election of one director due to concerns they are not suitably qualified.

## Votes Abstained

Company	Meeting Details	Resolution(s)	Voting Rationale
Anker Innovations 'A'	EGM 01/07/24	2, 2	We abstained on the auditors as we have concerns over the professional suitability of the lead audit partner, who received a warning letter from a regulator.
Midea Group 'A'	EGM 02/07/24	8	We abstained on the provision of guarantees to a controlled subsidiary because the provision does not stipulate the use of counter guarantees and also does not appear to be proportionate to the company's holding.

## Votes Withheld

We did not withhold on any resolutions during the period.

## New Purchases

Stock Name	Transaction Rationale
Zijin Mining Group 'A' - Stock Connect	Zijin Mining is a copper and gold miner with good quality assets. It is likely to grow production volumes at 10% per annum via a combination of organic growth and M&A. We believe that the demand supply outlook, for copper in particular, is very attractive given strong demand from the green transition, along with limited forecast supply due to resource scarcity and low capex investment from developed market peers. The pricing outlook for Zijin's products therefore looks attractive and should add further to its top line opportunity. Zijin is a state owned enterprise but one that has a history of being managed well in terms of its track record in acquisitions, production growth, and cost control. The company has a double digit volume growth opportunity ahead of it, with potential for outlier returns in the event of strong pricing for its key commodities and a re-rating.

There were no complete sales during the period.



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