Hong Kong and China Equities: Has the Tide Turned?

A Discussion with Polen Capital's Greater China Investment Team

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With China's equity markets trading at historic valuation discounts to the U.S. equity markets and recently showing signs of stabilization after years of underperformance, many investors are asking: Has the tide turned?

At Polen Capital's recent Hong Kong luncheon, our China investment team—June Lui, Kevin Chee, and Yingying Dong—shared their insights on the market's inflection points, structural opportunities, and how they identify sustainable growth companies in this complex environment. Below, we address key questions from the discussion, combining macro perspectives with bottom-up investment insights.

Polen Capital's Greater China Investment Team

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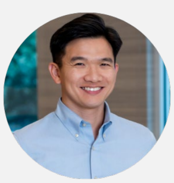
Portfolio Manager & Analyst

June leads Polen Capital's China Growth strategy. Previously at BMO and LGM (acquired by Polen in 2023), she specializes in Greater China markets. She is a CFA and ESG-certified analyst with degrees from the Chinese University of Hong Kong and the University of Hong Kong.



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Kevin co-manages Polen Capital's China Growth strategy. Previously at Jefferies and LGM (acquired by Polen in 2023), he holds an applied mathematics degree from National University of Singapore and is a CFA charterholder.

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Portfolio Manager & Analyst

Yingying co-manages Polen Capital's China Growth strategy. She previously worked at Deutsche Bank and LGM (acquired by Polen in 2023). She holds a degree in economics from Fudan University, is a CFA charterholder, and holds a CFA certificate in ESG investing.

Q: Let's start with the big picture. June, do you believe the recent China rally has legs?

June: When we look at the performance of the MSCI China Index versus the S&P 500 over the past decade, the divergence is startling. We're at historically wide valuation gaps, which suggests that in China's equity market, much of the bad news is being priced in. However, rallies need fundamentals to sustain them, not just cheap valuations.

What's encouraging is that we are finally seeing some green shoots after a difficult period of property stress and deflationary pressures. The policy shift in September 2024 was important because it signaled to markets that supporting growth is back on the agenda.[1] Recently, retail sales and industrial production have been relatively robust. However, we're watching closely to see if this momentum holds beyond the initial stimulus bump.

Q: With the concerns of tariffs and policy uncertainties, how should investors view China?

June: In a period of heightened volatility, we believe active management is more necessary than ever to navigate risks proactively. As we see it, the best way to invest in China is to be very selective. We are very cautious about potential geopolitical and tariff impacts, and we avoid investing in businesses that are directly affected by these risks. We invest in companies that have competitive business models, which we believe are positioned to grow earnings and cash flows at an attractive rate.

We look for companies with wide and sustainable competitive moats, long-term structural growth, management teams who are capable and trustworthy, who have demonstrated good capital discipline, and business models that can self-finance growth. These businesses usually have attractive financials, such as a high return on invested capital, real organic revenue growth, strong free cash flow, and healthy balance sheets. We are very selective and identify what we believe are the highest-quality 30 to 40 businesses for investment in our portfolio.

[1] Polen Capital, Policy Pivot: China at a Crossroads, October 2024

Q: Where do you see attractive investment opportunities in China?

June: Through bottom-up fundamental research, we are able to capture structural opportunities with a long-term perspective.

In our portfolios, we have outstanding companies that are leaders in industrial automation, digitalization and AI, energy transition and electrification, healthcare improvements, and the fulfillment of evolving consumption needs.

These companies have delivered robust annual earnings growth of mid-to-high teens in the last couple of years, even when the overall macro environment has been challenging. Also, with their attractive cash flows and balance sheets, these businesses have shown good capital discipline in increasing dividend payouts and doing more share buy-backs to improve shareholder returns.

Q: Where are you seeing the most interesting opportunities in consumption?

Kevin: The consumption story has fundamentally changed post-pandemic. What's fascinating is how quickly Chinese consumers have shifted from buying things to buying experiences. Travel is one clear example. Consumers are putting more budget on traveling, but they are spending differently when they travel. Instead of coming home with suitcases filled with goods, they're shifting their priorities toward unique experiences like concerts.

Trip.com is a prime example of a company benefiting from the tailwind of the experiential consumption trend.[2] The competitive landscape has also improved vastly. Ten years ago, this was an industry where venture capital funded fierce price competition. Now, with high customer acquisition costs and ByteDance unable to gain traction, the competitive dynamics have rationalized significantly.

Q: What aspects should investors think about when investing in consumer companies where China is a big end market?

Kevin: Consumers are putting less budget toward their normal routines and more on getaways. For example, within sportswear, outdoor sneakers are growing fast while basketball shoe sales are declining. Also, consumers are now more open-minded in terms of brands, putting considerations on factors like materials and local aesthetics when making decisions. This opens an opportunity for several domestic brands, while the global brands that don't adapt lose relevance.

Q: Are you concerned about China's demographics and the impact on long-term growth?

Yingying: Indeed, population aging and the shrinking labor force are significant trends in many countries, including China. However, challenges also bring opportunities. For example, we believe automation is an important structural trend in the coming decade. It is a powerful tool to enhance productivity and ranks among the top priorities for policymakers in China. From 2020-2023, robot density grew at about 25% CAGR in the country, much faster than the global average of less than 10%. By annual installation, China alone accounts for half of the volume globally.[3]

The automation industry is a sticky business and was long dominated by foreign multinational corporations in Europe and Japan. For example, the large-size programmable logic controller (PLC) sector is fully dominated by foreign players with Siemens alone taking about half the market share.[4] As such, localization, improved quality, and the reliability of core components for international standards are all mission-critical.

Chinese companies have put a lot of effort into R&D and have gradually evolved from big consumers of industrial robots to increasingly meaningful producers of them. We believe these companies will enjoy a long runway of growth, benefiting from China's growing automation market and continued localization.

[2] Trip.com was a holding in Polen's China Growth strategy as of 31 March 2025.
[3] International Federation of Robotics, World Robotics 2024
[4] A PLC is a specialized computer used to control and monitor industrial processes and machinery. It functions as the "brain" of an automated plant.

Q: How would you rate the competitiveness of Chinese companies?

Yingying: For industrial robots, the core technology is led by European and Japanese players, and China is trying hard to catch up. However, this might no longer be the case in humanoid robots, where China files about two-thirds of patents globally.[5] In fact, a similar story has already played out in electric vehicles. For internal combustion engines (ICEs), global original equipment manufacturers (OEMs) dominate China's passenger vehicle market with over 70% share.[6] But when the industry marched into electric vehicles (EVs), the dynamics shifted dramatically.

Local OEMs take the opportunity of technology disruption and become increasingly competitive, accounting for 80% of EVs sold in the country. Today China accounts for 60% of global EV sales and leads penetration globally.[7] During this transition, we witnessed the rise of a few highly competitive local brands with impressive innovations on various fronts rolling out rapidly. Recently, we have also seen an accelerating adoption of Advanced Driver Assistance Systems (ADAS) in China, which could potentially make local OEMs more compelling than ICE incumbents globally.

Q: Lastly, what would be your one piece of advice for investors considering China today?

June: Look past the short-term market noises and focus on business fundamentals. Some of the world's best "compounding machines" are companies listed in Hong Kong and China. When there is a pessimistic outlook toward the region, it can offer patient investors with a good understanding of the market the opportunity to invest in wonderful businesses at attractive prices. Doing the work to build that understanding is essential, though.

Kevin: Dig deeper to understand what lies beyond the headlines. For example, a simplistic narrative that Chinese consumers are "not spending" misses how profoundly spending patterns are evolving.

Yingying: Today, many Chinese local leaders are becoming increasingly competitive in the global context. This means overseas expansion could bring further room for growth.

Key Takeaway for Investors

While China's economic transition creates volatility, we're finding compelling opportunities in companies that are innovating, gaining share, and returning capital to shareholders. In our view, the key is being selective. For active investors who have deep knowledge of the fundamentals and exercise strong investment discipline, we believe there are attractive alpha opportunities in the China markets.

[5] Google Patents and Morgan Stanley Research, 2025
[6] Chinese Association of Automobile Manufacturers, 2025
[7] BloombergNEF, Electrical Vehicle Outlook 2024

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