

The Changing Mood Towards China

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Meeting clients in North America, I am often asked: “Do you still feel safe in China? Aren’t you worried that your phones and laptops will be hacked?” My go-to response is to say, “No. It’s all good. Palantir doesn’t operate in China.” Until recently, this typically went down like a lead balloon. Clients failed to see the humor in complaining about the lack of tech privacy in China when the best-performing US stock is a company whose biggest client is the US government, and whose whole purpose is to map everyone’s electronic communications.

However, having just spent a week in the US and having been handed the chance to use my well-worn joke a few times, I was surprised when my quip raised a few chuckles, or at least some wry smiles. After a week of meetings, it feels that US investor perceptions around China are evolving for the better.

Admittedly, this could be a massive over-projection after just a few meetings with an unrepresentative sample. It could also be wishful thinking. Or maybe clients were just being polite, given how vocal Gavekal has been over the past year about the opportunity-set in Chinese equities: attractive valuations, record-low bond yields, massive government support, an undervalued currency, and record-high trade surpluses that need to be recycled somewhere.

But somehow, on this latest US tour, the “vibe” surrounding China felt very different. No more questions about when China will launch military operations against Taiwan. Instead, lots of questions about DeepSeek, about BYD’s “God’s eye” autonomous driving system, about the Unitree dancing robots that featured in the Chinese new year television gala, about China’s sixth-generation fighter aircraft, about its 6G satellite-to-phone telecom system, its rapidly growing nuclear industry, and so on.

The simplest explanation for this mood shift is the release of DeepSeek’s new AI models, which blew holes the size of the Grand Canyon in many market narratives, including the one about how US restrictions on semiconductor sales would contain China’s technological growth (see [The DeepSeek Leap](#)).

Attractive valuations, record low yields and official support, plus a cheap currency

DeepSeek’s model releases blew holes in the prevailing market narratives

Checking The Boxes

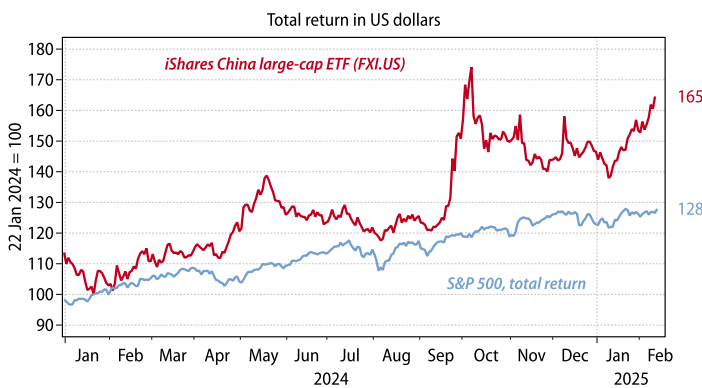
Our short take on the latest news

Fact	Consensus belief	Our reaction
US PPI rose 3.5% YoY in Jan, the same pace as in Dec	Faster than expected 3.3%; PPI ex-food & energy rose 3.6% YoY in Jan, versus 3.7% in Dec	More signs that inflation is likely to run persistently above target, limiting room for Fed easing
Eurozone industrial production fell -1.1% MoM in Dec, versus 0.4% in Nov	Softer than expected -0.6%; YoY, industrial production fell -2% vs -1.8% in Nov	Stagnation continues; aggregate number dragged down by Germany, France & Italy
UK GDP rose 0.1% QoQ in 4Q24, versus 0% in 3Q	Performance stronger than expected -0.1%; YoY, GDP rose 1.4% in 4Q24 versus 1% in 3Q	Mainly driven by growth in the services sector; points to some easing of UK economic malaise
Philippines left benchmark rate unchanged at 5.75%	-25bp cut was expected	Temporary pause in easing due to external uncertainty; BSP guidance remains dovish

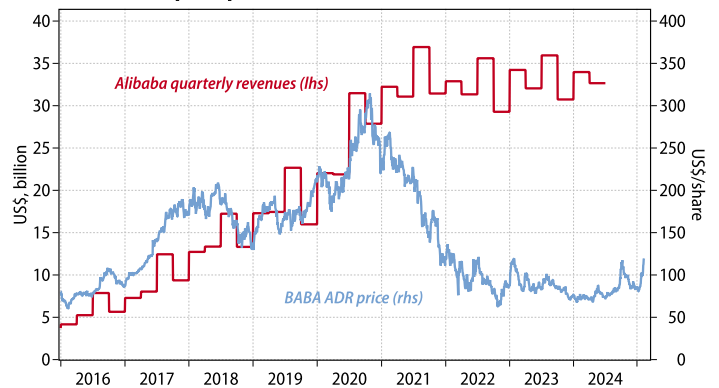
Suddenly, the second half of the narrative that “China dominates manufacturing, the US dominates digital” is looking very shaky. One of the things that stands out about DeepSeek’s AI models, Unitree’s robots, the best-selling Black Myth: Wukong video game, or the animated movie *Ne Zha 2*, released at the end of January and already one of the top-20 grossing movies of all time, is the people behind these products.

A decade ago, important breakthroughs in China were typically the work of graduates of Peking University, Tsinghua or Fudan—essentially the cream of China’s crop. Today, graduates of second-rank universities living in tier-two cities are coming out with revolutionary products that upend established markets (DeepSeek) or even create new ones (Unitree). This is a clear sign of the broadening and deepening of the Chinese education system. As the 16th century French humanist philosopher Jean Bodin famously said, “*il n’y a richesse ni force que d’hommes*,” which one might translate as “the only wealth is man.”

Beyond DeepSeek, the mood shift probably also reflects the unfolding bull market in Chinese equities. Since the Chinese authorities injected liquidity into the domestic system in late January 2024 in a bid to shore up market confidence, FXI.US (the biggest US-listed China ETF) is up 65%. That’s not bad for a year’s work, although most international investors have yet to acknowledge the breadth and depth of China’s equity market rebound.

Chinese stocks are in a full-on bull market


Gavekal Research/Macrobond

Alibaba's share price performance has disconnected from its revenues


Gavekal Research/Macrobond

One of my pet theories is that the outperformance of US mega-cap tech stocks in recent years has “cage trained” investors to look at a market solely through the prism of mega-cap tech stocks. If I had had a martini for each time I was told in 2024 that “Chinese equities can’t be doing well, Alibaba isn’t going anywhere,” I wouldn’t have been able to walk in a straight line all year. Now this is changing. Chinese tech stocks are joining banks, large state enterprises, and consumer and health care plays in rallying in earnest. Especially Alibaba.

One of the key drivers of Alibaba’s sharp year-to-date rally has been the announcement of a tie-up with Apple to deliver Alibaba’s AI solution on Chinese iPhones (there are reckoned to be over 200mn iPhone users in China, compared with around 150mn in the US). Aside from any potential boost for either company’s bottom line, what message does this tie-up send?

Following Alibaba founder Jack Ma's "misunderstandings" with the Chinese leadership and his resulting "reeducation," it seems unlikely Alibaba's management would consider a partnership with the biggest company in the US without first clearing the idea with the very top authorities in Beijing. And given the prevailing anti-China mood in Washington, it seems unlikely Apple CEO Tim Cook wouldn't at least have mentioned the idea over one of his recent dinners with Donald Trump to take soundings and find out if there were any presidential objections.

The market response to the Apple-Alibaba tie-up epitomizes the change of mood

Let's face it: if the biggest company in the US announces a tie-up with one of the largest Chinese companies, and both see their stocks rise on the news, it feels like quite a change of narrative compared with where the world was just a few months ago.

This leads back to the age-old question: does the news make markets, or do markets make the news? Longstanding readers will know my bias is massively towards the latter. I see developments so far in 2025 as yet another example. A few months ago, most investors were worried that Trump's return would mean the imposition of US tariffs on China, which would derail China's fragile recovery. Sure enough, one of Trump's (many) first acts in office was to slap a 10% tariff on all US goods imports from China, and to threaten more once the USTR, Commerce and Treasury special reports on trade land on April 1 (see [Tariffs Delayed Are Not Tariffs Denied](#)).

Could a potential US-China deal involve a port handover in the Panama Canal zone?

Yet today, the market doesn't seem to care that much, preferring to assume that April will be "bash China" month as a necessary softening-up exercise ahead of a later summit at which Trump will negotiate some kind of agreement with Chinese president Xi Jinping. (As an aside, Trump's repeated complaints that China controls the Panama Canal might signal a good possibility of an agreement. Xi could potentially force CK Hutchison, the Hong Kong conglomerate that operates ports at either end of the canal, to sell its Panamanian assets to the new US sovereign wealth fund—a nice political win for Trump that would cost China absolutely nothing. The art of the deal!)

None of this is to say that China is out of the woods yet. Nevertheless, for the first time in a long while, most investors I met on the road in the US seem open to the idea that China's unfolding bull market—which now encompasses almost all sectors and which is being driven by positive headlines on tech, the auto sector, the power distribution sector, the financial industry and others—may well have legs. And a bull market in the world's second largest economy and second largest stock market will send ripples around the world, with stronger Asian currencies, renewed outperformance from Latin American debt, and break-outs in commodity prices (see [The Upside Surprise In Commodity Demand](#)).