

China Quarterly Update

30 September 2024



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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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Product Overview

China is a regional equity strategy that adds value through active management by identifying and exploiting inefficiencies in growth companies.

Risk Analysis

Key Statistics

Number of Holdings	52
Typical Number of Holdings	40-80
Active Share	68%*
Rolling One Year Turnover	25%

*Relative to MSCI China All Shares 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 24th 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 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 Silergy and SG Micro, both 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. At the other end of the tech stack, you can't look too far beyond the likes of Alibaba, Tencent and Bytedance as companies most likely to benefit from the commercial application of AI in China.

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, as reflected in slower quarterly revenue growth at companies including Alibaba and Li Ning, 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 cancer leadership at Beigene 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.

One of the causes of Chinese companies increasingly looking globally is to escape the growing competition and slowing growth at home.

Domestically, consumers who are more conscious of slower wage growth and a reduced wealth effect from weak property prices, have been trading down. This has been supportive of companies such as Pinduoduo, Luckin Coffee and Proya, all growing market share by offering products and services that are very price competitive. Interestingly, at the other end of the spectrum, while big foreign consumer brands are reporting challenges in China in recent quarters, high end baijiu maker and China's leading consumer brand, Kweichow Moutai, announced good growth in revenues and profits for the first half of the year, highlighting its operational resilience while at the same time announcing an increased payout to shareholders. We take some confidence in companies using their cash to buy back shares at current valuations.

Performance

The Fund 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, with consumer discretionary and real estate best performing. Top contributors were largely for stock specific reasons and included Beigene and Meituan.

Beigene is a global oncology company focused on innovative and affordable medicines. The company recovered from broader concerns about the risk of geopolitical tensions affecting its business, reporting strong numbers which highlighted the strength of its existing drugs and its impressive R&D capabilities which underpin excitement in its growth pipeline.

Meituan is China's leading food delivery and local services business which is showing resilient growth despite weaker macro conditions and competition has become more rational. The announcement of an increase in the size of their share buyback reflects the company's confidence in its outlook and the cheap valuation.

The top detractors were Shenzhou International and Silergy.

Shenzhou International is a clothing manufacturer supplying some of the world's leading sportswear brands. While the company reported reasonable quarterly numbers, there has been concern about slower volume growth for international clients and further pricing pressure. This likely overlooks growth from a number of clients and the benefit from new capacity and

production efficiency improvements expected in coming years.

Silergy is an analogue semiconductor company, operating in a cyclical industry which often results in its performance flip-flopping between quarters. Despite reporting good revenue growth and stronger than expected gross margins during the quarter, flattish near-term sales guidance may have disappointed market expectations. We think this has little influence on the long-term structural growth story for a leading domestic semiconductor company committed to R&D leadership, expanding its product lines and playing to China's drive for greater self-sufficiency.

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 three 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

GBP	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	16.4	15.4	1.0
1 Year	4.6	9.7	-5.2
3 Years	-12.0	-5.9	-6.1
5 Years	-0.6	0.4	-1.0
10 Years	7.2	6.3	0.9
Since Inception	8.4	7.5	1.0
USD	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	23.5	22.5	1.0
1 Year	14.9	20.6	-5.7
3 Years	-12.1	-6.1	-6.1
5 Years	1.1	2.2	-1.0
10 Years	5.2	4.3	0.9
Since Inception	6.9	5.9	0.9
EUR	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	18.6	17.6	1.0
1 Year	9.0	14.4	-5.4
3 Years	-11.0	-4.9	-6.1
5 Years	0.7	1.7	-1.0
10 Years	6.5	5.6	0.9
Since Inception	7.3	6.3	0.9
CAD	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	21.9	20.9	1.0
1 Year	14.8	20.5	-5.7
3 Years	-10.2	-4.0	-6.2
5 Years	1.5	2.6	-1.0
10 Years	7.2	6.3	0.9
Since Inception	7.9	6.9	0.9
AUD	Composite Net (%)	Benchmark (%)	Difference (%)
3 Months	18.9	17.9	1.0
1 Year	6.9	12.2	-5.3
3 Years	-10.9	-4.8	-6.1
5 Years	0.6	1.6	-1.0
10 Years	7.7	6.8	0.9
Since Inception	7.3	6.3	0.9

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

Inception date: 28 February 2006

Figures may not sum due to rounding.

Benchmark is MSCI China All Shares Index (MSCI All China Index prior to 27 November 2019, MSCI Golden Dragon Index to 02 May 2019).

Source: FE, Revolution, MSCI.

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

Discrete Performance

GBP	30/09/19- 30/09/20	30/09/20- 30/09/21	30/09/21- 30/09/22	30/09/22- 30/09/23	30/09/23- 30/09/24
Composite Net (%)	44.8	-1.7	-25.6	-12.2	4.6
Benchmark (%)	26.2	-2.8	-17.4	-8.0	9.7
USD	30/09/19- 30/09/20	30/09/20- 30/09/21	30/09/21- 30/09/22	30/09/22- 30/09/23	30/09/23- 30/09/24
Composite Net (%)	51.9	2.5	-38.4	-4.0	14.9
Benchmark (%)	32.4	1.4	-31.6	0.6	20.6
EUR	30/09/19- 30/09/20	30/09/20- 30/09/21	30/09/21- 30/09/22	30/09/22- 30/09/23	30/09/23- 30/09/24
Composite Net (%)	41.3	3.7	-27.2	-11.2	9.0
Benchmark (%)	23.1	2.6	-19.1	-7.0	14.4
CAD	30/09/19- 30/09/20	30/09/20- 30/09/21	30/09/21- 30/09/22	30/09/22- 30/09/23	30/09/23- 30/09/24
Composite Net (%)	53.3	-2.8	-33.2	-5.6	14.8
Benchmark (%)	33.5	-3.8	-25.8	-1.0	20.5
AUD	30/09/19- 30/09/20	30/09/20- 30/09/21	30/09/21- 30/09/22	30/09/22- 30/09/23	30/09/23- 30/09/24
Composite Net (%)	43.0	1.7	-30.8	-4.4	6.9
Benchmark (%)	24.6	0.6	-23.2	0.2	12.2

Benchmark is MSCI China All Shares Index.

Source: FE, Revolution, MSCI.

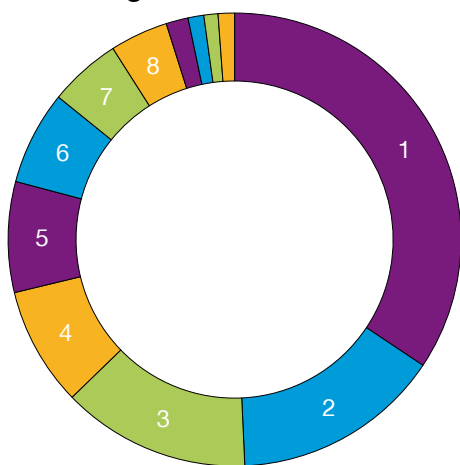
The China composite is more concentrated than the MSCI China All Shares Index

Top Ten Largest Holdings

Stock Name	Description of Business	% of Portfolio
Tencent	Technology conglomerate	9.1
Meituan	Chinese online services platform	7.2
Alibaba	Chinese e-commerce, cloud infrastructure, digital media, and payments.	6.3
Kweichow Moutai	Spirits manufacturer	5.1
PDD Holdings	Chinese e-commerce platform focused on social commerce	4.1
CATL	Battery manufacturer	3.6
China Merchants Bank	Chinese bank	3.4
Ping An Insurance	Provides insurance services in China	3.3
Midea	Household appliance manufacturer	2.8
BeiGene	Chinese biotech	2.7
Total		47.6

Totals may not sum due to rounding.

Sector Weights



	%
1 Consumer Discretionary	34.4
2 Industrials	14.9
3 Communication Services	13.5
4 Consumer Staples	8.5
5 Information Technology	7.9
6 Financials	6.7
7 Health Care	5.2
8 Materials	4.1
9 Real Estate	1.6
10 Utilities	1.1
11 Energy	1.0
12 Cash	1.2

Totals may not sum due to rounding

Voting Activity

Votes Cast in Favour		Votes Cast Against		Votes Abstained/Withheld	
Companies	15	Companies	2	Companies	2
Resolutions	116	Resolutions	3	Resolutions	2

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, Zijin Mining Group Company Limited
Governance	BYD Company Limited, Dongguan Yiheda Automation Co., Ltd, Hangzhou Robam Appliances Co., Ltd., Kingsoft Corporation Limited, Midea Group Co., Ltd., NetEase, Inc., Shanxi Xinghuacun Fen Wine Factory Co.,Ltd., Sungrow Power Supply Co., Ltd., Zijin Mining Group Company Limited
Strategy	Tencent Holdings Limited

Company	Engagement Report
Contemporary Amperex Technology Co.Limited	<p>Objective: 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>Discussion: 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>Outcome: 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>
Tencent	<p>Objective: To get insight from the company on gaming regulation trends and to learn the company's take on social value in gaming.</p> <p>Discussion: Tencent perceives the regulatory environment for gaming industry as generally supportive, drawing from recent policy documents and its own interactions with regulatory bodies. The supportive nature of these policies likely facilitates a more favourable environment for the development and distribution of video games. The company places a strong emphasis on innovation in gaming to foster new gameplay, content creation and the development of new technologies, which can benefit cross-sector applications and thus have broader implications. While we acknowledge the social headwinds which have been extensively discussed elsewhere, it was helpful to discuss the changing perspectives with a more positive focus on how game studios integrate social benefits into games, the protection of historic relics, promoting global cultural exchange, and advancing the use of AIGC (AI-generated content) tools.</p> <p>Outcome: The meeting provided additional insights into the company's strategic thinking on the regulatory environment and its social responsibility. It is helpful to learn that the social value of gaming extends beyond the gaming arena and that Tencent intends to contribute positively to society and national interests.</p>

Company	Engagement Report
Zijin Mining Group	<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
Alibaba Group Holding, Anker Innovations 'A', Estun Automation 'A', Fuyao Glass Industry Grp 'H', Guangzhou Kingmed 'A', Huayu Auto Systems 'A', Jiangsu Azure Corp 'A', Midea Group 'A', Proya Cosmetics 'A', 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.
SG Micro 'A'	EGM 19/09/24	2.1, 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	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
CNOOC	<p>CNOOC is a leading oil and gas company in China which generates through the cycle returns of 15%, is likely to grow its production at 7% pa in coming years, and offers a dividend yield of 7%. CNOOC is a low cost producer with an all-in production cost of approximately \$28 meaning that its production is cash flow positive at oil prices as low as \$30. Profitable and cash generative growth and an attractive dividend is therefore likely at oil prices significantly below today's. We believe there is significant upside risk to the growth numbers if oil prices are above \$80 or via additional M&A. Issues in the Middle East, Iran and Russia, the increasing political cost of production growth for developed market competitors, and counter-intuitively, an acceleration of the green transition (in some scenarios) are all supportive of higher prices. The company has net cash of \$15bn on its balance sheet and its forecast free cash flow yield is 18% even after forecast capital expenditure of \$17bn. With SOE reform, there is a chance that the firm's capital structure further improves to the benefit of minority shareholders. The potential upside is not being captured in its valuation of 6x 2024 p/e, half the rating of comparable global oil and gas companies, and we would expect the higher growth outlook to be reflected in a rerating of the shares. We believe the risk return profile for the stock is attractive and have therefore decided to take a holding.</p>

Complete Sales

Stock Name	Transaction Rationale
Ping An Bank	<p>Ping An bank is a commercial bank offering financial services to corporate and individual clients throughout China. We had hoped that a major organisational and management restructuring would allow it to benefit more broadly from the Ping An Group, across branding, management and other synergies, particularly the group's best in class technology which we hoped would help a continued transformation towards becoming one of the country's leading retail banks. This investment case has not played out. It has not exhibited the strengths we had envisioned, and been increasingly challenged within a sector undergoing a number of regulatory and economic headwinds. We have sold the position.</p>

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