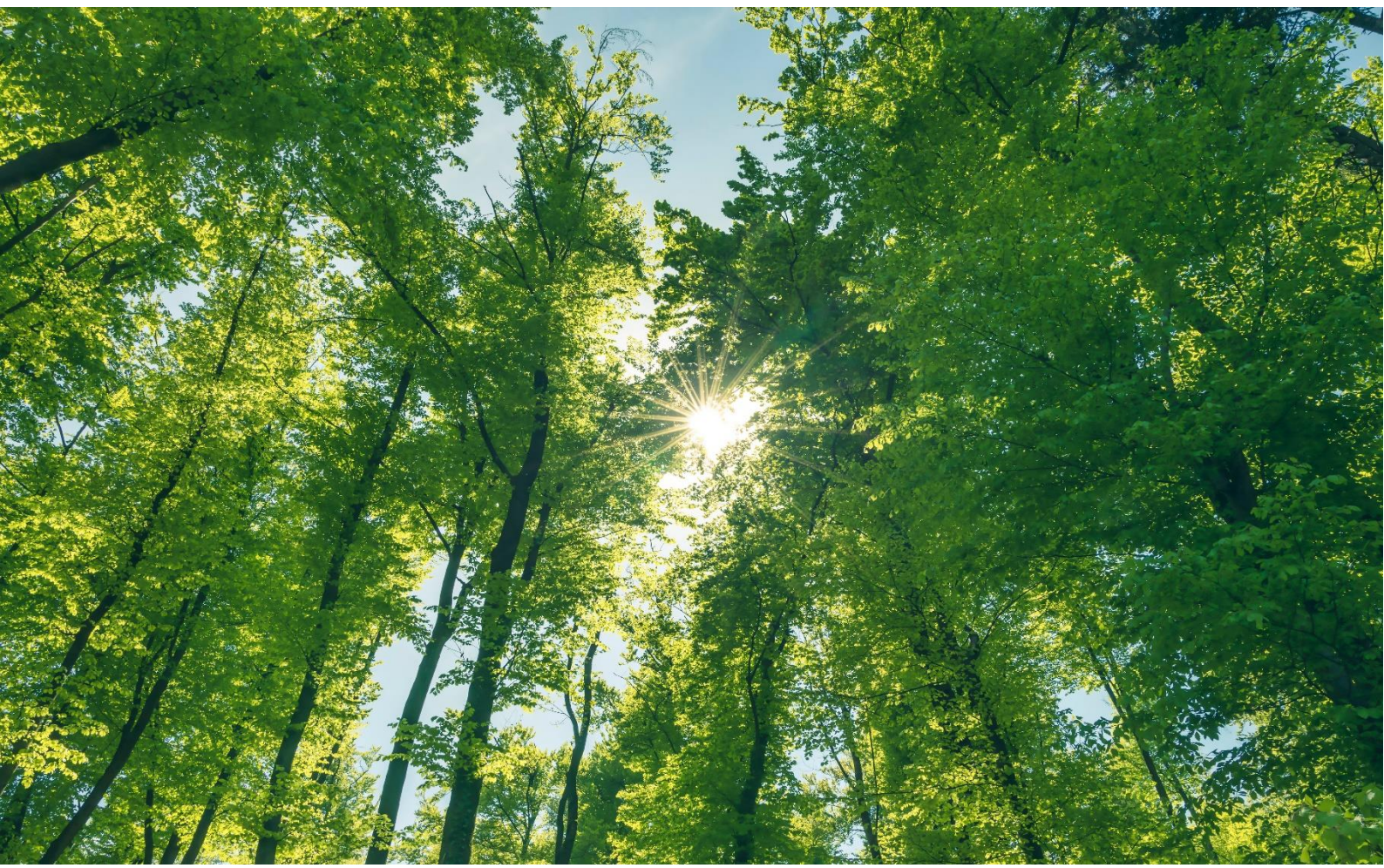




Market Insights

# China — From Uninvestable to Desirable



## **China — From Uninvestable to Desirable**

For the first time in many years, foreign holdings of Chinese assets have all turned positive this year. China, once considered uninvestable by foreign investors, has now turned into one of the most desirable markets. Short-term gains in the markets look fast and furious. Investors may look to lock in their profits, but we believe there is greater potential for a structural re-rating.

Over the last 33 years, China economic growth has outpaced the US by 8 times. During the same period, the HSI, which is a proxy of foreign-capital buying into China assets, has underperformed the S&P 500 by 60%. In terms of valuation, the Hong Kong market is trading at a 50% discount as compared to the US. Considering the current value-added components of Chinese manufacturing, its level of innovation, global economic dominance, and advancements in AI, should one still argue that China needs to trade at a discounted valuation?

It is true that the China economy is neither too cold nor too hot. We argue that the best equity market does not need the best economy as investors are not buying the current state of the economy but the future change of the policy direction as shaped by the current economy. A soft economy is the ideal condition for the equity market as monetary policy will be accommodative.

In short, the Hong Kong/China markets may consolidate in the short term driven by profit-taking. We would take advantage of any consolidation opportunities to accumulate for a multi-year re-rating potential.

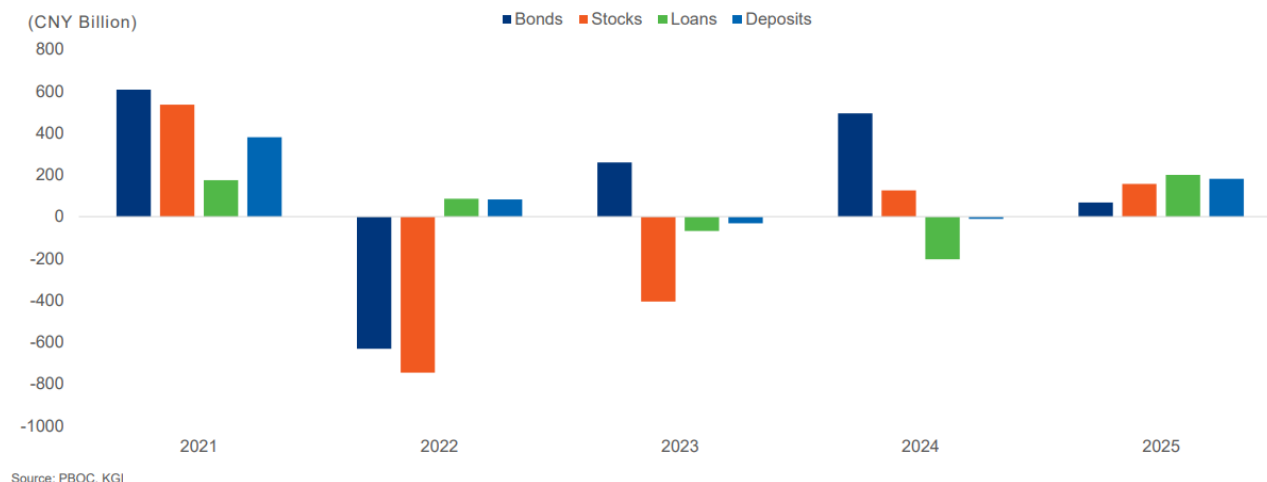
### **A 180-degree change in investment sentiment**

The perception of Chinese equities has shifted markedly in recent years. Once viewed as uninvestable amid prolonged market downturns and economic headwinds, China now presents a compelling case for investors. This transition is driven not by an outright economic boom, but by a confluence of policy signals, improving sentiment, and structural undervaluation. Critically, the strongest equity markets do not always require the most robust economies. Instead, they often thrive on anticipation of policy support and early recovery dynamics, conditions that align closely with China's current trajectory.

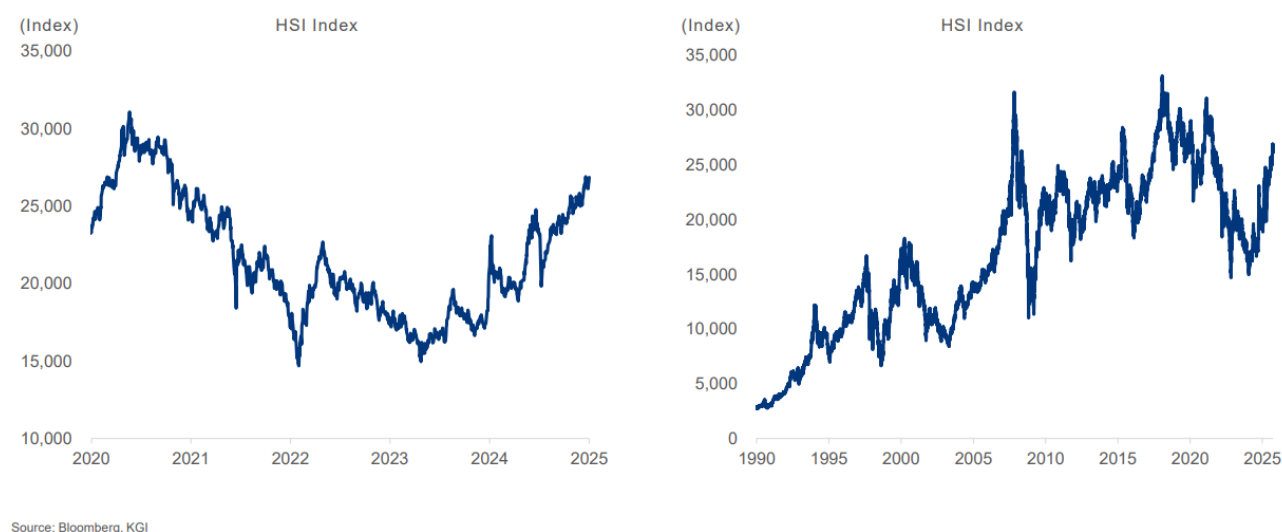
A key indicator of this resurgence is the influx of foreign capital into Chinese assets. After years of outflows, 2025 has marked a turning point, with net holdings expanding across all major categories—bonds, stocks, loans, and deposits—for the first time in four years. This broad-based growth reflects renewed confidence amid global uncertainties, particularly policy ambiguity in the United States, which has redirected flows toward emerging markets including China. Foreign investors, previously sidelined, are rebuilding positions from historically low levels following an extended bear market.



### Foreign Holdings of Chinese Assets Expand Across Board 2025 shows net growth in every asset class for first time in 4 years



The Hang Seng Index (HSI) serves as a reliable barometer for foreign interest in Chinese assets. Its recent uptick follows a three-year decline that left valuations depressed and positioning extremely light. From troughs near 15,000 in late 2022, the HSI has climbed toward 25,000 by mid-2025, signaling a catch-up phase rather than overextension. This recovery builds on a base of limited prior exposure, allowing for sustained upside without immediate overcrowding risks.



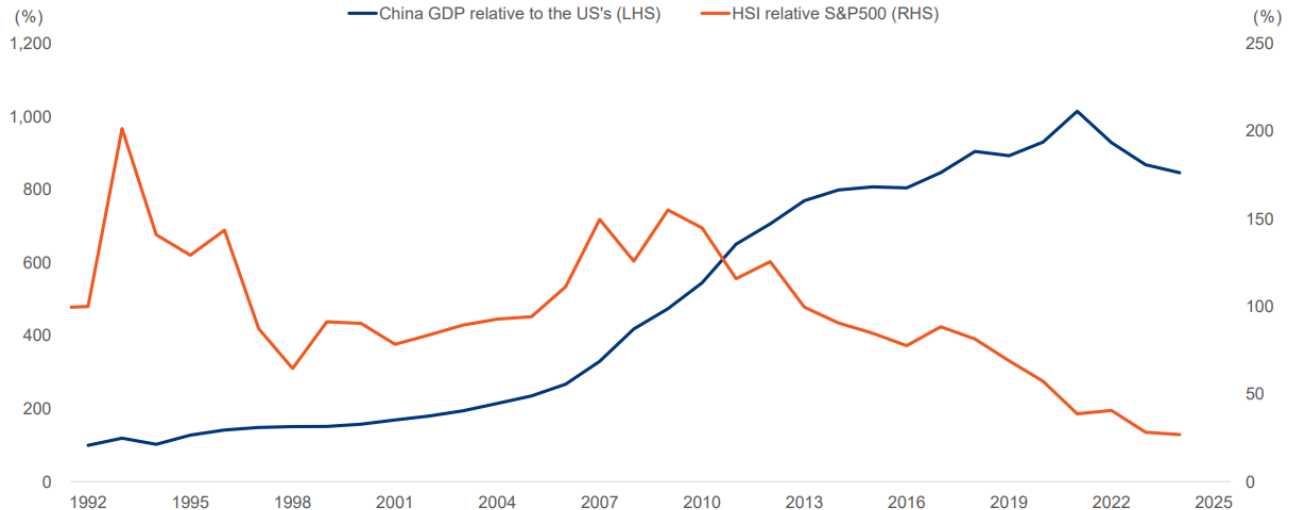
Domestic sentiment tells a parallel story through the Shanghai A-Shares Index, which tracks mainland investor behavior. After stagnating below 3,000 for much of 2023-2024, it has begun to stabilize and edge higher, approaching 3,500 in recent months. This modest rebound indicates the early stages of confidence restoration among local participants, who had retreated amid property sector woes and subdued growth. While not yet euphoric, the trend suggests a foundation for broader participation as policy measures take hold.



Source: Bloomberg, KGI

### Historical context underscores the opportunity

Over the past 33 years, China's GDP has expanded eightfold relative to the United States, outpacing it in real terms and establishing the country as the world's second-largest economy. Yet, the HSI—a proxy for China-linked equities—has lagged the S&P 500 by 60% over the same period. This disconnect highlights a profound undervaluation, where economic achievements have not translated into commensurate market rewards. Factors such as regulatory interventions, geopolitical tensions, and global risk aversion contributed to this underperformance, but they now appear to be abating.

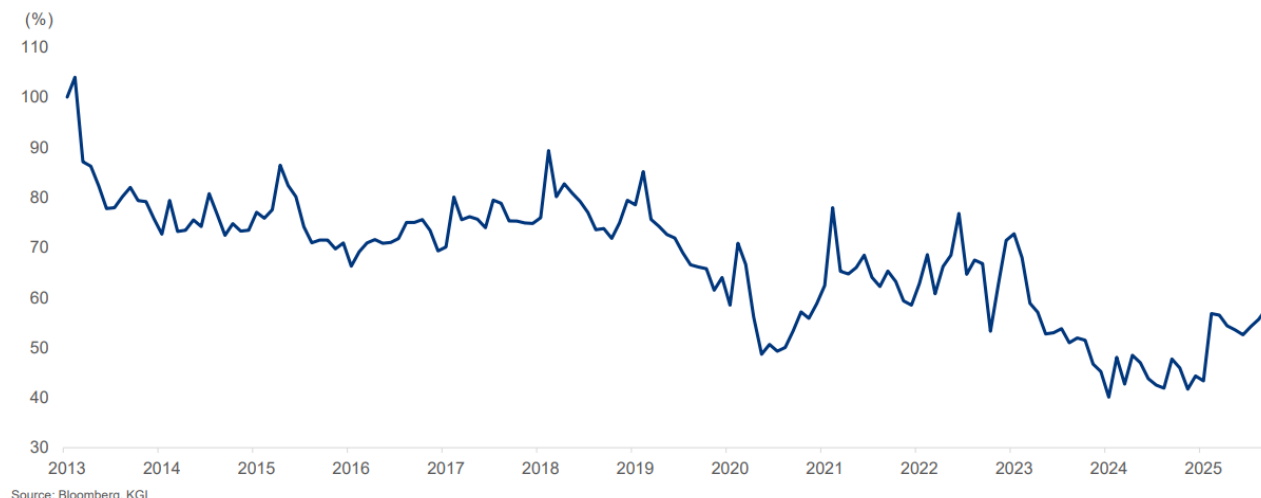


Source: Bloomberg, KGI

### Valuation metrics reinforce this re-rating potential

The price-to-earnings ratio (PER) of the HSI relative to the S&P 500 has bottomed out near 60% of its long-term average in 2024, the lowest in over a decade. As of late 2025, it stands at around 70%, signaling the onset of a multi-year normalization process. With earnings recovery underway and interest rates accommodative, this gap offers room for multiple expansion without relying on aggressive growth assumptions.

PER Relative of HSI &amp; S&amp;P500



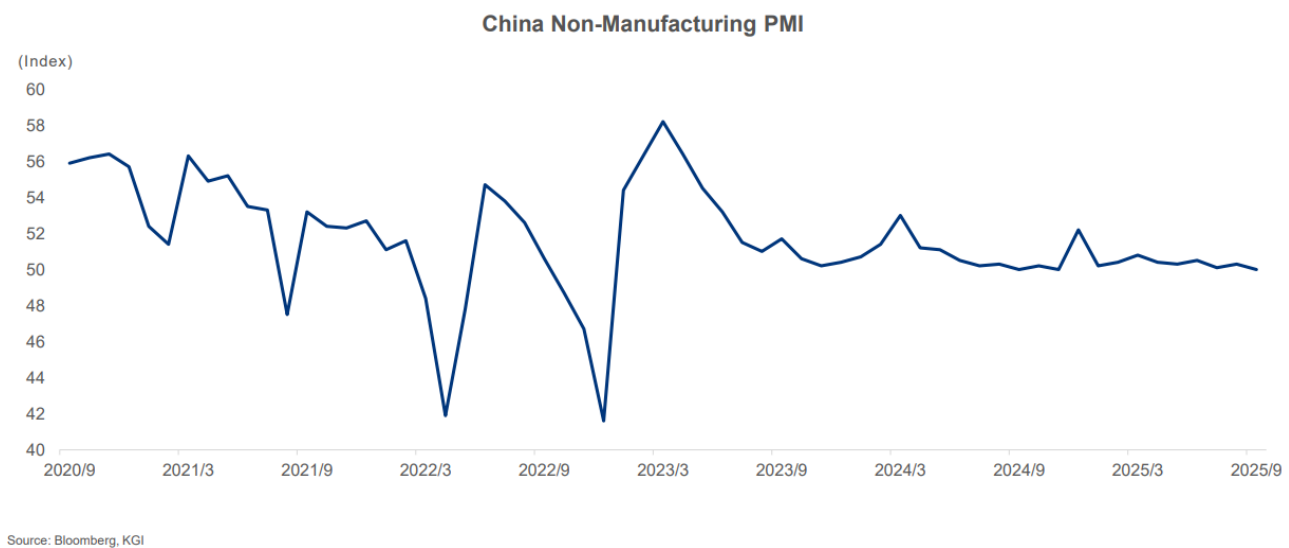
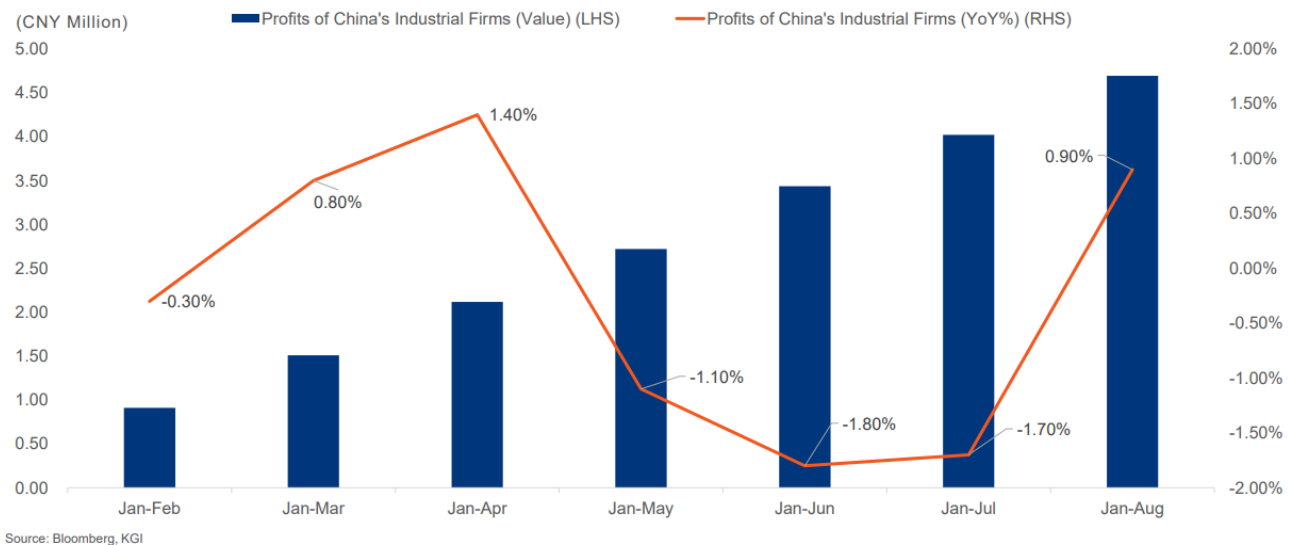
Central to this outlook is the premise that equity outperformance stems from policy expectations rather than peak economic cycles. Optimal conditions include GDP growth improving from low bases in an early recovery phase, stable or mildly declining inflation to avoid tightening, and consumer confidence rising gradually to spur spending without overheating. China's profile matches these criteria. Consensus forecasts peg 2025 GDP growth at 4.5%, below the official 5% target but sufficient to signal stabilization and lift corporate profits without prompting rate hikes. Core inflation hovers below 1%, supporting easy monetary conditions and borrowing. Retail sales, while in low single digits, reflect moderate optimism that could accelerate with targeted stimulus.

Indicator	Optimal Condition	Reason	China
GDP Growth Cycle	Improving from low levels (early recovery phase)	Signals recovery and rising corporate profits without triggering immediate rate hikes; market anticipates future growth	The consensus forecast for China GDP growth is at 4.5%, below the official target of 5%
CPI Trend	Stable or declining (low to moderate inflation, around 2%)	Avoids central bank tightening; supports borrowing and investment, keeping policy accommodative	Core inflation is running at below 1%
Consumer Confidence Strength	Rising from moderate/low levels	Indicates increasing spending and optimism, driving earnings, but not so high as to fuel inflationary pressures	Retail sales growth is at low single digit level

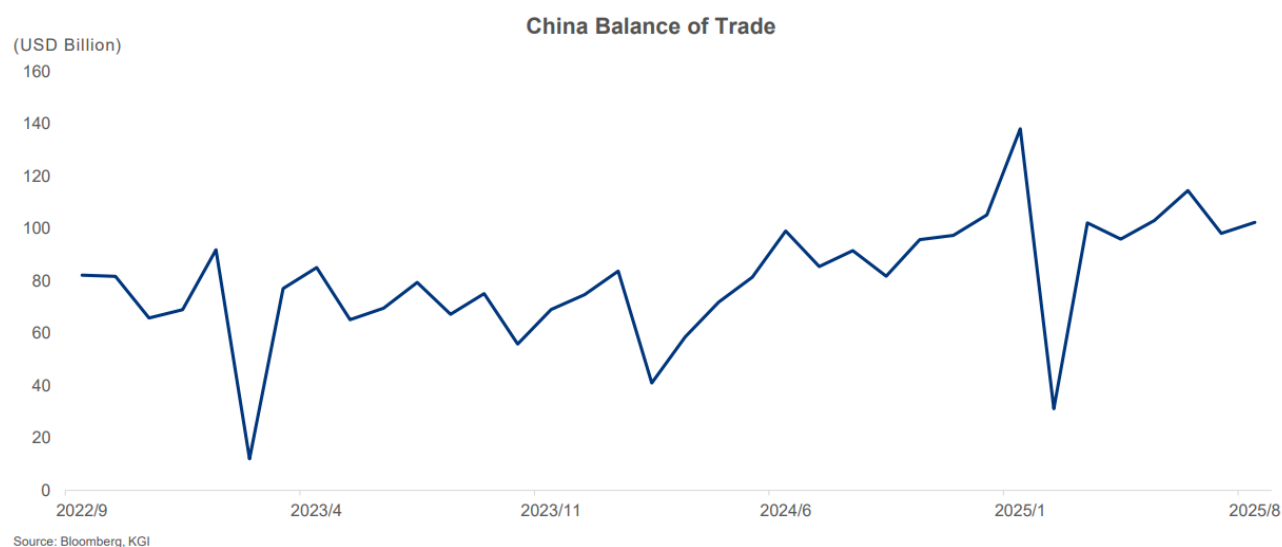
Source: KGI

### Profits at industrial firms turned positive

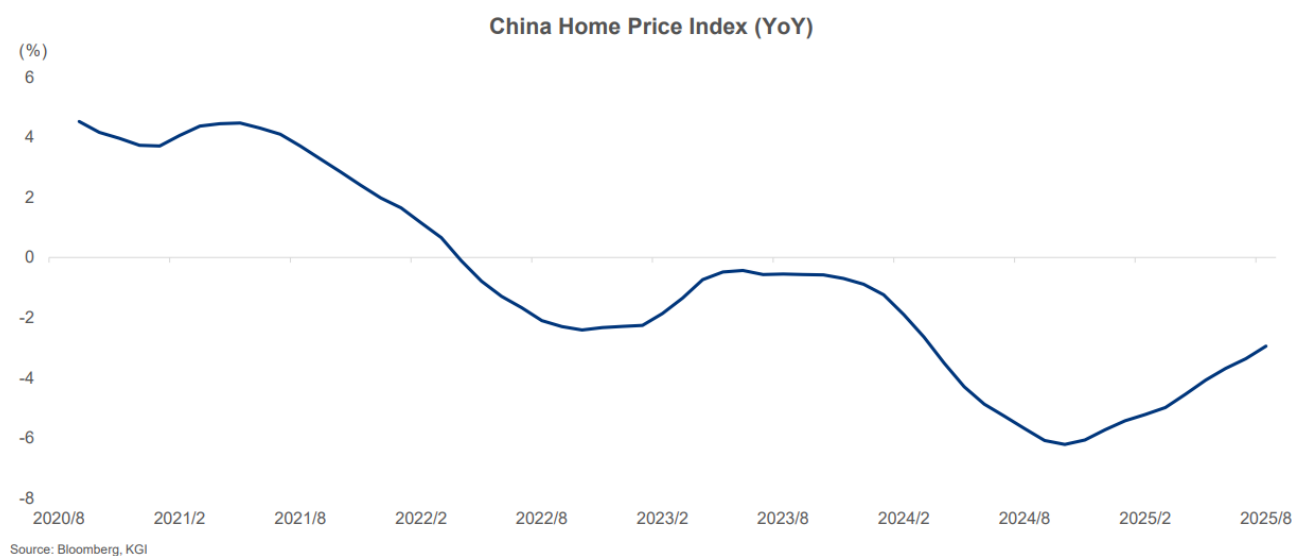
Profits at industrial firms turned positive in August 2025, growing 0.9% year-over-year after a -1.7% contraction through July. This shift, from cumulative losses of CNY 1.1 billion to gains of CNY 0.9 billion in the first eight months, points to easing cost pressures and demand recovery in manufacturing. The non-manufacturing PMI, at 50.2 in September 2025, confirms an economy that is neither accelerating nor contracting—ideal for equities sensitive to growth surprises.



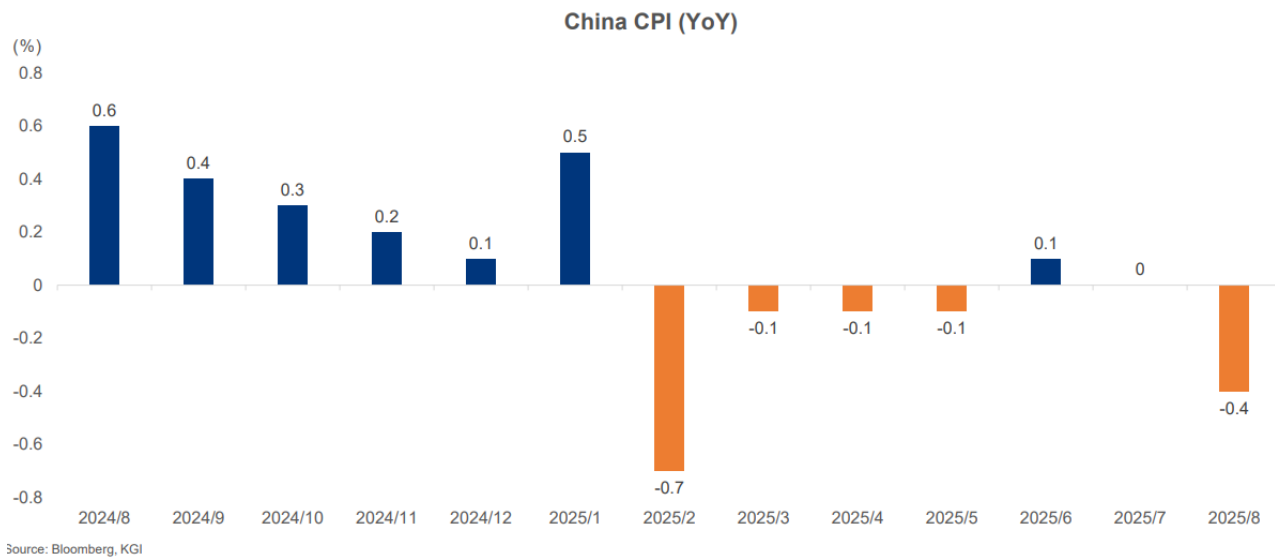
External balances bolster this narrative. China's trade surplus reached USD 102.33 billion in August 2025, exceeding expectations of USD 99.2 billion and underpinning the renminbi's stability. This resilience counters softer domestic indicators, such as industrial production, which eased to 5.2% year-over-year from July's 5.7% and missed forecasts of 5.8%. While production remains subdued, it aligns with a controlled slowdown rather than recessionary forces.



The property sector, a longstanding drag, shows tentative improvement. Home prices have declined year-over-year but at a narrowing pace since the third quarter of 2024, with August's drop at -2.1% versus -4.5% earlier in the year. This moderation, aided by policy easing on developer financing and buyer incentives, reduces downside risks without fueling bubbles.



Inflation dynamics remain benign, with headline CPI edging into deflation at -0.1% in August 2025. Core measures, excluding food and energy, rose to 0.9%—an 18-month high following July's 0.8%—indicating underlying demand without wage-push pressures. This environment has kept the 10-year government bond yield below 2%, at 1.8% in September, ensuring ample liquidity for investment and corporate refinancing.



In summary, China's equity markets are poised for outperformance not despite economic moderation, but because of it. The combination of foreign inflows, undervalued benchmarks, and policy-aligned indicators creates a desirable entry point. Investors stand to benefit from a re-rating that rewards anticipation over perfection, positioning China as a core allocation in diversified portfolios. As global flows normalize, the transition from uninvestable to essential appears well underway.



## Investment Products and Solutions Department

## ◆ LEUNG Kai Tong · CFA

SFC licensee (CE No. ADU276)

[cusson.kt.leung@kgi.com](mailto:cusson.kt.leung@kgi.com)

## ◆ LEUNG Wai Hang

SFC licensee (CE No. ARA294)

[vitus.wh.leung@kgi.com](mailto:vitus.wh.leung@kgi.com)

## ◆ MOK Raymond · CFA

SFC licensee (CE No. BHJ465)

[raymond.mok@kgi.com](mailto:raymond.mok@kgi.com)

## ◆ KUNG Chun Wah · CFA

SFC licensee (CE No. BRY438)

[tommy.kung@kgi.com](mailto:tommy.kung@kgi.com)

## ◆ YIP Chun Yi

SFC licensee (CE No. BSQ196)

[derek.yip@kgi.com](mailto:derek.yip@kgi.com)

## DISCLAIMER

All the information contained in this document is not intended for use by persons or entities located in or residing in jurisdictions which restrict the distribution of this document by KGI Asia Limited ("KGI"), or any other affiliates of KGI. Such information shall not constitute investment advice, or an offer to sell, or an invitation, solicitation or recommendation to subscribe for or invest in any securities, insurance or other investment products or services nor a distribution of information for any such purpose in any jurisdiction. In particular, the information herein is not for distribution and does not constitute an offer to sell or the solicitation of any offer to buy any securities in the United States of America, or to or for the benefit of United States persons (being residents of the United States of America or partnerships or corporations organised under the laws of the United States of America or any state, territory or possession thereof). All the information contained in this document is for general information and reference purpose only without taking into account of any particular investor's objectives, financial situation or needs and may not be redistributed, reproduced or published (in whole or in part) by any means or for any purpose without the prior written consent of KGI. Such information is not intended to provide any legal, financial, tax or other professional advice and should not be relied upon in that regard.

All investments involve risks. The prices of securities fluctuate, sometimes dramatically. The price of a security may move up or down, and may become valueless. It is as likely that losses will be incurred rather than profit made as a result of buying and selling securities.

Bond investment is NOT equivalent to a time deposit. It is NOT protected under the Hong Kong Deposit Protection Scheme. Bondholders are exposed to a variety of risks, including but not limited to: (i) Credit risk - The issuer is responsible for payment of interest and repayment of principal of bonds. If the issuer defaults, the holder of bonds may not be able to receive interest and get back the principal. It should also be noted that credit ratings assigned by credit rating agencies do not guarantee the creditworthiness of the issuer; (ii) Liquidity risk - some bonds may not have active secondary markets and it would be difficult or impossible for investors to sell the bond before its maturity; (iii) Interest rate risk - When the interest rate rises, the price of a fixed rate bond will normally drop, and vice versa. If you want to sell your bond before it matures, you may get less than your purchase price. Do not invest in bond unless you fully understand and are willing to assume the risks associated with it. Please seek independent advice if you are unsure.

You are advised to exercise caution and undertake your own independent review, and you should seek independent professional advice before making any investment decision. You should carefully consider whether investment is suitable in light of your own risk tolerance, financial situation, investment experience, investment objectives, investment horizon and investment knowledge.

No representation or warranty is given, whether express or implied, on the accuracy, adequacy or completeness of information provided herein. In all cases, anyone proposing to rely on or use the information contained herein should independently verify and check the accuracy, completeness, reliability and suitability of the information. Simulations, past and projected performance may not necessarily be indicative of future results. Information including the figures stated herein may not necessarily have been independently verified, and such information should not be relied upon in making investment decisions. None of KGI, its affiliates or their respective directors, officers, employees and representatives will be liable for any loss or damage of any kind (whether direct, indirect or consequential losses or other economic loss of any kind) suffered or incurred by any person or entity due to any omission, error, inaccuracy, incompleteness or otherwise, or any reliance on such information. Furthermore, none of KGI, its affiliates or their respective directors, officers, employees and representatives shall be liable for the content of information provided by or quoted from third parties.

Members of the KGI group and their affiliates may provide services to any companies and affiliates of such companies mentioned herein. Members of the KGI group, their affiliates and their directors, officers, employees and representatives may from time to time have a position in any securities mentioned herein.