

China Investment Strategy: Selectivity in a policy managed market

Bottom line: China's financial markets in late 2025 are defined by policy driven stabilization in the macro economy, selective resilience in equities, and record low yields in government bonds. The interplay between domestic stimulus and external headwinds will determine whether 2026 brings a genuine cyclical upswing or a continuation of the slow grind recovery.

- ▶ A-shares offer domestic policy insulation but require careful earnings screening.
- ▶ H-shares provide global exposure but carry higher geopolitical beta.
- ▶ Government bonds remain a haven anchor, though with limited yield appeal.
- ▶ Corporate bonds have recovered but sector-specific stresses remain.

China Macro: Policy support amid internal vulnerabilities and external headwinds

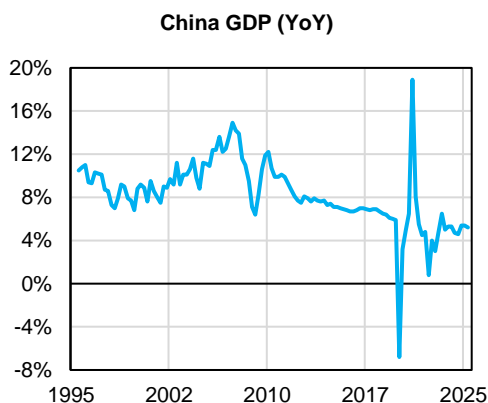
China's economy has been navigating a delicate balance between domestic policy stimulus and external trade pressures. We expect GDP growth to hover around 5% for the next four quarters (exhibit 1) – supported by targeted fiscal measures, infrastructure investment, and a gradual recovery in consumption.

Key macro features:

- ▷ Consumption recovery: Policies such as consumer goods trade in programs and lower mortgage rates are improving household cash flows. Yet consumer prices have deflated in recent months (exhibit 2).
- ▷ Investment mix: Manufacturing upgrades and infrastructure spending are offsetting the still negative, though narrowing, drag from real estate investment.
- ▷ External risks: US tariffs on Chinese imports are still a concern, but China has offset reduced exports to the US by expanding exports to other countries.
- ▷ Monetary Policy: The People's Bank of China (PBoC) is maintaining an easing bias, with overall interest rates trending lower and aggregate financing growth stabilizing after a weak first half.

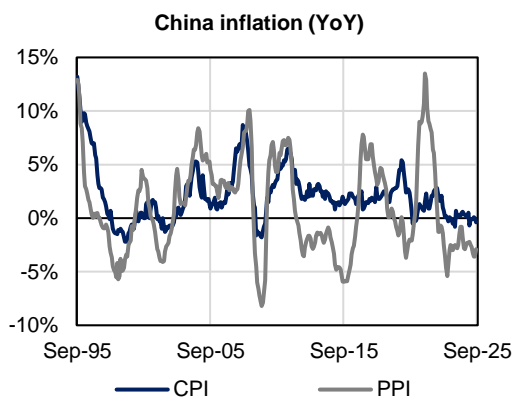
The macro backdrop is one of policy led stabilization, but with persistent uncertainty from geopolitics and global trade protectionism.

Exhibit 1: China's GDP growth at 5% is weak compared to history, but remains strong in global comparison ...



Source: National Bureau of Statistics of China, LSEG Workspace, and ADCB Asset Management

Exhibit 2: ... inflation remains contained, and in sharp contrast to its global peers, China is experiencing a deflationary environment



Source: National Bureau of Statistics of China, LSEG Workspace, and ADCB Asset Management

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China Real Estate: prolonged stress, patchy stabilization

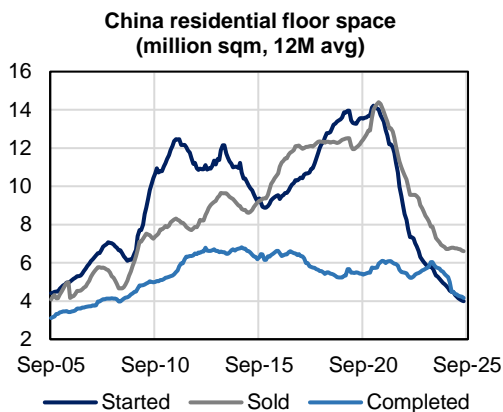
China's property sector remains under significant strain in late 2025, with no broad-based recovery in sight (exhibit 3). House prices are projected to fall 4.8% this year, with Reuters poll of analysts expecting stagnation through 2026. Average prices are now roughly 30% below their 2021 peak, reflecting several consecutive months of declines in new build prices (exhibit 4). Investment has contracted by double digits year on year, and new construction starts are down sharply even in 2025.

Policy measures – including mortgage rate cuts, unsold inventory financing, and the multi trillion yuan “Whitelist” lending program – have slowed price declines in first and second tier cities. However, liquidity stress persists for developers, with major names facing rating downgrades amid large 2025 maturities.

Structural challenges remain: oversupply, weak consumer confidence, and high household debt (over 60% of GDP at present compared to just 39% long-term average) continue to weigh on demand. First time buyers and families seeking upgrades in prime school districts are providing pockets of resilience, but younger households are increasingly opting to rent.

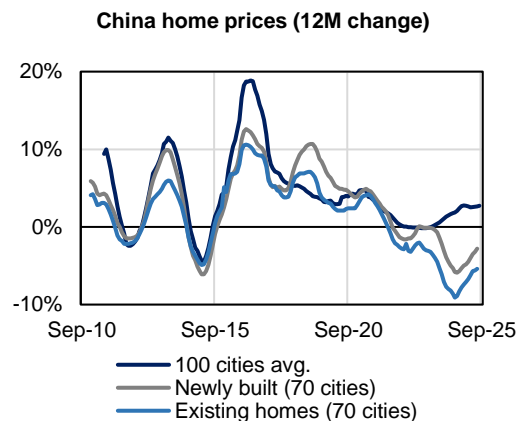
Without more decisive fiscal support — the IMF has suggested a stimulus worth 5% of GDP over several years — the sector is likely to remain a drag on growth, investor sentiment, and local government finances well into 2026.

Exhibit 3: Residential construction activity continues to fall ...



Source: National Bureau of Statistics of China, LSEG Workspace, and ADCB Asset Management

Exhibit 4: ... with home price growth remaining elusive



Source: National Bureau of Statistics of China, LSEG Workspace, and ADCB Asset Management

China A-shares: domestic focus and policy cushion

The onshore A share market has been volatile in 2025, reflecting both macro headwinds and shifting investor sentiment, yet delivered strong returns – especially in USD terms (exhibit 5).

Key considerations:

- ▷ Earnings pressure: Downward revisions continue (exhibit 6), particularly in cyclical sectors, amid deflationary trends and property sector weakness.
- ▷ Liquidity support: The PBoC's targeted re lending programs and liquidity injections have helped stabilize turnover, even as daily volumes on ChiNext and main boards fell 10–17% in late August (in part reflecting the summer lull).
- ▷ Geopolitical insulation: A-shares are less sensitive to currency swings and offshore sentiment shocks compared to H-shares, making them relatively defensive in periods of external stress.

Policy support, corporate buybacks, and dividend growth (projected +6% in 2025) could underpin selective gains, but earnings momentum remains the key swing factor.

Exhibit 5: Thanks to the weakness in the greenback, domestic China stocks outperformed in USD terms ...



Source: CSI, LSEG Workspace, and ADCB Asset Management

Exhibit 6: ... as valuation multiples expanded and the earnings momentum remained weak despite recovering from deep negative territory



Source: CSI, I/B/E/S, LSEG Workspace, and ADCB Asset Management | Notes: *showing the revisions to rolling 12m forward earnings over the three-month rolling period

China H-shares: offshore sentiment barometer

H-shares – Hong Kong listed Chinese companies – remain a critical bridge between China’s economy and global capital. Their performance in 2025 has been shaped by:

- ▷ Dual market forces: H-shares are influenced by both mainland policy and Hong Kong’s market dynamics, including HKD interest rates and capital flows.
- ▷ Currency sensitivity: Periods of RMB weakness have made H-shares more attractive to foreign investors but also increased volatility.
- ▷ Sector divergence: Financials and energy have outperformed on valuation support, while property developers remain under pressure from refinancing challenges.

H-shares have lagged A-shares in the initial part of the year but caught up later (exhibit 7), reflecting their higher beta to global risk sentiment and geopolitical news flow. However, any easing in US–China tensions or clarity on tariff policy could boost the relative rebound given the still wide valuation discount of the offshore equities (exhibit 8).

Exhibit 7: China offshore stocks outperformed onshore stocks in recent months ...



Source: CSI, Hang Seng, LSEG Workspace, and ADCB Asset Management

Exhibit 8: ... but still offshore stocks trade at a sizable valuation discount to their onshore counterparts



Source: CSI, Hang Seng, I/B/E/S, LSEG Workspace, and ADCB Asset Management

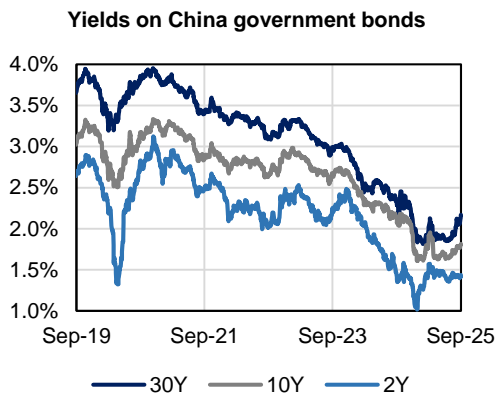
China Government Bonds: record low yields, policy driven rally

China's government bond market has been in a powerful rally through 2025, with the 10Y yield falling (exhibit 9) to a record 1.697% in late August – down 86bps year to date, the largest annual drop since 2014. Despite the sharp fall in yields, the yield curve does not yet indicate a recession (exhibit 10).

- ▷ Monetary Easing: The December 2024 Politburo meeting signalled “moderately loose” policy, prompting expectations of further rate cuts. Deflationary environment helped further.
- ▷ Risk Aversion: Investor scepticism about the strength of the recovery has driven flows into safe assets.
- ▷ Curve Dynamics: The yield curve remains normally sloped, with a 37bps spread between 10Y and 2Y bonds, suggesting no imminent recession pricing.

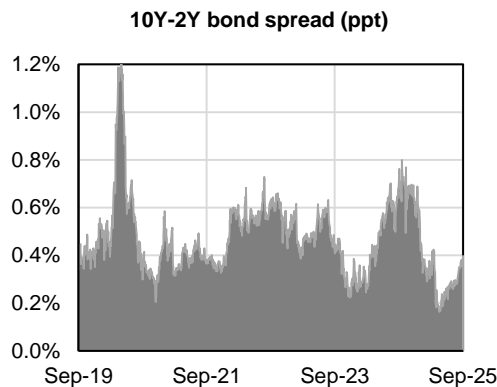
Near term volatility has emerged — notably in September, when 30Y bond futures saw their steepest weekly drop in 10 months as commodity prices spiked and risk appetite briefly shifted to equities. Government bonds remain a core defensive allocation, but ultra-low yields limit upside unless growth data undershoots further.

Exhibit 9: China sovereign bond yields have broadly trended lower over the past five years on growth weakness ...



Source: LSEG Workspace, and ADCB Asset Management

Exhibit 10: ... yet the 10Y2Y yield spread does not indicate a recession



Source: LSEG Workspace, and ADCB Asset Management

China Corporate Bonds: stability with selective stress

China's corporate bond market in late 2025 is showing signs of cautious stability after a volatile two-year stretch marked by property sector defaults and tighter liquidity. Government and quasi-government bonds have outperformed the overall corporate sector (exhibit 11). Credit spreads for high quality issuers — particularly policy banks and large state-owned enterprises (SOEs) — have compressed sharply, with policy bank spreads over China Government Bonds narrowing to just 5bps, down from an average of 65bps in the five years before 2020 (exhibit 12 and exhibit 9).

Issuance volumes have been steady, supported by accommodative monetary policy and targeted fiscal measures, including central government transfers to ease local government debt burdens. SOEs continue to dominate primary issuance, benefiting from investor preference for implicit state support.

However, stress remains in lower rated private issuers, especially in sectors linked to real estate, construction, and cyclical manufacturing. Refinancing risk is elevated for maturities in 2026–27, and investor appetite for non-SOE credit remains selective.

Foreign participation in the onshore corporate bond market has been stable, aided by RMB strength and index inclusion, though capital controls limit arbitrage with offshore markets. Overall, the market is bifurcated – robust at the top end, but still fragile for weaker credits – making credit selection and sector allocation critical for performance.

- ▷ SOE spreads are clustered at the low end, especially in financial and policy linked sectors, reflecting strong investor confidence in implicit state support.
- ▷ Private issuer spreads remain much wider, particularly in real estate and construction, where refinancing risk and weak demand keep risk premia elevated.
- ▷ Manufacturing shows a more mixed picture – some private names have tightened spreads thanks to export resilience, but the gap with SOEs persists.

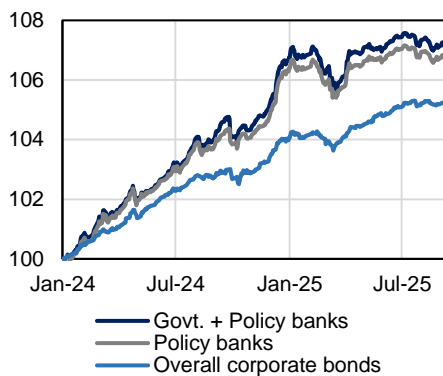
The private credit market remains structurally smaller — at RMB 21tn, half its 2017 size — due to tighter regulation and competition from public bond markets.

Credit growth should look healthier in 2026 if policy easing continues, but demand from the private sector remains subdued, and refinancing risks for weaker corporates persist.

Exhibit 11: Quasi-government entities outperformed the overall corporate bond indices since start of 2024

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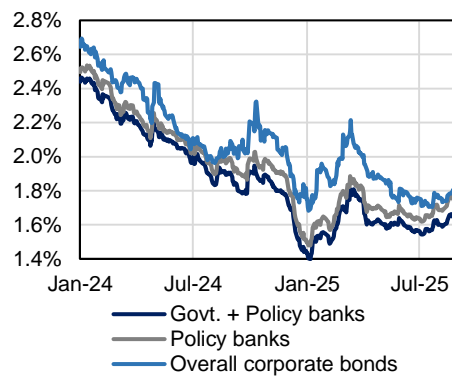
FTSE China bond indices: prices



Source: FTSE, LSEG Workspace, and ADCB Asset Management

Exhibit 12: ... yet yields stand comparable to the broader corporate sector

FTSE China bond indices: YTW



Source: FTSE, LSEG Workspace, and ADCB Asset Management

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