Chinese Tech Displacement: Silver Linings Of The Growth Downturn

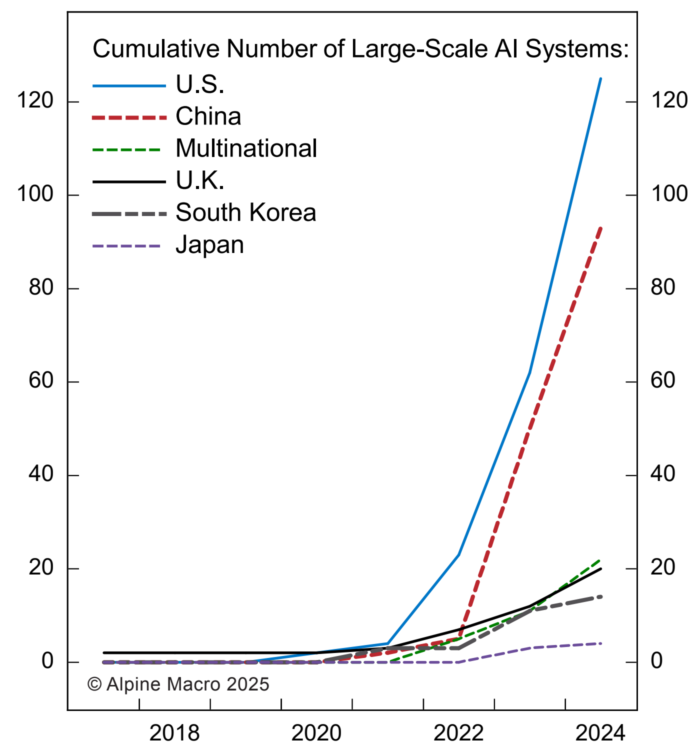
In This Report

Chinese stocks have rallied strongly of late, catalyzed by DeepSeek. The bigger story is the emergence of Chinese AI models that rival their American counterparts. The global race to develop large-scale AI systems, as in many other high-tech domains, is essentially a competition between the U.S. and China, with other nations struggling to keep up (Chart 1). DeepSeek is leading the pack of other Chinese AI models – such as Qwen, Ernie, Doubao, Hunyuan, and Kimi – developed by both established tech giants and young startups. Any of these names could potentially reshape the global AI landscape but have long been overlooked outside of China.[1] Now, they are finally appearing on global investors' radars.

The Rerating Has Further To Go

Beyond the specific technicalities of AI, the macro investment theme is a common one. China's manufacturing prowess, productive labor force, strong entrepreneurship and the government's R&D support have created formidable competitiveness, causing massive disruptions for established global players in numerous industries. The displacement began in low value-added products, such as textiles, base metals, and electronics. In more recent years, the impact has moved to higher value-added sectors, such as green energy, drones, batteries, and electric vehicles. DeepSeek and the emergence of other Chinese AI models are a continuation of this recurring theme.

Chart 1 Global AI Race: A Contest Between The Two



Note: The source defines AI models as "large-scale" when their training compute is confirmed to exceed 10^23 FLOP
Source: Epoch, OurWorldinData

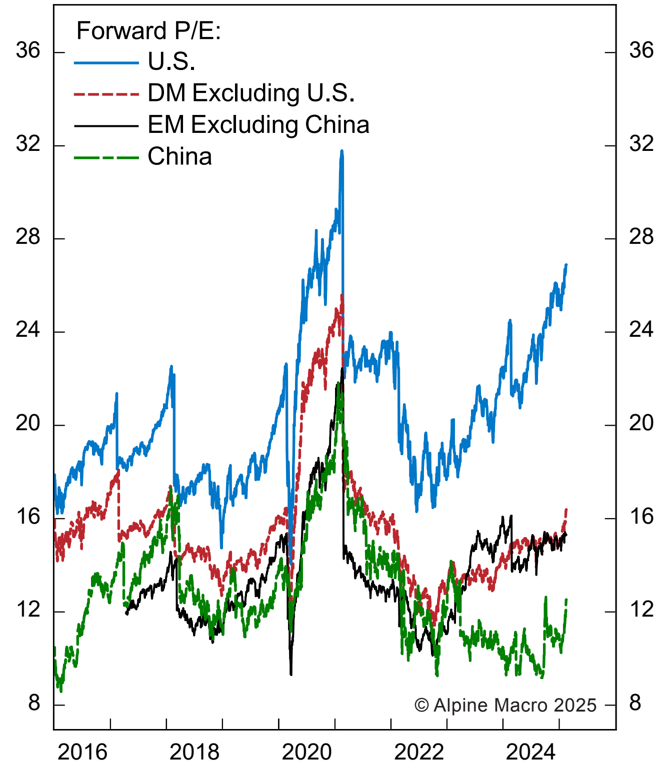
1 Alpine Macro *U.S. Themes & Strategy* "China, Tariffs And What Could Go Right" (February 12, 2025).

Table 1 Chinese And American Techs: Mind The Valuation Gap

	Forward P/E	P/B	P/S
Tesla	127.7	15.7	11.6
Netflix	42.5	18.3	11.7
Xiaomi	41.0	5.9	3.2
Nvidia	35.2	51.6	30.1
Apple	32.5	55.1	9.4
Amazon	31.9	8.5	3.8
Meta	28.4	10.2	11.3
BYD	21.2	6.2	1.4
Alphabet	20.3	7.0	6.5
Tencent	19.2	4.7	6.7
Alibaba	13.6	2.3	2.3
NetEase	13.6	3.7	4.6
Baidu	11.1	1.0	1.8
JD.com	9.4	1.9	0.4

Note: Shaded are Chinese companies © Alpine Macro 2025

Chart 2 China: The Rerating Has Further To Go



Source: Bloomberg Finance L.P.

For investors, the latest developments reinforce our long-held thesis that China is not only investable but increasingly indispensable in the rapidly emerging "G2" world.[2] The significant valuation gap between the U.S. and China presents a compelling long-term investment opportunity. Our long positions in Chinese stocks have delivered substantial returns, and we anticipate further upside in prices.

- Despite the recent sharp rally in some Chinese tech stocks, their valuation indicators remain significantly lower than those of their American counterparts (Table 1). The discount on the broader Chinese investable benchmark is even greater, and Chinese equities are among the cheapest globally (Chart 2).

- China's growth numbers are showing marginal improvement. Travel and consumption during the Chinese New Year holiday have largely returned to pre-COVID trends, while the latest credit data has exceeded expectations. Recent breakthroughs in the tech sector and the stock market rally could help restore business confidence, addressing a key factor behind China's sluggish growth.

- Beijing has hinted at a 5% GDP growth target for 2025, which will require further policy easing, particularly in the face of additional U.S. tariffs. The upcoming National People's Congress in early March will be a key event to watch. We expect a meaningful fiscal stimulus to be announced and will provide updates as more details emerge.

2 Alpine Macro *EM & China Strategy* "Part I: Will China Become Uninvestable?" (May 2, 2023) and "Part II: What If China Becomes Uninvestable?" (May 23, 2023).

Chart 3 Housing Bust Redirecting Resources To "Real Economy"

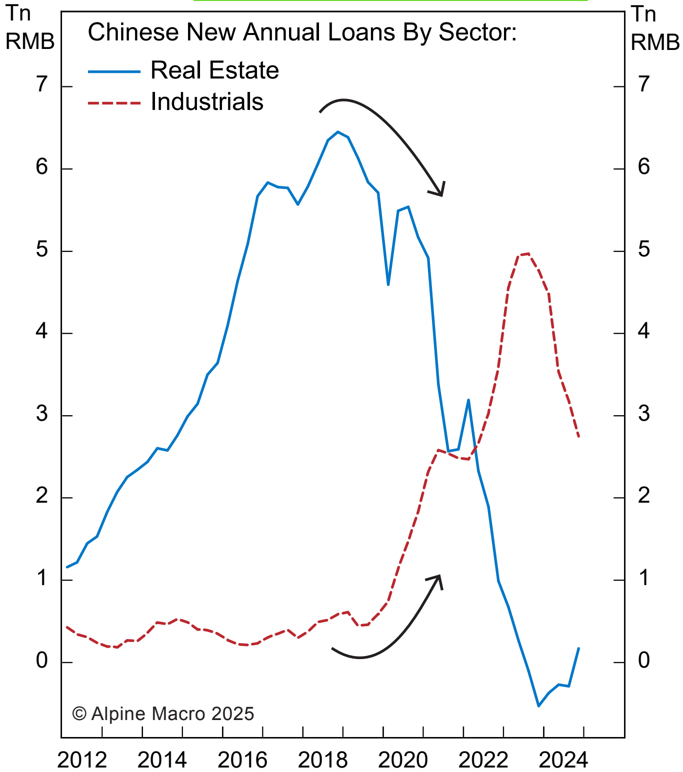
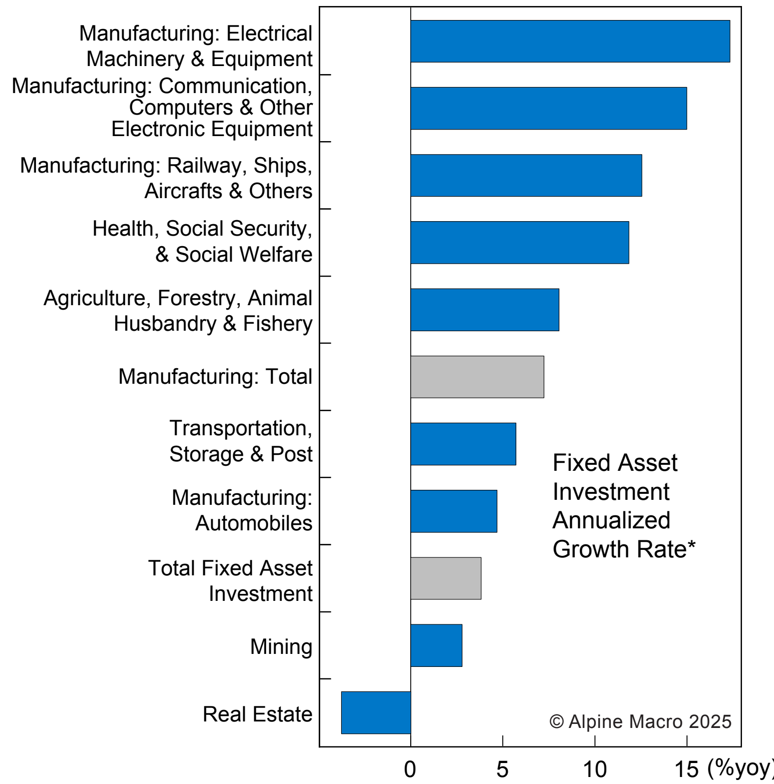


Chart 4 CapEx Divergence Between Real Estate And High-Tech Manufacturing



*Average of annual growth rate from 2020 to 2024

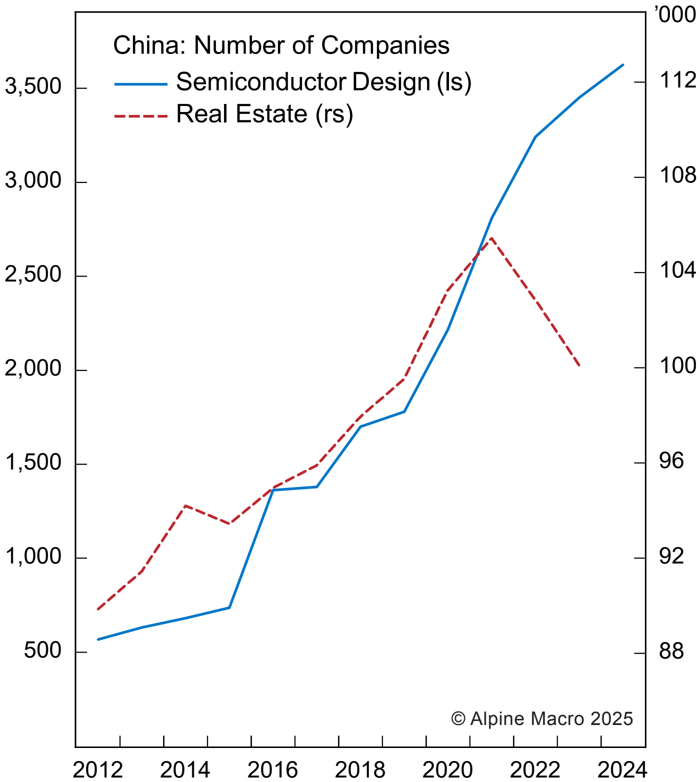
The Blessings Of Policy Mishaps

Beijing's policy missteps in recent years have significantly hampered economic growth and weighed down asset prices. However, the economic slowdown, particularly the housing collapse, has helped reallocate financial resources and creative energy toward more productive sectors, fueling a tech boom.

- Falling property prices in recent years have shattered the long-held belief among Chinese households and enterprises that real estate is a sure path to quick wealth. Bank lending to the property sector has virtually dried up, which, in turn, has helped "crowd in" loans to other sectors, particularly manufacturing and high-tech industries (Chart 3). There is a similar divergence in investment and output, with high-tech sectors far outperforming real estate and the broader economy (Chart 4).

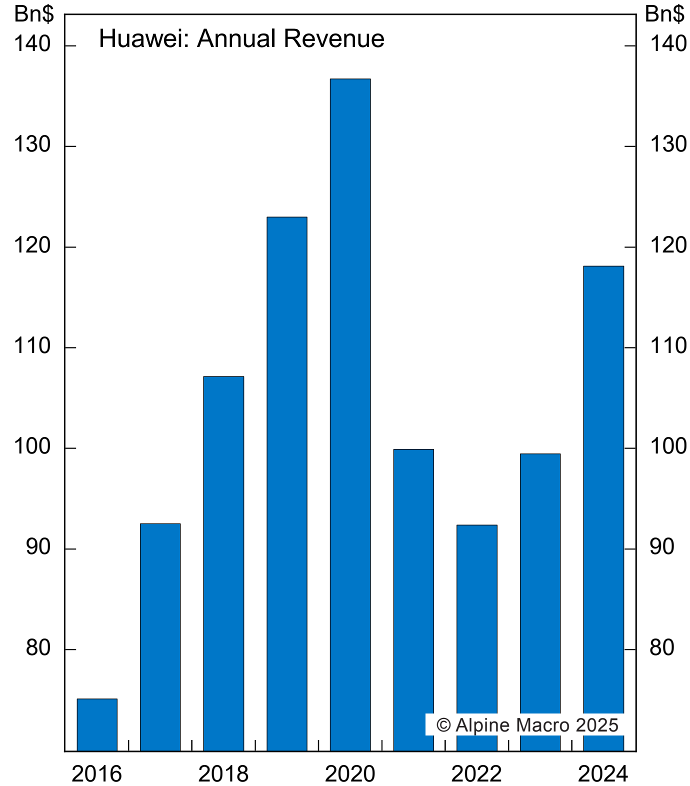
- Beijing's regulatory crackdown on the tech sector has shaken overall business confidence, contributing to the economic slowdown. However, antitrust measures and tighter regulations on giant tech conglomerates have also created strategic opportunities for smaller firms to expand. The absolute dominance of large tech platform companies in certain sectors has been weakened, enabling smaller players to focus on technological breakthroughs in niche areas without fear of being squeezed out or acquired by established giants. Investments and resources

Chart 5 **The Developing High-Tech Boom**



Source: Chinese National Bureau of Statistics, Ibid, other media reports

Chart 6 **Huawei: Back To Growth**



Source: Huawei Annual Report, 2024 figure is based on remarks by company chairman

have begun to flow toward smaller tech firms, particularly in strategic fields such as artificial intelligence, semiconductors, and new energy (**Chart 5**).

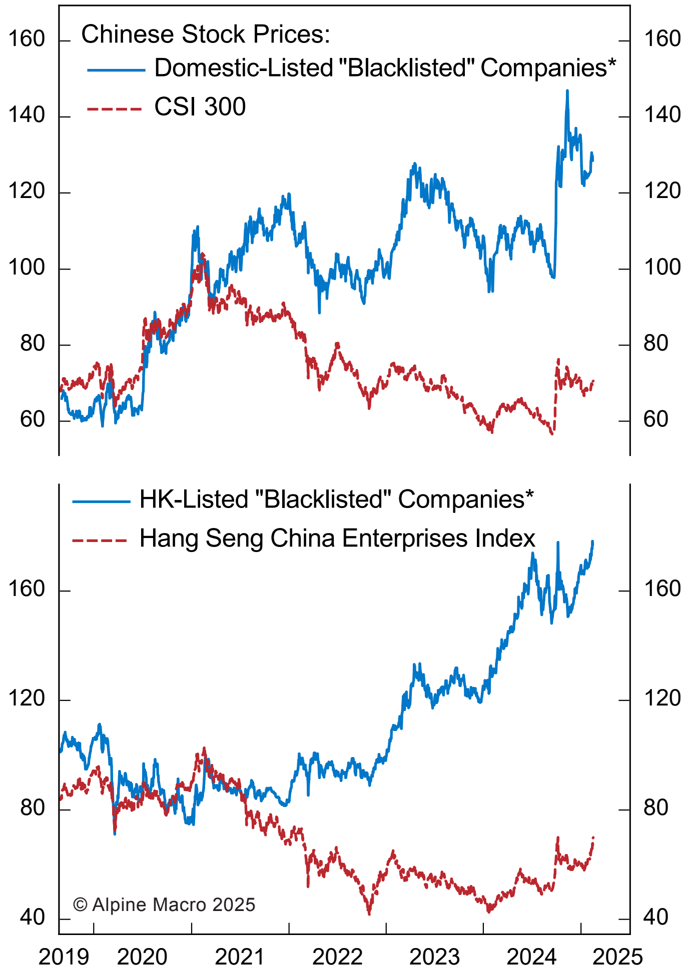
- America's increasingly stringent embargo has posed significant headwinds for the Chinese tech sector, though, ironically, it has brought some unintended benefits. Cut off from access to the most advanced semiconductor chips and equipment, and further constrained by a slump in venture investments – due to China's weak stock market performance – Chinese tech companies have been forced to optimize aggressively, creating extraordinary cost advantages over their American competitors.

Overall, Beijing has deliberately deflated the housing bubble and reined in the expansion of some dominant tech firms to achieve "higher-quality" growth. However, the transition has been poorly managed. Policymakers failed to implement sufficient countercyclical measures to fill the void of the housing collapse, and the new sectors have not generated enough strength to drive the broader economy.

We have long highlighted the "two-speed" nature of the Chinese economy, while investors have primarily focused on the weaker segments, as reflected in the deeply depressed multiples of Chinese stocks.[3] The rise of DeepSeek is now drawing investors' attention to China's economic "bright spots."

3 Alpine Macro *EM & China Strategy* "Inside China: A Month Of Travel And Conversations With Locals" (August 8, 2023).

Chart 7 "Blacklisted" Chinese Firms Defy Pressure



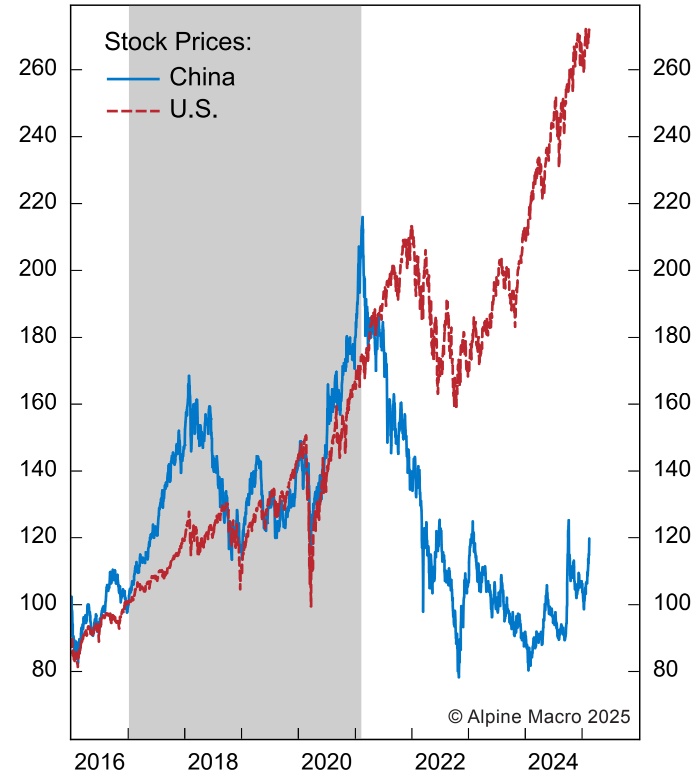
*Alpine Macro calculation based on U.S. NS-CMIC List; source: Bloomberg Finance L.P.
Note: All series are rebased to Feb 2021=100

The Tech Race And Implications

Looking ahead, the great power competition between the U.S. and China will persist, and it is too early to draw definitive conclusions. However, a few broad observations can be made.

First, the emergence of Chinese AI models underscores the resilience of China's tech sector amid intense geopolitical headwinds. Huawei, the Chinese telecom giant facing the harshest U.S. restrictions, has not only weathered the pressure

Chart 8 Chinese Stocks Under "Trump 1.0": How Did They Fare?

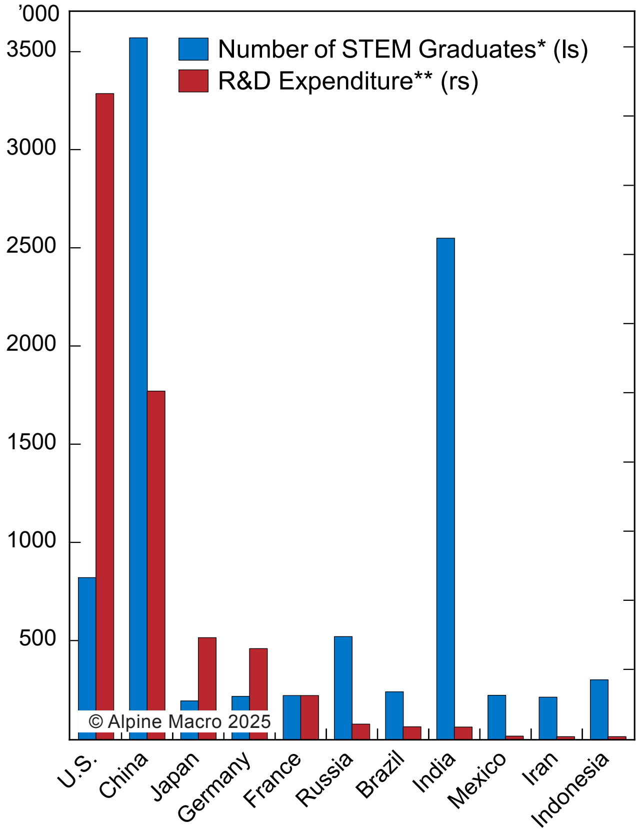


Note: Both series are rebased to Jan 2017=100; shaded area denotes "Trump 1.0"; source: MSCI

but has also begun to expand again (Chart 6). Additionally, many Chinese entities placed on various U.S. blacklists have massively outperformed Chinese equity benchmarks (Chart 7).

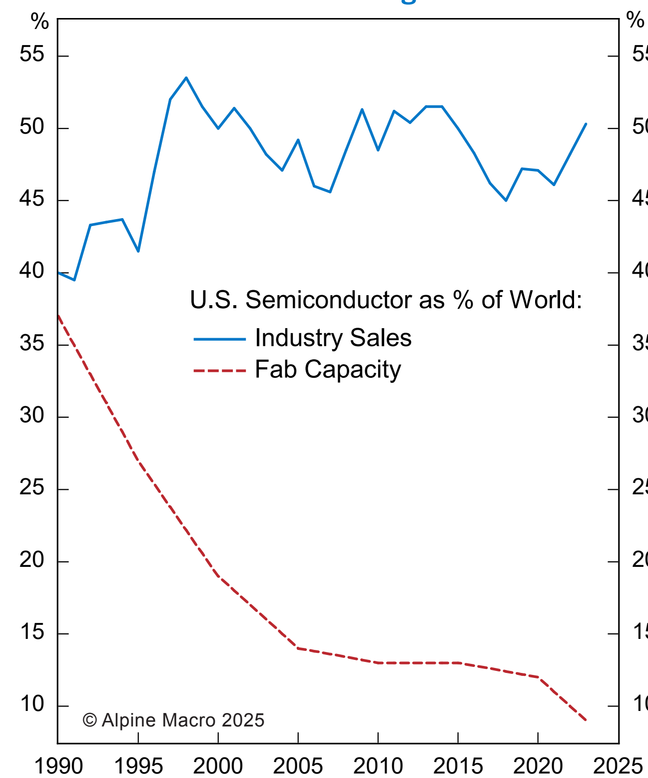
The upshot is that the broader impact of the trade war on the Chinese economy should be limited. Even during President Trump's first term, when the U.S. and China were locked in a bitter tariff war, Chinese stocks performed on par with the S&P 500, and economic growth far outpaced that of the U.S. (Chart 8). In recent years, Chinese exporters have further reduced their reliance on the U.S. market. Ultimately, Beijing's domestic policies remain far more influential than external factors in shaping China's economic trajectory.

Chart 9 China's Advantage In High-Tech Development



*Source: CSET
**Source: UNESCO

Chart 10 U.S. Semiconductor Dominance Will Be Challenged



Source: SIA "2024 Factbook", BCG and SIA "Emerging Resilience in the Semiconductor Supply Chain (May 2024)"

Second, Beijing's commitment to self-sufficiency in key technologies will only strengthen, supported by the country's vast human resources (**Chart 9**). The American embargo on leading-edge tech exports has forced Chinese users to turn to "Plan B" alternatives, driving demand for domestic producers – even when their offerings are technologically inferior. This, combined with government-backed R&D spending, will continue to provide strong tailwinds for Chinese tech firms.

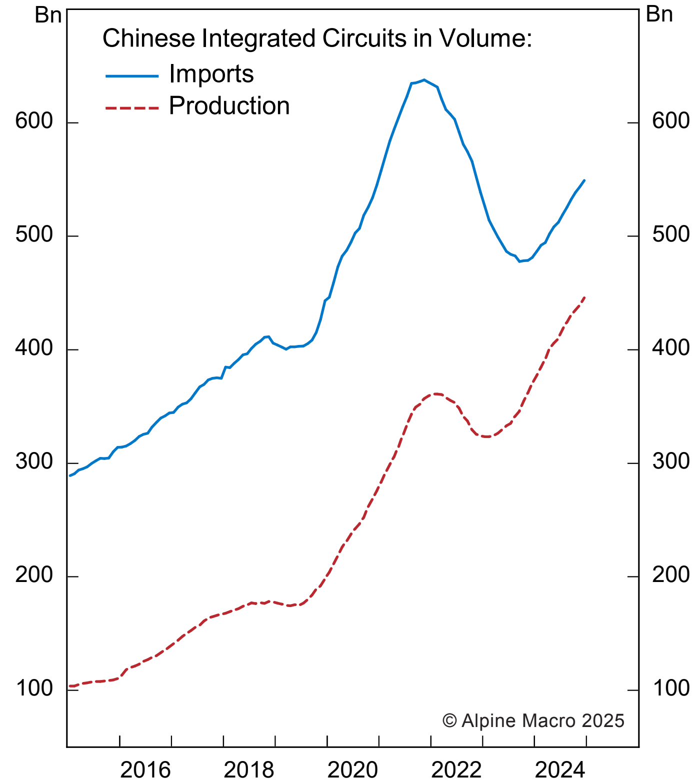
How the U.S. responds to these challenges remains to be seen. China's AI breakthroughs suggest that the American embargo has been less effective than intended, and further restrictions could prove counterproductive. While America's share of semiconductor fabrication has steadily declined, U.S.-headquartered companies still account for roughly 50% of global semiconductor sales, a figure that has remained virtually unchanged over the past three decades (**Chart 10**).

However, the landscape will almost certainly evolve in the coming years as tech "decoupling" continues to push Chinese users to domestic Chinese fabs, challenging the dominance of U.S. firms. Financial markets may start pricing in this shift sooner than many anticipate.

Finally, the rise of Chinese AI, semiconductors, and the broader tech sector will have a deflationary impact on existing players. Chinese firms have long relied on low-cost production as their ultimate competitive moat, and the tech embargo has pushed Chinese AI startups to double down on efficiency gains, creating formidable cost advantages over global competitors. This impact is already evident in lower-end segments and is likely to move up the value chain (**Chart 11**). At present, Korean semiconductor companies appear to be the most vulnerable to Chinese displacement.

Meanwhile, Taiwanese semiconductor firms, particularly TSMC, still hold a significant technological edge over their Chinese counterparts. However, TSMC's overwhelming market position is increasingly seen as untenable from the U.S. perspective, and it will likely face pressure to diversify production. As such, Taiwan's dominance in semiconductors may have reached a secular peak.

Chart 11 **China's Expanding Capabilities In Legacy Chips**



Note: Both series are shown as 12-month moving sum

Yan Wang, CFA
Chief Emerging Markets & China Strategist

Investment Recommendations

Strategic Positions (6 - 12 months)				
Recommendations	**Open Date**	**Closing Date**	**Total P&L**	**Notes**
Long Colombian 10-year Government Bond, Currency Unhedged	11/21/2023		6.6%	Long Colombian 10-year Government Bond, Currency Unhedged; stop point at -10%.
Long MSCI Greece Equity Index	11/21/2023		21.6%	Long MSCI Greece Equity Index in US$ terms; stop point at -10%.
Long Indian 10-year Government Bond, Currency Unhedged	06/04/2024		3.1%	Long Indian 10-year Government Bond, Currency Unhedged; stop point at -10%.
Long MSCI Malaysia Equity Index	08/20/2024		-3.4%	Long MSCI Malaysia Equity Index in US$ terms; stop point at -10%.
Long BRL/MXN	09/23/2024		1.4%	Long Brazilian *Real* against Mexican Peso; stop point at -10%.
Short CNY/JPY	10/29/2024		1.8%	Short Chinese Yuan against Japanese Yen; stop point at -5%.

Tactical Investment Positions (3 - 6 months)				
Recommendations	**Open Date**	**Closing Date**	**Total P&L**	**Notes**
Long MSCI China Equity Index	02/20/2024		39.9%	Long MSCI China Equity Index in US$ terms; rolling stop point at -10%, or -10% from current level.
Long CSI 300 Index	02/20/2024*		8.2%	Long China A-shares Index in US$ terms; stop point at -10%. *Trade opened on Feb 20, 2024, closed on Sep 13, 2024 and reopened on Sep 24, 2024.
Short CNY/USD	10/29/2024		1.9%	Short Chinese Yuan against US Dollar; stop point at -5%.
Short THB/SGD	11/05/2024		-1.5%	Short Thai Baht against Singapore Dollar; stop point at -5%.

EM Equity Country Allocation

Strong Overweight	Overweight	Neutral	Underweight	Strong Underweight
	Chile China Colombia Greece Malaysia South Africa Indonesia Philippines Hungary Poland	India Peru Czech Republic	Brazil South Korea Thailand Mexico Taiwan Turkey	

EM Equity Sector Allocation

Strong Overweight	Overweight
	Health Care Consumer Discretionary Consumer Staples Utilities
Neutral	
Energy Communication Services Information Technology Financials	
Strong Underweight	**Underweight**
	Materials Industrials

EM Local-Currency Government Bond Allocation

Overweight	Neutral	Underweight
Indonesia Peru Brazil Colombia Chile India	Poland Hungary South Korea Malaysia Philippines South Africa Mexico	Czech Republic Thailand China Taiwan Turkey

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