



China Equity

The rewards of a disciplined
and dynamic approach

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When we launched our China Equity Strategy in July 2022 it was during a tough period for the asset class. However, we did not just see risks, we saw opportunities. Despite various headwinds, we saw enduring potential in a market that remains one of the most dynamic in the world – and that conviction has been rewarded.

- China Equity hit its three-year milestone this year and its dynamic and disciplined approach – guided by the same contrarian valuation-led philosophy as our Asia ex-Japan Equity Strategy – has allowed it to prosper throughout a volatile market cycle.
- The economic backdrop may have been challenging, but it has created plenty of opportunity for disciplined stock pickers. One of our skillsets is identifying businesses where the valuation has become compelling and the fundamentals remain resilient – regardless of external macro factors.
- The Strategy is designed to uncover stocks that have fallen out of favour but, in our view, have been over-penalised by the market. This framework allows us to scale across the quality spectrum, allocating capital where valuations are most compelling – whether in mispriced high-quality companies or overlooked value names.

When we launched the China Equity Strategy in July 2022 it was not during a period of exuberance and optimism about the asset class – it was a time of deep market uncertainty.

China faced a raft of structural challenges: a collapsing property market, weakening consumer confidence, demographic headwinds, declining foreign investment and rising geopolitical tensions with the West. At the same time, many companies – particularly in the tech sector – faced a regulatory clampdown as part of President Xi Jinping's 'common prosperity' agenda.¹

As a result, investor sentiment fell sharply. The Hang Seng Index tumbled more than 50% between February 2021 and October 2022.² The second-largest economy in the world was labelled 'uninvestable'. Yet it was at this moment – when many investors were retreating – that we chose to launch the Strategy.

Our decision was guided by the same contrarian valuation-led philosophy that has underpinned our Asia ex-Japan Equity Strategy for more than 15 years. We did not just see the risks, we saw opportunity. Valuations had dropped well below historical averages, and in our opinion, much of the negative sentiment was already priced in.



The sweeping market sell-off had created a rich and varied backdrop for stock selection – with both low-quality value and high-quality growth companies trading at compelling levels.

Many businesses – that had once commanded premium valuations – were now available at prices we considered very attractive.

We did not launch the Strategy because conditions were favourable. In the months that followed, the market continued to decline (The Hang Seng Index hit a bottom in October 2022³). We launched it because the opportunity was exceptional. Despite short-term headwinds, we saw enduring potential in a market that remains one of the most dynamic and transformative in the world – and that conviction has been rewarded.

A deep-rooted philosophy

The China Equity Strategy hit its three-year milestone in July this year. It has delivered 48.7% cumulative net returns (from launch to end-September 2025) outperforming its benchmark⁴ by 18.1%.⁵

Our performance has not just been based on buying cheap stocks that re-rated. It has been underpinned by a dynamic and disciplined approach that has prospered throughout a volatile market cycle (we launched into a bear market which has transitioned into a consolidating bull market).

In the early stages of the Strategy, we prioritised yield and focused on companies offering a margin of safety and stable cash flows. In addition, we selectively added mispriced growth and quality stocks that have continued to deliver on the back of company-specific strengths, despite various macro headwinds.

Since 2022, capital market reforms in China have encouraged listed companies to increase dividend payouts and return on equity has become a key performance metric for state-owned enterprises.

At the same time, many private company management teams (often major shareholders themselves) have begun aggressive share buybacks, on the belief that their businesses were deeply undervalued as markets fell in 2023.

¹ Common prosperity is a Chinese Communist Party political slogan and stated goal to bolster social equality and economic equity.

² Bloomberg as at October 2025.

³ Bloomberg as at October 2025.

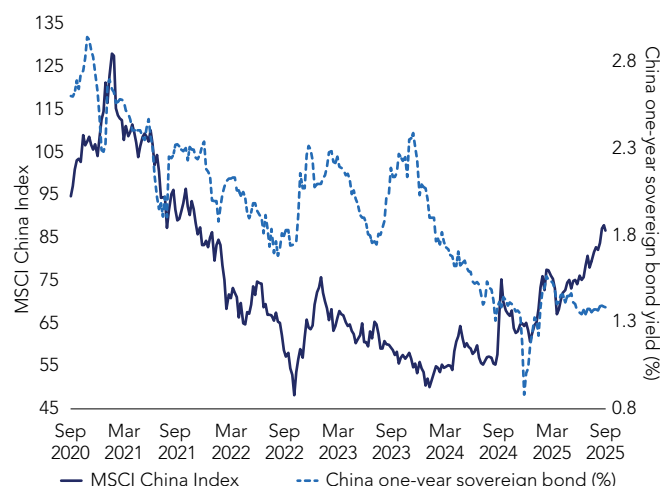
⁴ MSCI China All Shares Net Total Return USD.

⁵ Federated Hermes Limited, NT as at 30 September 2025.

Together, dividends and buybacks have formed a floor for stock prices, offering valuation support and boosting total shareholder returns – particularly as interest rates have been steadily falling in China over the last few years.

In the first two years of the Strategy, high-yield stocks were key contributors to our overall performance. In a deflationary environment – which has seen China's benchmark rates continue to fall – such names remain attractive.

Figure 1: MSCI China vs. China one-year sovereign bond

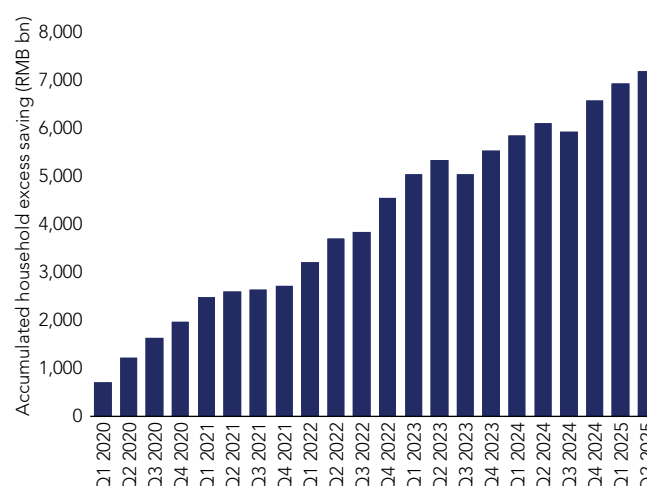


Source: Bloomberg as at 24 September 2025. **Past performance is not a reliable indicator of future performance.**

For domestic investors in China sitting on rising household savings, dividends from cash-rich companies offer far better returns than deposit rates.

As yields have become a more important part of total return, we see continued value in companies that combine a strong cash flow with consistent capital return – a theme that remains central to our portfolio construction.

Figure 2: China's rising excess household savings



Source: CEIC, UBS-S estimates, as at 30 June 2025.

Figure 3: Attractive portfolio yields at leading Chinese companies

Stock	Diluted shares count reduction in the last 4 quarters/ Semi-annuals (%)	Indicated Yield (%)	TSR (%)
Cathay Pacific Airways	8.6	6.6	15.2
Cimc Enric Holdings	6.6	3.7	10.3
Cosco Shipping International	0.0	9.4	9.4
China Yongda Automobiles	1.0	7.9	8.9
Autohome	4.4	4.0	8.3
Wh Group	0.0	7.0	7.0
Weibo	0.0	6.6	6.6
Zhongsheng Group Holdings	1.3	4.8	6.1
China Bluechemical	0.0	5.6	5.6
Wuliangye Yibin Co	0.0	5.2	5.2
Guangdong Tapai Group	0.0	5.0	5.0
Jd.com	2.1	2.8	5.0
Qualcomm Inc*	2.7	2.1	4.9
Nexon Co Ltd*	3.6	0.9	4.6
Tsingtao Brewery Co	0.0	4.5	4.5
Ck Hutchison Holdings	0.0	4.4	4.4

* Stocks not listed on China stock markets may be bought if the companies generate most revenue or earnings, or have most net assets or value from China.

Source: Federated Hermes analysis, Bloomberg as of September 2025. Share count reductions includes one-off cancellation of preference shares and convertible bonds in some instances. Illustrative example of companies held within the portfolio and not a complete list. This information does not constitute a solicitation or offer to any person to buy or sell any related securities or financial instruments. **Past performance is not a reliable indicator of future results.**

Investments across four categories

Our Strategy is designed to uncover stocks that have fallen out of favour but, in our view, have been over-penalised by the market.

This framework allows us to scale across the quality spectrum, allocating capital where valuations are most compelling – whether in mispriced high-quality companies or overlooked value names.

Broadly, we favour companies that fall into one of the following four categories:

- Consolidated industries with pricing discipline
- Niche segments with healthy organic growth
- Market share-gaining companies with globally competitive products
- Deep value stocks with strong balance sheets and cash flows

As bottom-up investors led by fundamentals, we focus on company-specific investment cases and valuations, rather than broad market trends. While China's overall market has become cheaper, not all stocks have become attractive. The last few years have seen many companies' earnings fall faster than their share prices, or they have traded at historically rich multiples leaving further capacity to de-rate.

The backdrop may have been challenging, but it has created plenty of opportunity for disciplined stock pickers. One of our skillsets is identifying businesses where the valuation has become compelling and the fundamentals remain resilient – regardless of external macro factors.

Consolidated industries

Weak consumption and deflationary pressures in China have caused Chinese consumer staples to suffer a sharp de-rating – and within this group, Chinese brewery groups have sold-off even further.

Brewing companies – such as China Resources Beer and Tsingtao Brewery – trade at a historic discount to their consumer staples' peers.

China Resources Beer is gaining share in the premium beer segment, while Tsingtao is one of the cheapest large-scale global breweries on an earnings ex-cash basis and offers a generous, cash-backed yield.

Despite the challenges facing the sector, both companies have delivered earnings growth year-to-date and remain highly sensitive to any recovery in consumption, making them compelling long-term opportunities.

Niche segments

Since the Strategy's inception, we have held electronic component manufacturer Foxconn Industrial Internet.

While US chip giant Nvidia has dominated headlines in developed markets, Foxconn has quietly benefited from the same AI-led demand dynamics. The company supplies intelligent manufacturing solutions to global hyperscalers – primarily in the US, where the majority of AI cloud revenue is generated.

Foxconn – which operates in a high-barrier, working capital-intensive niche – has exhibited resilience and delivered steady growth despite broader tech headwinds in China.

Figure 4: Foxconn Industrial Internet share price



Source: Bloomberg as at 24 September 2025. **Past performance is not a reliable indicator of future performance.**

The Strategy's performance has evolved with the market. As previously outlined, our early returns were driven by cheap, lower-quality stocks offering strong yields and a margin of safety. But as conditions improved – particularly since the latter half of 2024 when growth stocks rebounded – we benefited from exposure to mispriced, high-quality growth names. Our philosophy mirrors that of our long-standing Asia ex-Japan Equity Strategy, where alpha comes from a blend of overlooked value and underappreciated quality.



Growing global companies

Our investment in consumer electronics group Xiaomi – which was added to the portfolio in November 2023 – is illustrative of our approach.

When we purchased the stock, it was underearning. The company's management was prioritising market share gains over products margin on top of heavy investment in research and development (R&D).

However, Xiaomi had a strong balance sheet, positive free cash flow, and was increasing its market share in high-end smartphones. What the market had not priced in was Xiaomi's potential for growth in electric vehicles (EVs), the Internet of Things (IoT), semiconductors, and artificial intelligence (AI).

Today, Xiaomi trades at 23x forward price-to-earnings (P/E) ratio and its earnings growth is forecast to increase more than 50% in 2025.⁶

The company was once seen as a value-for-money brand but it has broadened its appeal following its move into premium products and its successful EV launch.⁷ The strength of Xiaomi's brand allows it to drive organic demand on the back of minimal marketing spend, creating a self-reinforcing cycle of premium pricing, shorter inventory days,⁸ and reinvestment into R&D. Yet its strategic investments can be overlooked.

Figure 5: Xiaomi share price



Source: Bloomberg as at 24 September 2025. **Past performance is not a reliable indicator of future performance.**

In a challenging earnings environment, we have focused on identifying companies that are gaining market share in China or expanding overseas.



One example is US-listed online brokerage Futu.⁹ The company competes with various Chinese financial groups but it has a cleaner balance sheet and can bypass some of the policy-led risks faced by state-owned institutions. Futu's superior user experience and innovative products – it is expanding into wealth management and crypto – have seen it outperform peers and it is expanding into new markets, such as Japan, Malaysia, and Australia.

Deep value

We are always on the lookout for companies that are deeply discounted with minimal downside risk and have the potential for significant returns.

The companies that screen well typically have strong balance sheets and might be viewed as attractively-valued because, for example, they have net cash that exceeds market capitalisation and supportive yields.

Cosco Shipping International – which we have held since inception – is one such example.

The company has delivered steady earnings growth, maintained a 100% payout ratio, and currently offers a 9-10% yield.¹⁰ The company was trading at below cash value when we first purchased stock and today net cash still represents more than half of its market capitalisation.

We believe that another holding, China BlueChemical could follow a similar trajectory. The Hainan-based chemical group currently trades at below cash value and offers a 6% yield based on a 50% payout on trough-cycle earnings – implying more than 10% in a normal cycle.¹¹ We continue to engage with China BlueChemical's management on capital allocation, and believe a higher payout could also unlock substantial value.

⁶ Bloomberg as at October 2025. Forward price-to-earnings.

⁷ Xiaomi delivered approximately 135,000 EVs in 2024 after launching its EV range. The company has increased its full-year EV delivery target to 350,000 units for 2025 and reportedly delivered over 40,000 vehicles in September. The company plans to start selling cars in Europe in 2027.

⁸ Short inventory days refer to a low number of days a company takes to sell its inventory, indicating that products are sold quickly. A low number is generally desirable because it means less cash is tied up in stock, and there is a reduced risk of inventory becoming obsolete or expiring.

⁹ Futu is another example of a market share-gaining company with globally competitive products.

¹⁰ Bloomberg as at October 2025.

¹¹ Bloomberg as at October 2025.

¹² A-shares are mainland China-listed stocks sold in yuan primarily to domestic investors on the Shanghai and Shenzhen exchanges, while H-shares are same Chinese companies' stocks listed on the Hong Kong Stock Exchange, traded in Hong Kong dollars and open to international investors.

¹³ Federated Hermes analysis for A vs H dual listed stocks premium.



Valuation gaps

We don't just look for undervalued stocks, we also seek to exploit structural inefficiencies. One such opportunity lies in the valuation gaps between Chinese A- and H-shares,¹² as well as US-listed American depositary receipts (ADRs) and their domestic counterparts. Historically, A-shares have traded at a premium – often around 30%¹³ – because of various market differences, including investor access, regulatory controls and varying levels of speculative retail trading.

During 2024, many Chinese companies found their earnings under pressure and, as a consequence, only a few A-share names offered meaningful dividends or buybacks.

In contrast, our holdings in Hong Kong and ADRs provided similar growth profiles at more attractive valuations, prompting us to overweight those segments.

This year – which has seen A-shares underperform H-shares¹⁴ – we selectively added exposure where we believed valuation differentials had become compelling.

In a few cases, we introduced new A-share positions or switched existing holdings from H-shares to A-shares, capturing upside while maintaining exposure to the same underlying company.

While these relative valuation switches are not a dominant theme in the portfolio, the adjustments reflect our ongoing focus on price discipline and relative value.

A long-term opportunity

The Hang Seng China Enterprises Index is up 34% YTD.¹⁵ The 'DeepSeek moment'¹⁶ at the start of the year marked a key inflection point. It highlighted China's push toward technological self-reliance and sparked broader discussions around AI leadership and investment.

Over the last year, the Beijing government has adopted a noticeably more business-friendly approach to policy, which has further boosted investor confidence.

Recent reforms designed to improve the quality of listed companies and ramp-up shareholder returns should add to the overall appeal of Chinese equities.

At the present time, many global investors are underweight the asset class but sentiment looks to be changing. Foreign institutional investors have become key liquidity sponsors¹⁷ in China, which has helped expand participation in the asset class beyond domestic flows.

Chinese household exposure to equities remains modest, but with the property market still in a slump, rates at historic lows, and record-high levels of savings, conditions are supportive for this to shift, as confidence in China's tech and industrial sectors increases.

We believe the stage is set for a potentially significant reallocation of flows into Chinese equities on the back of attractive valuations, improving profitability, and structural shifts towards higher-growth, higher-return companies.

China remains a broad, inefficient, and sentiment-driven market – but this volatility creates fertile ground for stockpickers.

While many leading global indices are trading around all-time highs, China remains well below its 2021 peak, offering a differentiated and sizable growth opportunity.

As evidenced during the first three years of our Strategy, our contrarian, bottom-up approach – targeting mispriced opportunities across the quality spectrum – remains well positioned to capitalise on the improving outlook for the asset class.

¹⁴ Bloomberg as of October 2025.

¹⁵ Bloomberg as at 8 October 2025

¹⁶ In January 2025, DeepSeek, a Chinese artificial intelligence (AI) startup, released its latest model, DeepSeek R1, which it said rivalled technology developed by ChatGPT-maker OpenAI in its capabilities, while costing far less to create. Its popularity and potential rattled investors, and called into question whether American firms would dominate the booming AI market, as many assumed they would.

¹⁷ A liquidity sponsor, more commonly known as a liquidity provider (LP) or market maker, is a financial institution or individual that supplies assets to markets by committing to buy and sell securities to ensure there is always a buyer and seller for a given asset. By providing continuous buy and sell orders for a specific security, they create a more active market, reduce price volatility, and make it easier for other investors to trade efficiently and without significant delays.

Rolling year performance (%)

	30/09/24 to 30/09/25	30/09/23 to 30/09/24	30/09/22 to 30/09/23	30/09/21 to 30/09/22	30/09/20 to 30/09/21
Strategy	34.18	22.37	4.09	–	–

Source: Federated Hermes as at 30 September 2025. Composite inception date: 1 August 2022. Returns are in USD gross of fees. The information shown is supplemental to the GIPS® compliant composite report provided in the Appendix. **Past performance is not a reliable indicator of future results.**

Schedule of Rates of Return and Statistics

Composite: **Federated Hermes China Equity**

Index: **MSCI China All Shares Net**

Periods ending: **30 September 2025**

	Returns (%)		
	Composite Gross Return	Benchmark	Composite Net Return
Q3 25	22.95	20.46	22.72
YTD	40.54	34.63	39.75
1 Year	35.19	25.27	34.18
3 Years (Annld)	20.47	14.79	19.56
Aug-22 - Sep-25 (Annld)^^^	14.20	8.79	13.34

^^Represents composite inception period. See page 2 for additional notes to the schedule of rates of return and statistics

The composite includes all discretionary portfolios following the China Equity strategy run by the Federated Hermes Asia ex Japan Equity team (London Office) and has an inception date of 1 August 2022. The objective of the strategy is to achieve long term capital appreciation. The benchmark is the MSCI China All Shares (net) index, which is designed to measure the equity market performance of China and covers all large and mid-market capitalization securities. The benchmark is market-cap weighted and rebalanced on a quarterly basis. The return is calculated on a total return basis net of withholding tax. This composite was created in August 2022. Performance shown for 2022 is for a partial period starting 1 August 2022. Federated Hermes claims compliance with the Global Investment Performance Standards ("GIPS®") and has prepared and presented this report in compliance with the GIPS® standards. Federated Hermes has been independently verified for the period of January 1, 1992, through June 30, 2025. The verification report is available upon request. A firm that claims compliance with the GIPS® standards must establish policies and procedures for complying with all the applicable requirements of the GIPS® standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS® standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report. The management fee schedule for this strategy is 0.75% per annum. Gross of fees returns have been calculated gross of management/custodial fees and net of reclaimable withholding taxes, but after all trading commissions.

Annual Returns (%)									
Year	Composite Gross Return	Composite Net Return	Benchmark Return	*Composite 3-Yr St Dev	*Benchmark 3-Yr St Dev	No of Portfolios	**Dispersion	Composite Assets (Million)	Firm Assets (billion)
2022	-1.70	-2.01	-5.81	N/A	N/A	<5	N/A	26.8	627.4
2023	-7.51	-8.21	-11.53	N/A	N/A	<5	N/A	5.0	720.0
2024	19.17	18.28	16.38	N/A	N/A	<5	N/A	7.5	792.2

* Represents the 3-year annualized standard deviation for both the gross composite and the index returns. Statistic is used to measure the volatility of composite returns.

** Standard deviation is calculated using gross returns. Standard deviation is not applicable (N/A) for any period if fewer than five accounts are in the composite for that period.

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