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Data Driven Insight, Unconventional Foresight

The Buy & Optimize Approach to Value Investing in China

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Introduction

At its core, value investing is simple yet profound: buying shares of real businesses when the market prices them below their intrinsic worth. The market's misjudgments—its impatience, biases, and cycles—create these opportunities. For protection, the value investor insists on a margin of safety.

Within this broad philosophy, two types of opportunities tend to appear. The first involves companies with stable intrinsic value that are momentarily trading at deep discounts. The second involves companies whose intrinsic value is steadily growing, available at fair but not excessive prices.

As Warren Buffett and Charlie Munger often reminded investors: *"Buy a great company at a fair price, or a fair company at a great price."* The ideal case, of course, is a great company trading at a great price.

Both paths can compound wealth. In practice, investors often move between them as markets evolve and their own capital base grows. Buffett himself shifted from buying "cigar butts" to owning "great businesses," partly because his scale limited access to smaller, deeply undervalued stocks. From this evolution came the mantra most associated with him: *buy and hold.*

But even Buffett, famously patient, held only a fraction of his investments for the long run. Which leads to a deeper question: if *buy and hold* defines one end of the value spectrum, what lies on the other?

From "Buy & Hold" to "Buy &Optimize"

At Banyan Partners, we call the other end of that spectrum **Buy &Optimize**.

The premise is straightforward: while valuation dictates when to buy, it should also guide when to sell. As Seth Klarman observed, *"If you buy on valuation, you should also sell on valuation."*

For us, portfolio management is a continuous process of optimization —

1. always holding the best opportunities available,

2. balancing quality (the strength and durability of the business) against cheapness (the margin to intrinsic value), and

3. reallocating capital when better risk–reward trade-offs emerge.

This approach naturally involves more activity than traditional "buy and hold." In highly efficient markets, such optimization may add little value. But in markets where mispricing is common and cycles turn fast, the payoff can be meaningful.

Why China Is Fertile Ground

Nowhere does this logic apply more strongly than in China.

Over 80% of A-share trading is retail-driven—an environment where sentiment routinely overwhelms fundamentals. Many professional managers, often young and aggressive, behave little differently from retail investors, amplifying volatility. Meanwhile, China's hyper-competitive business environment shortens industry cycles. Winners and losers emerge faster, and intrinsic values evolve more rapidly than in mature markets.

The result is a market rich in dispersion, inefficiency, and opportunity—conditions where *Buy &Optimize* thrives.

Empirical data backs this up. Rotations between large- and small-cap stocks, valuation extremes, and sectors occur with unusual frequency and intensity, creating both risk and opportunity for disciplined investors.

To illustrate this, the table below summarizes the annual returns of the A-shares universe over the past ten years, segmented by market capitalization. The CSI 300, CSI 500, CSI 1000, and CSI 2000 indices represent progressively smaller market-cap tiers, with no overlap among them. Each index is constructed sequentially by size: the CSI 300 includes China's largest listed companies, followed by the next 500 in the CSI 500, then the next 1,000 in the CSI 1000.To complete the picture, we also calculated the annual returns for all remaining listed companies outside these indices("Rest"[1])—stocks that fall below the CSI 1000 threshold but are still part of the broader A-share universe.

Return	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
CSI300	5.6%	-11.3%	21.8%	-25.3%	36.1%	27.2%	-5.2%	-21.6%	-11.4%	14.7%
CSI 500	43.1%	-17.8%	-0.2%	-33.3%	26.4%	20.9%	15.6%	-20.3%	-7.4%	5.5%
CSI 1000	76.1%	-20.0%	-17.4%	-36.9%	25.7%	19.4%	20.5%	-21.6%	-6.3%	1.2%
Rest	81.6%	21.2%	-3.7%	-30.9%	30.8%	26.7%	-4.9%	-9.4%	-5.8%	-15.8%

This breakdown provides a clear view of return dispersion across market-cap segments, illustrating how leadership in the Chinese equity market shift frequently between large-cap and smaller-cap stocks. This pattern was especially evident during 2015–2017.

Valuation adds another layer of insight. The table below shows the annual returns of cheap, expensive, and median stocks as defined by SWS Research's index division. Using a cleaned and standardized P/E and P/B dataset across the A-share universe, SWS Research selects 300 stocks[2] for each valuation group to represent the market's valuation extremes and midpoint.

PB ratio	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
High	57.7%	-30.3%	-10.1%	-30.2%	58.7%	68.3%	4.4%	-25.8%	-20.4%	-0.4%
Mid	39.3%	-17.5%	-7.3%	-36.0%	39.3%	20.9%	18.5%	-22.2%	-5.7%	-7.9%
Low	9.8%	-5.3%	12.0%	-19.8%	14.5%	-5.2%	5.3%	-7.1%	-2.1%	25.1%

PE ratio	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
High	52.2%	-29.8%	-22.9%	-36.7%	36.4%	48.8%	15.4%	-25.6%	-11.0%	10.3%
Mid	53.8%	-21.4%	-12.9%	-30.2%	41.4%	57.5%	23.3%	-29.8%	-11.6%	1.8%
Low	15.8%	-6.2%	25.3%	-22.5%	24.9%	0.2%	-9.3%	-11.8%	-7.1%	20.3%

For the P/B ratio, take special note of 2017, 2020, and 2024. For the P/E ratio, focus on 2016, 2017, 2020, and 2021. The wide return dispersion between cheap and expensive stocks once again highlights how rapidly investor sentiment shifts, often driven by speculative behavior.

Finally, sector performance data further illustrates the market's dynamism.The table below presents the annual returns of the top- and bottom-performing sectors. For each

[1]"Rest" represents all stocks excluding those in the CSI 300, CSI 500, and CSI 1000 indices. These return estimates are calculated by adjusting for annual market capitalization changes after removing the top 1,800 stocks, scaled by the ratio of the number of constituents in the two adjacent years, to account for increase in number of stocks in universe due to new IPOs.

[2]"Low" represents the 300 stocks with the lowest ratios;"High" represents the 300 stocks with the highest ratios;"Mid" represents 150 stocks above the median and 150 stocks at or below the median.

of the ten years, it highlights the returns of the three best- and three worst-performing sectors among the 124 sectors categorized and indexed by SWS Research.

Sector Returns	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
TOP#1	Veterinary	Snack Food Packaging	Metallurgical Materials	Condiments	Semiconductors	Solar Power	Non-Metallic Materials	Hospitality	Consumer Electronics	Commercial Vehicles
	198.1%	**61.8%**	**118.3%**	**4.7%**	**119.8%**	**191.0%**	**138.1%**	**28.8%**	**44.2%**	**58.1%**
TOP#2	Electronic Chemicals	Homebuilding	Energy Metals	Livestock Farming	Alcoholic Beverages	Other Power Equipment	Electric Machinery	Tourism	Publishing	Motorcycle & Others
	167.9%	**30.0%**	**95.0%**	**-3.1%**	**102.1%**	**138.4%**	**83.4%**	**26.4%**	**33.7%**	**54.5%**
TOP#3	Movies & Entertainment	Alcoholic Beverages	Alcoholic Beverages	Professional Service	Consumer Electronics	Battery Manufacturing	Rare Metals	Coal Mining	Gaming	Chain Stores
	134.8%	**28.4%**	**93.1%**	**-3.2%**	**93.4%**	**135.2%**	**69.3%**	**22.2%**	**31.8%**	**51.0%**
BOTTOM#3	Coal Mining	IT Services	Education	Optoelectronics	Engineering Consulting Services	Rail Transportation	Personal Care	Optoelectronics	Energy Metals	Biological Products
	-11.7%	**-32.9%**	**-28.0%**	**-49.9%**	**-10.3%**	**-21.6%**	**-32.3%**	**-37.0%**	**-33.6%**	**-27.7%**
BOTTOM#2	Construction Machinery	TV Broadcasting	Oil & Gas Equipment & Services	Real Estate Services	Rail Transportation	Diversified Financial Services	Insurances	Semiconductors	Hospitality	Non-Metallic Materials
	-14.1%	**-35.1%**	**-29.0%**	**-50.9%**	**-13.5%**	**-21.6%**	**-39.0%**	**-37.1%**	**-38.4%**	**-27.8%**
BOTTOM#1	Brokerages	Movies & Entertainment	TV Broadcasting	Kitchen & Bathroom Appliances	Real Estate Services	Oil & Gas Equipment & Services	Education	Consumer Electronics	Solar Power	Veterinary
	-26.2%	**-38.0%**	**-30.8%**	**-53.2%**	**-14.2%**	**-24.9%**	**-41.3%**	**-40.4%**	**-38.9%**	**-28.7%**

Taken together, data all point to rotations underscore the inefficiency and dynamism of the market. Behind these swings lies the same investor behavior: overreaction followed by reversal. For disciplined investors, such volatility is not a risk to be feared but raw material to be refined.

The Practice of Optimization

Buy &Optimize does not mean trading for its own sake. It means recognizing when price moves faster than fundamentals—and acting on that gap.

Often, a stock’s rise or fall reflects changes in valuation multiples rather than business fundamentals. When prices run ahead of value, we trim or sell. When pessimism overshoots, we buy.

The process is systematic yet anchored in judgment. For each holding, we track the implied return if we were to “buy and hold” from entry to exit. We then compare it with the actual return achieved through interim trades. Over time, this comparison shows the incremental value created by optimization—value often invisible in a simple snapshot of holdings.

Our results are telling. Across a decade of investing (September 2015 – September 2025), our trading decisions consistently added value relative to a passive hold. Weighted by position size, this effect becomes even more evident. As a smaller fund, we can implement such trades efficiently without moving the market—an edge large pools of capital have long surrendered.

During this period, we invested in approximately 200 stocks, of which about 130 are classified as “qualified” investments after excluding trades such as IPO allocations[3] that were sold after a short holding period. Within this group, we define “long-term” names as holdings maintained for more than three years (either consecutively or cumulatively), or held for more than two years cumulatively over a span exceeding three years.

Ratio	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
“long-term” /TOTAL	52.9%	59.1%	72.7%	50.0%	71.1%	73.8%	71.4%	76.8%	82.5%	69.0%	67.7%

The “long-term” names as a percent of total names traded in a year data reveal an important insight: while our dollar turnover may be higher due to optimization, our name turnover remains low. We do trade more, but mostly around our core holdings, staying well within our circle of competence.

Our philosophy is grounded in fundamental research, but in today’s fast-moving market, an information edge is critical. We integrate data-driven tools to monitor market movements, company fundamentals, investor sentiment, and news flow in real time. These tools not only help us identify when market emotion has pushed prices away from intrinsic value, but also provide the raw material to evaluate each *Buy & Optimize* trade.In essence, they allow for the continuous refinement of where each incremental dollar can work hardest.

An Illustrative Trade

To illustrate the Buy & Optimize approach, consider the case of HLA (ticker: 600398.SH). Founded in 1997 as a textile manufacturer, HLA later evolved into a leading men’s apparel company, launching its flagship “HLA” brand in 2002.

We first identified the company in late 2013, when trading in its shares was suspended pending completion of a reverse takeover of a listed shell, which was finalized in March that year. At the time, HLA was already a dominant player in China’s menswear market with 2900 stores and an ambitious plan to open around 250 new stores annually. We were particularly attracted to its “asset-light, high-turnover” business model, under which suppliers bear inventory risk and distributors provide capital for store investments. HLA consistently delivered EBITDA margin more than 25%, way ahead of peers. However, with the stock trading at anelevated valuation of more than 26x EV/EBITDA, we decided to stay on the sidelines.

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[3]These are small-lot lottery allocations in IPOs, which almost always generated profits in the first few days of trading—a phenomenon unique to A-share IPOs prior to the transition from the approval-based system to the registration-based IPO reform in 2019.

We strive to identify exceptional companies — highly capable organizations that consistently generate superior returns for their investors. Although HLA did not initially meet our valuation criteria, it was retained in our “core” pool, where it continued to be closely monitored by our analysts. Over the subsequent years, as market conditions evolved, we entered and exited the position multiple times, guided by shifts in valuation, fundamentals, and investor sentiment.

The triangle on the chart indicates when we began evaluating the stock. The solid circle represents the initiation of a position, while the open circle marks its closure.

By 2015, HLA’s core brand operated around 3,500 stores and continued rapid expansion under its “asset-light, high-turnover” model, delivering over 40% annual growth in both revenue and profit. We initiated our position in 2016, after HLA’s valuation corrected following the 2015 A-shares market meltdown. While we realized a modest gain during the 2015–2018 holding period, we observed over several quarters that growth momentum had slowed to below 5% by 2018.As valuations recovered and new growth drivers failed to materialize—despite several attempts, including ventures into children’s and women’s apparel—we exited the position in early 2018.

From 2018 to 2022, we remained on the sidelines, continuing to monitor the company as its stock price declined by about 50%. HLA demonstrated operational resilience through the pandemic, showing early progress in digitalization and brand rejuvenation, which prompted us to reinitiate our position. By 2022, valuation once again appeared attractive, with EV/EBITDA below 4x and a dividend yield above 5%. We participated in the subsequent rally for more than two years.

By early 2024, HLA began expanding into new retail collaborations with Adidas and JD, signaling a shift in its business model that required heavier inventory commitments. As valuation rose and visibility diminished, we substantially pared down our position but continue to keep a watchful eye on HLA’s progress in its new initiatives.

By the end of the period, our cumulative return on HLA was 68.1%, representing an IRR of 13.9% over an actual cumulative holding period of about 4 years, far exceeding a simple buy-and-hold strategy's IRR of 2.6% over the entire 8 years holding period. Importantly, this approach allowed us to capture multiple value cycles within a single company, rather than relying on a single long-term holding.

This example demonstrates the essence of *Buy &Optimize*: disciplined valuation-based investing, staying within our circle of competence, and actively reallocating capital to maximize risk-adjusted returns. It highlights how, in a market as dynamic and occasionally inefficient as China's, careful timing and repeated engagement with high-quality companies can significantly enhance portfolio performance.

Conclusion

China's market is volatile, fast-changing, and inefficient. For some, these features signal risk. For us, they represent recurring opportunity.

A *Buy &Optimize* approach recognizes that in such an environment, long-term value creation depends not only on identifying great businesses but also on reallocating capital with discipline as valuations shift. At Banyan Partners we believe in*Buy &Optimize* approach of value investing—dynamic rather than static, active without being speculative.

By combining the timeless principles of value investing with a dynamic optimization process, supported by technology-driven insights, we aim to consistently capture the best opportunities China's unique market has to offer.