Chinese Equity

Quarterly Report | Third Quarter 2021

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Composite Performance

Total Return (%) — Periods Ended September 30, 2021[1]

	3 Months	YTD	Since Inception[2]
HL Chinese Equity (Gross of Fees)	-14.86	-10.99	-10.99
HL Chinese Equity (Net of Fees)	-15.07	-11.63	-11.63
MSCI China All Shares Index[3]	-13.29	-10.55	-10.55

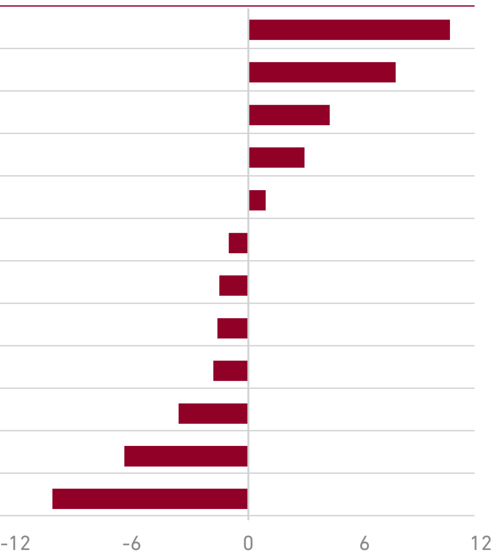
[1]The Composite performance returns shown are preliminary; [2]Inception Date: December 31, 2020; [3]The Benchmark Index gross of withholding taxes.

Please read the above performance in conjunction with the footnotes on the last page of this report. Past performance does not guarantee future results. All performance and data shown are in US dollar terms, unless otherwise noted.

Portfolio Positioning (% Weight)

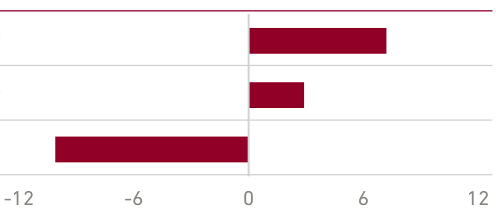
Sector	HL CE	MSCI CAS
Industrials	19.5	9.1
Health Care	16.8	9.2
Info Technology	13.6	9.4
Cash	2.9	–
Cons Discretionary	23.0	22.1
Utilities	1.7	2.7
Comm Services	9.9	11.4
Real Estate	1.9	3.5
Energy	0.0	1.8
Cons Staples	5.5	9.1
Materials	0.0	6.4
Financials	5.2	15.3

(Under) / Over



Market	HL CE	MSCI CAS
Other Emerging Markets	7.2	–
Cash	2.9	–
Mainland China + Hong Kong	89.9	100.0

(Under) / Over



Sector and geographic allocations are supplemental information only and complement the fully compliant Chinese Equity Composite GIPS Presentation. Source: Harding Loevner Chinese Equity Model; MSCI Inc. and S&P. MSCI Inc. and S&P do not make any express or implied warranties or representations and shall have no liability whatsoever with respect to any GICS data contained herein.

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Market Review

The most extensive series of regulatory changes in years, affecting many prominent companies, has made the recent months turbulent for businesses across China. Among other reforms, policymakers mandated that most of the after-school tutoring industry become not-for-profit, pressed antitrust and labor regulations extensively across online businesses, barred children from playing online games beyond three hours each week, and aggressively lowered government procurement prices for medical products. The breadth across industries and the rapidity with which these reforms were enacted have little precedent. The sectors most affected—Consumer Discretionary, Communication Services, Health Care, and Real Estate—all underperformed the broad China market. Industrials fared better, as one of the few sectors relatively unscathed by new regulations. Utilities, Materials, and Energy all rose strongly, buoyed by increased industrial demand for power and commodities such as oil, steel, lithium, and aluminum.

Policies implemented since the start of the year to curb an overheated real estate market brought Evergrande, China's second-largest real estate developer, to the brink of default. Markets quickly priced in contagion risk for other property developers, banks, building-materials suppliers, and to the consumer sectors, which are exposed to the knock-on effects of a potential fall in home prices, given that an estimated three-quarters of Chinese household wealth is tied to property. As details of Evergrande's finances emerged, perhaps the biggest surprise was that the company managed to survive as long as it did, considering its unusually high leverage and unorthodox business practices, including using cash to expand to a number of noncore businesses (such as spring water) and reportedly forcing employees to purchase its wealth management products to help fund the company's operations.

MSCI China All Shares Index Performance (USD %)

Sector	3Q 2021	YTD
Communication Services	-23.5	-22.0
Consumer Discretionary	-24.5	-26.0
Consumer Staples	-12.4	-13.2
Energy	19.3	51.0
Financials	-6.9	-7.5
Health Care	-17.6	-1.8
Industrials	3.3	14.1
Information Technology	-10.6	-8.7
Materials	11.6	27.6
Real Estate	-16.5	-18.8
Utilities	15.6	27.2

Source: FactSet (as of September 30, 2021). MSCI Inc. and S&P.

What has tied many of the government's wide-ranging regulatory policies together are its renewed focus on achieving "common prosperity," and its pursuit of a more inclusive development model—goals critical to its plan for achieving a high-enough per capita GDP to become a moderately developed country by 2035. Policymakers appear especially focused on ensuring that the middle class enjoys rising disposable income, a key ingredient for consumption-led growth, which has faltered due to structural impediments such as high real estate prices. Persistent income inequality higher than that of any major developed market, as well as social spending and fiscal redistribution below those of even many emerging markets, have begun to threaten social mobility and stability. Amid the recent policy announcements, e-commerce giant **Alibaba** and online video game and social media conglomerate **Tencent** took what they positioned as a first step in redressing inequality when each pledged payments of 100 billion yuan (approximately US$15 billion) toward common prosperity initiatives—the equivalent of a several percentage-point hike in their corporate tax rates.

China also suffered two Delta variant outbreaks, the country's most extensive resurgence of COVID-19 since the original outbreak in Wuhan last year. In both instances, the government continued its "zero-COVID" public health strategy, reinstating extensive local travel restrictions to contain the spread. As the country approaches the 80% mark for vaccination of its 1.4 billion citizens, albeit with traditional vaccines less effective than the mRNA formulations produced by Western vaccine makers, the government has come to a critical juncture for its strategy. Will the government maintain the strategy, which has produced the lowest mortality rates in the world, until it is able to deliver boosters or finish developing its own mRNA shots, or will it loosen restrictions to try to stem the economic costs of the zero-COVID approach?[1] In the meantime, between the travel restrictions and the early impact of the Evergrande collapse, growth in retail sales has fallen to half of its pre-pandemic pace, the lowest in at least two decades, helping to push China's non-manufacturing purchasing manager index (PMI) back into contraction territory for the first time since the virus's emergence. Unsurprisingly, shares of companies in the Consumer Discretionary sector bore the brunt of these headwinds during the quarter.

While attention has been largely focused on the recent torrent of regulations, several key areas have seen significant *deregulation* in line with the government's long-term policy objectives. This was particularly the case in the financial and automotive sectors, both sizable components of the Chinese economy. In early September, President Xi Jinping announced the creation of a new stock exchange in Beijing to help smaller companies access

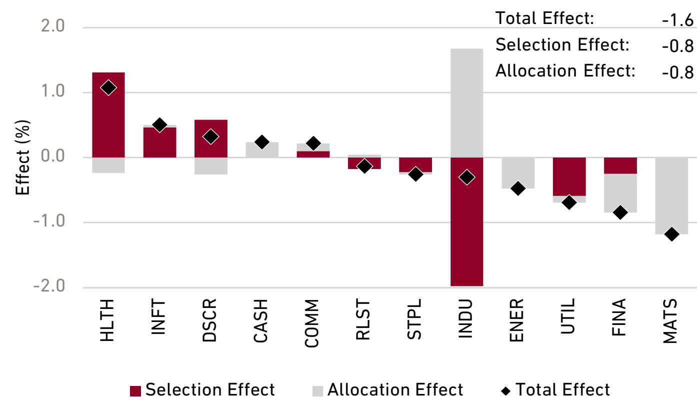
[1]Plans announced earlier this summer for a joint venture between BioNTech and Fosun Pharma to manufacture and distribute BioNTech's mRNA vaccine in China are now being "slow-rolled" by the government, according to *The Wall Street Journal*, so as not to hurt public confidence in the current domestic-made vaccines. Focus has shifted instead to the mRNA vaccine development efforts led by China's Academy of Military Medical Sciences, currently in late-stage trials in China and Mexico. Authorities have also been encouraged by preliminary data suggesting that delivering a third dose of the existing SinoFarm and Sinovac vaccines as a booster may raise protection levels comparable to those achieved by the BioNTech and Moderna shots.

capital markets. It joins the Shanghai Stock Exchange's Science and Technology (STAR) Board and the Shenzhen Stock Exchange's ChiNext Board as the third such platform designed to lower hurdles for public listing of relatively small businesses. Two weeks later, Chinese regulators launched Wealth Management Connect, allowing qualified investors based in mainland China to purchase select Hong Kong-listed investment products and funds, while opening similar investments in mainland China to investors based in Hong Kong.

These financial reforms follow a series of actions over the past couple of years loosening restrictions on foreign investment at the corporate level. In August, Tesla, the first foreign automaker to have a wholly owned China business, designated its Shanghai Gigafactory as its new primary global export hub, taking over from its original factory in Fremont, California, in supplying most of the completed vehicles bound for markets lacking their own production facilities. Tesla now makes in China three times as many cars as it sells locally, taking advantage of China's extensive supply chain, readily available engineering talent, and lower manufacturing costs—without having to share those economics with a joint venture partner. The rise of an export market for Chinese-made automobiles expands the addressable market dramatically for Chinese parts suppliers, several of which are owned in the portfolio.

Third Quarter 2021 Performance Attribution Sector

Chinese Equity Composite vs. MSCI China All Shares Index



Source: FactSet; Harding Loevner Chinese Equity Composite; MSCI Inc. and S&P. The total effect shown here may differ from the variance of the Composite performance and benchmark performance shown on the first page of this report due to the way in which FactSet calculates performance attribution. This information is supplemental to the Composite GIPS Presentation.

Performance and Attribution

The Chinese Equity composite declined 14.9% in the third quarter gross of fees, underperforming the 13.3% decline of the MSCI China All Shares Index.

Style factors were a significant headwind this quarter as regulatory changes hit fast-growing online businesses hard: the MSCI China Growth Index declined 22.4% versus the 13.5% decline of the MSCI China Value Index. The slowest-growing quintile of companies, where we have relatively low exposure, significantly outperformed the rest of the index, while the two highest-quality quintiles of companies, our much-preferred neighborhood, underperformed. Our lack of holdings in Materials and Energy and underweight in Financials hurt.

We outperformed in Consumer Discretionary (including retailing), and Health Care, two of the areas most affected by regulatory change. Within Health Care, our key contributors were the contract development and manufacturing organizations (CDMOs) **WuXi AppTec** and **WuXi Biologics** and contract research organization (CRO) **Tigermed**. WuXi Biologics added new capacity and capabilities as its project backlog has grown. Tigermed recovered from a moratorium on clinical trials during the pandemic and won new COVID-19-related projects. The company has gained market share thanks to its comprehensive service capabilities, strong track record, and good reputation.

We also had good performance by Information Technology holdings. **Silergy**, a semiconductor manufacturer that makes power management integrated circuits, saw increasing demand from a variety of end markets, including consumer goods, industrial, and automotive. The company expects that orders will keep rising due to the widespread global chip shortage, and as its own production capacity is limited the company is prioritizing orders from mid- to high-end customers, which should improve margins.

Stock selection in Industrials, the portfolio's largest sector overweight, was negative. **Techtronic Industries**, which manufactures power tools under the Milwaukee and Ryobi brands, was the lone bright spot, reporting outstanding results fueled by product development and expansion efforts. The company benefits from the accelerating do-it-yourself trend and migration to convenient high-powered cordless tools. Techtronic's outperformance was offset, however, by a pullback in the shares of pneumatic-equipment manufacturer **AirTAC**, which lagged on weaker manufacturing activity in China, and **Meyer Optoelectronic**, a maker of dental-imaging products, amid concerns about pricing pressure on government procurement of medical equipment. In the case of Meyer, we think the concerns are overblown, because most of its dental imaging products are used in private-pay clinics for discretionary services not eligible for reimbursement.

Companies held in the portfolio during the quarter appear in bold type; only the first reference to a particular holding appears in bold. The portfolio is actively managed therefore holdings shown may not be current. Portfolio holdings should not be considered recommendations to buy or sell any security. It should not be assumed that investment in the security identified has been or will be profitable. To request a complete list of holdings for the past year, please contact Harding Loevner. A complete list of holdings at September 30, 2021 is available on page 10 of this report.

Perspective and Outlook

Though the lack of Western-style public debate around proposed regulations and the suddenness with which they can be implemented in China can be destabilizing to companies and entire industries, we do not believe these recent regulatory changes are capricious or random. Reforms in areas such as carbon emissions, data security, and social equality are consistent with Beijing's desire to shift the economy toward more sustainable growth, with an explicit focus on balancing social and environmental goals. If this sounds familiar, it is because these objectives are being debated and pursued by policymakers around the world.

Our fundamental approach to grappling with the implications of regulatory change is the same no matter the country. Despite the speed and scope of the Chinese regulatory reset, analyzing it falls within our usual work. We routinely integrate regulatory risks and impacts into our assessment of the growth and profitability potential of individual businesses and their industries. In particular, we closely examine their effects on the level of rivalry and competitive landscape, the threat of new entrants, the ease with which a company's products might be substituted, and the bargaining power of a company's buyers and its suppliers, which together form Harvard professor Michael Porter's "Five Forces" framework, our workhorse template for analyzing business strategy. We also scrutinize the impact of existing and potential future regulations within the context of environmental, social, and governance (ESG) issues that underlie, and often drive, regulatory change. We are ever mindful that regulation is a double-edged sword—capable of being benign or malignant, and that the consequences of regulatory change is seldom completely good or bad for any given firm. And predicting what regulators will do next is never easy.

> The irony is that, in addition to raising industry rivalry from incumbent brick-and-mortar retailers, the unwinding of deceptive practices by community buying group leader Meituan could help otherwise-embattled Alibaba and JD.com, which have been looking to increase their toeholds in the segment.

Beijing's aspirations under "common prosperity" require our risk assessments of companies to consider seriously the environmental and social factors that are critical to the government. Beyond our very selective approach to business quality, in China we must make additional distinctions: we need to explicitly consider whether the objectives of non-state-owned companies align with (or at least don't run afoul of) the government's priorities. Government priorities may also shift, necessitating further evaluation. Below, we offer illustrations of how our analysts are using the Porter framework to evaluate the impact of the latest regulatory changes on companies in three industries that have been most affected: e-commerce, online games, and health care.

E-Commerce

The e-commerce industry, among the first to be scrutinized by Chinese regulators, has been under pressure on multiple fronts. Antitrust investigations resulted late last year in fines against several companies—most notably Alibaba (to the tune of US$2.8 billion)—for requiring exclusivity arrangements from the merchants on their platforms. We had been worried about the escalating rivalry Alibaba faced from other large companies such as Pinduoduo, Meituan, and **JD.com**. But by forcing the unwinding of exclusivity, regulators also toppled a key barrier to a group of smaller players gaining access to merchants previously found only on larger platforms. Antitrust investigators also concluded that market leaders in community group buying (CGB),[2] such as Meituan, used illegal subsidies and deceptive pricing to lure customers from local brick-and-mortar stores onto their platforms. The irony here is that, in addition to raising industry rivalry from incumbent brick-and-mortar retailers, the unwinding of *these* practices could help Alibaba and JD.com, which have been looking to increase their toeholds in online grocery, the largest emerging untapped e-commerce market in China. Indeed, earlier this year, Alibaba said it will invest heavily in the grocery business to strengthen its position in CGB.

With the announcement of Alibaba's common prosperity payment, government, as a "supplier" in the Porter structure, becomes more powerful as the implicit tax has pushed up the company's cost of doing business. But while we trimmed our exposure to Alibaba this quarter, we maintained a position. The company remains the market leader in e-commerce and has several other attractive and fast-growing businesses such as cloud services with significant scale advantages compared to rivals. We expect Alibaba to generate more than 15% cash flow returns on investment over the next five years. And after its recent decline, the price of its shares is now quite attractive relative to our assessment of their fair value.

Online Games

Over the past several years, Chinese regulators concerned with the ill effects of online games on kids have issued a series of rules governing how children can access games and the amount of time they can spend playing them. Recently, the government took more radical action. New regulations now limit minors' playing time to a maximum of three hours per week and their in-game weekly purchases (the largest source of game revenue) to US$30–60, depending on the player's age. With many game companies having acceded to government pressure and requiring accounts to be authenticated by facial recognition (thwarting children from evading the caps by using their parents' logins), the new restrictions are likely to be more enforceable than earlier ones.

[2]CGB is a popular new business model and an important avenue of growth in the large but less-penetrated segment of online grocery purchases. Under this model, shoppers place online grocery orders that are then aggregated and delivered in bulk to neighborhood pickup locations, allowing economies of scale and cheaper prices. CGB helps e-commerce companies acquire customers who frequently purchase fresh grocery, while overcoming problems like higher logistics costs and short shelf life that cannot be efficiently addressed by traditional e-commerce models.

Looking at these changes through the Porter framework, we see a significant increase in buyer power (that is, the bargaining power of the children playing the games, as they will be operating on a strict time budget), relative to the pricing power of industry participants. The regulations also include antitrust elements that may prevent large firms from continuing to gobble up small studios, which would increase the threat of new entrants and intensify rivalry. Stricter data security regulations will also likely make it harder for game companies to collect personal data, and lead to higher compliance costs. Moreover, the industry's effective tax rates will likely increase as China claws back certain favorable tax arrangements. And that is apart from the approximately US$15 billion common prosperity payment pledged by Tencent.

In our portfolio, we own Tencent and **NetEase**, two of China's largest companies developing and operating online games. The unfavorable regulatory changes will likely slow growth for both firms. But while we have reduced our exposure, the slowdown does not negate the fact that these remain high-quality growing businesses. At least officially (depending on how many children were using their parents' accounts), revenues from minors represented only 6% of Tencent's domestic game business in its last fiscal year. (NetEase doesn't publicly break down its revenues by age.) The impact of the regulations seems to be largely reflected in Tencent's current valuation. Meanwhile, NetEase's latest blockbuster release, *Harry Potter: Magic Awakened*, has been more successful than projected earlier this summer, a testament to either the enduring adult appeal of Harry Potter or enduring ability of certain games to catch fire. For both companies, if their growth inside China slows, a stronger push into international markets could help take up the slack. We note that Tencent, in particular, is also a well-diversified company with significant businesses in social media, payments, and cloud services.

Health Care

The overarching purposes of regulatory actions in health care are two-fold: to increase affordability through expanding access to generic drugs, and to encourage the local biotech and pharmaceutical industries to innovate more in order to compete more effectively with their Western competitors. As China expands public health care coverage, the government has been using centralized procurement programs and bulk bargaining power to drive down health care costs, including prices for generics. In the first half of this year, China conducted two rounds of large-scale open tenders covering more than 100 drugs and devices, which on average have resulted in prices for the tendered drugs being cut by over half. For our portfolio company **Jiangsu Hengrui Medicine**, the effect of centralized procurement has significantly compressed sales for the company's generic drugs: revenues for six of them dropped by 57% in the first half of this year.

We have remained invested in Hengrui because, with its impressive R&D pipeline, it is a market leader in innovative new drugs. The company's new-drug revenue grew over 43% in the first half of this year and now accounts for nearly 40% of its total sales. This part of its business actually benefits from some of the recent regulations. For example, patents on innovative drugs are stronger after a revamp in June deferred marketing approvals of generics until after the original drugs' protections expire and extended the protection periods. At the same time, regulators have raised the bar for what is considered an innovative new drug. Drugs only marginally more efficacious will no longer enjoy the same patent protections and economic rewards as truly innovative ones. The higher standards should ultimately work to Hengrui's advantage, given its R&D edge over many rivals. The new rules will also benefit CDMOs and CROs, including WuXi Apptec, WuXi Biologics, and Tigermed, which comprise 80% of our portfolio's Health Care investments. Not only are such companies spared the pricing compression seen in generics, but they stand to benefit from the increased pressure on their customers to develop world-class drugs.

Portfolio Highlights

Taking a long-term perspective of the blizzard of regulatory changes, we cannot help but view the heightened risks against the background of new investment opportunities in China arising from innovation and economic growth. We have generally become less constructive on the largest internet companies in the index, and the portfolio is now underweight online media, entertainment, and e-commerce, a notable difference from the beginning of this year. Outside of e-commerce, we sold our position in **Suofeiya**, a maker of custom wardrobes and kitchen cabinets, due to the rising risk from the financial woes of real estate developer Evergrande. Though Suofeiya maintains a large net cash position and remains well-capitalized, we see its growth potentially slowing due to disruption in the new-home market. We also sold our position in after-school tutoring leader **New Oriental** before the hammer fell on this industry, turning it "not-for-profit."

> We have maintained our large overweight in Industrials, which reflects the superior opportunities in a sector that is less affected and, in some respects, directly aided by recent regulatory action.

We have maintained our large overweight in Industrials, which reflects the superior opportunities in a sector that is less affected and, in some respects, directly aided by recent regulatory action. Several companies in the sector, such as **Inovance** and AirTAC, are domestic leaders expected to benefit from the increasing penetration of industrial automation in China, as well as from increasing global market share due to their competitive cost structures and customized service offerings. We think others, such as thermal management component supplier **Sanhua Intelligent Controls**, should benefit from the rapid growth in electric vehicles (EVs) spurred by beneficial regulations in line with China's carbon neutrality goals.

Our bottom-up process leads us to seek investment opportunities that look more attractive in a changing environment. This quarter, we purchased three high-quality companies whose long-term structural growth outlooks have recently improved.

We bought a new position in **Hong Kong Exchanges (HKEx)**, a holding company that operates the stock exchange, futures exchange, and securities clearinghouse of its namesake city, including the Stock Connect program that links to the primary exchanges in Shanghai and Shenzhen trading in mainland-listed ("A-share") stocks. HKEx is a highly profitable company whose main businesses remain the global exchanges of choice for Chinese clients who wish to invest money outside the mainland and for international clients seeking exposure to Chinese stocks and futures. The company has a robust IPO pipeline, which we consider a key driver of HKEx's long-term growth. Moreover, HKEx benefits from the elevated tensions between US and China. Chinese companies that currently have an ADR listing in the US have been additionally listing in Hong Kong to guard against the possibility of their ADRs being forcibly delisted. The potential expansion of HKEx's fixed income and currency trading businesses, as well as new products such as A-share index futures, should also support the company's long-term growth.

We also bought **ANTA Sports**, China's largest sportswear company. It has a multi-brand strategy: the company's main brand, Anta, focuses on the mid-market through offering affordable yet differentiated products with high functionality and strong consumer appeal, while its premium FILA brand targets customers seeking more fashionable sports apparel. ANTA's earnings growth has been very strong this year as consumers upgraded to premium products and increasingly preferred domestic brands. The company's ongoing transition from a wholesaler-driven distribution to a direct-to-consumer strategy should improve efficiency and facilitate more premium product sales at its own stores. We think a cultural shift toward health and wellness also has the potential to sustain ANTA's domestic growth. The government is not just forcing kids off their video games—it has made more regular exercise an explicit national goal, supported by higher spending on parks and other fitness-related infrastructure.

Our final addition to the portfolio last quarter was **Fuyao Glass**, China's largest automotive-glass manufacturer and the leading player in a global glass oligopoly. Its integrated supply chain and economies of scale provide Fuyao with a cost advantage over peers that leads to superior margins. Fuyao's long-term growth should be aided by increasing penetration of automobile ownership in China from a current level of around 20%, compared to 80% penetration in developed countries such as the US. Sales of its premium products like panoramic sunroofs have been boosted by the rapid growth in EVs (many of which sport this feature), helping to further grow profits. Based on its order pipeline, Fuyao's management expects more than 70% of EVs and 20% of cars with internal combustion engines to adopt panoramic sunroofs in the next five years, up from 20% and 2%, respectively.

More Context for the Vexed

By Lee Gao

There are few precedents for China's quick-fire regulatory changes, which over the past few months have transformed everything from ecommerce and education to health care and real estate.

One can only speculate on the reasons for this synchronous timing, but one possibility that stands out is the confluence of the five-year policy and leadership cycles in China. This is the first year of the 2021-25 Five-Year Plan, but more importantly, it is the final full year before the top 200 or so members of the Central Committee of the Communist Party of China are selected at its National Congress in October 2022. It bears remembering that those politicians are similar to counterparts elsewhere in facing challenges that have diverted them from other priorities. They spent the first two years of their terms coping with escalating US-China trade tensions, and just when "normal order" loomed after the signing of the Phase One trade agreement, COVID-19 hijacked everyone's lives. Only recently have they gotten a chance to work on much-delayed goals.

As policymakers picked up where they had left off, they found themselves facing stakes heightened by the pandemic: stagnating incomes, weak consumer confidence, and a growing demographic crisis as birthrates continue to decline. These challenges may have accentuated their top priorities, ones that have been repeatedly highlighted in official policy statements over the last few years: innovation, rule of law, culture, the environment, and social harmony.

The fact is that ever since Deng Xiaoping initiated the initial series of capitalist overhauls in the 1980s, China has undergone multiple periods of reform. These changes cut a wide swath across economic activity and drastically curtailed certain targeted sectors. They were painful in their time, creating mass unemployment and fueling social discontent. Ultimately, they laid the groundwork and helped sustain several decades of nearly uninterrupted growth.

Previous reforms were far less visible to foreign observers because they barely touched the companies widely held by global investors at the time. For example, the coordinated supply-side reforms of 2015, undertaken in part to reduce chronic pollution, shuttered roughly one-fifth of China's steel capacity (equivalent to Japan's entire steel output) in under two years. Air quality improved dramatically, while bankruptcies almost tripled as many marginal producers were killed off. But not many foreign investors owned marginal steel producers, preferring to own faster growing companies such as Alibaba and New Oriental. Likewise, the anti-corruption campaigns that began in 2013 may have ushered in a more sustainable business environment, but they were terrible for liquor makers, whose products had become popular high-priced gifts to lubricate business deals and lobbying efforts. Kweichow Moutai, producer of its fiery namesake liquor, saw its sales growth plummet in 2014 and 2015, but the company was not nearly as widely owned externally as Tencent is today.

Much of the focus of late has been on one policy priority: common prosperity. Redolent of China's collectivist past (the term was first used by Mao in 1950), the phrase frightens some foreign investors who are unsure which companies' prosperity will be sacrificed at the altar of the commons. Yet policymakers have been clear: their focus is on growing middle-class disposable income, not "robbing the rich to help the poor," according to Han Wenxiu, executive deputy director of the General Office of the Central Financial and Economic Affairs Commission. This overt aversion to a European-style welfare model may seem contradictory for a party that still pays lip service to its Marxist roots. But the reality is that China systematically underinvested in education, healthcare, and other social spending—especially in rural areas—as it sought to catch up economically with more developed economies. Until now, policymakers have done little in the way of redistribution; indirect taxes, which generally serve to widen income inequality, still represent two-thirds of fiscal revenue. With China coming into its own, we should expect its practices to converge with those in more advanced economies, including some form of income and wealth redistribution.

> To my mind, these regulations are reminiscent of the US Progressive Era of the late 19th and early 20th centuries, epitomized by Theodore Roosevelt's Square Deals.

In practice, the government's targets for common prosperity—judging from recent policies and the detailed roadmap for its first pilot program in Zhejiang, the richest province in China and home to Alibaba—are education, healthcare, and housing. In these pivotal areas, structural impediments have exacerbated inequalities over time, producing a set of challenges that would be very familiar, for example, to residents of California. One of the more draconian national policy shifts, which recently consigned much of the private after-school tutoring business to the non-profit sector, does not go as far as South Korea's complete ban of private tutoring in the 1980s.[3] In each

[3]The South Korean ban was ultimately overturned by the courts two decades later, though South Korea's government has been adding new restrictions on tutoring ever since.

country, the reforms were designed to ease the burden on parents who spend up to thousands of dollars each month coaching their children on how to pass exams. (To put this cost in perspective, the Chinese city with the highest average annual per capita disposable income in 2020 was Shanghai at $11,000.) Likewise, China's recent online regulations covering antitrust, data security, and the safety of minors are similar to the concerns of consumer advocates everywhere.

To my mind, these regulations are reminiscent of the US Progressive Era of the late 19th and early 20th centuries, epitomized by Theodore Roosevelt's Square Deal. It was not an easy time to invest and was marked by muscular antitrust interventions, the inception of a progressive income tax, and the appearance of the first federal consumer and environmental protections. Certain industries faced a permanently higher level of regulation with which they had been unfamiliar. But many companies thrived, and the reforms arguably laid the foundation for a century of growth that shaped the American economy into the largest in the world today, home to the largest number of globally competitive companies.

Structural changes of this magnitude will inevitably shake up competitive forces, buffeting the outlook for growth and strength of free cash flow generation for many businesses—but not all of them in negative ways. If China's reforms succeed in improving middle-class disposable income while opening more opportunities for more people and still ensuring that the country remains a meritocracy, the government will have set the stage for more sustainable end demand for many industries. It's a tall order, but one notable advantage enjoyed by Chinese policymakers today is the benefit of a century of hindsight observing which policies worked—and which did not—in the countries that have tried them.

Chinese Equity Holdings (as of September 30, 2021)

Communication Services	Market	End Wt. (%)
Baidu (Internet products and services)	Mainland China	1.9
NetEase (Gaming and internet services)	Mainland China	2.5
Tencent (Internet and IT services)	Mainland China	5.6
Consumer Discretionary		
Alibaba (E-commerce retailer)	Mainland China	4.3
ANTA Sports (Athletic footwear and apparel retailer)	Mainland China	2.4
China Tourism Group Duty Free (Duty free services)	Mainland China	4.5
Fuyao Glass (Automotive glass manufacturer)	Mainland China	1.4
Gree Electric Appliances (Air-conditioner mfr.)	Mainland China	1.5
JD.com (E-commerce retailer)	Mainland China	2.6
Midea Group (Consumer appliances manufacturer)	Mainland China	2.4
Shenzhou International (Textile manufacturer)	Mainland China	2.6
Trip.com Group (Online travel services)	Mainland China	1.3
Consumer Staples		
Foshan Haitian (Condiments manufacturer)	Mainland China	1.4
Wuliangye Yibin (Alcoholic beverages manufacturer)	Mainland China	2.6
Yili (Dairy products manufacturer)	Mainland China	1.4
Energy		
No Holdings		
Financials		
AIA Group (Insurance provider)	Hong Kong	3.3
Hong Kong Exchanges (Clearing house and exchange)	Hong Kong	1.3
Ping An Insurance (Insurance provider)	Mainland China	0.6
Health Care		
CSPC Pharmaceutical Group (Pharma manufacturer)	Mainland China	1.8
Jiangsu Hengrui Medicine (Pharma manufacturer)	Mainland China	1.5

Health Care	Market	End Wt. (%)
Tigermed (Clinical development services)	Mainland China	3.2
WuXi AppTec (Biopharma manufacturer)	Mainland China	4.5
WuXi Biologics (Biopharma manufacturer)	Mainland China	5.8
Industrials		
AirTAC (Pneumatic-equipment manufacturer)	Taiwan	3.6
Haitian International (Injection-molding machines mfr.)	Mainland China	2.3
Inovance (Industrial controls manufacturer)	Mainland China	1.8
Meyer Optoelectronic (Optical machine manufacturer)	Mainland China	1.2
Sanhua Intelligent Controls (HVAC&R parts mfr.)	Mainland China	2.5
SF Holding (Delivery services)	Mainland China	2.7
Shanghai International Airport (Airport operator)	Mainland China	1.2
Techtronic Industries (Power tools manufacturer)	Hong Kong	4.1
Information Technology		
Sangfor (IT security services)	Mainland China	2.2
Silergy (Electronics chips manufacturer)	Taiwan	3.6
Sunny Optical (Optical components manufacturer)	Mainland China	3.4
TravelSky (Aviation IT services)	Mainland China	2.6
Yonyou (Enterprise software developer)	Mainland China	1.9
Materials		
No Holdings		
Real Estate		
Country Garden Services (Residential property mgt.)	Mainland China	1.9
Utilities		
ENN Energy (Gas pipeline operator)	Mainland China	1.7
Cash		2.9

Model Portfolio holdings are supplemental information only and complement the fully compliant Chinese Equity Composite GIPS Presentation. The portfolio is actively managed therefore holdings shown may not be current. Portfolio holdings should not be considered recommendations to buy or sell any security. It should not be assumed that investment in the security identified has been or will be profitable. To request a complete list of portfolio holdings for the past year contact Harding Loevner.

3Q21 Contributors to Relative Return (%)

Largest Contributors	Sector	Avg. Weight HL CE	Avg. Weight MSCI CAS	Effect
Techtronic Industries	INDU	4.0	–	1.08
Silergy	INFT	2.9	–	0.61
WuXi AppTec	HLTH	4.3	0.5	0.45
NIO Inc.*	DSCR	0.0	1.3	0.30
SF Holding	INDU	2.4	0.3	0.25

Largest Detractors	Sector	Avg. Weight HL CE	Avg. Weight MSCI CAS	Effect
Alibaba	DSCR	10.2	8.1	-0.54
New Oriental	DSCR	0.3	0.1	-0.37
Meyer Optoelectronic	INDU	1.5	<0.1	-0.31
Suofeiya	DSCR	1.4	<0.1	-0.28
NetEase	COMM	2.7	0.9	-0.26

*Company was not held in the portfolio; its absence had an impact on the portfolio's return relative to the index.

Portfolio Characteristics

Quality and Growth	HL CE	MSCI CAS
Profit Margin[1] (%)	17.9	15.4
Return on Assets[1] (%)	10.2	7.2
Return on Equity[1] (%)	19.7	15.2
Debt/Equity Ratio[1] (%)	19.5	39.4
Std. Dev. of 5 Year ROE[1] (%)	3.8	2.9
Sales Growth[1,2] (%)	18.6	20.1
Earnings Growth[1,2] (%)	19.1	16.4
Cash Flow Growth[1,2] (%)	25.6	24.3
Dividend Growth[1,2] (%)	23.0	16.6

Risk and Valuation	HL CE	MSCI CAS
Price/Earnings[3]	28.1	12.9
Price/Cash Flow[3]	26.2	12.4
Price/Book[3]	5.0	2.6
Dividend Yield[4] (%)	0.9	1.7
Size		
Wtd. Median Mkt. Cap. (US $B)	46.1	37.4
Wtd. Avg. Mkt. Cap. (US $B)	92.5	123.1

[1]Weighted median; [2]Trailing five years, annualized; [3]Weighted harmonic mean; [4]Weighted mean. Source: FactSet (Run Date: October 4, 2021, based on the latest available data in FactSet on this date.); Harding Loevner Chinese Equity Model, based on the underlying holdings; MSCI Inc.

Completed Portfolio Transactions

Positions Established	Market	Sector
ANTA Sports	Mainland China	DSCR
Fuyao Glass	Mainland China	DSCR
Hong Kong Exchanges	Hong Kong	FINA

Positions Sold	Market	Sector
New Oriental	Mainland China	DSCR
Suofeiya	Mainland China	DSCR

The portfolio is actively managed therefore holdings identified above do not represent all of the securities held in the portfolio and holdings may not be current. It should not be assumed that investment in the securities identified has been or will be profitable. The following information is available upon request: (1) information describing the methodology of the contribution data in the tables above; and (2) a list showing the weight and relative contribution of all holdings during the quarter. Past performance does not guarantee future results. In the tables above, "weight" is the average percentage weight of the holding during the period, and "contribution" is the contribution to overall relative performance over the period. Contributors and detractors exclude cash and securities in the Composite not held in the Model Portfolio. Quarterly data is not annualized. Portfolio contributors and detractors and characteristics are supplemental information only and complement the fully compliant Chinese Equity Composite GIPS Presentation. Portfolio holdings should not be considered recommendations to buy or sell any security.

Chinese Equity Composite Performance (as of September 30, 2021)

	HL Chinese Equity Gross (%)	HL Chinese Equity Net (%)	MSCI China All Shares Index[1] (%)	HL Chinese Equity 3-yr Std. Deviation[2] (%)	MSCI China All Shares Index 3-yr. Std. Deviation[2] (%)	Internal Dispersion[3] (%)	No. of Accounts	Composite Assets ($M)	Firm Assets ($M)
2021 YTD[4]	-10.99	-11.63	-10.55	+	+	N.A.[5]	1	4	73,857

[1]Benchmark Index; [2]Variability of the composite, gross of fees, and the index returns over the preceding 36-month period, annualized; [3]Asset-weighted standard deviation (gross of fees); [4]The 2021 YTD performance returns and assets shown are preliminary; [5]N.A.–Internal dispersion less than a 12-month period; +Less than 36 months of return data.

The Chinese Equity Composite contains fully discretionary, fee-paying accounts investing in equity and equity-equivalent securities of companies domiciled predominately in China and Hong Kong and cash reserves and is measured against the MSCI China All Shares USD Total Return Index (Gross) for comparison purposes. Returns include the effect of foreign currency exchange rates. The exchange rate source of the benchmark is Reuters. The exchange rate source of the Composite is Bloomberg. Additional information about the benchmark, including the percentage of composite assets invested in countries or regions not included in the benchmark, is available upon request.

The MSCI China All Shares Index is a free float-adjusted market capitalization index that is designed to measure large and mid-cap China share classes listed in Hong Kong, Shanghai, Shenzhen, and outside of China. You cannot invest directly in this Index.

Harding Loevner LP claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Harding Loevner has been independently verified for the period November 1, 1989 through June 30, 2021.

A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.

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Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Composite performance is presented gross of foreign withholding taxes on dividends, interest income and capital gains. Additional information is available upon request. Past performance does not guarantee future results. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

The US dollar is the currency used to express performance. Returns are presented both gross and net of management fees and include the reinvestment of all income. Net returns are calculated using actual fees. Actual returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. The standard fee schedule generally applied to separate Chinese Equity accounts is 1.15% annually of the market value up to $20 million; 0.80% of amounts from $20 million to $100 million; 0.75% of amounts from $100 million to $200 million; 0.55% of amounts over $200 million. Actual investment advisory fees incurred by clients may vary. The annual composite dispersion presented is an asset-weighted standard deviation calculated for the accounts in the composite the entire year.

The Chinese Equity Composite was created on December 31, 2020 and the performance inception date is January 1, 2021.