

# China Equity Strategy

## Latest thoughts: capital preservation the near term priority

### Equity Strategy

#### China

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### Too early to bottom fish here

Despite the recent pullback, in the near term we believe downside risks continue to outweigh upside for the China equity markets given: 1) continued escalations in US China tensions and potential deterioration in global economic conditions, 2) the share price reactions so far have only reflected the China tariff announcements to-date in our view, 3) significant global uncertainty is likely to result in higher equity risk premium and put downward pressure on valuation multiples, and 4) given the uncertainties, investors' focus is likely to be more shorter term in nature and as such the AI benefits, which are more longer dated, are likely to take a backseat to concerns around external shocks. MSCI China is still trading at a 13% discount vs its historical average P/E rel vs MSCI World and we agree with our EM team's view that China is less impacted by tariffs and more attractive vs other regions (see [here](#)). That said on an absolute basis we believe near term returns are likely to be capped given the unprecedented level of uncertainties. Our preference remains for the A-shares given the support of the 'national team' (see [note](#)) and its underperformance YTD vs H-shares.

### Market not yet pricing in further deterioration in trade and geopolitics

While MSCI China has declined 13% since the tariff announcement, we believe it has only reflected the tariffs announced to-date - historically every 10% tariff increase typically would have led to a c.2% market drawdown. Any further deterioration, particularly if other countries were to put up their own trade barriers (see [here](#)), could result in further drawdowns. Our geopolitical fear gauge (see Figure 3) shows that market has more recently started to price in more geopolitics concerns but are still not at extreme levels vs recent history. Furthermore we are also concerned by the negative drag from overseas equity markets amid a potential global slowdown which could also spillover to the Chinese markets. We note that historically the Chinese indices have not outperformed on occasions when there was a global equity market rout (see Figure 8). As global equity risk premium rises due to the significant levels of uncertainty, this is likely to put pressure on H-shares and ADR's valuation multiples and as such we believe returns are likely to be capped in these markets near term.

### Earnings sensitivity to 104% tariffs?

We previously estimated that the 54% additional tariff would result in 1-2% earnings downside directly to company earnings and if the total tariffs were raised to 104%, this would likely bring down earnings by up to 3% with US making up 3% of MSCI China listed companies' revenue. There is likely to also be secondary impacts from slower GDP growth as a result of higher tariffs - as a sensitivity, every 1ppt reduction in GDP historically resulted in a c.2% earnings reduction for MSCI China companies (See Figures 6 and 7).

### Sector picks - capital preservation a near term priority

We expect investors to become more myopic in their stock selections given the elevated levels of uncertainties. In 2018, the most resilient stocks tended to be high yield defensive names, e.g. telecom while even some of the domestic focused sectors such as internet did not outperform (see Figure 10). As such in the very near term, we would tilt more towards high yield names for defensiveness while avoiding exposures to exported oriented sectors for now. We have retained overweight in internet and some consumer sectors for potential consumption policy stimulus though we acknowledge that even

though these sectors have limited overseas exposures, their share prices have not been resilient in times of sell-offs.

## Sector picks

Given a more conservative stance, we have made the following changes to our sector preferences:

- We would look to prioritise high dividend names for defensive purposes;
- For consumers, we have become more focused on the more defensive staple names for now which should also benefit from policy stimulus. We have removed education given its more discretionary spending nature;
- We continue to prefer A-share TMT names for the self-reliance and domestic substitution thematic though would avoid those that are involved in the global supply chains;
- We continue to keep certain quality but lower beta internet names.

**Figure 1: UBS Strategy sector preferences**

Most preferred	Least preferred
High dividend names	Construction
Consumer (staples)	Machinery
Internet	Healthcare
A-share TMT	Shipping
Education	

Source: UBS

**Figure 2: UBS strategy top picks**

Most preferred names								
Stock Code	Company name	Lead analyst	UBS rating	Last close	Price target	FY25 P/E	FY26 P/E	UBSe FY25 EPS growth
600941.SS	China Mobile - A	Sara Wang	Buy	112.60	145.00	16.7	15.9	5%
NTES.O	NetEase	Felix Liu	Buy	91.37	133.00	12.2	11.2	5%
002371.SZ	NAURA Technology Group	Jimmy Yu	Buy	460.00	545.00	32.2	24.1	34%
0700.HK	Tencent Holdings	Kenneth Fong	Buy	441.20	676.00	14.6	13.0	19%
0939.HK	China Construction Bank	May Yan	Buy	6.13	7.40	4.3	4.2	1%
1766.HK	CRRC Corp - H	Phyllis Wang	Buy	4.55	6.60	8.3	7.3	16%
1818.HK	Zhaojin Mining Industry	Sharon Ding	Buy	15.06	14.70	22.1	16.5	100%
600066.SS	Zhengzhou Yutong Bus	Wei Shen	Buy	24.50	38.00	10.7	8.9	26%
688111.SS	Beijing Kingsoft Office Software	Sara Wang	Buy	303.95	420.00	72.7	57.3	18%
600900.SS	China Yangtze Power	Yishu Yan	Buy	29.57	33.70	19.1	17.9	14%
603345.SS	Fujian Anjoy Foods	Veronica Song	Buy	79.22	98.00	14.6	13.2	12%
0168.HK	Tsingtao Brewery	Christine Peng, CFA	Buy	59.65	63.27	16.0	14.4	10%
YUMC.N	Yum China	Christine Peng, CFA	Buy	44.01	57.26	16.6	14.5	14%
000596.SZ	Anhui Gujing Distillery - A	Christine Peng, CFA	Buy	178.29	208.61	15.4	13.7	14%
000651.SZ	Gree Electric Appliances Inc of Zhuhai	Rennie Pan	Buy	44.87	58.50	7.6	7.1	11%
Removals								
Stock Code	Company name	Lead analyst	UBS rating	Last close	Price target	FY25 P/E	FY26 P/E	EPS growth
EDU.N	New Oriental Education & Technology	Felix Liu	Buy	41.22	76.20	14.7	11.7	36%
BABA.N	Alibaba Group	Kenneth Fong	Buy	99.37	176.00	12.3	9.2	105%
2899.HK	Zijin Mining Group - H	Sharon Ding	Buy	14.84	24.50	9.2	7.4	25%

Source: UBS estimates

**Figure 3: Geopolitical fear gauge**



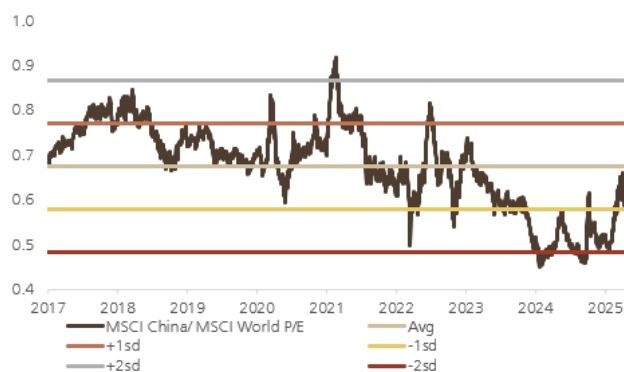
Source: FactSet, UBS

**Figure 4: MSCI China forward P/E**



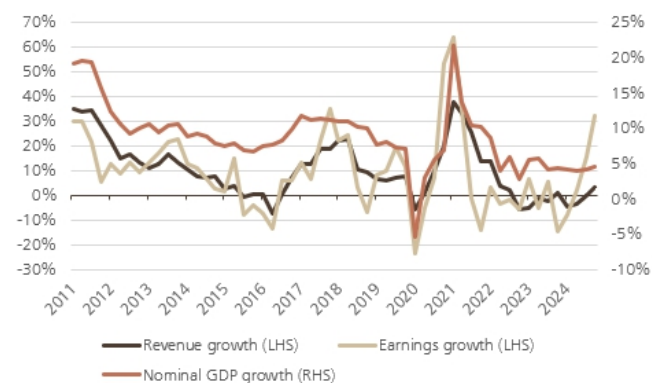
Source: Bloomberg, UBS

**Figure 5: MSCI China/ MSCI World forward P/E**



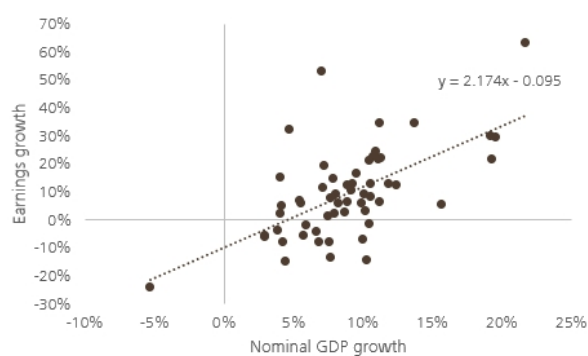
Source: Bloomberg, UBS

**Figure 6: MSCI China quarterly revenue/ earnings growth vs nominal GDP growth**



Source: CEIC, FactSet, UBS

**Figure 7: MSCI China earnings sensitivity to nominal GDP**



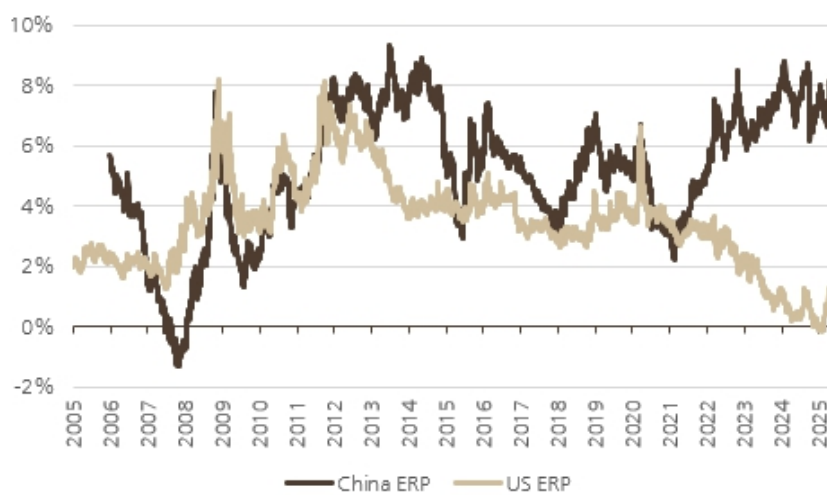
Source: CEIC, FactSet, UBS

**Figure 8: China equity market historically did not outperform during global market sell offs**

Indices	2007 GFC	2015 EM sell off	2018 rate hike cycle	2020 COVID	2022 rate hike cycle	2025 trade war	Average (ex-current)
Start date	Oct-07	May-15	Sep-18	Feb-20	Jan-22	Apr-25	
End date	Mar-09	Feb-16	Dec-18	Mar-20	Oct-22	N/A	
MSCI AC World	-56%	-19%	-16%	-32%	-23%	-7%	-29%
MSCI China	-66%	-40%	-12%	-18%	-36%	-12%	-34%
CSI 300	-61%	-39%	-11%	-15%	-23%	-5%	-30%
HSCEI	-67%	-46%	-8%	-19%	-33%	-12%	-35%
Std. dev. of relative valuation at the beginning of sell-off	3.0	-0.4	0.5	-0.1	-1.4	-0.1	0.4

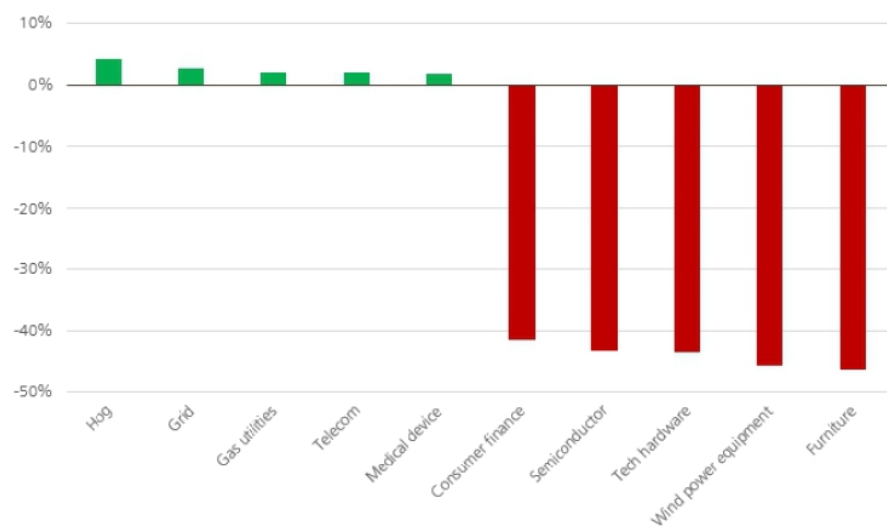
Source: FactSet, UBS

**Figure 9: MSCI China vs S&P 500 ERP**



Source: FactSet, UBS Note: Calculated as forward earnings yield minus 10Y govt bond yield

**Figure 10: Best & worst performing sectors in 2018**



Source: FactSet, UBS. Note: Returns from Apr to Dec 2018 were shown

**Figure 11: Share price moves around tariff hikes in 2018 and in 2025**

Index/ sector	2018 trade war						2025 (22 Jan & 28 Feb 2025)					
	Day 1	Day 2	Day 3	Day 4	Day 5	Day 10	Day 1	Day 2	Day 3	Day 4	Day 5	Day 10
MSCI China	-1.9%	-0.6%	-1.2%	-1.7%	-1.6%	-3.4%	-1.4%	-2.2%	-0.2%	2.5%	3.5%	4.2%
Hang Seng Index	-1.7%	-1.0%	-0.7%	-1.2%	-1.5%	-2.3%	-2.5%	-2.5%	-1.7%	0.0%	1.7%	2.0%
CSI 300	-2.4%	-2.3%	-1.6%	-2.5%	-2.0%	-2.7%	-1.4%	-1.4%	-1.0%	-1.0%	-0.4%	0.1%
Auto	-2.4%	-2.9%	-2.4%	-4.2%	-4.4%	-5.8%	-3.2%	-4.1%	-4.5%	-3.8%	-3.1%	2.3%
Bank	-1.2%	-1.2%	-1.2%	-1.9%	-1.9%	-2.4%	-1.0%	0.1%	0.2%	1.8%	1.4%	0.3%
Broker	-3.5%	-2.9%	-1.9%	-2.5%	-2.1%	-1.1%	-2.1%	-2.1%	-1.3%	-2.1%	-0.8%	-0.9%
Consumer	-2.2%	-2.4%	-1.6%	-2.6%	-2.1%	-3.6%	-1.4%	-1.7%	-1.4%	-0.9%	-0.1%	0.1%
Defensives	-1.2%	-1.1%	-0.5%	-0.8%	-0.7%	-0.4%	-0.5%	-0.5%	-0.6%	0.9%	1.2%	0.9%
Energy & materials	-2.6%	-2.5%	-1.6%	-2.1%	-2.1%	-2.0%	-0.9%	-0.6%	-0.6%	0.2%	0.4%	1.9%
Healthcare	-2.3%	-1.0%	0.3%	0.0%	0.1%	-1.5%	-1.9%	-1.9%	-1.5%	-1.1%	-0.2%	0.6%
Industrials	-2.2%	-2.1%	-1.3%	-1.7%	-1.6%	-1.7%	-1.4%	-1.1%	-0.5%	0.1%	0.4%	0.7%
Insurance	-1.8%	-1.7%	-1.8%	-2.9%	-2.5%	-3.1%	-2.7%	-1.6%	-1.1%	-0.7%	0.8%	-0.3%
Internet	-2.1%	-1.1%	-1.0%	-0.6%	-0.9%	-4.5%	-3.1%	-2.8%	-1.6%	0.6%	4.7%	4.9%
Property	-1.5%	-1.4%	-0.2%	-1.1%	-1.4%	-2.2%	-2.3%	-2.3%	-2.2%	-1.6%	-0.2%	-1.9%
Renewables	-2.1%	-0.7%	0.5%	0.0%	0.9%	0.9%	-1.9%	-0.9%	-1.4%	-2.6%	-1.8%	-1.3%
Tech	-4.3%	-2.9%	-2.2%	-2.9%	-2.4%	-2.1%	-2.0%	-3.2%	-1.2%	-1.5%	0.0%	2.0%

Source: FactSet, UBS. Note: The four tariff announcement dates are 23 Mar 2018, 19 Jun 2018, 11 Jul 2018 and 3 Aug 2018

Figure 12: Sector valuation

Sector	Valuation						2025 YTD Return (%)
	Current P/E or P/B*	5Y Average	Standard deviation	5Y minimum	5Y maximum	Downside to 5Y minimum	
Telecom	12.2	9.2	2.1	6.6	13.3	-46%	7%
Construction materials	12.5	9.8	1.6	6.6	14.9	-47%	-3%
Transportation	12.8	11.5	0.7	9.1	16.2	-29%	-2%
Power operator	13.7	13.4	0.3	11.2	17.7	-18%	-3%
Banks*	0.5	0.5	0.2	0.4	0.7	-24%	-1%
Broker	15.5	15.3	0.1	9.8	25.4	-37%	-10%
Consumer finance	5.6	5.5	0.0	1.9	15.7	-66%	1%
Software	58.4	58.4	0.0	31.0	96.9	-47%	-2%
Port	7.8	7.9	0.0	3.3	15.6	-58%	-13%
Construction	4.9	5.0	-0.2	3.8	6.3	-23%	-9%
Energy	8.0	8.7	-0.2	5.5	17.9	-32%	-14%
Solar supply chain	20.8	23.3	-0.3	9.4	42.9	-55%	-11%
Chemicals	12.8	13.6	-0.3	9.0	23.4	-30%	-7%
Semiconductor	34.3	38.2	-0.3	18.7	82.1	-46%	-5%
Gas utilities	8.8	9.4	-0.3	6.4	14.2	-28%	-9%
Data center*	1.5	2.1	-0.4	0.5	6.1	-66%	-13%
Auto	18.6	20.6	-0.5	11.1	30.9	-40%	-3%
Education*	1.2	2.8	-0.6	0.4	9.3	-64%	-27%
Airline airport*	1.6	1.8	-0.6	1.2	3.0	-22%	-11%
Property*	0.6	0.7	-0.7	0.4	1.2	-28%	-5%
Tech hardware	15.6	18.3	-0.7	11.8	30.0	-24%	-13%
Pharma	20.5	25.6	-0.7	15.7	44.0	-23%	0%
Leisure	16.2	35.9	-0.8	13.7	137.9	-15%	-14%
Machinery	14.9	16.5	-0.9	12.2	23.4	-18%	-2%
EV Battery & materials	14.7	36.3	-0.9	11.2	96.5	-23%	-16%
Aerospace & defense	28.7	35.8	-0.9	19.9	66.1	-31%	-16%
Home appliance	10.4	13.6	-0.9	9.3	23.4	-10%	-8%
Basic materials	9.9	13.4	-0.9	8.6	24.9	-13%	2%
Hog*	2.2	2.7	-0.9	1.7	4.7	-24%	9%
Biotech, CRO	30.1	116.2	-0.9	27.1	557.8	-10%	0%
Auto retail	7.8	10.8	-1.0	5.8	17.5	-27%	-14%
Grid	19.1	22.4	-1.0	16.8	35.7	-12%	-8%
Food & beverage	16.7	22.5	-1.0	14.2	39.5	-15%	0%
Wind power equipment	9.3	12.1	-1.0	6.2	20.6	-33%	-24%
Health care service	25.5	51.6	-1.1	19.2	115.4	-25%	-2%
Pharma retail	15.5	37.8	-1.1	11.4	108.1	-26%	8%
Restaurant	16.6	30.8	-1.1	12.1	63.0	-27%	-5%
Internet (Media & entertainment)	14.3	24.3	-1.1	12.4	47.9	-13%	5%
Internet (E-commerce)	9.9	20.7	-1.2	8.3	40.6	-16%	6%
Express delivery*	1.4	2.8	-1.2	1.3	5.6	-12%	-6%
Internet (Online game)	13.6	17.9	-1.2	10.9	28.3	-20%	-2%
Beer	17.0	29.5	-1.2	12.6	51.7	-26%	4%
Furniture	9.6	17.1	-1.2	7.6	34.1	-20%	-11%
Personal product	16.1	22.6	-1.3	13.5	34.9	-16%	-3%
Baijiu	17.1	29.2	-1.3	14.1	56.5	-18%	0%
Sportswear	13.2	22.7	-1.3	11.0	42.6	-16%	10%
Truck	9.1	11.1	-1.3	7.5	15.3	-17%	0%
Auto parts	13.9	18.6	-1.4	11.9	27.3	-14%	-9%
Medical device	17.0	29.8	-1.5	16.0	58.4	-6%	-11%
Insurance	7.2	9.6	-1.7	7.2	13.3	0%	-10%

Source: FactSet, UBS



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For various stocks across the industries we cover in the Hong Kong and mainland China stock markets, we use a variety of valuation approaches, including DCF models, Gordon growth model analysis and relative valuation analysis using various multiples such as PE, EV/EBITDA and P/BV.

We think the risks facing China's equities include a hard landing for the property market, a capital exodus associated with currency depreciation and slow structural reform progress. In our view, any government policies that do not adequately address these risks could result in a shock to the market. For example, an excess of stimulus policies could pose a risk to the transition from an investment-driven to a consumption-driven economy and increase the debt of government and state-owned enterprises.



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12-Month Rating	Definition	Coverage <sup>1</sup>	IB Services <sup>2</sup>
Buy	FSR is > 6% above the MRA.	52%	24%
Neutral	FSR is between -6% and 6% of the MRA.	40%	20%
Sell	FSR is > 6% below the MRA.	8%	22%
Short-Term Rating	Definition	Coverage <sup>3</sup>	IB Services <sup>4</sup>
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 March 2025.

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

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