CHINA EQUITIES OUTLOOK 2026

Year of the Horse: China's Growth Path Ahead

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EXECUTIVE SUMMARY

China enters 2026, the Year of the Horse, on a firm footing after a notable rebound in 2025, supported by a confluence of factors: a triad of policy support, improving investor sentiment, and the emergence of new growth drivers. Growth, while more moderate, is now healthier and better balanced. Policymakers have shifted from broad stimulus to smart, targeted support and strategic structural upgrades, laying a resilient foundation for the future.

Against this backdrop, we believe a window of achieving attractive risk-adjusted returns in China equities is now open, supported by a new wave of structural opportunities.

Looking ahead, we maintain a constructive but measured macroeconomic outlook. China's GDP growth is expected to moderate to around 4.5% in 2026. This pace reflects cyclical rebalancing and a transition away from property and low-end manufacturing toward innovation-led and sustainable development. Inflation is expected to remain subdued, with consumer prices gently rising after a prolonged bout of deflation. That said, if growth falters or deflation reemerges, modest rate cuts or liquidity injections are likely. Policymakers are likely to continue a supportive policy mix - targeted fiscal measures and accommodative monetary settings - while refraining from aggressive stimulus, thus striking a balance between stabilising growth and containing debt risks.

At the same time, investors should expect - and embrace - higher volatility. Key swing factors include: the sustainability of the US artificial intelligence (AI) driven rally, where a narrow group of mega-cap technology names dominate index performance and capex; domestically, property sector challenges being addressed proactively through significant policy measures - aiming for a stable and controlled adjustment; trade and technology tensions between US and China expected to persist into 2026, but the prevailing trend pointing toward managed competition and negotiated solutions; and a more fragmented global trading system marked by industrial policy and rising protectionism. We see these as well-defined and, to a degree, already reflected in prices.

We remain optimistic that these are sources of volatility rather than thesis-breaking risks. First, the triad of policy support - monetary, fiscal, and regulatory - is being increasingly calibrated toward stabilising growth while fostering private-sector confidence. Second, flows from domestic retail investors and selective re-allocation from global investors are beginning to rebuild market depth and breadth, providing additional support to equity valuations. Third, a new generation of growth engines, led by innovation-rich sectors and higher value-added manufacturing, is gradually offsetting the drag from legacy sectors.

For equity investors, **the focus should shift from pursuing headline GDP growth to aligning with fundamental market drivers such as innovation, industrial upgrades, lifestyle change and sector consolidation.** These four significant long-term growth themes are expected to generate robust earnings and cash flow within China's equity market, and they are increasingly complemented by renewed domestic retail interest and early signs of re-engagement from global investors.

We are particularly optimistic about innovation and industrial upgrades, where strong policy support and global competitiveness are most apparent. Within lifestyle change, we see exciting growth from within the consumption complex - services, experiences and sports - offering potentially vibrant opportunities for discerning investors. Consolidation stands out as a crucial theme, promising enduring upside for quality franchises in sectors, accelerating a healthy exit from weaker players, and paving the way for stronger incumbents to claim higher market share and pricing power.

Overall, we believe China equities in 2026 present an attractive **blend of macroeconomic stability, dynamic sectoral growth, and compelling valuations relative to their global peers.**

WINDOW OF ACHIEVING ATTRACTIVE RISK-ADJUSTED RETURNS IS OPEN

The investment environment in China has become more favourable as policy trends shift positively while economic tail risks are closely monitored.

Policy developments have a significant influence on stock prices in China, given the complex interplay between political dynamics and capital markets. In September 2024, policy direction reached a turning point following the announcement of a series of stimulus measures from Beijing. The move marked a major shift toward more proactive government intervention and was perceived by investors as a strong commitment to supporting markets. Indeed, Beijing has actively addressed critical economic tail risks, particularly those related to debt management and the property sector downturn, through a combination of monetary and fiscal policies in with targeted structural reforms - the ‘1-2-3 punch’ – over the past year (see Exhibit 1).

The expectation of a massive, ‘bazooka-style’ stimulus is becoming increasingly unrealistic as there is no quick fix for the ailing economy. Instead, healing takes time under the government’s ‘Chinese Herbal Medicine’ approach – the recovery is happening, albeit slowly amid domestic economic rebalancing, deglobalisation, and a growing emphasis on technology self-reliance.

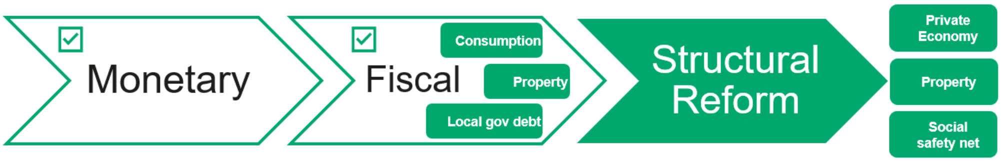
Notably, recent regulatory easing directed at the private sector is poised to provide considerable support to China’s equity market, fostering renewed animal spirits and strengthening profit prospects for privately owned enterprises (POEs), which contribute over 50% of the nation's tax revenue, more than 60% of GDP, over 70% of the nation's technological breakthroughs, and over 80% of urban employment.

President Xi’s high-profile meeting with private sector entrepreneurs in February 2025 underscored renewed policy support for China’s private/tech sector and signalled a turnaround in Beijing's stance towards its tech giants from a regulatory clampdown four years ago.

Exhibit 1: A “1-2-3 punch” to underpin the market

A coordinated policy approach is essential to transition the market narrative from a tactical trade to a structural ‘next China’ investment story.

1. Monetary Easing
2. Fiscal Stimulus
3. **Structural Reform:** provides the foundation for long-term growth by addressing systemic issues



Source: BNP Paribas Asset Management, as of 30 November 2025.

With measured policy measures underpinning the economy, a new wave of structural opportunities is revitalising the equity market.
While the low hanging fruits from valuation reversals might have been taken, new growth narratives around China innovation assets are only beginning to surface. Beneath the (US import) tariffs and macroeconomic headwinds, an important aspect that global investors have ignored or underestimated over the last few years is the potential of Chinese enterprises.

The ‘DeepSeek moment’ serves as a prime illustration of the often-underappreciated capabilities of Chinese firms within the technological transformation, notwithstanding various US-imposed barriers on technology infrastructure. The gap between China and the US in the AI drive may not be as large as the market initially estimated: Despite US restrictions, China has achieved cutting-edge AI capabilities with significantly less hardware. This trajectory is reminiscent of previous trends during the mobile internet era, when China, although initially behind in smartphone and 4G internet hardware development, rapidly advanced in applications and technology usage - particularly through the rise of major e-commerce and internet services companies now recognised as global leaders.

China’s competitive advantage increasingly lies in its ability to disseminate, commercialise and manufacture technology. Supported by a substantial talent pool and growing confidence among POEs, bolstered by supportive policies, it is anticipated that more champions and innovators will emerge within the Chinese market. Importantly, these advancements in innovation and technology are evident not only in upstream AI models but also extend across diverse downstream sectors such as electric vehicles (including smart driving technologies), humanoid robots, biotechnology and drones.

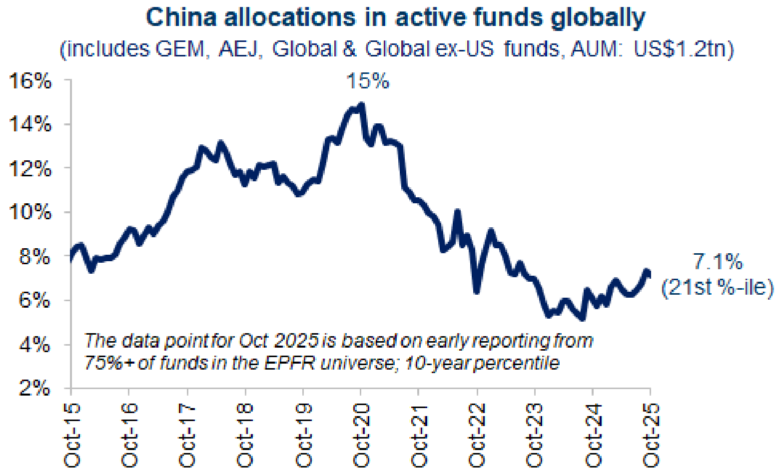
Flow factors are projected to remain positive for 2026: domestic long-term capital continues to be a stable presence, while incremental inflows from retail and foreign investors show potential for further growth.

In 2025, domestic capital - including flows from insurers and the national team - has been the primary buyer within the Chinese market, supported by policymakers' commitment to eliminating obstacles and enabling increased equity allocations from long-term funds. Looking ahead to 2026, we anticipate these trends continuing, particularly in light of subdued long-term China Government Bond yields.

Concurrently, global investors are looking to diversify away from US equities and the dollar. A possible peak in the 'US exceptionalism' theme, along with the Trump administration's unpredictable trade policy moves, has prompted many global investors to seek alternatives. While foreign investor participation in Chinese equities has improved during 2025, most remain cautious and largely uncommitted for now (see Exhibit 2).

Furthermore, domestic retail participation exhibits signs of recovery; however, it has yet to attain significant levels, indicating potential for further engagement. The low interest rates and ongoing weakness in the property market will likely remain key factors prompting Chinese households to seek higher returns beyond traditional bank deposits and real estate investments. With record savings exceeding 160 trillion yuan (~$22.6 trillion) as of mid-2025 on the sidelines, an accelerating shift into the equity market may unfold should market sentiment improve further.

Exhibit 2: Foreign investor participation in Chinese equities improved in 2025, but remains at lower end of historical level



Source: EPFR, Goldman Sachs Global Investment Research, as of 31 October, 2025

INNOVATION POWER HORSE BEYOND DEEPSEEK

Over the past decade, China has undergone a profound transformation from being perceived largely as the world's manufacturing base to asserting itself as a formidable engine of innovation. The shift has not only been technological in nature but institutional and structural.

As we enter 2026, China's innovation capacity now underpins a renewed economic model - focused on quality growth, productivity enhancement and global competitiveness - with significant and increasingly positive implications for China's equity markets.

Over the past decade, China's governance of innovation has shifted from a decentralised model to a more centralised, 'whole-of-nation' approach.

In the past, local governments were given more room to promote Beijing's growth initiatives that aligned with their own local incentives, often linked to GDP growth targets. In contrast, the central government now actively orchestrates innovation through national strategies, cross-ministerial coordination, and the strategic mobilisation of capital toward critical sectors such as semiconductors, renewable energy, and AI.

The central government has recently established high-level bodies like the Central Science and Technology Commission in 2023 and launched a *'new-style' whole-of-nation* system to steer innovation toward national strategic goals such as semiconductor self-reliance. This new approach aims to create a more manageable 'shock and leap' process to reach a decisive breakthrough rather than the previous local government-led model where excesses in capacity and competition were more extreme and has a longer-term focus that aims to achieve lasting productivity gains, as opposed to constantly shifting local government initiatives predicated on short-term goals (e.g., GDP growth).

What further distinguishes China's innovation ascent is the dominant role played by its private sector research & development (R&D) spending.

As of 2018, more than 70% of China's R&D expenditure was financed by enterprises, up dramatically from 32% in the early 1990s. This growth has been led by world-class technology firms such as Huawei, Tencent and Alibaba, whose R&D budgets now rival – and in some instances exceed – those of many Chinese provinces.

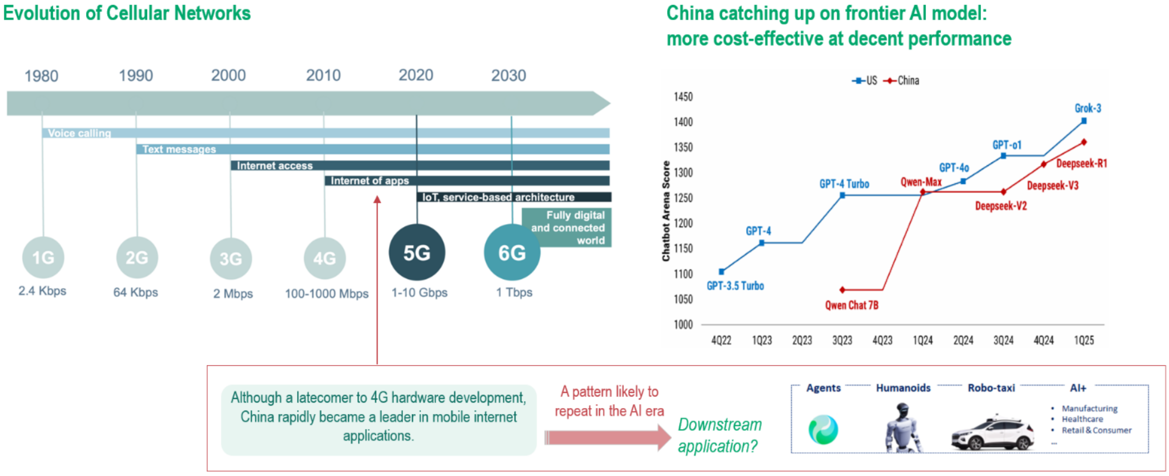
The private sector's role in innovation has shifted from being reactive and imitative to increasingly being ground-breaking and globally influential. Tech giants now operate at the cutting edge of AI, 5G, fintech and cloud services, while startups across various sectors have demonstrated a remarkable ability to scale and iterate at speed.

While the US may lead globally in many zero-to-one innovations such as AI GPUs, China's technology sector shows incredible flexibility and creativity in achieving breakthrough by building on existing innovation and super-fast scaling in adoption (see Exhibit 3).

For example, Tencent's WeChat has long grown beyond a pure messaging app that actually originated from the US. WeChat is now an indispensable every day app that covers almost every part of people's daily life, from communication to transportation, shopping, entertainment and news. With the launch of the WeChat Mini Program, Tencent developed a mobile ecosystem unique to China that delivers a frictionless user experience to connect hundreds of millions of users with a wide variety of products/services provided by brands, merchants and municipalities. This has enabled Tencent to further scale its advertising revenues, fintech and cloud business.

China's technology leaders also increasingly levelling the playing field against western rivals with alternative pathways rather than blindly following in the footsteps of US tech companies. In May 2025, Huawei announced its first rack scale AI computer cluster Matrix 384, which exceeds Nvidia's latest rack scale GB200 NVL72 in performance. Without access to leading edge chip fabrication, Huawei made the most of its strength in optical interconnects by developing a proprietary protocol named Unified Bus (UB) to connect 384 GPUs and 192 CPUs in rack with thousands of high-speed transceivers, enabling higher computing power and throughput than Nvidia's GB200 systems. This is an example of the flexibility and creativity that is enabling China to catch up quickly even as a latecomer.

Exhibit 3: China's competitive advantage lies in its ability to disseminate, commercialise and manufacture technology



Source: BNP Paribas Asset Management, Chatbot Arena score, Morgan Stanley Research, Luxembourg Institute of Science and Technology, as of 30 November 2025.

Another defining feature of China's innovation ecosystem is the unparalleled pace of iteration – 'China Speed'.

Enabled by dense industrial clusters, vertically integrated supply chains, and a competitive entrepreneurial culture, Chinese firms iterate products faster than most of its global peers. In sectors like consumer electronics, batteries and electric vehicles design-to-deployment cycles are counted in months, not years.

This agility is not just a function of work intensity but of structural advantages – such as proximity of suppliers, rapid prototyping, real-time consumer feedback loops, and a culture that tolerates failure as a necessary step toward success. The result is a manufacturing and innovation ecosystem that supports continuous, market-responsive refinement – a critical advantage in fast-evolving industries.

Beyond policy and enterprise factors, China's innovation prowess is underpinned by its extraordinary depth of human capital and energy supply.

On the talent front, China now awards almost twice the number of STEM (science, technology, engineering and mathematics) PhDs of the United States (if we do not count Chinese students awarded a STEM PhD in the US) with over 50,000 doctorates annually, and the gap is widening.

The scale of scientific training – including more than two million STEM undergraduate degrees per year – equips China with an unmatched base of technical expertise, supporting everything from basic research to commercial product development. Such a pipeline of scientists, engineers and data scientists provides a deep reservoir of ability for the next wave of innovation, from AI and biotech to quantum computing.

Complementing this talent base is China's competitive advantage in energy supply. In 2024, China added 430GW power generation capacity, more than 10 times the 30GW added in the US. With electricity costs significantly lower than in Europe and more stable than in other emerging markets, China offers a cost-efficient environment for energy-intensive industries such as semiconductors, electric vehicle battery manufacturing and data centres. Its continued investment in renewables – now the largest globally –ensures long-term energy security and price stability, reinforcing the competitiveness of its innovative economy.

China's innovation is no longer confined to technology – it also lies in business models.

The ecosystem has moved rapidly from low-cost manufacturing and 'copy-cat' products to original intellectual property (IP) creation and globally scalable platforms. In consumer sectors, Chinese firms have successfully built cultural IP such as Labubu, and world-class gaming franchises from groups like NetEase that now enjoy meaningful traction among non-Chinese players overseas.

At the same time, new cross-border e-commerce formats, exemplified by Temu, are reshaping how value chains are organised, using data-driven merchandising, dynamic pricing and ultra-lean logistics to reach consumers worldwide at scale. These examples highlight that China's edge is not just in producing more technology, but in recombining technology, supply chains and consumer insight into distinctive, exportable business models.

Chinese companies are no longer merely playing catch-up. In many cases, they are now setting the pace globally. With increasing global recognition of its innovation credentials, **China's capital markets are poised to reflect a new narrative – not just of scale, but of originality, speed and resilience.** China stands as an innovation powerhouse - **its fusion of scale, talent, policy coordination and commercial agility positions it uniquely among global peers.**

MORE OPTIMISTIC BUT HIGHER VOLATILITY: STAYING IN SADDLES

While our view for 2026 is optimistic overall, we remain vigilant about certain risks. Investors should monitor these risks, as they have implications not just for market volatility but also for relative performance between regions and sectors.

In the end, the key factors that led to the surprising strength of the Chinese equity market in 2025 have now unfolded, such as very cheap valuations at the beginning of the year and the sudden 're'-discovery of China's innovation advancement with the 'DeepSeek Moment'. The bar for the market to achieve another strong year is now higher. Still facing domestic and international macroeconomic challenges, the market in 2026 will likely be more prone to volatility, although the new favourable drivers discussed in the previous section are also more visible.

As long as these positive factors remain, we believe any drawdown risks could be narrower and recovery could be faster compared to the previous market down cycle. Here are what we see as the main risks and our assessment of their potential impact:

Sustainability of the AI rally in US: An important external risk for China equities in 2026 is the sustainability of the US AI-driven rally. So far, strong earnings and extraordinary capex have justified much of this performance. However, capital spending is becoming increasingly concentrated in a small cluster of firms, and analysts have highlighted echoes of past overinvestment cycles. China's AI landscape is in a slightly better position as the current investment cycle started later than that in the US and from a lower base (e.g., less than 40% of US hyperscalers' capex and lagging by at least two years). This 'late mover' position means China has more buffer room by drawing upon on alternative technology roadmaps such as algorithms and networking rather than adding pure raw computing power. This should reduce the risk of over-investing. China's domestic AI players also have ample room to substitute US-led technology stacks in their infrastructure. Nevertheless, any disappointment in AI monetisation, regulatory shocks or a macroeconomic slowdown could trigger a sharp de-rating and a broader global risk-off move. We see this as the key macroeconomic market risk and we are monitoring it closely in our portfolio construction and scenario development.

China property – Needs careful management: While policy support is gradually stabilising activity, the property sector remains a macroeconomic risk should not be neglected going into 2026. A slower-than-expected resolution of unfinished projects or renewed price declines could reignite stress among weaker developers and put pressure on banks' asset quality, particularly smaller regional lenders with concentrated exposure. A prolonged drag from housing wealth and new starts would also weigh on household confidence, dampening spending on home upgrades, durable goods and related services. An under-delivery on policy execution or a renewed loss of confidence could tighten financial conditions and cap the recovery in domestic consumption.

US - China trade conflicts: Despite the volatility caused by tariff-related headlines throughout the year, current market valuations and investor positioning indicate that the Chinese equity market has already internalised the reality of ongoing managed competition between China and the United States. There is no clear dominant player, and both markets have adjusted to this new environment. The current truce, however, has not resolved the long-standing structural issues between the two sides. China is also preparing to play a longer game than the US, which prefers quick results. This may lead to a sudden and violent re-escalation of trade conflicts.

Fragmented global trade system – Navigating protectionism: China's export performance has been resilient this year, largely attributable to its strategic diversification beyond the US market. This shift has, however, prompted growing apprehension in other regions – most prominently in Europe – regarding the supply of Chinese goods in global markets. The reconfiguration of global trade remains a structural risk for Chinese exporters in 2026. Further tariffs, anti-subsidy probes or local-content requirements from the US and Europe could expand beyond a few sensitive sectors into broader value chains in cars, renewables and electronics, raising effective trade barriers to Chinese goods that would weigh on earnings.

MACROECONOMIC PICTURE: STABILISATION WITH A PRO-GROWTH TILT

In 2026, sustaining China's growth and the rally in its stock market will likely hinge on Beijing pressing ahead with its two-prong policy approach.

On the supply side, structural reforms that improve economic efficiency, such as anti-involution measures, are essential to lift potential growth and corporate profitability. In parallel, demand must be underpinned by more assertive but disciplined policy easing. Targeted fiscal support, calibrated monetary loosening, and selective housing and consumption measures can offset the growth drag from structural rebalancing without fuelling financial excesses. If executed consistently, this combination of reform and reflation should stabilise medium-term GDP growth, support earnings visibility, and narrow the persistent valuation discount in Chinese equities, setting a more constructive backdrop for 2026.

After achieving the government's ~5% GDP growth target in 2025, the economy is expected to expand at a slightly slower pace next year. One notable macroeconomic shift is the tentative end of China's mild deflation in October. Officials attributed the price stabilisation to efforts to curb industrial overcapacity and price wars – for example, cutting excess output in sectors and promoting fair competition has helped firm up prices for goods like batteries and cars.

In 2026, we expect a similar pro-growth, targeted easing bias. Indeed, Beijing has demonstrated a de facto 'Beijing Put' under the equity market, intervening via state-controlled funds to stabilise stocks during bouts of weakness.

On the monetary front, if growth falters or deflation re-emerges, modest rate cuts or liquidity injections are likely – especially now that inflation is not a constraint. The People's Bank of China's (PBoC) lender-of-last-resort backstop for the stock market (e.g., funding brokerages to support equities) and explicit guidance to banks and insurers to deploy funds into markets, all signal that financial conditions will remain supportive.

Similarly, fiscal policy is expected to remain expansionary but efficient: we anticipate continued investment in areas like innovation, advanced manufacturing, and infrastructure such as energy storage and power grid, rather than a return to property and traditional infrastructure.

Externally, 2026 will open with a complex backdrop. The US economy has been surprisingly robust, buoyed by an investment boom in AI capex spending. However, US policy has become more protectionist and unpredictable. The return of 'America First' trade policies under President Trump – including tariff threats and export controls – introduces uncertainty and headline volatility to the market.

A renewed US-China trade war remains a risk, but so far both sides have shown some restraint. China's economy in 2025 proved resilient to trade pressures, prompting an upgrade of China's growth forecast for 2025. This resilience partly stems from China's adjusted trade strategies: Chinese firms have also diversified their exports toward the Global South – ASEAN, Africa and Latin America – cushioning the blow from US tariffs. In fact, China's share of global exports has risen since 2018, while that of the US has fallen – an indication that, when it comes to tariffs, 'what doesn't kill you makes you stronger', by forcing Chinese companies to become more competitive globally.

Nevertheless, export momentum is expected to normalise in 2026 with a high base. This reinforces China's push to cultivate domestic drivers – namely high-tech investment and industrial upgrades – to shoulder more of the growth load.

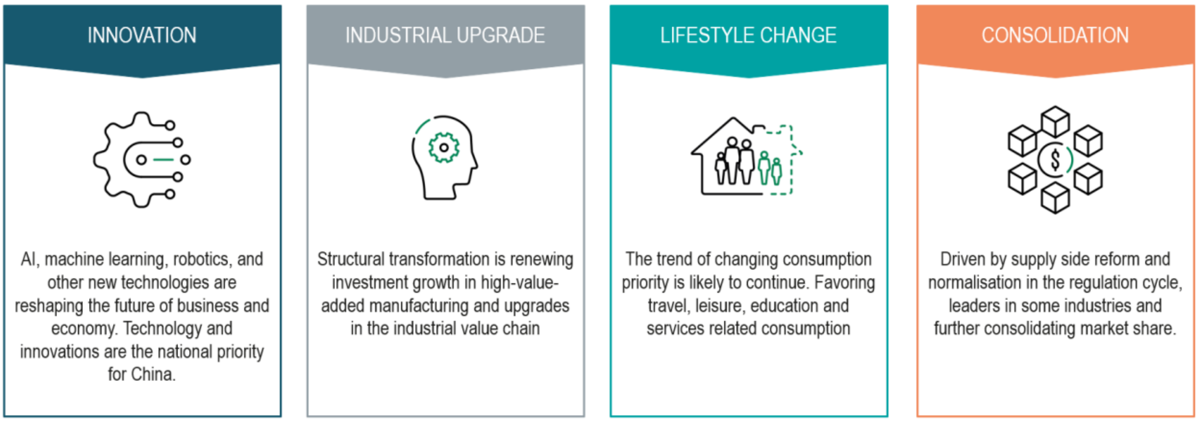
GROWTH THEMES – BET ON THE RIGHT HORSE

A selectively aggressive approach is essential for navigating China's evolving market landscape in 2026.

This approach is becoming increasingly important since many Chinese stocks are still highly dependent on the turnaround of the macroeconomic environment and are running on the previous era's megatrends (e.g., premiumisation in consumer products).

Instead of betting on the growth of the broad market, we believe it is better to concentrate investment in selective megatrends that will more likely stand the test of time in the coming years (see Exhibit 4).

Exhibit 4: Long-term portfolio strategy aligning with China's growth focus



Source: BNP Paribas Asset Management, as of 30 November 2025.

INNOVATION - DRIVING GLOBAL LEADERSHIP

In 2026, innovation-driven sectors are set to be among the fastest-growing and best favoured by the market as China strives for technological self-reliance and global leadership in pivotal industries.

China is indisputably the world's largest EV market, accounting for over 60% of global EV sales. Homegrown manufacturers and EV battery makers (CATL, BYD, etc.) dominate domestically and are expanding their exports. Cutting-edge battery chemistries (sodium-ion and high-nickel) are being commercialised, promising higher performance and lower costs.

By the end of 2025, more than 60% of new cars in China came equipped with Advanced Driver Assistance Systems (ADAS). Technologies critical to the advancement of autonomous driving and ADAS, such as AI chips and Light Detection and Ranging (Lidar), are positioned to benefit significantly. Moreover, China's prowess in AI research is notable – the country holds roughly half of the world's AI-related patents. Chinese firms, including major players such as Alibaba, are developing advanced AI algorithms across language processing, computer vision and autonomous driving technologies. This ongoing research and development effort should ensure that China remains at the cutting edge of technological innovation. We also expect increased synergies between AI and manufacturing (smart factories, robotics, humanoid) as well, which would improve productivity.

In pharmaceuticals, China's innovative drug pipeline has grown dramatically. Chinese biotech firms and pharmaceutical companies have been producing a rising share of novel therapies. In fact, China is now the source of more than 30% of global innovative drug approvals, a testament to its expanding biomedical capabilities. Breakthroughs in areas like oncology, gene therapy and vaccine development are not only improving healthcare at home but also making China a player in global drug markets. Regulatory reforms such as the encouragement of biotech IPOs support this momentum. Perhaps no area of innovation is more geopolitically charged than semiconductors. China has poured resources into developing its microchip design and fabrication abilities in the face of US export controls. Additionally, domestic equipment makers – from etching tools to lithography – are gradually closing the gap with imported equipment.

China's capabilities are more advanced than many have assumed, exemplified by breakthroughs such as the 'DeepSeek Moment' when a domestic firm achieved AI models rivalling the best from Silicon Valley at a fraction of the cost. This underappreciated innovation capacity is starting to be valued by the market. Beijing's agenda (15th Five-Year) explicitly prioritises tech innovation. We interpret this as a long-term tailwind to China equities.

INDUSTRIAL UPGRADES - ELEVATING PRODUCTIVITY AND EXPORTS

China's industrial upgrading is both an internal necessity and an external opportunity. Domestically, large parts of the capital stock remain low-tech and energy-inefficient; internationally, China aims to move up the value chain in machinery, robotics and power equipment exports.

China's economy has long been associated with manufacturing might, but often of the lower-margin, high-volume variety. This is changing. The new emphasis is on 'industrial upgrading' – producing higher-value, high-tech industrial goods, and using advanced technologies to modernise production.

In 2026, sectors like machinery, industrial automation and power equipment stand to benefit from both domestic investment and global demand, as Chinese firms make the most of their cost and scale advantages to capture more of the value chain.

A decade ago, Chinese heavy equipment makers were seen as followers. Now they are world-beaters. What lies behind this success is reflective of the broader trend: Chinese heavy machinery firms have aggressively invested in R&D and have expanded abroad, establishing production bases and distribution in Asia, Africa and Latin America. This has led to more global market share at the expense of some traditional Western and Japanese competitors.

Additionally, infrastructure drives as part of the Belt and Road Initiative provide a steady pipeline of overseas projects requiring Chinese equipment. The pivot to electric and autonomous machinery (e.g., electric excavators, automated port cranes) is another promising development – one that taps into both decarbonisation trends and China's strength in EV batteries.

China's commitment to carbon peaking before 2030 and carbon neutrality by 2060 is driving unparalleled investment in power infrastructure. This includes not just generation (solar panels, wind turbines) but also transmission, grid upgrades and energy storage.

Chinese companies today manufacture the bulk of the world's renewable energy hardware – more than 90% of the entire solar supply chain equipment comes from China. In power transmission and distribution, China is a leader in ultra-high-voltage (UHV) grid technology, exporting it to other countries as well. Additionally, energy storage is a burgeoning sub-sector: large-scale battery storage and pumped hydro storage projects are ramping up to stabilise the grid – an area where Chinese engineering firms excel.

The overarching story in industrial upgrades is that Chinese manufacturers are no longer competing only on cost; they are competing on technology and value. Exports of high-tech machinery and equipment are rising, even as exports of low-end goods plateau. This diversification should make China's economy more resilient and its listed industrial firms more attractive. Valuations in many of these sectors remain reasonable, reflecting past concerns about overcapacity and cyclicality. The slogan 'Made in China, upgraded in China' captures the idea that Chinese industrials are evolving into quality producers and not just quantity producers, a trend we believe the market will increasingly reward.

LIFESTYLE CHANGE - QUALITY AND EXPERIENCE OVER QUANTITY

As China's population and society evolve, so do consumption patterns. Lifestyle changes refer to shifts in how people spend, what they value, and the emergence of new consumer trends. Unlike the rapid, credit-fuelled consumption surges of the past, the current changes are more nuanced. They offer opportunities for companies that can tap into the qualitative aspects of consumption – health, experience, convenience and personalisation – even as aggregate consumer spending grows at a measured pace.

While potential upside exists, broad-based consumer exuberance (the 'consumption beta' that lifts all boats) is unlikely to be the main story in 2026. Instead, we see it being better to focus on pockets of growth and 'opportunities from within' the evolving lifestyle landscape.

One clear trend is the prioritisation of experiences over goods, especially among the middle class and younger Chinese. This includes experiential leisure – theme parks, cultural festivals, outdoor sports – which are gaining traction as people seek varied leisure activities. Companies able to innovate in entertainment could capture consumer interest. Chinese consumers are increasingly embracing domestic brands, a phenomenon known as *guochao* (national trend). This patriotic or pride-driven consumption is evident in sectors like sportswear (e.g., Anta gaining share over foreign brands), cosmetics (Mao Geping appealing with Chinese cultural branding), and even cars.

In 2026, we expect this trend to continue, partly thanks to quality improvements in local products. Companies that successfully blend tradition with modern design, or use local celebrity/influencer marketing effectively, can ride this wave.

Without dramatic policy shifts (like large-scale consumption vouchers) consumption will likely grow in line with income growth, which is steady but not spectacular. Therefore, we do not position for a broad consumer rally; instead, we advocate selectivity: picking sub-sectors and firms that can grow faster than the average by tapping into the specific lifestyle shifts outlined here.

CONSOLIDATION - STRONGER PLAYERS RISING

Over the past decade, many Chinese industries saw explosive growth in the number of competitors. Now, as sectors mature and growth rates normalise, a wave of consolidation is underway. This theme is about the 'survival of the fittest' – stronger companies gaining market share as weaker ones exit or are acquired. While consolidation can be painful for the losers, it ultimately leads to healthier industries with more rational competition and better margins.

For investors, consolidation often heralds a turning point: it can mark the bottoming of a cycle and the beginning of more sustainable growth for the winners. In 2026, we expect consolidation to be prominent not only in the upstream sectors such as building materials and renewables, but also in the mid-downstream sectors across consumer, financial and industrial segments.

FINAL REMARKS: FOCUS ON HIDDEN GEMS

In summary, we expect more volatility in China in 2026. That said, underneath the dusty macroeconomic challenges of the previous growth model, favourable factors are becoming more visible and investors should embrace the resulting volatility as it could present attractive entry points.

With a more determined and growth-focus policy, a new age of acceleration along the innovation curve and positive flow support from both domestic and foreign forces, the same positive factors behind the Chinese market's resurgence in 2025 should carry the market into next year.

This combination of events implies that equity investment in China for 2026 will require a selective approach by more aggressively prioritising the next wave of mega trends – innovation, industrial upgrades, evolving consumer preferences, and sector consolidation – over headline GDP growth.

As the window of achieving favourable risk-adjusted returns opens, investors should focus less on the modest outlook of this great old department store, but rather more on the large set of jewels inside it that are yet to be uncovered.