

China Watch

US ROADSHOW: INVESTORS LEAST BEARISH ON CHINA IN FIVE YEARS

Rory Green

- Investors today are the least negative on China since at least 2020
- Political risk and growth are their main concerns
- US exceptionalism vs China and Europe is the subject of a major debate

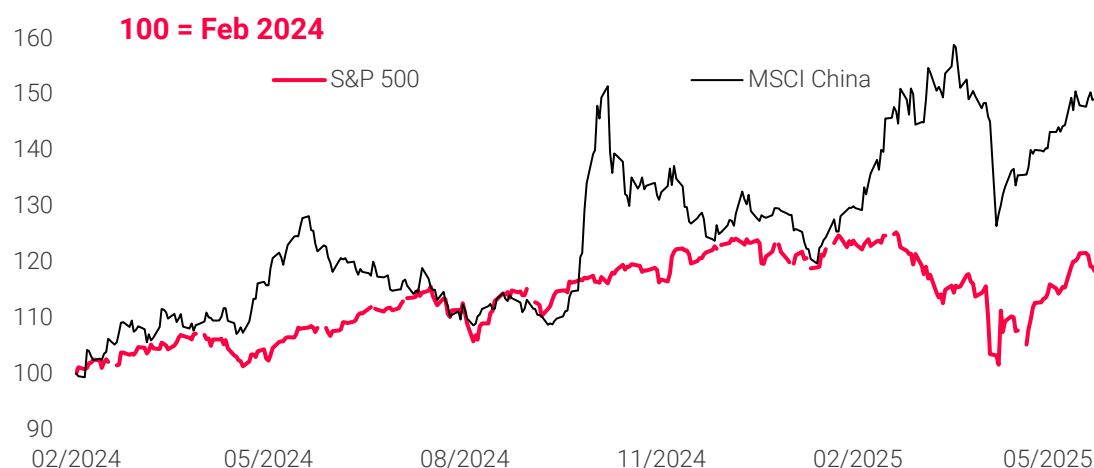
One of our regular US roadshows has just concluded. This China-focused trip took us down the East Coast and involved meetings with an array of buy-side investors – from hedge funds to institutions and family offices. The most striking takeaway: US investors are the least bearish on China in at least five years. The combination of PRC tech, China stimulus and relative US performance is shifting sentiment. Pre-Covid, the China team would be asked “How should we invest in China?” After 2020, the question, quite rightly, shifted to “Why should we even bother?” This year investors appear to be moving closer to the old paradigm. Admittedly, the sample – self-selected as China curious (why else take a meeting?) – still had a number of concerns: above all, about political risk and growth. We tackle the top five questions below.

1. What are the political risks?

For US investors in particular, a significant concern remains geopolitical threats. We can break down the sources of political risk for Chinese assets into three areas:

- 1 Domestic politics and regulation, e.g. consumer internet crackdown/property
- 2 US-China tensions, e.g. tariffs, financial decoupling
- 3 Geopolitics, e.g. Taiwan, South China Sea and North Korea

Chart 1: China outperforming – on some metrics



Source: BBG.

We think the first risk has reduced significantly. Beijing has pivoted to favour growth. Jack Ma is back and even the stock market is now a KPI for senior officials. Regulatory changes are still possible; but as one PRC-based entrepreneur explained: in 2021, the rules of the game changed, but nobody knew what the new rules were. Today, those rules are clear: as long as you get rich in a politically approved area – chips, robots, AI, consumer, bio-tech, etc. – Beijing will support your endeavours.

US-China tension is, of course, prominent in the trade arena. Financial decoupling risk, including the de-listing of Chinese ADRs and limits on US investment into the PRC and its firms, did rise following Trump's inauguration (the America First Investment Policy memo) and again after the rapid tariff escalation. Since then, US-China relations appear to have stabilized (see below for our tariff outlook) and China hawks are now out of favour in the White House. That JPMorgan, which has one of the more politically astute CEOs, underwrote and subsequently purchased a significant stake in CATL a blacklisted Chinese company, suggests near-term decoupling risks are low.

With regard to Taiwan, our view remains that an invasion or blockade is unlikely in the next five to 10 years. This is based on two core assumptions. First, the PLA and the political leadership recognize that an invasion – and, to a lesser extent, a blockade – is militarily and economically highly risky. Second, Beijing believes “the East is rising, the West is declining”, meaning that time is on China's side. If invasion is the intent, why strike now if the US is going to be weaker in Asia in 10 years' time. Meanwhile, Taiwan domestic politics could trigger periods of heightened risk perception: President Lai is under significant domestic pressure and is leaning into a more hawkish China stance, but markets tend to look through such events (see here for our tracker of Taiwan invasion risk).

2. Will Trump and Xi strike a trade deal?

After “Liberation Day”, Trump 2.0 tariffs on China went up 145% and have now dropped to 30%, with an additional 24% subject to a 90-day pause. The rapid reversal vindicates Beijing's trade war playbook: the US has been shown to be a “paper tiger”. Looking beyond the propaganda and geopolitical victory, we expect a bumpy negotiation process that leaves the permanent tariff rate in the 20–30% range (our longstanding forecast). A “Phase 1.5” deal could include provisions on FX, investment and tech.

Chart 2: Offramps available for Trump and Xi

Custom & Border Protection fentanyl seizures, monthly



Source: Custom and Border Protection.

Chart 3: Front-loading and re-routing boost trade



Sources: CEIC, GlobalData TS Lombard.

There is little pressure on Xi Jinping to rush into a deal. A 30% tariff rate would equate to an eventual 0.9 ppt hit to GDP (Chart 4). But in the near term, trade re-routing and front-loading (Chart 3) are, in fact, delivering a positive impulse to growth.

Putting a floor on the most important bilateral relationship in the world is an objective of PRC leaders. While many in Beijing believe an economic and technological Cold War is already under way, it is better to hug your enemy closer or, to put it differently, engage in asymmetric decoupling.

The China offering is likely to be a combination of:

- Opening up of selected industries to foreign investment (part of existing PRC policy)
- Purchasing of US goods
- FDI into America (wanted by PRC corporates and politicians)
- Implicit agreement on FX (Xi wants a strong RMB)
- Cooperation on fentanyl-precursor trade reduction

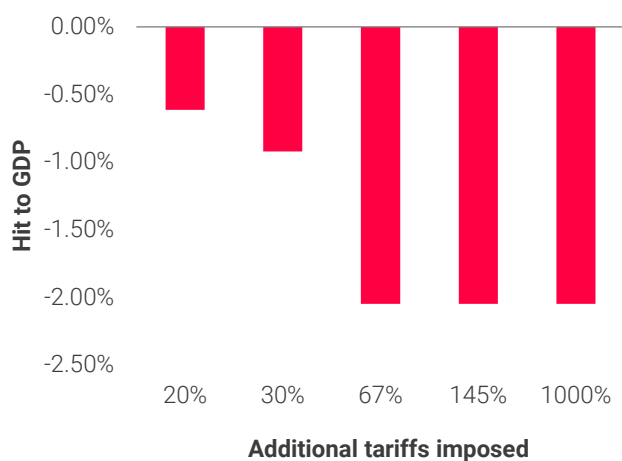
Several of the points listed above align with longer-term political-economic objectives (see [here](#) for more details). Moreover, as the Phase 1 deal highlighted, China may not need to abide by any conditions beyond Trump's term in office. All of which paves the way for a limited deal to be struck.

In return, China will want more than just tariff reduction. Areas of interest to Beijing include access to the US market for exports and manufacturing investment, ability to purchase advanced technology and the recognition of geopolitical spheres of influence (Taiwan and South China Sea). Deal prospects will hinge on the balance of power in Washington between the national security lobby and Trump/Wall St.-aligned staffers. The US President wants to negotiate, which suggests the hawks will have to compromise. A deal will form slowly over the coming months.

3. Is China really bottoming out?

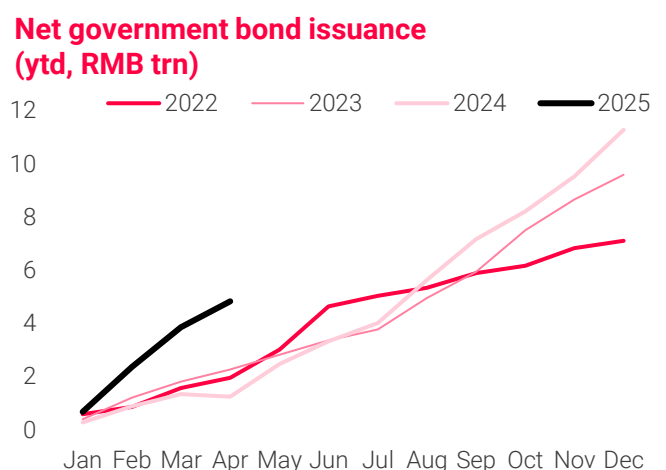
We think it is and we have said so for several months now. Crucially, in September last year Beijing shifted to a stance TS Lombard characterized as doing "whatever it takes – eventually" to stabilize growth. Authorities have delivered with front-loaded fiscal stimulus and clear pivots on the private sector, markets and property. The change has been sufficient for fragile green shoots to emerge across an array of hard, soft and leading indicators. We note clear upswings in total

Chart 4: Tariff impact is manageable



Sources: CEIC, GlobalData TS Lombard.

Chart 5: Fiscal is going strong



Sources: CEIC, GlobalData TS Lombard.

social financing and retail sales, as well as improvement in property and continued strong export numbers (re-routing and front-loading). Infrastructure new starts are up 50% ytd yoy.

April data slightly undershot expectations, in part owing to the Liberation Day shock. Nonetheless, our high frequency trackers suggest decent momentum in May. This is still a weak recovery – one that will require greater stimulus to reach the “about 5%” GDP target. We think additional fiscal firepower will be forthcoming in H2/25, with the July Politburo meeting providing a key signal. Spending will continue to focus on infrastructure, property and consumption-boosting schemes. As ever, it will be on the government to crowd in private-sector expenditure by generating domestic demand, raising economy-wide confidence and limiting real estate declines. Progress has been made across all three areas, but there is still a long way to go to reach pre-Covid levels of private activity.

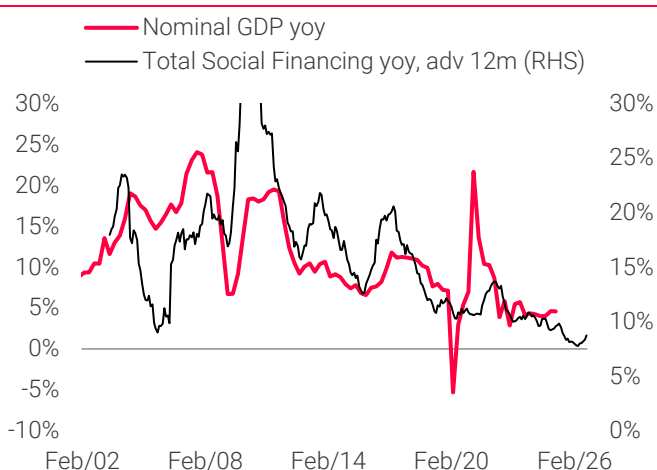
4. How real is China tech progress?

There is a unique combination of factors that make Chinese firms likely to dominate across almost all areas of advanced manufacturing in the next five to 10 years (in terms of software, it is marginally less competitive). Those factors are: i) a 30% share of global manufacturing; ii) DM-level technology; iii) an EM-like cost base; and iv) massive state support. This is an unprecedented set of advantages and it means an Emerging Market will be at the forefront of world tech-hardware output for the first time since the industrial revolution.

Chinese dominance in science and technology will have profound geoeconomic consequences. While protectionism may limit its reach in DM, the rest of the world is likely to run on PRC hardware. A Huawei/BYD/CATL/DeepSeek sphere of influence is not difficult to imagine. And although it may not be sufficient to power growth (unless a Chinese firm produces the EV equivalent of the Ford Model T), it will generate profits and drive equity valuations.

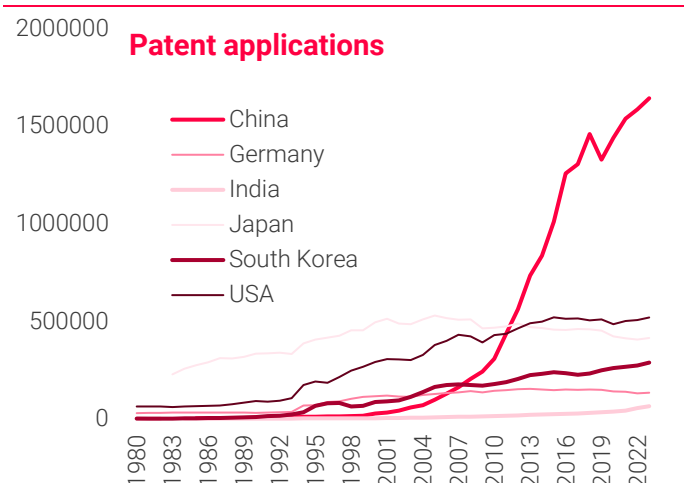
Since November 2023, we have maintained a long-term buy and hold rating for China tech. Now is still a good time to add/build positions. For long-term investors, a modest allocation to the industry via one or more of the leading players – Alibaba, Tencent, Xiaomi, Huawei, BYD etc. firms that have proved their ability to compete in multiple sectors, including AI, EVs, cloud computing, gaming and consumer internet – is a strong bet. Unless managers have deep China connections, picking the next winner is difficult. Beyond PRC equities, screening portfolios for China competition risk is required. German, Korean and Japanese firms are being squeezed first in the

Chart 6: Monetary growth signals upswing



Sources: CEIC, GlobalData TS Lombard.

Chart 7: China is winning the tech race



Sources: WIPO, GlobalData TS Lombard.

Middle Kingdom and increasingly across EM and even DM. That profit pressure will continue. The China Tech Shock is only just getting started.

5. Are foreigners selling America?

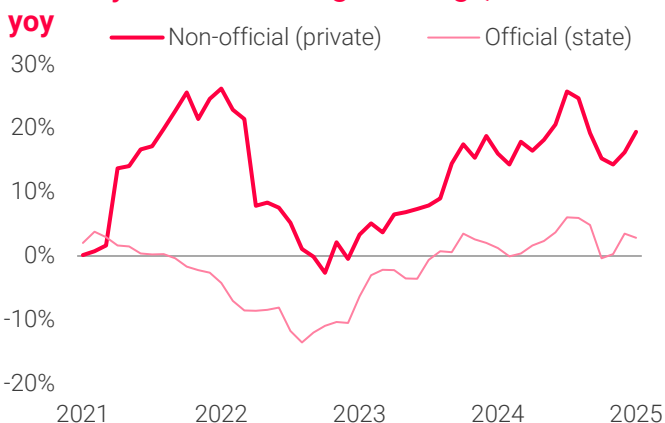
The end of US exceptionalism is a popular market narrative and a question that came up at most meetings. TS Lombard reckons the US is moving from hyper-exceptional to a more normalized economic outperformance. The core factors that powered US market dominance – fiscal-driven domestic demand, a perceived monopoly on tech especially AI and relative political stability (compared with China and war-battered Europe) – are all fading. Europe is finally ready to invest, and we think Beijing is committed to doing “whatever it takes – eventually” to stabilize growth. China tech, as noted above, is seriously competitive. Meanwhile, the White House is undermining business confidence in the States. Interestingly, the main pushback from clients on this thesis is the European component, on which I refer to my colleague Davide Oneglia’s excellent work.

We are not writing off the American economy, but we note that its relative outperformance is eroding. This will necessitate a significant shift for portfolios that are heavily overweight US to ~~one~~ a position that is consistent with a marginal flow of capital to other jurisdictions – namely, Europe, China and several selected DMs.

There are signs of rebalancing in the data: the dollar has fallen consistently and ETF flows suggest movement out of the US. As, indeed, do IMF FX reserve, SWIFT trade/financing and TIC foreign holding data (state assets have been shifting since the Russia-Ukraine war began). Non-financial capital is much stickier and, we think, likely to maintain significant dollar positions. We are watching UST purchases by foreign official and private accounts to gauge the extent of the “Sell America” trade.

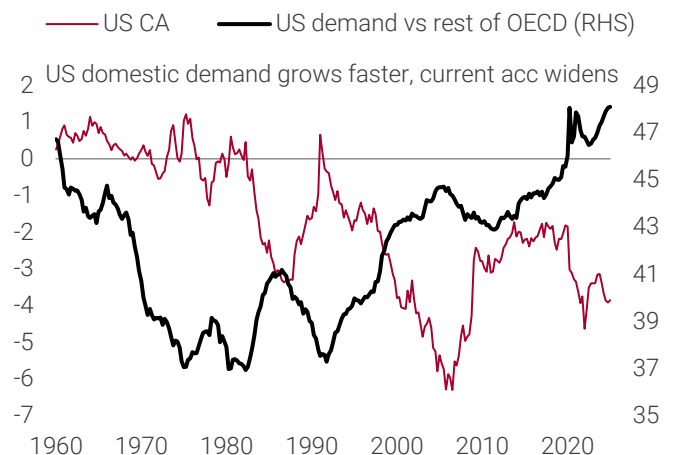
Chart 8: States rebalance FX reserves

Treasury securities foreign holdings, yoy



Sources: TIC, GlobalData TS Lombard.

Chart 9: US growth led to exceptionalism



Sources: OECD, GlobalData TS Lombard.

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