

China A Shares Theme Update

Q4 2025

In a Nutshell

A good year for China A shares in 2025

Summary

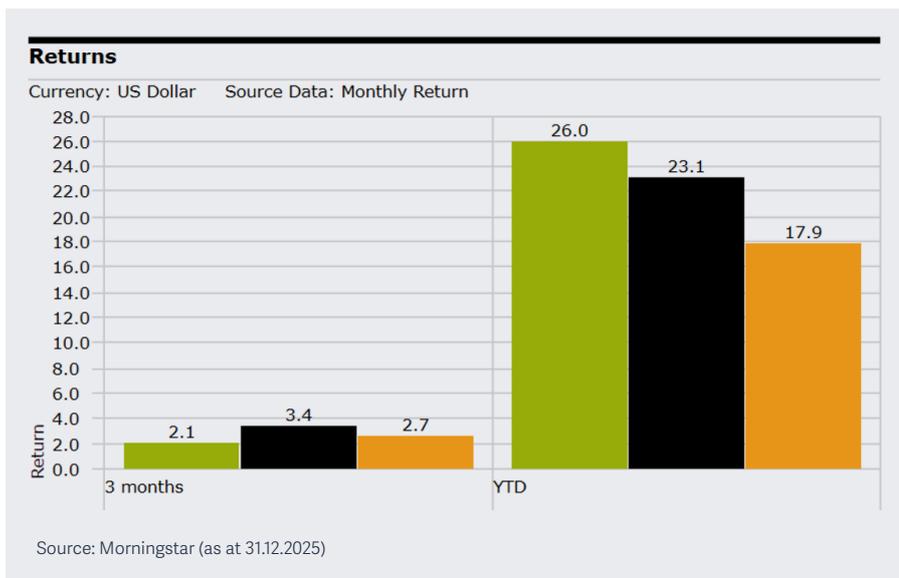
The iShares MSCI China A ETF gained 2% in USD terms in Q4, to finish the year up 26% in USD terms. This was ahead of both FTSE All World and S&P 500 indexes, up 23% and 18% respectively. The Chinese market remains cheap by historical standards. It trades on 1.6x Price-to-Book-Value ratio, compared with the US trading near an all-time high (5.6x P/BV).

The macro picture remains mixed. Growth momentum slowed into year-end, although household consumption and exports both helped support growth in Q4. Inflation remains under control, despite domestic deflationary forces from an ailing property sector. President Xi consolidated his power base as China's defence ministry opened an anti-corruption investigation into General Zhang Youxia, who sits on the 24-person Politburo. The move follows the expulsion of nine top generals in October.

This quarter we sold the physically backed iShares MSCI China A ETF and bought the swap-based Amundi Core MSCI A Swap ETF. The Amundi ETF is cheaper at 0.25% and earns a premium (currently in the region of 3%) due to a restriction on stock lending in the underlying index.

Performance

The iShares MSCI China A ETF gained 2% in USD terms in Q4, to finish the year up 26% in USD terms. This was ahead of FTSE All World and S&P 500 indexes, up 23% and 18% respectively.



The China A shares ETF led global and US stock markets this year

Recent price action in Chinese equity markets looks promising. The Shanghai Composite index has broken through to a decade high. This index is similar to the MSCI China A shares index, but it has a longer price history. If the bull market in China continues, there is still plenty of upside to the prior highs of 2015 and 2007. The chart below shows monthly returns over a 20-year time frame.



The Shanghai Composite index is breaking out higher

In addition to healthy returns of late, we also like the China A shares market because of diversification benefits. It exhibits a low correlation to other global stock markets. This is because of a domestic investor base, a lack of China A shares in broad global indexes, and different liquidity cycles.

Over the last 5 years the China A ETF has had a correlation of just 0.17 against the S&P 500 index. Whereas the S&P 500 index has a correlation of 0.97 with FTSE All World.

Correlation Matrix

Time Period: 01/01/2021 to 31/12/2025

Currency: US Dollar Source Data: Monthly Return

	1	2	3
1 iShares MSCI China A ETF USD Acc	1.00		
2 FTSE All World TR USD	0.29	1.00	
3 S&P 500 TR USD	0.17	0.97	1.00

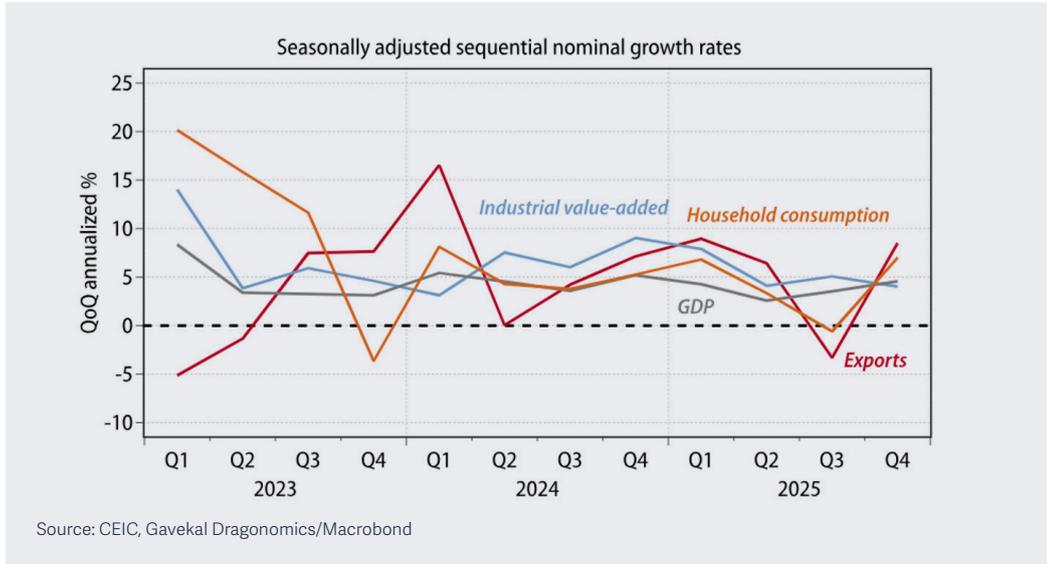
1.00 to 0.80
 0.80 to 0.60
 0.60 to 0.40
 0.40 to 0.20
 0.20 to 0.00
 0.00 to -0.20
 -0.20 to -0.40
 -0.40 to -0.60
 -0.60 to -0.80
 -0.80 to -1.00

Source: Morningstar (as at 31.12.2025)

China A Shares exhibit low correlation to the rest of the global stock market

Macro Update

The macroeconomic picture remains mixed for China. Growth momentum slowed into year-end, with real GDP growth slowing to 4.5% YoY, from 4.8% in Q4. Household consumption and exports both helped support growth in Q4. Core CPI inflation was unchanged at 1.2%.



Overall GDP growth remains subdued, under 5% official target

The property market remains subdued, with many property developers on the verge of bankruptcy or restructuring. China Evergrande, the severely indebted real estate developer with over \$300bn of debt and a posterchild for the malaise in the property sector, was delisted from the Hong Kong stock exchange last year and is in the process of liquidation.

The policy response by the Chinese government has (so far) avoided aggressive wholesale measures, instead favouring marginal nudges. The latest support measure was a 25bp rate cut for monetary policy tools as well as subsidies for other types of borrowing. A wholesale resolution to underpin the property sector would no doubt be much more bullish for Chinese assets, especially the equity market, given the amount of Chinese household wealth tied up in the property sector.

On the political front, China’s defence ministry opened an anti-corruption investigation into the country’s highest ranking general Zhang Youxia who sits on the 24-person Politburo. His father was a founding member of the Chinese Communist Party. The move follows the expulsion of nine top generals in October. It is extremely difficult for outsiders to divine the rationale for these moves, but it seems clear Xi has consolidated his power base once again.

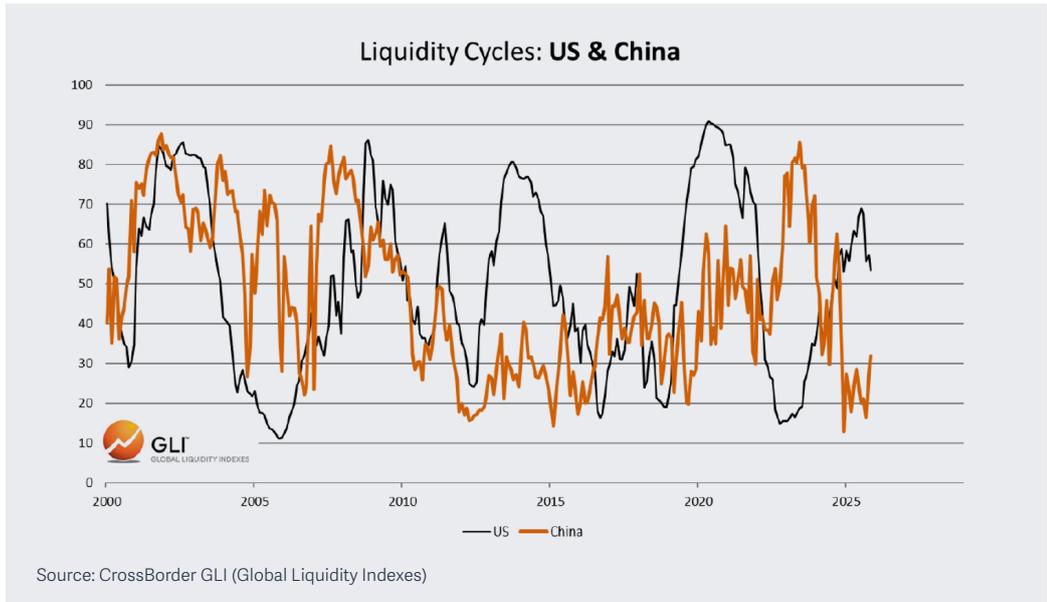


President Xi is consolidating his power base

Liquidity

Meanwhile, central bank liquidity has become less accommodative. Research provider CrossBorder report:

“China’s policymakers continue to veer between shoring up the economy and supporting the currency. China’s economy is gaining traction but still weak, while the Yuan has hit a 32-month high against the dollar (RMB6.97/US\$). The latter gives policymakers room to manoeuvre.”



US & China liquidity cycles are often quite different, as is the case now

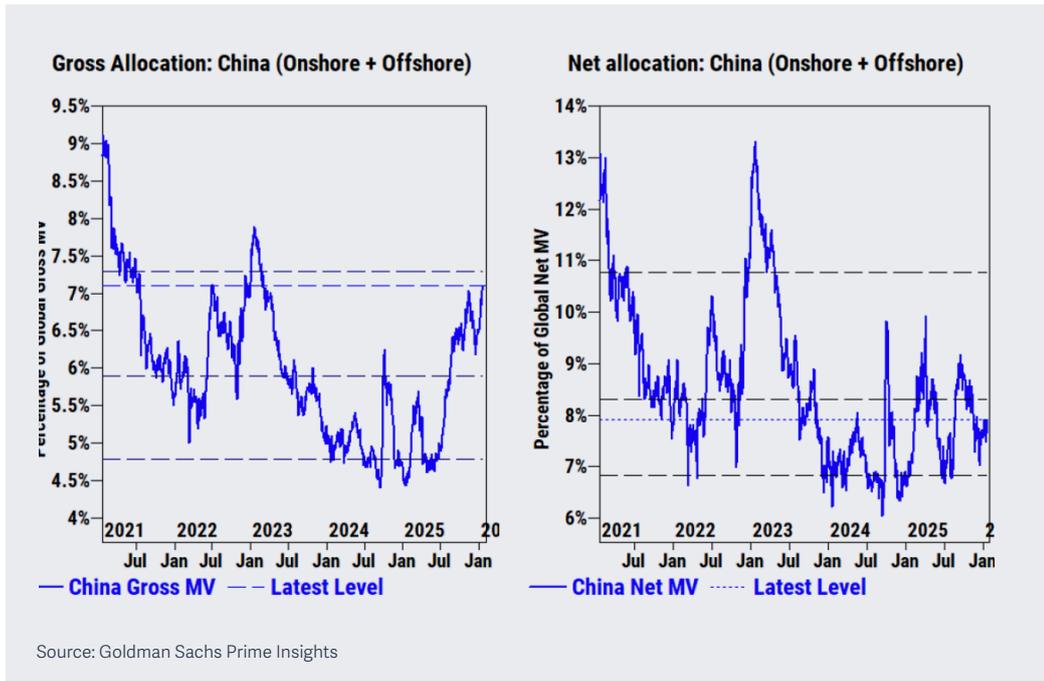
Sentiment

According to Goldman Sachs, risk on activity was strong in China in 2025, particularly the A-share market. Whilst long positions increased in 2025, this was more than offset by selling in ADRs. As a result, gross trading flows were up last year (right hand chart below), yet net long positions decreased as shorts outweighed longs (left hand chart below).



Gross trading flows were up last year, but net long decreased due to greater short positions

Investors remain significantly underweight China. Hedge funds' net allocations to China have increased from the low end of historical ranges, but still remain below average levels.



Investors' gross positions are now average, but net long positions remain subdued: a contrarian indicator

Valuation

The valuation of China A shares has varied dramatically over time, with today's low valuations representing a compelling, if contrarian, opportunity. The price/book multiple is one of our favoured valuation ratios for China, because historically it has identified important turning points. Simply put, when the P/B ratio falls to 1.5x or lower, it infers high returns over the next few years. As of December 2025, the P/B ratio had ticked up a little higher to 1.6x as a result of strong recent performance.

However, the Chinese market (green line) still looks very cheap compared to other global markets. The US market (blue line) is trading near all-time high valuations on a Price-to-Book-Value ratio of 5.6x. The China A shares market also stands at a significant discount to other unloved, value markets such as the UK (2.3x P/BV), indicating the potential value to be unlocked should the macro data and/or investor sentiment change.



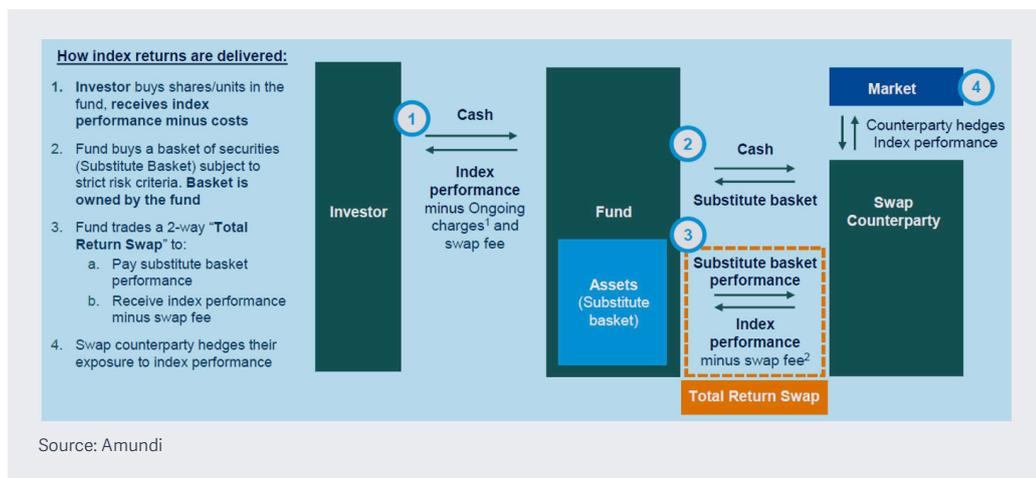
The Chinese market has much less valuation risk than (very) expensive US market

While valuation is an important ingredient for generating long-term rewards, it is not the sole tool for timing entries and exits into markets. We continue to complement our valuation analysis with a broader ongoing assessment of China's economic and liquidity conditions.

Positioning

We changed the A shares ETF this quarter. We sold the physically backed iShares MSCI China A ETF and bought the swap-based Amundi Core MSCI A Swap ETF. We generally have a preference for physically backed ETFs which hold underlying shares in the reference index. However, there can be certain exceptions. In this case, China swap-based ETFs can earn a premium over the index return due to restrictions on stock lending in the underlying index. The swap based ETF is also cheaper from an OCF perspective: the Amundi ETF charges 0.25% compared to iShares at 0.40%.

The underlying economic exposure does not change. The Amundi ETF still delivers the return of the MSCI China A shares index. The ETF owns a pool of developed market equities, then swaps this return for the performance of the reference index, plus a spread (in the region of 3% additional return at present). The diagram below helps explain this. The Amundi ETF uses six swap counterparties to spread risk and the swap P&L is reset daily.



How a swap based ETF is structured

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