

# ALIBABA, CHINA & ECONOMIC RECOVERY: A CONTRARIAN INVESTMENT PERSPECTIVE



## Trellis Research

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MARKET REPORT

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*“Dripping water can penetrate the stone.”*

Chinese Proverb

## OVERVIEW

Over the past year, I have become particularly interested in several Chinese equities, which appear to trade at significant market discounts. Alibaba, one of the world's leading e-commerce and technology companies, is a prime example: its stock has sunk over 80% since reaching an all-time high of \$306 per share, back in 2020.

Don't get me wrong - investing in China is not without substantial political and economic risk; Western media continues to proliferate the geopolitical implications of a growing global superpower, and since the pandemic, China's very real, real estate crisis has delivered a deep-seated blow to consumer confidence, perpetuating a vicious cycle of stifled consumption, investment, and constrained GDP growth via aggregate demand.

Trump's impending presidency only adds to these challenges; US import tariffs on China could reach rates as high as 100% for certain goods, which would significantly inflate the country's costs of doing business abroad. Current equity valuations have already begun to price-in these costs since the election outcome, as the president's threats become a stark, imminent reality.

Yet despite surmounting headwinds, this article posits a long-term investment rationale that is deeply rooted in the principles of Value Investing. The contrarian perspective is made possible through a dominant, global narrative characterised by fear and pessimism towards China and its economy; while most of the market has steered vehemently away from its set of unfolding, socio-economic crises, I see an opportunity to buy high-quality businesses at cheap prices.

While the speed of China's economic recovery is dependent on several factors, including the scale and success of both its fiscal and monetary policy interventions, I firmly believe that the probable, long-run trajectory is one of growth and eventual confidence restoration, for the world's second-largest economy. If true, this approach offers a value-oriented exposure to Chinese technology businesses, which continue to demonstrate strong potential for long-run growth from fundamentals.

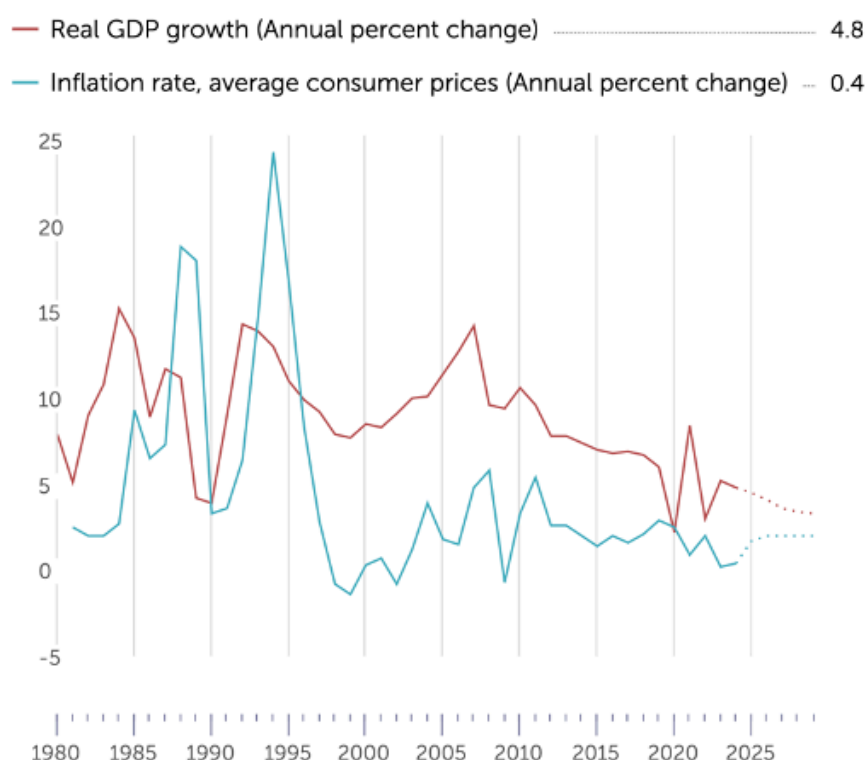
# THE CHINESE MACROECONOMY: PROBLEMS, POLICY, AND STIMULUS

China's poor economic performance of late reflects a long list of co-constitutive factors: perhaps most pivotal of these is the nation's slumping housing market, which has had a deep and direct effect on consumer spending and confidence. Economists note that the domestic property sector is nothing short of plummeting; through August 2024, the value of new homes sold dropped by as much as 23% (Mujiangqu and Wei 2024).

The downward property spiral has become particularly problematic given the sector's disproportionate, systemic weighting within China's economic composition: while the US economy has a housing-market contribution to GDP of roughly 15%, China's contribution (at its peak) accounted for an overwhelming 29% of national GDP. With the highest home-ownership rate globally (93%), this economic structure is due in large part to an explosive period of accelerating urbanisation, along with middle-class incomes.

This data begins to capture the true burden that China's property implosion has had on starving consumer confidence. Excess property inventory reached 'epic proportions' in May (Girard 2024), comprising the equivalent of 60 million unsold apartments, the highest rate ever recorded for the nation.

October marked China's weakest real GDP growth in 18 months, reflecting the persistence of the unfolding crisis. In Q3, the economy only expanded 4.6% year-on-year.



*China's annual (CPI) inflation rate and Real GDP growth rate [IMF]*

China remains short of its 5% annual growth target as it heads into Q4, with most recent CPI data reflecting a similar story in its unresponsive consumer environment: this came in at a mere 0.3% rise in prices year-on-year, missing an estimated 0.4% increase.

Despite this, September featured the announcement of China's **largest monetary stimulus package** since the on-set of the pandemic. Chinese equities initially rebounded after these announcements, yet prices have since reconvened at lower levels, as investors and economists alike were left unimpressed by fiscal intervention plans, discussed initially last month. Trump's victory has only accentuated this price movement downwards, a trend likely to continue in the near-term.

Regardless of how 'powerful' the monetary policy support may have seemed, it remains abundantly clear that any resemblance of an economic recovery will hinge upon an equally comprehensive fiscal package: one which can support the consumer meaningfully and consistently...

Burgeoning local government debt is a similarly pertinent issue which requires strong fiscal addressal. Local governance has been heavily responsible for the majority of public service provisions, however revenue from land sales have significantly dried up alongside property-sector transactions (Cheng 2024); according to chief China economist at Nomura, the nation is currently burdened with somewhere between \$7tn and \$8.45tn in outstanding 'hidden' debt, which only adds further drag to economic growth and momentum.

After an initially vague guidance last month, the long-awaited details regarding the scale and extent of China's incoming fiscal package are expected this week; lawmakers are convened in a strategic consultation, where decisions on the national approach are to be broadcasted by Friday evening.

Consumer confidence, geopolitical tension, and a set of wavering economic crises are certainly weighing heavily on China's growth. Undergirding headline statistics also remain deeper questions, over the motivations of an inherently opaque (and 'communist') Chinese government; to what extent can even bad macro data be trusted? Economic realities may well be far worse than reported data, only 'massaged' for lessened global market reactivity.

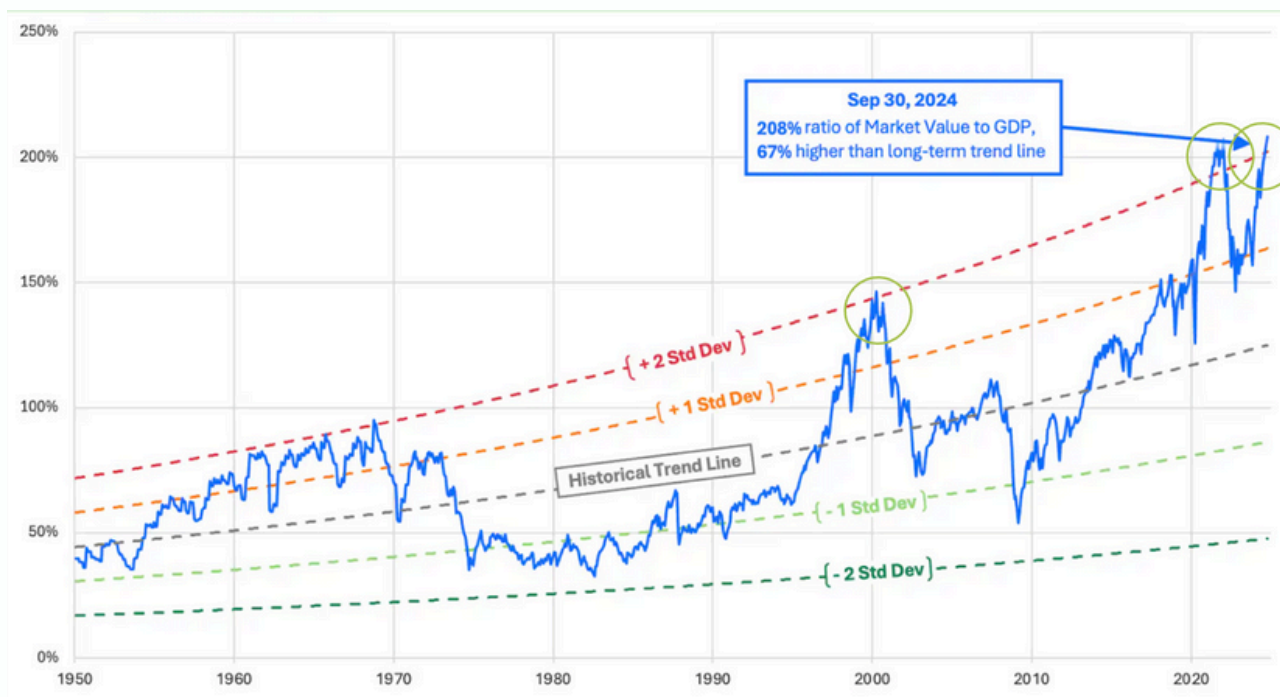
We should also question to what extent unfolding policy mechanisms are predominantly *performative*... while big stimulus numbers might work to bolster equity prices and global perception, are these the right policies which can rectify deeper issues? Consumer confidence is interwoven with the prevailing level of trust between a government and its citizens, which does not simply resolve via stock-market-moving announcements. Genuine consumer support, and a rebuilding of this trust, is likely to take far longer to filter through via real improvements to aggregate data.



## A CONTEXT OF RED-HOT US EQUITIES

With Trump winning the election, US stocks could be on track for their best week so far this year. The S&P500 has seen a 37.8% gain over the past year, as investors have increasingly deployed their capital in anticipation of weakening inflation, and a subsequently lower interest-rate environment. Bitcoin may well be poised for an imminent bull-run “to the moon” (to use Trump’s words himself), and calls for a year-end rally across markets certainly would have history on their side.

Yet at the same time, Buffett’s Berkshire Hathaway has accumulated a record cash position, which now makes up 56% of its total holdings. The US stock-market-to-GDP ratio, commonly referred to as ‘the Buffett Indicator’, has been central to how the world’s most renowned value investor assesses relative valuations in the market. It now sits at 209%, which by historical standpoints would imply egregious market-overvaluation, having recently reached its highest level on record.



*US stock-market-to-GDP ratio 1950- 2024*

*[currentmarketvaluation.com]*

While it's important to note that (most) equity valuations remain a long-way from the absurd multiples which characterised the dot-com era (e.g. Cisco’s peak PE ratio of 472 in 1999), this doesn’t necessarily rule out a future where volatile, corrective market behaviour is on the cards: present growth rates may well be unsustainable, and concerns over US government debt and secondary bouts of inflation could be pertinent macro themes for 2025.

What’s more, there is an unquestionable over-concentration in US equity markets, compared to historical averages: the ‘mag-7’ currently account for well-over a third of the entire S&P500 index value.

With many believing that an imminent, AI-driven productivity boom is upon us, that all too historical argument that ‘it’s different this time’, lingers over prevailing sentiment. This time may well be different for markets and the global economy; former chief business officer at Google X, Mo Gawdat, compares the potential super-intelligence of AI to humans, as synonymous with Albert Einstein when compared to a fly. Only time will tell as to when and whether present valuations align with the expected rate of AI tech realisation and adoption.

## ALIBABA

Regardless of speculation on growth, value-oriented investors will be sceptical of a red-hot US market. Contrary to this crowded corner, an out-of-favour Chinese economy offers countless stocks which trade at significant discounts to earnings, sales, and free-cash-flow.

Alibaba, one of these, is the country’s largest e-commerce and cloud services company, comprising a vast array of business offerings: brick-and-mortar stores, logistics services, alongside several digital and cloud-computing segments. Known as the “Amazon of China”, the business’ largest revenue stream comes from its domestic e-commerce business, which of course, has suffered as of late. Yet, Alibaba’s international digital commerce group (driven by *AliExpress*) continues to expand rapidly, as does the company’s software-oriented segments.

In addition to a robust, competitive positioning at present, where revenues remain surprisingly strong amidst domestic economic crisis, Alibaba also offers considerable exposure to the AI that it increasingly adopts and develops throughout its business ventures; while the company has long-used features of AI to better serve its customers, it views the technology as an increasingly critical component of future operational efficiency, which extends far beyond customer-service.

Firstly, advanced AI robotics can drive productivity gains for its warehouse operations. Optimising processing and delivery networks, for example across its logistics business, *Cainiao*, these technology improvements will continue to drive cost-efficiency as the company increasingly penetrates international markets.

Alibaba also continues to become increasingly software oriented; having already released over 100 of its large language models to the global open-source community, ‘Qwen 2.5’, *AlibabaCloud* aims to fuel both a growing global and domestic demand for AI computing power. The company is consistently innovating its ‘full-stack AI infrastructure’, which offers businesses a holistic set of solutions for implementing the latest cloud-computing tech into their models. In Q2, while cloud-computing revenues only rose a modest 6%, this perhaps understates the 155% parallel rise in the segment’s adjusted earnings. As these nascent revenue streams grow as a proportion of the business’ total sales, higher net-margins here are only expected to drive stronger returns on invested capital, which Alibaba believes can help re-ignite adjust net income, to new record levels.



*Alibaba (BABA) all-time chart since initial-public offering*  
*[finviz.com]*



*Hong Kong's Hang Seng Index over the 10-year period*  
*[finance.yahoo.com]*

The company's share price, however, reflects an entirely different story than a narrative of investment, growth, and robust market positioning; additional to prevailing macro headwinds, BABA's past 5 years have also been characterised by a wave of harsh, regulatory hurdles.

In 2021, the company was hit with a record \$2.75bn fine by China's anti-trust regulators, following a series of 'unapproved' investments and acquisitions, anti-competitive merchant relationships, and several aggressive, loss-making promotions.

While Alibaba has since adjusted to its new regulatory environment (for example, it is now faced with the stronger market presence of competitors **JD.com** and **Pinduoduo**), a combined effect with the overlaying, macroeconomic deterioration has been deadly for BABA's share price, only submerging company growth AND global sentiment further, accentuating the broader trend for Chinese tech.



However, as history has proven time and time again, short-term demise can mean the crowding out (and thus creation) of a long-term opportunity, when fundamentals remain strong: Alibaba not only offers powerful promise of future growth, but robust fundamentals too, both of which are rooted in an attractive valuation. In fact, some might go as far as to say that Alibaba is absurdly undervalued; it could be an opportunity truly hard to come by in today’s market environment...

BABA has been a high-growth performer over the past decade, despite this being divorced significantly from stock performance. From fiscal 2014 to 2024, revenue expanded at a compound annual growth rate of 33%, with adjusted net income compounding at 19% per annum over this period. After an initial public offering (IPO) of \$68 per share, the stock went on to reach highs well-over 4x this, during 2020; since then, the ensuing tsunami of setbacks has plunged the stock right back down as low as IPO levels. It reached a 52-week low of \$66.60 in January this year.

Fiscal Year	Revenue (USD Billions)	Gross Profit (USD Billions)	Operating Expenses (USD Billions)	Net Income (USD Billions)
2015	12.3	8.8	6.7	3.9
2016	15.7	10.4	8.7	11.1
2017	23.0	14.4	10.8	6.3
2018	39.9	22.8	15.0	10.2
2019	56.2	25.3	18.0	13.1
2020	72.0	32.1	19.1	21.1
2021	109.5	45.2	23.5	22.9
2022	134.6	49.5	29.0	9.8
2023	126.5	46.4	27.6	10.6
2024	130.4	49.1	28.8	11.0

*Alibaba financial data for fiscal years since 2015 [finviz.com]*

Growth did decelerate in 2022 and 2023 for BABA, as headwinds culminated in pretty stagnant revenue growth, and a significant drop in net income after unfathomably prolonged ‘zero-COVID’ lockdowns, where the resultant effects on the aggregate consumer stifled and delayed recovery no doubt. Reported annual adjusted net income fell more than 50% during 2022, versus the previous year.

In 2024, while growth has still been modest so far when compared with pre-pandemic rates, the company has showed signs of picking up once again: BABA reported record annual revenues of \$130.04bn for the fiscal year, while earnings also showed some improvement, coming in at \$11bn.

When an eventual uplift for the domestic economy does truly arrive, Alibaba will be positioned centre-stage to capitalise...

So while growth has indeed slowed recently (and for valid reasons), I feel that there is still a lot to love about the stock; despite a recent cooling-off in top-line growth, Alibaba is still generating a lot of cash - fiscal 2024 saw a record amount of free cash flow, \$20.86bn, where the company bought back \$12.5bn in cheap shares, alongside announcement of its first cash dividend. A low pay-out ratio of 51% gives BABA plenty of room for dividend hikes in the future.

The stock becomes particularly attractive when its unignorable discounted valuation is put into perspective. Alibaba's price-to-earnings (P/E) ratio sits at a modest 12.7, even while it has managed to achieve record revenues in the fiscal year ending March 2024. Its price-to-free-cash-flow (P/FCF) ratio is also extremely low (just below 12), despite perennial investment into an increasingly international, software-oriented future.

By comparison, the S&P500's average P/E ratio stands at roughly 28, with the index's average P-FCF being far above 30. 'Big-sibling', Amazon, trades at a P/E as high as 44, despite a market-capitalisation that stands at over 12x BABA's. While many might suggest that Amazon's moat and market conditions are superior to Alibaba's, their valuations are truly worlds apart; in my view, Alibaba is a potential tech-and-commerce, global titan, and its strongly undervalued.

## CONCLUDING THOUGHTS

China's macroeconomic headwinds are both real and persistent, as dissected throughout this article. No doubt, many will feel uncomfortable with their capital wading in a currently sluggish and recovering economy, while the geopolitical motivations of President Xi Jinping and his government remain elusive.

Sure, China's growth may be slowing down due to a plummeting housing-market, which continues to drag on its lop-sided economy... And yes, anaemic consumer confidence continues to be a prevailing co-factor in this narrative, which will take a lot of stimulus and support to revitalise.

However, through *all* of this, I strongly believe that the market has overreacted. **Especially** in the case of Alibaba, the stock currently trades at valuation multiples which have been suppressed to unrealistic levels. The prevailing market narrative fails to acknowledge a robust, growing, and innovative global business; a dominant market position, and most importantly, a future where the Chinese economy is likely to be far stronger than it is today.

From stimulus-pathways to the geopolitical landscape; the realisation of Trump-tariffs to the evolution of AI-tech; time will tell as to how these factors play out, and how this will affect the speed of China's economic recovery. For investors seeking long-term, compounding returns (within a well-diversified portfolio), I believe that Alibaba's valuations may be too attractive to ignore.

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