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China

2023 China Equity Outlook: Investing in a new political regime as China reopens

Kinger Lau, CFA
+852-2978-1224 | kinger.lau@gs.com
Goldman Sachs (Asia) L.L.C.

Timothy Moe, CFA
+65-6889-1199 | timothy.moe@gs.com
Goldman Sachs (Singapore) Pte

Si Fu, Ph.D.
+852-2978-0200 | si.fu@gs.com
Goldman Sachs (Asia) L.L.C.

Kevin Wang, CFA
+852-2978-2446 | kevin.wang@gs.com
Goldman Sachs (Asia) L.L.C.

Reopening bounce amid structural headwinds

China could be the only major economy globally to deliver positive GDP growth delta (from 3% to 4.5%) with still-easy policy and mild inflation in 2023, assuming the **reopening impulse to materialize in 2H23**. But, investor concerns about the housing market downturn, de-globalization, technology restrictions, private-sector policy, and the aging population will keep **China's potential growth in focus** beyond the long-awaited reopening excitement.

New thinking in a new political regime

We forecast 8%/13% EPS growth for MXCN/CSI300 in 2023, inline with our estimated normal profit for Chinese corporates that could be deemed acceptable under "Common Prosperity". Reopening and reduction of left-tail risk in the housing market could tactically boost equity prices, but profitability, geopolitical, and positioning overhangs could cap re-rating upside for Offshore equities. We forecast **16% index returns for MXCN and CSI300** in 2023, staying Overweight both in APxJ, but reiterating a strategic preference for A over H/ADRs.

Investing alongside Chinese consumer and policy

Tactically, we favor **Reopening Beneficiaries** to trade rising reopening hopes. Strategically, we focus on policy-powered themes, notably our new **National Security portfolio**, **Little Giants**, and **select high-quality SOEs**. Sectorally, we emphasize **a consumer tilt**, upgrading Consumer, and Medical Services to Overweight, Property to MW, but lowering Autos and Media to MW, and Energy and Tech Hardware to UW to start 2023.

GS China 2023 views at a glance

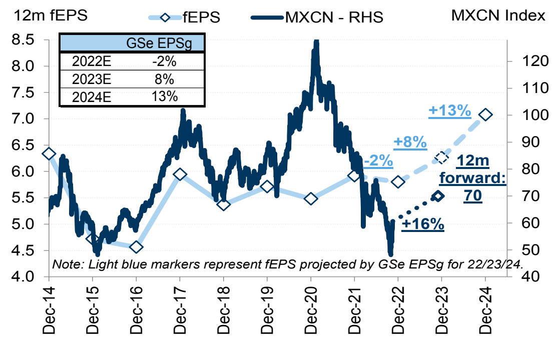
1 We forecast China to grow 4.5% in 2023, improving from 3.0% this year mainly on reopening growth boost

GS macro forecasts

Real GDP (%, yoy)	2022	2023	2024
China	3.0	4.5	5.3
US	1.9	1.1	1.6
Europe	3.3	-0.1	1.4
Japan	1.5	1.3	1.4
Asia Pacific	4.0	4.1	4.9
World	3.3	2.3	3.3
World ex-China	3.3	1.7	2.8

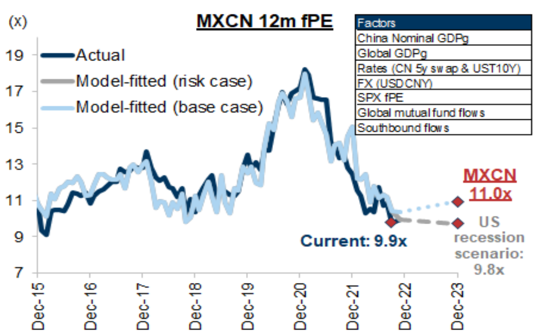
Source: Goldman Sachs Global Investment Research

2 We forecast MSCI China to reach 70 by end-23, translating into 16% potential price returns from current levels



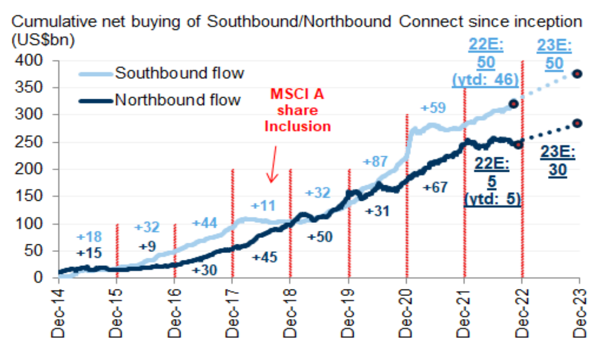
Source: MSCI , FactSet, Goldman Sachs Global Investment Research

3 MSCI China is trading at discounts to its fair value even after factoring in a challenging global macro outlook



Source: MSCI , FactSet, Goldman Sachs Global Investment Research

4 We forecast US$30bn for Northbound and US$50bn for Southbound flows in 2023



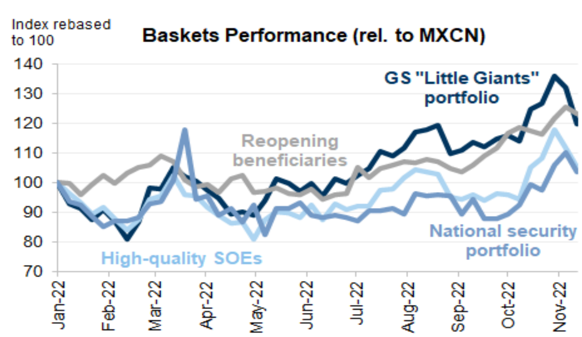
Source: Wind, Goldman Sachs Global Investment Research

5 Reopening and policy alignment are two key axes driving our sector allocation ideas

Allocation	MXCN industry groups	Past 1M perf	22-24E EPS CAGR	23E P/E (X)
Overweight	Consumer Durables	-12%	20%	17.7
	Consumer Svcs	3%	211%	27.8
	HC Equip & Svcs	7%	16%	15.7
	Retailing	-8%	19%	16.1
	Semis	12%	25%	17.6
Underweight	Banks	-6%	7%	3.4
	Energy	-6%	-4%	5.1
	Materials	0%	16%	8.1
	Tech Hardware	10%	19%	12.8
	Telecom	-4%	10%	12.9

Source: FactSet, Goldman Sachs Global Investment Research

6 Buy Reopening Beneficiaries, and structural policy-powered themes in 2023



Source: MSCI, FactSet, Goldman Sachs Global Investment Research

Macro: Reopening bounce amid structural headwinds

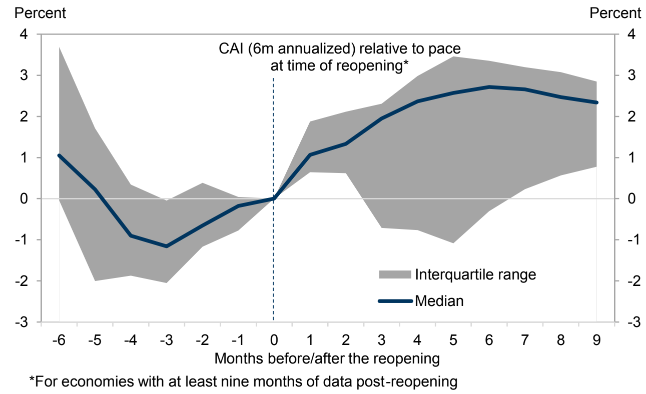
- **Our economists expect China to deliver 4.5% real GDP growth in 2023**, improving from 3% in 2022. The growth acceleration (albeit from a low base) is largely predicated on their assumption that China will gradually exit its Zero Covid Policy (ZCP) regime starting 2Q23, with **consumption leading the charge** (in 2H23) and contributing to two-thirds of their full-year GDP growth target.
- Aggregate fixed asset investment (FAI) growth will likely slow in 2023 vs. 2022 as the housing downturn further develops. However, the inter-sector divergence will likely persist, with **property FAI remaining a drag** (but less so compared to 2022) but **infrastructure FAI staying robust** as new projects launched in 2022 transition into construction phases. Thematically, we continue to expect New Infra, which tends to be less commodity-intensive, to outpace traditional infra, with the former likely accounting for 17% of the total in notional terms by end-2023 per LGFV bond issuance data.
- **Net exports** have been a key growth driver for China for the most part in the pandemic era, bringing in more than US$1.9tn of trade surplus since 2020. But they **will likely turn into a modest growth drag** in 2023 amid slowing global demand. Moderate depreciation potential of the Rmb (vs the USD), most likely front-loaded in 2023, could buttress export growth at the margin, but ongoing supply chain diversification and reorganization could be a risk for Chinese exports in the long run.
- **Macro policy should stay largely accommodative in 2023** across the monetary, fiscal, and property cohorts, although China's augmented fiscal impulse could turn less expansionary as easing Covid restrictions take over and turn growth-stimulative (or less of a policy dampener). Together with still-well-contained inflationary pressures in both PPI and CPI terms, **China continues to position favorably** along the three global macro cycles – growth, policy, inflation – that have weighed on broader risk assets so far in 2022.
- **The coast is far from clear when it comes to China's longer-term growth trajectory.** Well-telegraphed structural headwinds spanning a likely prolonged property market deleveraging process, supply-chain diversification away from China, bans of advanced technology exports to China from the US, policy stance towards the private economy, and moderating demographic dividend are consequential to China's potential growth and will shape the macro narrative and the equity investment case beyond the reopening bounce. See our Earnings and Risks sections for details.

Exhibit 1: Our economists expect China growth to improve to 4.5% in 2023 from 3% this year

		2021	2022F	2023F
GDP	**% yoy**	**8.1**	**3.0**	**4.5**
Domestic Demand	pp	6.4	2.1	4.7
Consumption	% yoy	9.7	1.9	6.1
Household Consumption	% yoy	12.3	1.0	7.0
Government Consumption	% yoy	3.9	4.0	4.0
Gross Fixed Capital Formation	% yoy	2.3	3.5	3.0
Net Exports	pp	1.7	1.0	-0.2
Exports of Goods (nominal USD)	% yoy	29.8	8.5	-2.0
Imports of Goods (nominal USD)	% yoy	30.7	2.0	4.0
Inflation				
CPI	% yoy	0.8	2.0	2.2
Core CPI	% yoy	0.8	0.7	1.2
PPI	% yoy	8.1	3.8	-1.8
Other				
Current Account	% GDP	1.8	2.4	1.7
USDCNY (eop)	level	6.35	7.20	6.90
OMO 7-Day Repo Rate (eop)	%	2.20	2.00	2.00
TSF Stock Growth (eop)	%	10.3	10.5	9.5
Augmented Fiscal Deficit	% GDP	11.3	14.3	12.3

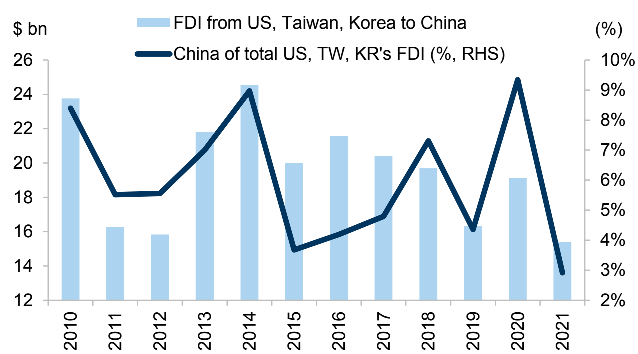
Source: Goldman Sachs Global Investment Research

Exhibit 2: Noticeable demand boost normally materializes 1 to 2 quarters post the initial reopening



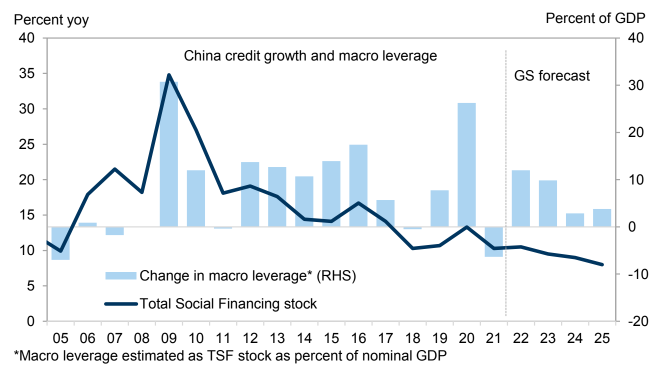
Source: Goldman Sachs Global Investment Research

Exhibit 3: Supply-chain reorganization is underway



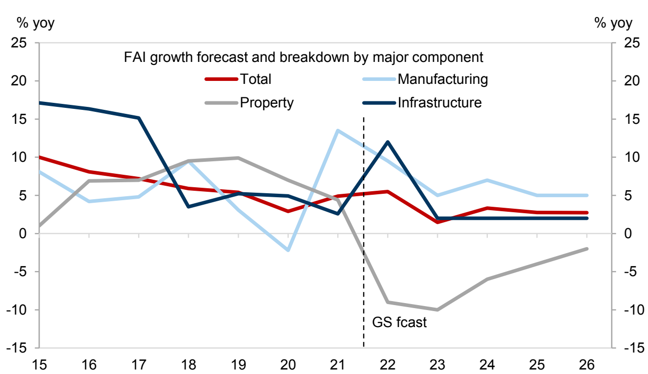
Source: CEIC, Goldman Sachs Global Investment Research

Exhibit 4: We expect smaller increases in the macro leverage ratio next year as monetary policy stance normalizes from the very accommodative level this year



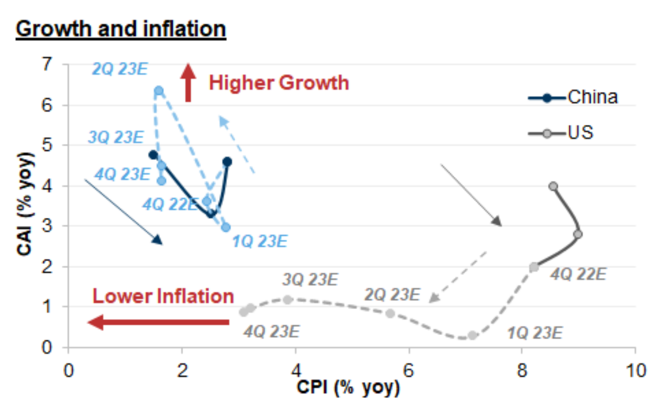
Source: CEIC, Goldman Sachs Global Investment Research

Exhibit 5: FAI growth should slow in 2023, mainly on weaker infrastructure and manufacturing investment



Source: CEIC, Data compiled by Goldman Sachs Global Investment Research

Exhibit 6: China is favorably positioned along the growth and inflation axes compared to the US



Source: Wind, Goldman Sachs Global Investment Research

Market cycles into 2023: The setup for a recovery rally is in place

- As of Nov 15, MSCI China has corrected 28% so far in 2022, and has endured a 63% peak-to-trough drawdown from early 2021 to Oct 2022 despite registering two powerful "bear-market" rallies in 2Q22 and so far in November. This is the most significant market selloff since the dislocation during the Global Financial Crisis, also **putting the drawdown into the Systemic category** per our classification. While it is impossible to call the market bottom simply based on empirical trading patterns, **the market on average recovered 36% in 6 months and 86% in 12 months** after reaching the ex-post troughs in a Systemic corrective episode.
- Through a political cycle lens, the equity market **tends to trade poorly post the twice-a-decade Chinese National Party Congress,** falling 13% 6 months after the event and 20% in the ensuing year. However, as the pre-Congress rally didn't materialize, on no basis should we assume the post-Congress weakness would apply this time around. In fact, the leadership changes in the 20th Party Congress deviate from the implicit post-Mao Party conventions in at least two aspects: a) a de facto 2-term limit for CCP General Secretary and the unwritten "7 up 8 down" retirement age for senior Party leaders; and, b) marking the first time for a top leader in the Party's history to officially extend his reign for a third term since the Mao Zedong era.
- Admittedly, from an equity cycle perspective (as defined by valuation and earnings changes), our previous call (in 2022 Outlook) for China to transition from Despair to Hope didn't prevail due to unforeseen geopolitical and Covid shocks. The market has been stuck in the Despair phase (PE derating plus anemic EPS growth) for the most part since early 2021 but **the reopening catalyst could help fuel the cycle shift to a Hope phase** where equity valuations tend to expand/recover despite a still-challenging earnings outlook.
- Overall, these cycle analyses point to a **strong prospect that the market could stage a recovery rally** sometime in 2023 after a very challenging performance in the past 2 years, although the longevity and magnitude of the recovery will be determined by other structural and fundamental considerations, notably the normal profitability and perceived equity risk premium for Chinese stocks under the new Party leadership, in our view.

Exhibit 7: China has experienced a "Systemic Correction" from early 2021 to Oct 2022 on our definition, falling 63% from peak-to-trough

China (MXCN) Market Corrections

	Period			Num of Days	Peak to Trough	Starting fP/E	fP/E at Trough	P/E Decline	1m post Trough	3m post Trough	6m post Trough	12m post Trough
1	Asian Financial Crisis	Aug-97	Sep-98	372	-81%	27.0x	4.9x	-82%	42%	54%	18%	103%
2	TMT Market Bubble	Jul-99	Sep-01	792	-72%	13.6x	9.4x	-31%	17%	36%	30%	16%
3	Global Slowing & SARS	May-02	Apr-03	342	-27%	13.7x	8.4x	-39%	15%	31%	58%	78%
4	Hard-landing fears	Feb-04	May-04	89	-30%	15.2x	10.1x	-34%	13%	11%	32%	29%
5	Mid-cycle slowing	May-06	Jun-06	37	-20%	13.3x	10.6x	-21%	12%	19%	48%	87%
6	Pre-Crisis Unwinding	Jul-07	Aug-07	17	-17%	18.6x	15.1x	-19%	34%	50%	28%	-1%
7	Global Financial Crisis	Oct-07	Oct-08	363	-74%	24.2x	5.9x	-76%	34%	30%	61%	138%
8	Tightening & Sov. Risk	Apr-10	May-10	46	-17%	13.8x	11.1x	-19%	11%	10%	21%	20%
9	Double-dip & Debt Concern	Apr-11	Aug-11	113	-20%	11.5x	8.7x	-24%	-4%	-3%	5%	-3%
10	US growth & EU debt Concern	Sep-11	Oct-11	34	-25%	9.1x	6.8x	-25%	28%	20%	31%	26%
11	China growth & EU Sov. Concern	May-12	Jun-12	34	-15%	9.4x	7.9x	-16%	6%	0%	18%	14%
12	QE Tapering Concern	May-13	Jun-13	46	-18%	9.4x	7.7x	-18%	11%	21%	22%	18%
13	China Credit Concerns	Dec-13	Feb-14	65	-14%	9.4x	7.9x	-16%	5%	2%	16%	21%
14	China correction/ growth concerns	Apr-15	Sep-15	133	-35%	12.5x	8.2x	-34%	13%	9%	-2%	16%
15	Fed Hike, China FX/Growth Concerns	Oct-15	Feb-16	109	-25%	9.6x	8.2x	-15%	13%	11%	27%	33%
16	US Election Uncertainty	Sep-16	Dec-16	92	-12%	12.6x	11.1x	-12%	8%	17%	28%	56%
17	US Rates Risk & Trade war concerns	Jan-18	Oct-18	277	-33%	14.8x	9.6x	-35%	10%	14%	25%	14%
18	Sino-US Trade Tensions	Apr-19	Aug-19	119	-17%	12.3x	10.4x	-15%	7%	11%	18%	36%
19	COVID-19 & Oil Shock	Mar-20	Mar-20	14	-19%	12.2x	10.1x	-17%	15%	26%	41%	60%
20	**Current Episode**	**Feb-21**	**Oct-22**	**621**	**-63%**	**18.6x**	**8.1x**	**-56%**				
	Historical Average			**186**	**-32%**	**14.0x**	**9.0x**	**-30%**	**15%**	**19%**	**28%**	**40%**
	8 "Minor" Correction Average (Peak to Trough < -20%)			**54**	**-16%**	**12.2x**	**10.2x**	**-16%**	**12%**	**17%**	**24%**	**28%**
	8 "Major" Correction Average (Peak to Trough b/w -20/-40%)			**142**	**-27%**	**12.5x**	**8.8x**	**-28%**	**12%**	**14%**	**28%**	**35%**
	4 "Systemic" Correction Average (Peak to Trough > -40%)			**537**	**-73%**	**20.9x**	**7.1x**	**-61%**	**31%**	**40%**	**36%**	**86%**

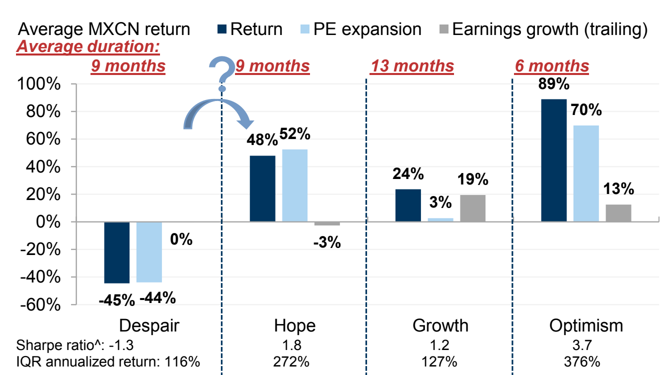
Note: Trough of Current Episode as of Oct 31, 2022

Source: MSCI, Goldman Sachs Global Investment Research

Exhibit 8: The pre-Congress optimisim didn't materialize but the post-Congress selloff has reversed quickly in the past few weeks

Source: MSCI, FactSet, Goldman Sachs Global Investment Research

Exhibit 9: The equity cycle may finally transition from Despair to Hope in 2023, in our view

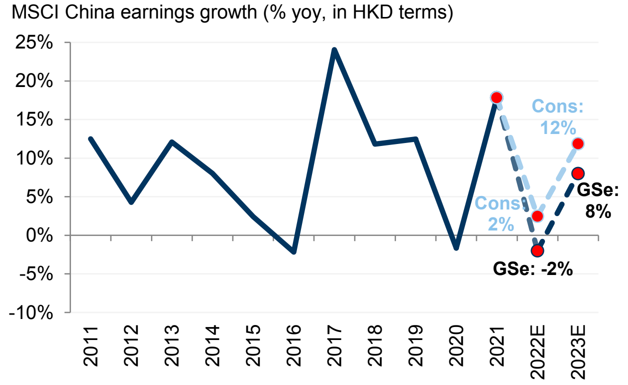


Source: MSCI , FactSet, Goldman Sachs Global Investment Research

Earnings: The normal profit for Chinese corporates

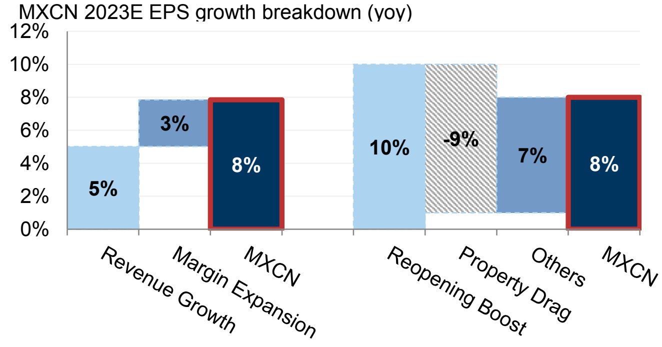
- **We forecast 8% profit growth for MSCI China and 13% for CSI300** in 2023, improving from 2% and 11% respectively in 2022 (consensus). Thematically, the earnings drags from the housing market could moderate somewhat (i.e. a positive 2nd derivative: nationwide housing sales growth falling 10% in 2023 from -24% yoy in 2022 on GSe), and the reopening boost could raise EPS growth by 10pp per our top-down modeling work. Aggregate net margin could recover modestly from historical trough levels (from 9.9% to 10.3%) but top-line growth should be the key driver of earnings in 2023 as activity gradually normalizes.
- Sectorally, we expect the **TMT sector's earnings to grow by 22%** after experiencing 48% earnings cut in the past 2 years amid regulatory changes and other macro headwinds. **Consumer sectors,** particularly those that are sensitive to reopening, could become profitable again for the first time since 2019 after seeing their revenue falling to the 2012 levels. On the more concerning side, property-centric cohorts, notably Banks, could see further downward revision risk to consensus earnings, and the outlook for Hardware Technology is still murky as US restrictions could meaningfully hurt both supply and demand.
- Looking beyond 2023, quantifying **the reasonable/acceptable normal profit** under the new leadership's development vision, which carries a strong flavor of efficiency, quality, equality, security, and Party influence, is consequential for investors to frame their long-term growth projection for China and the corresponding required returns for these assets. In this vein, we attempt to triangulate the trend, equilibrium profitability for Chinese companies via four approaches – governments' influence in the corporate sector, profitability gaps between SOEs and POEs globally, an empirical cost-plus model for Chinese SOEs, and China's trend growth and its impact on ROE – and arrive at the conclusion that **Chinese corporates (SOEs and POEs combined) could manage to generate about 12% ROE in an equilibrium state** under the assumption that the government will continue to emphasize Socialism with Chinese characteristics, proactively promote social equality/welfare through taxation, regulation, and other administrative measures, but not completely abandon Capitalism and free markets to ensure animal spirits and proper incentive mechanisms are in place to drive innovation, high-quality growth, and Common Prosperity.

Exhibit 10: We forecast 8% EPS growth for MSCI China in 2023, improving from -2% this year mainly on reopening demand normalization



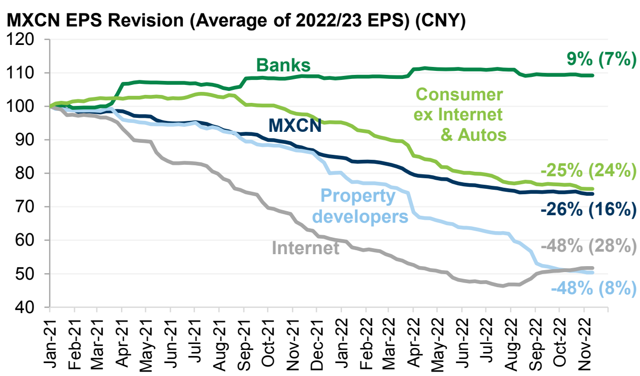
Source: MSCI, FactSet, IBES, Goldman Sachs Global Investment Research

Exhibit 11: Topline growth due to reopening demand boost could more than offset the moderating property drag to drive earnings growth in 2023



Source: MSCI, FactSet, Wind, Goldman Sachs Global Investment Research

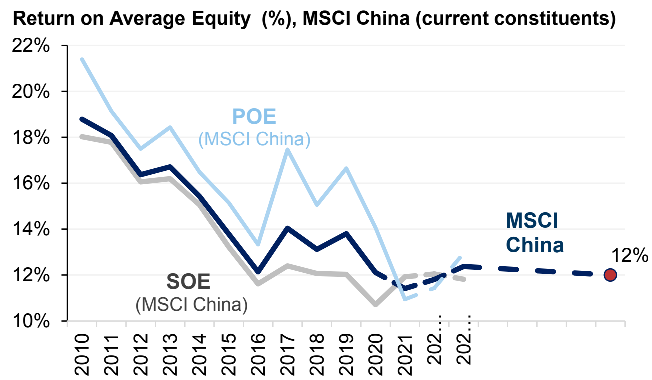
Exhibit 12: The earnings cycle should improve for TMT, but further downside risk likely for Banks



Note: Numbers in brackets represent 2022-24E EPS CAGR on consensus est

Source: FactSet, MSCI, Goldman Sachs Global Investment Research

Exhibit 13: We estimate that the trend ROE for MSCI China could settle at 12% in the long run under the new Party leadership's development vision



Source: FactSet, MSCI, IBES, Wind, Goldman Sachs Global Investment Research

Exhibit 14: Four approaches from us to estimate the long-term profitability trend for China

Approach	Benchmark universe	China ROE historical average	Gap	Estimated China ROE trend level	Assumptions
Governments' influence in the corporate sector	Other markets within the same IEF cohort		+1%	14%	ROE will converge to the level of other MSCI markets within the same EFI cohort (51-60)
Cross-country comparison of SOE vs. POE profitability gaps	World ex-China	13%	-1%	12%	ROE gap between POE and SOE will expand to the level of world ex-China (accounting for POE/SOE composition differences)
Empirical cost-plus model	All China corporates		-1%	12%	Assuming ROE for POE will converge to the level of SOE (accounting for POE/SOE earnings composition in China)
Return of capital	All China corporates	9%	+1%	10%	Return of capital (weighted average of return of debt and return of equity) will converge to nominal GDP growth rate in the long-run
Average				**12%**	

Source: Heritage, MSCI, FactSet, Wind, Goldman Sachs Global Investment Research

Exhibit 15: Improving earnings prospects for Consumer on reopening demand recovery, and 2023 earnings for TMT could also bottom-out

MXCN 2023E EPS Growth Forecast							
GICS Industry Groups		Earnings Weight	Consensus Estimates	GSe (Bottom-up)	GSe (Top-Down)	GSe (Bottom-up) - Cons (pp)
Internet and Consumer	Internet/Media & Enter.	10%	19%	23%	23%	3
	Cons. Retail & Svcs.	15%	21%	22%	21%	2
	Staples	3%	19%	19%	19%	-1
	Autos	2%	89%	80%	80%	-9
Financials	Banks	28%	3%	-2%	1%	-4
	Insurance/Other Fin.	10%	19%	17%	18%	-1
Property-centric	Real Estate	5%	6%	5%	-6%	-1
	Capital Goods	5%	13%	11%	12%	-3
	Chemicals/Other Mat.	2%	18%	9%	11%	-9
	Metals & Mining	2%	8%	9%	8%	1
Technology	Tech Hardware	2%	19%	12%	7%	-7
	Semiconductors	1%	1%	-11%	-7%	-12
	Telecom	0%	8%	-3%	6%	-11
	Software & Svcs.	0%	126%	136%	135%	10
Others	Energy	5%	-9%	-4%	-5%	5
	Utilities	3%	16%	16%	16%	0
	Transportation	3%	-27%	-19%	-14%	7
	Health Care	2%	41%	40%	41%	-1
MXCN		**100%**	**12%**	**9%**	**8%**	**-3**

Source: MSCI, FactSet, IBES, Goldman Sachs Global Investment Research

4 approaches of estimating the long-term profitability trend for Chinese companies

1. **Governments' influence in the corporate sector:** Using the Index of Economic Freedom as an objective measure of governments' control in the economy through parameters such as trade freedom, tax burden, and judicial effectiveness, we note that, somewhat contrary to common perception, while the index is positively correlated with per capita income, jurisdictions with low rankings (i.e. high State influence in the economy) on average have exhibited higher corporate ROEs in the listed universe. This could be attributable to high barrier of entry, tight industry regulation, protectionism, and monopolistic/oligopolistic abnormal profit in jurisdictions which embrace State capitalism, in our view. Assuming China's IEF (relative) ranking doesn't change materially from now, the trend ROE for China could stay at around 13-14% in the foreseeable future.

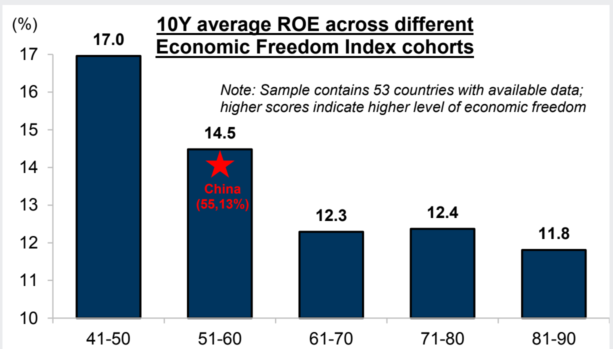
2. **Cross-country comparison of SOE vs. POE profitability gaps:** Our bottom-up classification indicates that 350 non-China SOE companies (as defined by at or more than 20% of government ownership) are currently listed in the Refinitiv Worldscope global equity index, with 249 in EM and 101 in DM. While the distribution of listed SOEs could be subject to country (not many SOEs in DMs) and sector biases (dominated by Old Economy in EMs), our profitability (ROE) comparison between the two shows that POEs have tended to generate stronger returns for shareholders than SOEs in most DMs but not necessarily the case in EMs. Applying the worldwide POE-SOE profitability gaps to China and adjusting for SOE representation, we estimate that the long-term ROE equilibrium level could be at around 12% under this approach.

3. **Empirical cost-plus model:** Focusing specifically on Chinese companies in the listed universe (6057 stocks, 1444 SOEs), we observe that Chinese SOEs in aggregate have managed to earn 7.7% net margin in the past decade, compared to 8.6% from the POE sector across sectors. This suggests that, in a hypothetical scenario where all companies are subject to some form of regulated margins (i.e. utilities and public goods), Chinese corporates would still be able to generate 12% trend ROE assuming

the asset turnover and financial leverage for the two groups to stay constant from current levels.

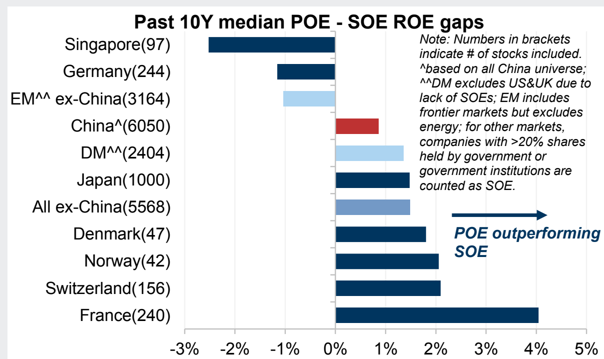
4. **Return of capital in a socialist economy:** In an ideal and simplistic world, a necessary condition to ensure wealth and income inequality doesn't exist is that the rate of return on capital (after tax) should equate to nominal GDP growth in the long run[1]. Relying on our economists' most recent estimated potential nominal GDP growth of 6% for China in the next 5 years, and assuming the historical, systemwide onshore and offshore blended cost (return) of debt for Chinese corporates to remain at 4%, we believe that investors would likely demand at least 10% to compensate for their non-idiosyncratic risk-taking in Chinese stocks over time, everything else being equal.

Exhibit 16: Governments' influence in the economy doesn't seem to correlate well with corporate profitability



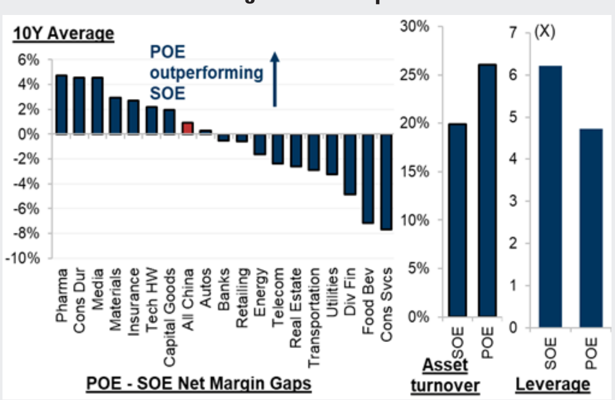
Source: Heritage, MSCI, FactSet, Goldman Sachs Global Investment Research

Exhibit 17: Applying worldwide ROE gaps between POE and SOE to China would reduce China's ROE by 1pp from its past 10-year median



Source: MSCI, FactSet, Datastream, Goldman Sachs Global Investment Research

Exhibit 18: SOEs have moderately lagged their POE peers in terms of realized net margins over the past decade



Source: Wind, Goldman Sachs Global Investment Research

Exhibit 19: Top-down, China's potential growth could translate into around 10% in return on equity in the medium to long run

Long-term real GDP growth	Average of GSe 2023 to 2027			4.2%
Long-term CPI inflation			+	2.1%
Long-term nominal GDP growth			=	**6.3%**
Return on corporate loans and bonds	RMB128tn^	58%	x	4%
Return on equities	RMB92tn^^	42%	x	**10%**

^based on total amount of outstanding loans + bonds issued by all Chinese corporates (as of 2021); based on total market cap of all Chinese equities (as of Nov 2022)

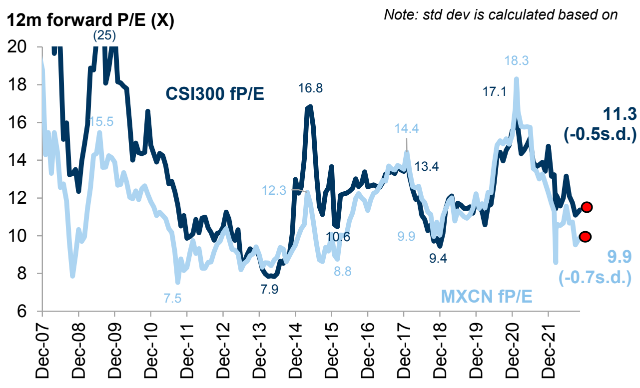
Source: Wind, FactSet, Goldman Sachs Global Investment Research

[1] Source: *Capital in the Twenty-First Century* by French economist Thomas Piketty.

Valuations: Fair value in a new normal

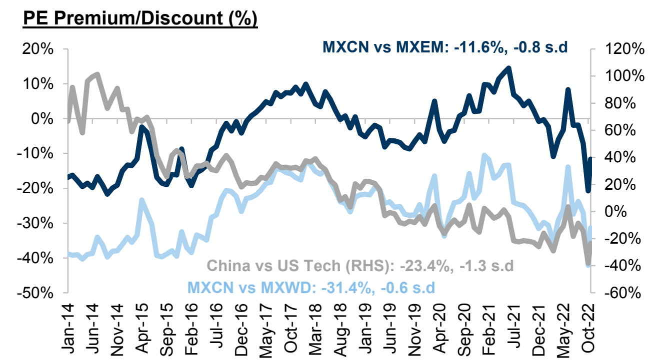
- **MSCI China and CSI300 currently trade on 12m fP/E multiples of 9.9x and 11.4x**, at -0.8 and -0.5 s.d, and in the 22%ile and 29%ile relative to their respective 10-year history. This compares to 18.6x and 17.1x when the markets reached their respective recent-year peaks in February 2021.
- The de-rating of Chinese stocks stands in sharp contrast to robust valuations for US/global equities, with **MSCI China being priced at a 31% discount** to MSCI ACWI and 41% to SPX, and China Internet trading 23% cheaper than their peers in the US, the widest gap in 6 years. China also looks attractively valued in a global context from a PEG or a sector-neutral perspective.
- The above suggests that **a high level of equity risk premium (ERP) is embedded in equity prices**, likely reflecting investor concerns revolving around degradation in corporate profitability, geopolitical risks, and domestic policy uncertainty. In fact, our DDM-derived implied ERP estimates and earnings yield gap analysis show that the required returns for investors to take risk in Chinese equities, especially in A shares where government bond yields have meaningfully compressed, have risen to the historically elevated levels.
- We adopt the following approaches to **objectively assess the fair valuation for China** in a highly dynamic environment: First, our **macro P/E model**, which allows us to relate our 12m macro, policy, regulation, and markets forecasts to index valuations, suggests that Chinese stocks should trade at **10.5x to 11x fP/E for MSCI China and around 12x-12.5x for CSI300 by end-2023**, even factoring in a scenario where the global economy may run into (mild) recession in 2023 per market pricing. Second, incorporating our normal profit (ROE) projection into our **DDM-based valuation framework**, we estimate that the theoretical fair P/E for MSCI China would be at around 11x on our base-case ERP assumption. Third, specifically forecasting the **fair cost of equity (COE)** on an ex-post basis simply based on long-term growth and geopolitical risks (i.e. China Geopolitical Risk Index), we observe that the market is probably undervalued by 20% even taking geopolitical tensions into consideration. And lastly, in the TMT sector, which accounts for 30% of index weight in MSCI China, valuations could see moderate re-rating potential amid an **improving regulation cycle** in terms of tightening intensity and policy transparency.
- All in all, while growth/profitability constraints and continued geopolitical tensions could fundamentally **cap market re-rating gains** beyond the reopening recovery, we continue to believe that Chinese stocks are trading below their theoretical fair value, offering investors attractive opportunities to engage tactically or accumulate strategic positions. See Strategies and Themes on page 17 for details.

Exhibit 20: Chinese equities are trading at the low-end of their respective valuation ranges



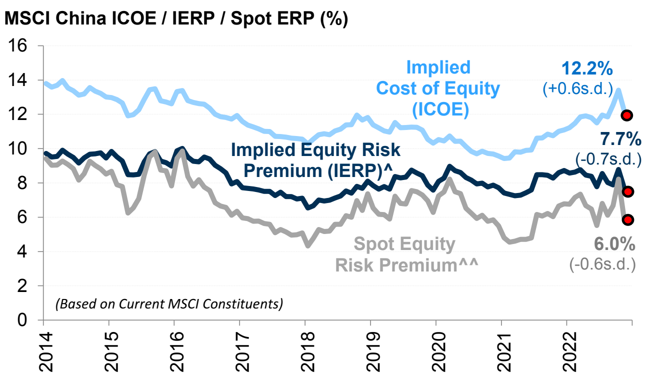
Source: MSCI, CSI, Goldman Sachs Global Investment Research

Exhibit 21: Chinese equities are trading at record-high valuation discounts to their global comps



Source: MSCI, FactSet, Goldman Sachs Global Investment Research

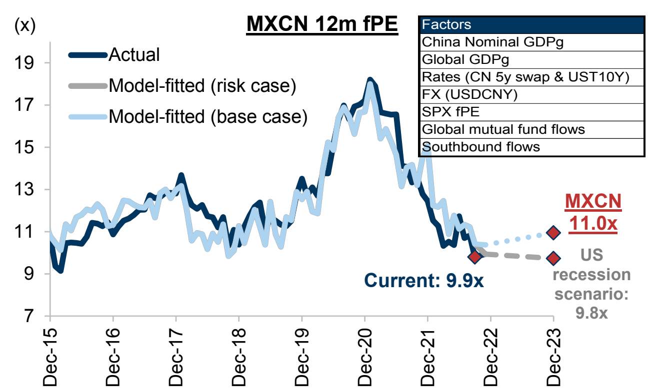
Exhibit 22: ERP for MSCI China has edged up but yet to reach elevated levels due to rising US interest rates



^calculated by bottom-up DDM method; ^^calculated by Inverse of aggregate fP/E - UST 10Y

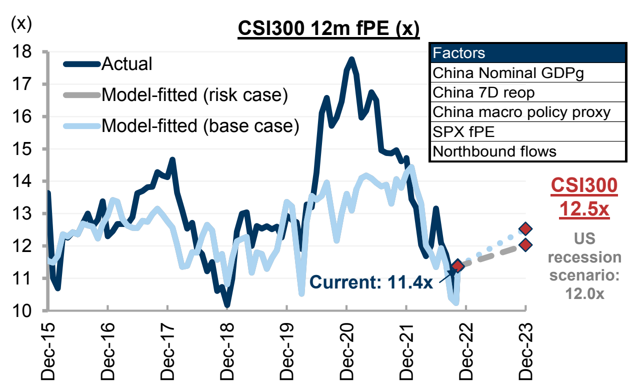
Source: MSCI, FactSet, Goldman Sachs Global Investment Research

Exhibit 23: MSCI China is trading at discounts to its fair value even after factoring in a challenging global macro outlook



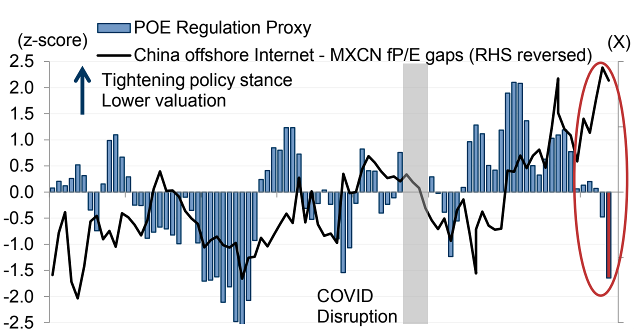
Source: MSCI, FactSet, Goldman Sachs Global Investment Research

Exhibit 24: We believe A shares could see further rerating gains under our macro assumptions



Source: Bloomberg, FactSet, Goldman Sachs Global Investment Research

Exhibit 25: An improving regulation cycle should be supportive to China TMT's valuations when other macro concerns moderate



Note: POE Regulation Proxy reflects the text-mining results of news among POE-heavy sectors. Data points during Mar-Jun 2020 have been removed due to COVID disruptions. Red bar shows the preliminary reading as of mid-Nov 2022.

Source: MSCI, FactSet, Factiva, Goldman Sachs Global Investment Research

Exhibit 26: Under our assumptions that China's long-term ROE would settle at 12% and a fair ERP of 6.5% in an equilibrium state, we estimate that China is currently trading at discounts to its fair value

Potential change in MSCI China's fair-value valuations under different ERP & ROE assumptions in a DDM model

Potential change in fair-value valuations under a DDM model — Equity Risk Premium (ERP) Assumptions	MSCI China medium-term ROE / EPS growth assumptions: ROE: 15% Implied EPSg: 10%	(Past 10yr avg) ROE: 14% EPSg: 9.3%	(Past 5yr avg) ROE: 13% EPSg: 8.6%	ROE: 12.5% EPSg: 8.3%	(GS Long-term equilibrium assumption) ROE: 12% EPSg: 8%	ROE: 11% Implied EPSg: 7.3%
9.5%	-16%	-25%	-33%	-36%	-39%	-44%
9.0%	-6%	-17%	-26%	-30%	-34%	-40%
8.5%	5%	-8%	-19%	-24%	-28%	-35%
8.0%	19%	3%	-10%	-16%	-20%	-29%
7.5%	36%	16%	1%	-6%	-12%	-22%
7.0%	59%	33%	14%	6%	-2%	-14%
6.5%	90%	55%	30%	20%	11%	-4%
6.0%	133%	85%	52%	39%	27%	9%

GS current ERP assumption (6.5%)

If geopoliitlca risks & regulation risks lower (6.0%)

(Current Market Priced / Implied Assumptions)

Note: Assume current blended (offshore USD/HKD & onshore RMB) risk-free rates = 4.5%

Source: FactSet, Goldman Sachs Global Investment Research

Exhibit 27: Our top-down modeling suggests China should trade at around 11-12x fP/E by end-2023

	Variable	GS baseline 2023E	US Recession 2023E	MXCN Sensitivity: Change from baseline	MXCN Sensitivity: PE impact	CSI300 Sensitivity: Change from baseline	CSI300 Sensitivity: PE impact
Growth	China nominal GDP	4.7%	3.2%	+50bp	1.1%	+50bp	1.2%
	World GDP (ex China)	1.2%	-2.0%	+50bp	2.1%	-	-
Policy /Rates	10-year UST yield	4.3%	5.0%	+10bp	-0.7%	-	-
	China 5Y swap rate	4.3%	4.3%	+10bp	-0.3%	-	-
	China 7D repo	2.0%	2.0%	-	-	+10bp	-0.6%
	China domestic policy proxy	-0.9^	-0.9^	+0.1	-0.6%	+0.1	-0.2%
FX /Flows	USDCNY	6.9	7.5	+10%	-1.4%	-	-
	Southbound Connect flows	US$50bn	US$50bn	+US$10bn	0.8%	-	-
	Northbound Connect flows	US$30bn	US$30bn	-	-	+US$10bn	0.5%
Market	S&P500 fPE	15.1x (mid-23) 16.4x (23YE)	14.3x (mid-23) 16.7x (23YE)	+10%	9.9%	+10%	7.6%
Risk	China Geopolitical Risk Index	2 s.d.	2 s.d.	+1 s.d.	-11.4%	+1 s.d.	-6.6%
	US-China relation (GSSRUSCN)	95%	95%	+10pp	-0.4%	+10pp	1.0%
	China regulation (GSSRCNRG)	50	50	+10	-2.4%	+10	-1.2%
	12m fPE forecast (baseline)				***11.0x***		***12.5x***
	35%*recession+65%*baseline				***10.5x***		***12.3x***
	Recession case				***9.8x***		***12.0x***

^ Assume the same as 2022E.

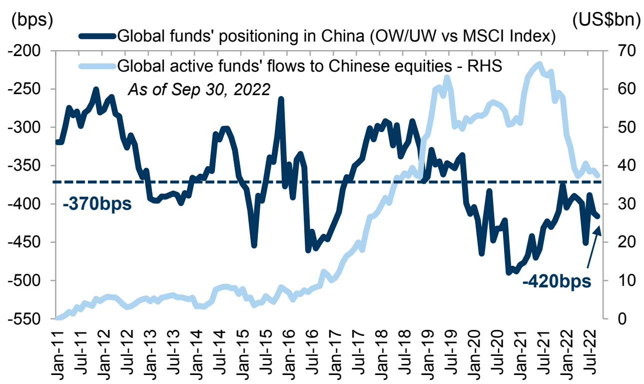
Source: Bloomberg, FactSet, Goldman Sachs Global Investment Research

Equity supply/demand: The capital re-denomination trend is underway

- **Active Global, EM, and APxJ mandates with an aggregate AUM of US$0.7tn are underweight MSCI China constituents by 420bps**, bouncing off the all-time lows of 490ps in Oct 2020. The improvement is however driven by China's reduced index weights in the benchmarks, with mutual fund investors net selling US$20bn so far in 2022 on our estimate. By market, EM and APJ investors are slightly overweight in A shares but are significantly trailing benchmark weights in both H shares and ADRs. **Hedge funds have halved their net exposures to Chinese stocks** (A, H, ADRs combined) since the historical peak of 15% (as a % of their total equity risk) per GS Prime Brokerage's statistics, bringing their total risk in China down to similar levels in 2018. Domestically, A-share equity-focused mutual funds are running at 12.6% cash ratios, moderately higher than the historical average of 12.3% over the past 5 years.
- We estimate that **US$140bn of potential derisking selling** would occur under what we viewed as a very harsh scenario where active mutual funds globally revert to their respective trough allocation weightings in China, and HF investors and US pension funds further halve their risk from current levels. That said, we suspect the bulk of **potential selling would come from US investors** who are disproportionately more sensitive to US-China tensions and US policy restrictions. As of Nov 10, our bottom-up ownership aggregation analysis shows that US investors in aggregate own around US$600bn of Chinese stocks, mostly in the HK and ADR markets.
- **We forecast US$30bn of Northbound net buying for 2023**, compared to US$5bn ytd, which is substantially below our prior forecast of US$65bn for 2022. The main impediments to Northbound flows, in our view, could be attributable to elevated geopolitical tensions and sizable positioning accumulation from international investors, who have net bought around US$100bn of A shares since 2020. In the opposite direction, we expect another solid year of **US$50bn net inflows for Southbound** which has surpassed the US$45bn mark for three consecutive years, buttressed by: a) the expansion and thematic diversification of the Southbound universe on new issuances and likely inclusion of dual-listings into the investable universe (GSe: US$20bn of potential Southbound buying); b) the wide A/H premium gap (at 72% now, +1.5 s.d. vs. 5Y averages; and c) the potential valuation recovery of China Internet companies, which have received 40% of the total ytd Southbound inflows.
- **Structural trends** of capital reallocation flows (from property to equity), financialization of housing savings, and asset institutionalization should underpin demand for Chinese equities, A shares in particular, and **corporate buybacks**, which have reached all-time high recently across A, H, and ADRs, should help partially offset the derisking flows internationally. All in all, these reaffirm our view that the **capital re-domination trend for Chinese stocks is in motion**, with Chinese investors becoming increasingly dominant in price setting (in Offshore) as their ownership gradually rises.

- On the supply side, **we believe primary market activity could recover in 2023 after a dismal year so far in 2022**, on the back of: a) further regulatory clarification on overseas/offshore listing frameworks for Chinese companies; b) higher visibility of risks surrounding ADR delisting; c) continued deleveraging and financing demand from Chinese corporates, especially in areas that are aligned with national growth objectives; and, d) ongoing market liberalization and accessibility enhancements in A shares.

Exhibit 28: Global active funds have net sold around US$20bn Chinese equities ytd and they underweight Chinese equities by 420bps as of end-Sep



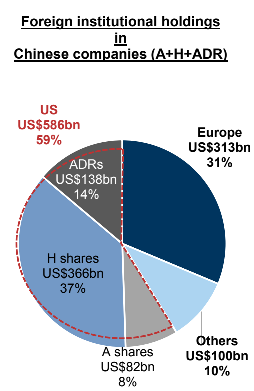
Source: EPFR, MSCI, FactSet, Goldman Sachs Global Investment Research

Exhibit 29: Hedge fund exposures in Chinese stocks have halved since the beginning of 2021

Source: Goldman Sachs Prime Services data

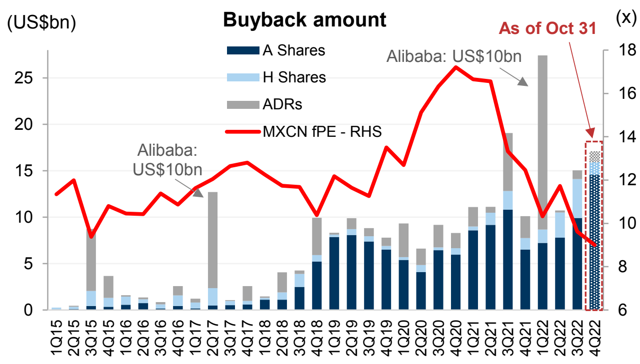
Exhibit 30: We estimate that around US$140-330bn of foreign holdings in Chinese stocks could be at risk if investors globally cut their China allocation based on what we view as very harsh assumptions

				Scenario 1		Scenario 2		Scenario 3	
		Allocation in Chinese equities (US$bn, estimated)	Current allocation in Chinese equities	Potential selling (US$bn, estimated)	Assumptions	Potential selling (US$bn, estimated)	Assumptions	Potential selling (US$bn, estimated)	Assumptions
Global active funds	EM/Asia funds	150	28% (UW570bps)	23	Cut 380bp (to the 2015 trough)	33	Cut 540bps (to trough since 2011)	88	50% of them benchmark to EM ex China indices
	Global funds	40	1.7% (UW370bps)	15	Cut 70bps (to historical trough)	40	Cut 170bps (no allocation in China)	40	Cut 170bps (no allocation in China)
	China funds (offshore)	75	100%	-	-	-	-	-	-
Global hedge funds	-	140	7%	70	Cut 400bps (to level in 2018, ~4% allocation)	105	Cut 600bps (to trough since 2017, ~2% allocation)	105	Cut 600bps (to trough since 2017, ~2% allocation)
Passive funds	Global/EM/Asia	138	11%	-	-	-	-	63	50% of them benchmark to EM ex China indices
	China (offshore)	70	100%	-	-	-	-	-	-
Pension /Endowment /Sovereign wealth funds	-	74	-	37	50% remove Chinese allocation	37	50% remove Chinese allocation	37	50% remove Chinese allocation
Other institutions (including banks, corporates, PE/VC funds and etc.)	-	312	-	-	-	-	-	-	-
Total		***999***		***145***		***214***		***332***	
Est. days of selling [calculated as the potential flows/(6m ADVT/3)]									
A shares				***1***		***1***		***1***	
H shares				***27***		***40***		***61***	
ADRs				***17***		***26***		***40***	



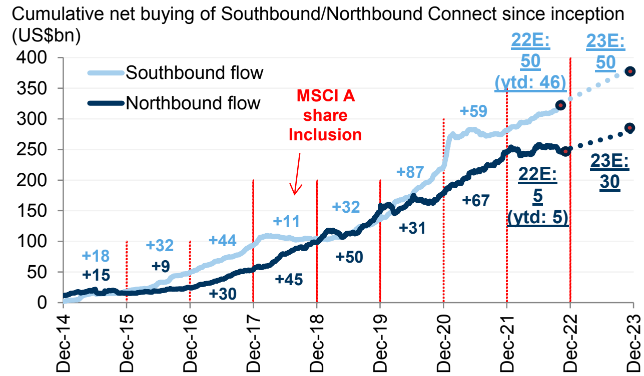
Source: EPFR, FactSet, Goldman Sachs Global Investment Research

Exhibit 31: Corporate buybacks in Chinese stocks have risen to historical highs



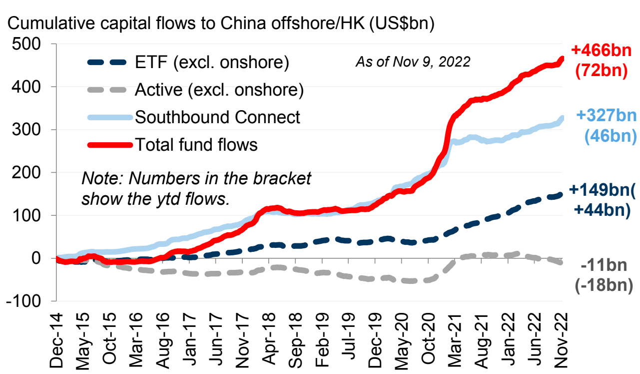
Source: Wind, Bloomberg, MSCI, Goldman Sachs Global Investment Research

Exhibit 32: We expect Southbound flows to stay robust and Northbound flows could recover if investor concerns about FX weakness and geopolitical risks moderate



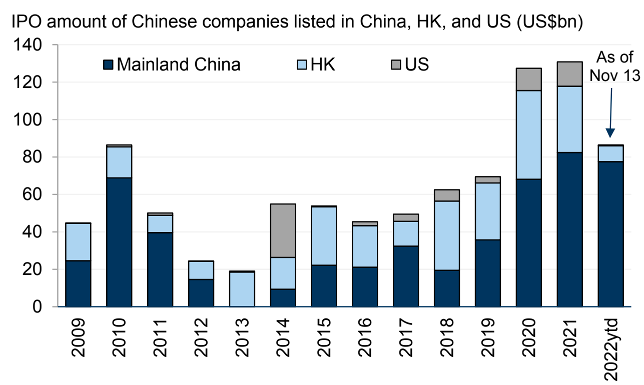
Source: Wind, Goldman Sachs Global Investment Research

Exhibit 33: Southbound net buying has become an important source of incremental capital inflows to the HK market, embodying the shifts in capital sponsorship in Offshore equities



Source: EPRF, Wind, Goldman Sachs Global Investment Research

Exhibit 34: Capital raising activity has remained robust in A shares but has been dormant in the HK and ADR markets



Source: Wind, Bloomberg, Goldman Sachs Global Investment Research

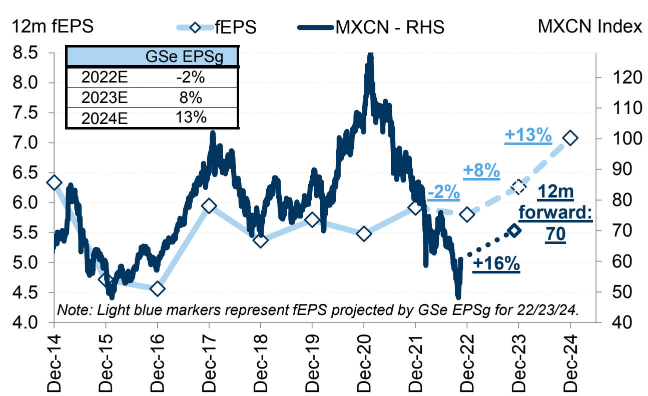
Strategies and themes: Investing along Chinese policy

Markets: We like both A and H to start 2023, but for different reasons and over different time horizons

We like the **tactical case for the Offshore market in 1H23** considering the possibility that the market may pre-trade the potential catalysts of reopening, likely more clarity of ADR delisting risks by end-22 or early 2023, and higher flow and sentiment sensitivity to the Fed hiking cycle (ends in May per GS expectation). However, we'd look to take profit on Offshore equities if the recovery materializes and rotate to the A-share market given its more compelling strategic investment case:

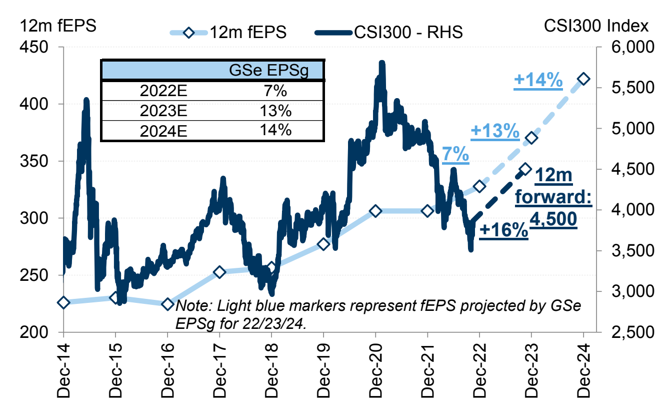
1. A shares are relatively **more immune to geopolitical tensions** from a liquidity perspective as less than 5% of the market cap is owned by foreign investors (24% for the Offshore market), and hence **less vulnerable to foreign de-risking** flows if China investability concerns return to the forefront;
2. **Index valuations are at the low end of the range**, with ERP reaching the peaks in 2015 and 2018, and the National Team could step in to support the market if it is called into action. On our forecast, the market offers an attractive growth/valuation tradeoff for investors in 2023 (13% EPS growth at 12.5x fP/E);
3. As detailed in our A-share Primer (5th edition), the market **boasts a strong strategic investment case** underpinned by its size, liquidity, diversification, and alpha generation appeal; and,
4. Thematically, A shares appear more **favorably exposed to long-term policy and development trends** under the new Party leadership, namely Common Prosperity and Little Giants.

Exhibit 35: We forecast MSCI China to reach 70 by end-23, implying 16% potential upside from current levels



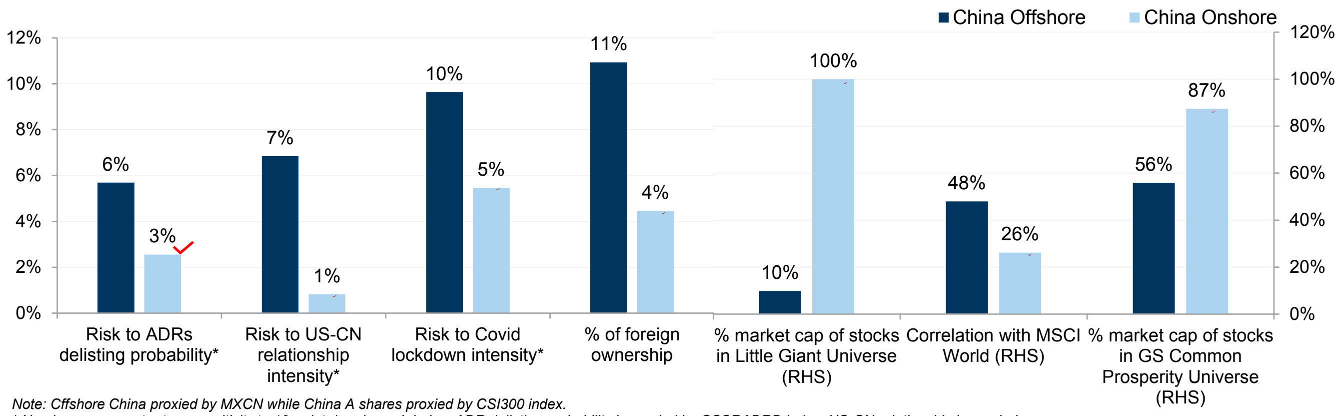
Source: MSCI, FactSet, Goldman Sachs Global Investment Research

Exhibit 36: For CSI300, the index could rise to 4500 over the next 12 months on our forecast



Source: CSI, Bloomberg, Goldman Sachs Global Investment Research

Exhibit 37: Chinese A shares look better positioned than Offshore equities from a macro and policy perspective



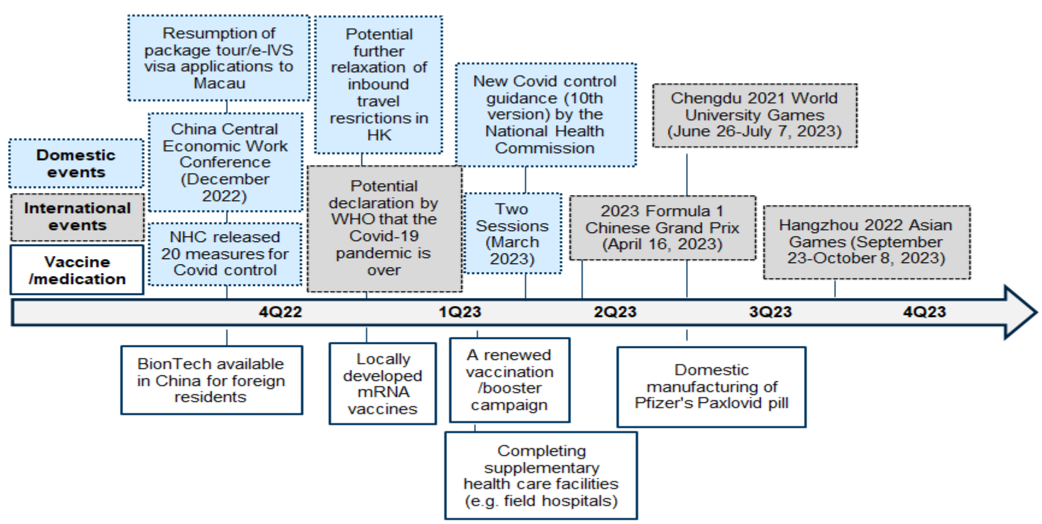
Note: Cffshore China proxied by MXCN while China A shares proxied by CSI300 index.
** Numbers represent return sensitivity to 10-point drop in each index. ADR delisting probability is proxied by GSSRADRD index; US-CN relationship is proxied by GSSRUSCN index; Lockdown level is proxied by GS Effective Lockdown index.*

Source: Bloomberg, Wind, FactSet, Goldman Sachs Global Investment Research

Tactical theme: Reopening Beneficiaries

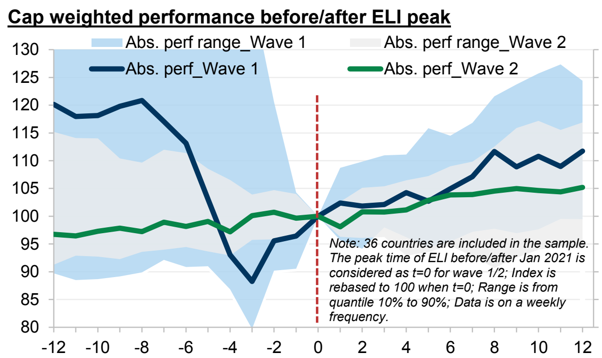
As detailed in our latest China Reopening Playbook, we believe sectors/companies that appear well-placed for easing social distancing/travel curbs, such as **Hotels, Restaurants, Travel, and Retailing/Entertainment (offline), could outperform** amid the potential reopening impulse in 2H23. This is consistent with our cross-country empirical analysis which shows that equity markets usually react more positively to local Covid policy relaxation than to international reopening, with Domestic Cyclicals and Consumer sectors leading. Our Reopening Beneficiaries portfolio, which contains 30 names across 10 consumer-related sectors, trades on 19x 24m fP/E, 40% median 22-24 EPS CAGR, and 0.3x fPEG.

Exhibit 38: Potential catalysts and key events for China reopening



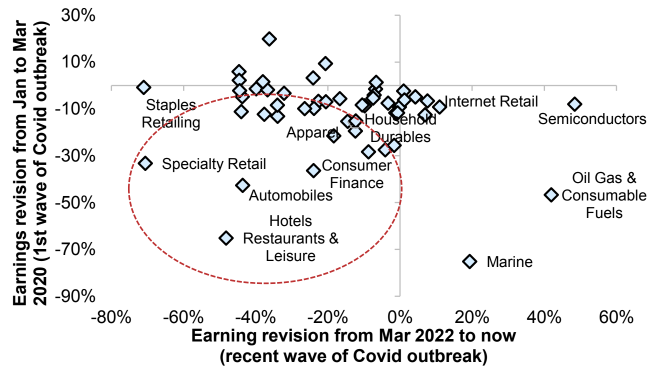
Source: NHC, State Council, Reuters, Data compiled by Goldman Sachs Global Investment Research

Exhibit 39: Equity markets are forward-looking: They usually pre-trade the actual reopening 1 month in advance



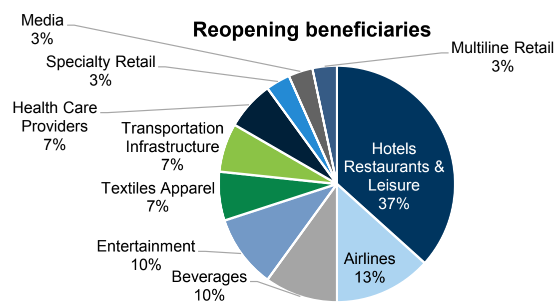
Source: MSCI, FactSet, Goldman Sachs Global Investment Research

Exhibit 40: Many consumer-facing sectors saw significant downward EPS revisions during the 2 Covid outbreak periods



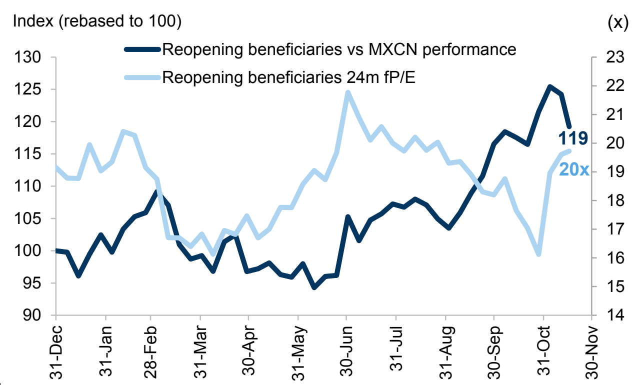
Source: FactSet, Goldman Sachs Global Investment Research

Exhibit 41: Reopening beneficiaries are mainly concentrated in consumer-facing sectors, notably Hotels, Catering, and Entertainment



Source: FactSet, Goldman Sachs Global Investment Research

Exhibit 42: Reopening beneficiaries have begun to outperform since July



Source: FactSet, Bloomberg, Goldman Sachs Global Investment Research

Exhibit 43: GS China Reopening Beneficiaries

Ticker	Name	GICS Sub-industry	Stock performance correlation with Effective Lockdown Index: Feb 2020-now	Stock performance correlation with Effective Lockdown Index: Mar 2022-now	Earning revision during Covid-19 outbreak: Jan-Apr 2020	Earning revision during Covid-19 outbreak: Mar 2022-now	Price	Currency	Listed mkt cap (US$bn)	6M ADVT (US$mn)	23E EPSg (%)	22-24E EPS CAGR (%)	23E PEG (X)	23E P/E (X)	23E P/B (X)	GS Ratings
		Selected industries	*Either < -50%*	*OR*	*Either < -20%*				*Top 30*	*>5mn*						*Not Sell-Rated*
Reopening beneficiaries																
601888 CG	China Tourism Group Duty Free	Specialty Retail	-67%	-79%	-53%	-43%	182.6	CNY	48.7	321	71	49	0.9	28	7.6	B*
2020 HK	ANTA Sports	Textiles Apparel & Luxury Goods	-50%	-18%	-23%	-15%	72.0	HKD	24.9	88	17	21	0.7	18	4.3	B
27 HK	Galaxy Entertainment	Hotels Restaurants & Leisure	-49%	-2%	-70%	NM	40.6	HKD	22.6	52	-	-	0.4	20	2.4	B
600009 CG	Shanghai Int'l Airport	Transportation Infrastructure	-5%	-24%	-56%	NM	58.6	CNY	19.9	106	-	-	1.1	65	3.8	N
9987 HK	Yum China	Hotels Restaurants & Leisure	-73%	-61%	-39%	-32%	373.2	HKD	19.9	25	57	41	1.1	28	2.4	B
291 HK	CR Beer	Beverages	-62%	-69%	-28%	-4%	42.7	HKD	17.6	63	17	21	0.9	24	4.2	B*
9961 HK	Trip.com	Hotels Restaurants & Leisure	-78%	-47%	NM	-50%	199.3	HKD	16.3	26	303	148	0.4	24	1.0	B
1928 HK	Sands China	Hotels Restaurants & Leisure	-32%	-14%	-86%	NM	16.2	HKD	16.7	44	-	-	0.1	41	-	B*
1179 HK	H World	Hotels Restaurants & Leisure	-75%	-48%	-78%	NM	24.8	HKD	10.2	5	-	-	0.8	28	5.7	B
002027 CS	Focus Media	Media	-67%	-42%	-35%	-54%	5.0	CNY	9.9	93	64	40	0.7	14	2.9	B
600115 CG	China Eastern Airlines	Airlines	-37%	-40%	NM	-	5.2	CNY	8.0	20	-	-	0.3	84	3.5	B
600754 CG	Jin Jiang Int'l Hotels	Hotels Restaurants & Leisure	-34%	-61%	-59%	-89%	56.6	CNY	7.1	42	723	238	0.9	35	3.3	B
601021 CG	Spring Airlines	Airlines	-54%	-73%	-62%	NM	55.4	CNY	6.9	26	-	-	0.4	30	3.7	N
600763 CG	Topchoice Medical	Health Care Providers & Services	-64%	-45%	2%	-31%	133.9	CNY	5.9	104	21	24	1.9	51	9.9	N
603885 CG	Juneyao Airlines	Airlines	-16%	-61%	NM	NM	15.5	CNY	4.7	21	-	-	0.3	37	3.2	NC
300144 CS	Songcheng Performance	Hotels Restaurants & Leisure	-52%	-21%	-41%	-90%	13.3	CNY	4.2	55	684	237	0.9	38	4.1	B
780 HK	Tongcheng Travel	Hotels Restaurants & Leisure	-57%	-47%	-42%	-49%	13.9	HKD	3.9	9	75	54	0.5	18	1.7	B
600258 CG	BTG Hotels	Hotels Restaurants & Leisure	-38%	-2%	-84%	NM	23.5	CNY	3.6	38	-	-	0.8	30	2.2	N
753 HK	Air China	Airlines	-10%	-52%	NM	NM	5.9	HKD	3.4	9	-	-	0.1	108	2.1	B
002739 CS	Wanda Film	Entertainment	-40%	-16%	-57%	NM	11.2	CNY	3.2	34	-	-	0.9	21	2.6	NC
600859 CG	Wangfujing	Multiline Retail	-58%	-51%	-33%	-48%	23.7	CNY	3.5	57	25	19	1.5	21	1.3	NC
002568 CS	Bairun	Beverages	-63%	-55%	8%	-57%	35.3	CNY	3.5	50	61	39	2.6	50	7.9	N
000516 CS	Xi'an Int'l Medical Investment	Health Care Providers & Services	-48%	-57%	-	NM	9.1	CNY	2.8	32	-	-	0.8	456	4.2	NC
600977 CG	China Film	Entertainment	-43%	-18%	-65%	-88%	11.0	CNY	2.8	14	771	205	3.5	23	1.7	NC
300251 CS	Beijing Enlight Media	Entertainment	-54%	-45%	-38%	-26%	7.2	CNY	2.7	20	33	26	1.1	21	2.1	CS
9922 HK	Jiumaojiu Int'l	Hotels Restaurants & Leisure	-58%	-31%	-61%	-49%	14.2	HKD	2.6	22	120	80	0.6	26	4.7	B
1128 HK	Wynn Macau	Hotels Restaurants & Leisure	-30%	-13%	NM	-	3.7	HKD	2.5	6	-	-	-	-	-	N
000089 CS	Shenzhen Airport	Transportation Infrastructure	-44%	-27%	-65%	NM	6.9	CNY	1.9	12	-	-	0.4	154	1.3	CS
002867 CS	Chow Tai Seng Jewelry	Textiles Apparel & Luxury Goods	-68%	-38%	-10%	-25%	11.9	CNY	1.8	11	18	15	0.7	9	1.8	NC
000869 CS	Changyu Pioneer Wine	Beverages	-71%	-52%	-9%	-48%	27.8	CNY	1.7	7	20	21	1.4	29	1.7	NC
Average			-50%	-40%	-45%	-47%	-	-	9	47	181	75	0.9	53	3.5	-
Median			-53%	-45%	-47%	-48%	-	-	4	29	61	40	0.8	28	3.0	-

*Note: Prices as of Nov 3; 23E PEG = 23E PE / 24E EPS growth. Valuations are based on IBSE consensus. "NM" indicates companies with earnings revised down from a positive number to a negative one. GS rating: B=Buy, N=Neutral, NC=Not Covered, CS=Cover Suspended. * indicates Asia Pacific Conviction List.*

Source: FactSet, IBES, Goldman Sachs Global Investment Research

Structural themes: Follow the Chinese policy

(1) Chinese National Security portfolio: "Security" has been one of the most frequently mentioned key words in President Xi's opening speech at the 20th National Party Congress. Broadly speaking, we see four "Security" categories that are of strategic importance to China – **Energy, Food, Technology, and Geopolitics**. Translating these Security focuses into equity sectors based on our analyst team's thematic reports (see here, here, and here), we are able to screen out 30 names across 17 sub-industries that appear critical in promoting the government's strategic priorities regarding "dual circulation" and domestic dependence. The portfolio is trading on 13x fP/E, 1.3x fPEG, and offering 16% EPS CAGR for the next 2 years on consensus forecast.

Exhibit 44: President Xi's opening speech at the 20th Party Congress focused a lot on "Development", "Socialism", and "Security"

based on 72-page full version of the speech delivered by President Xi Jinping at the opening of the 20th Party Congress on Oct 16, 2022; larger sizes of keywords indicate higher frequency of mentions

Source: Data compiled by Goldman Sachs Global Investment Research

Exhibit 45: Many sectors could potentially benefit from China's increasing emphasis on National Security

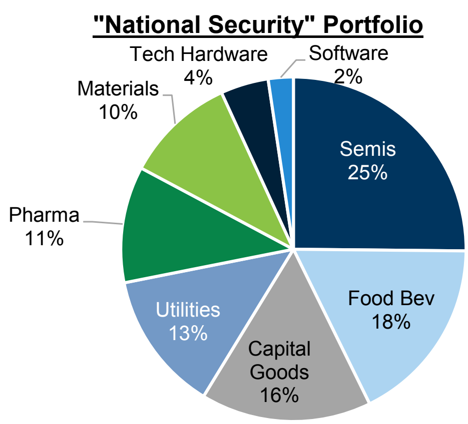
GICS sub-industries related to the "National Security" theme

Food Security	Energy Security
Agricultural Products	Agricultural Products
Biotechnology	Commodity Chemicals
Commodity Chemicals	Electrical Components & Equip
Fertilizers & Agricultural Chem	Heavy Electrical Equipment
Packaged Foods & Meats	Independent Power Producers
Pharmaceuticals	Renewable Electricity
	Semiconductor Equipment
	Semiconductors
	Specialty Chemicals

Technology	Military
Electronic Components	Aerospace & Defense
IT Consulting & Other Services	
Semiconductors	
Systems Software	
Technology Hardware Storage	

Source: MSCI, FactSet, Wind, Goldman Sachs Global Investment Research

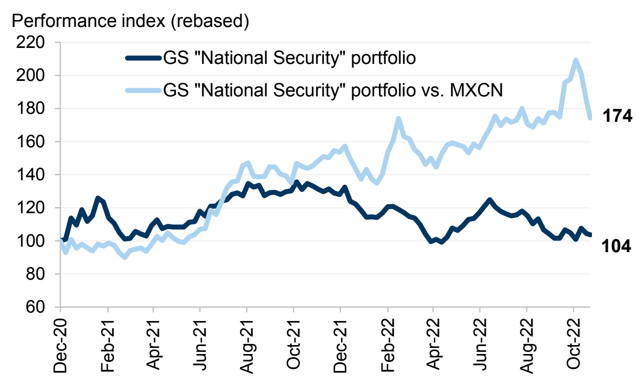
Exhibit 46: Our "National Security" portfolio is spread across the Tech, Consumer, Cap Goods, Utilities, and Pharma sectors



as of Nov 14, 2022

Source: FactSet, Goldman Sachs Global Investment Research

Exhibit 47: The theme of National Security has started to outperform in late 2021



Source: FactSet, Goldman Sachs Global Investment Research

Exhibit 48: A list of companies related to the National Security theme

		related to the "National Security" theme						*not Sell-rated*
Ticker	Name	Sub-Industry	Listed Mkt Cap (US$bn)	6M ADVT (US$mn)	23E PE (x)	22E PEG (x)	2022-24E EPS CAGR (%)	GS Ratings
A list of Chinese companies related to the "National Security" theme								
601012 CG	LONGi Green Energy	Semiconductors	51	599	16	1.0	19	B*
002714 CS	Muyuan Foods	Packaged Foods & Meats	37	270	10	-0.8	-12	B
600438 CG	Tongwei	Agricultural Products	29	546	10	-1.7	-4	B
600406 CG	NARI Technology	Heavy Electrical Equipment	25	91	19	1.5	17	B
600905 CG	Three Gorges Renewables	Renewable Electricity	23	148	13	0.9	17	N
300122 CS	Zhifei Biological Products	Biotechnology	22	154	14	0.8	19	N
002466 CS	Tianqi Lithium	Specialty Chemicals	21	787	8	-3.0	-4	N
002129 CS	TCL Zhonghuan	Semiconductor Equipment	20	338	13	0.9	19	NC
000792 CS	Qinghai Salt Lake Industry	Fertilizers & Agricultural Chemicals	19	320	8	0.9	9	B
000725 CS	BOE Technology	Electronic Components	19	153	9	0.3	50	B
300274 CS	Sungrow Power Supply	Electrical Components & Equipment	19	534	25	1.1	31	B*
002371 CS	NAURA Technology	Semiconductor Equipment	18	335	36	1.6	31	N
601985 CG	China National Nuclear Power	Independent Power Producers	16	98	9	1.2	8	NC
1093 HK	CSPC	Pharmaceuticals	15	42	14	1.3	12	B
600893 CG	AECC Aviation Power	Aerospace & Defense	14	197	45	1.9	32	NC
001289 CS	Longyuan Power	Renewable Electricity	14	18	15	1.1	18	NC
600703 CG	Sanan Optoelectronics	Semiconductors	12	222	24	0.9	33	B
601360 CG	360 Security Technology	Systems Software	7	45	42	6.0	29	NC
002013 CS	AVIC Electromechanical	Aerospace & Defense	6	80	19	1.1	21	NC
002385 CS	Dabeinong Tech	Agricultural Products	6	97	29	-	5	B
1347 HK	Hua Hong Semiconductor	Semiconductors	4	30	10	1.5	9	B
600299 CG	Adisseo	Commodity Chemicals	3	13	12	0.9	15	B
000513 CS	Livzon Pharma	Pharmaceuticals	3	36	14	1.1	14	N
2357 HK	AviChina	Aerospace & Defense	3	5	7	0.4	13	NC
002041 CS	Denghai Seeds	Agricultural Products	3	34	42	2.7	22	N
354 HK	Chinasoft	IT Consulting & Other Services	2	11	9	0.4	25	B
3868 HK	Xinyi Energy	Renewable Electricity	2	3	10	0.7	16	B*
600195 CG	CAHIC	Pharmaceuticals	2	20	16	0.8	28	B
600201 CG	Jinyu Bio-Tech	Biotechnology	1	23	17	0.9	23	N
300119 CS	Tianjin Ringpu Bio-tech	Pharmaceuticals	1	9	16	0.8	23	N
Average			14	175	18	0.9	18	-
Aggregate			418	5,258	13	1.3	16	-

*Notes: Prices as of Nov 14, 2022; Valuation items are I/B/E/S consensus. GS Ratings: B=Buy, N=Neutral, S=Sell, NC = Not Covered, and * indicates the Asia Pacific Conviction*

Note: We took top 30 names (ranked by market cap) within the related GICS sub-industries related to the "National Security" theme in the sector analysts' thematic reports, and took out Sell-rated names.

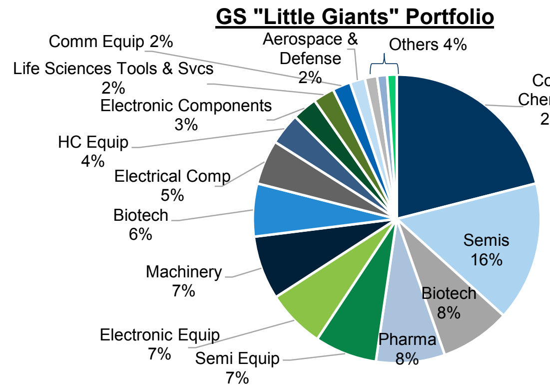
Source: FactSet, IBES, Goldman Sachs Global Investment Research

(2) Chinese "Little Giants": They are **emerging companies handpicked by the authorities for explicit policy support.** Sectorally, they mostly reside in Cap Goods, (new) Materials, Tech Hardware, and Semi, which are critical to Chinese national security, growth sustainability, and achieving "Common Prosperity". In terms of market attributes, they are growthy small/mid caps trading at historical-low and below-market valuations (PEG). Among the +700 listed "Little Giants", we screen for 40 names with favorable rankings in R&D intensity, management incentive plans, sell-side coverage, and attractive growth/valuation profiles to gain targeted exposure to this compelling story. They have an average market cap/ADT of US$4.6bn/US$62mn, trade at 19x fP/E and 0.7x fPEG, and offer 29% 22-24E EPS CAGR. Our back-test shows that the basket has risen 122% since 2020, outperforming MXCN/CSI300 by 154pp/129pp.

Exhibit 49: "Little Giants" are handpicked by Chinese authorities for policy support, and appear strategically important to China in terms of its growth sustainability and national security

Source: Wind, MIIT, Data compiled by Goldman Sachs Global Investment Research

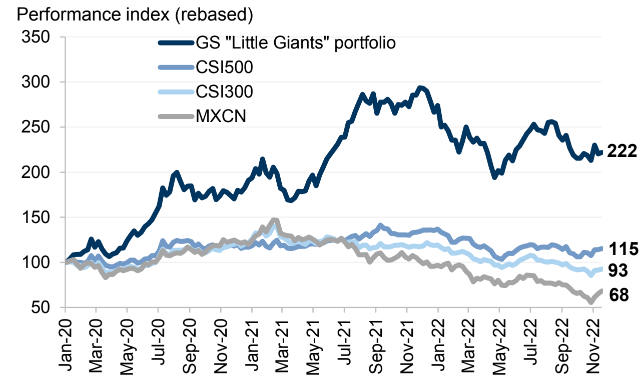
Exhibit 50: The constituents spread across 17 sub-industries, with a strong "Hard Tech" flavor



As of Sep 30, 2022

Source: Wind, FactSet, Goldman Sachs Global Investment Research

Exhibit 51: The basket has gained 122% since 2020, outperforming CSI500, CSI300 and MXCN by 107pp, 129pp and 154pp respectively



Source: Wind, FactSet, Goldman Sachs Global Investment Research

Exhibit 52: GS Little Giants Basket (GSSRCNLG)

				Top 50 (on avg %ile ranking)				>3	>1bn	>5mn			
Ticker	Name	GICS Sub-Industry	Basket weight^	R&D intensity (past 3y avg)	Revenue CAGR (2021-23E)	ROE (past 3y avg)	Management incentive plans^^	Analyst coverage (IBES)	Listed Mkt Cap (US$bn)	6M ADVT (US$mn)	23E PE (x)	22E PEG (x)	2022-24E EPS CAGR (%)
"Little Giants" Portfolio													
002812 CS	Yunnan Energy New Material	Commodity Chemicals	5.0%	5%	51%	18%	√	28	20.3	174	15	0.6	31
002049 CS	Unigroup Guoxin Microelectronics	Semiconductors	5.0%	15%	32%	20%		16	18.0	187	23	0.9	33
603659 CG	Putailai New Energy Technology	Specialty Chemicals	5.0%	5%	51%	13%	√	17	11.0	96	14	0.7	30
688063 CG	Pylon Technologies	Electrical Components & Equipment	5.0%	7%	109%	11%	√	10	6.9	160	15	0.5	41
300142 CS	Walvax Biotechnology	Biotechnology	5.0%	17%	35%	7%	√	6	9.4	112	32	1.5	23
603290 CG	StarPower Semiconductor	Semiconductors	5.0%	7%	48%	14%	√	22	8.6	112	42	1.7	35
603185 CG	Wuxi Shangji Automation	Industrial Machinery	4.9%	4%	81%	27%	√	4	7.5	199	7	0.4	20
002821 CS	Asymchem Laboratories	Pharmaceuticals	4.5%	8%	52%	16%	√	20	7.6	143	19	2.2	12
300661 CS	SG Micro	Semiconductors	4.5%	17%	41%	25%	√	21	7.7	74	36	1.8	28
300769 CS	Shenzhen Dynanonic	Commodity Chemicals	4.3%	5%	141%	26%	√	14	6.5	117	14	0.7	28
300699 CS	Weihai Guangwei Composites	Commodity Chemicals	4.0%	11%	17%	18%	√	12	5.3	62	25	1.4	22
688301 CG	Iray Technology	Health Care Equipment	3.6%	14%	28%	13%	√	8	4.7	28	30	1.3	28
300604 CS	Changchuan Technology	Semiconductor Equipment	3.2%	24%	58%	7%	√	7	4.6	78	30	1.1	36
002414 CS	Wuhan Guide Infrared	Electronic Equipment & Instruments	2.9%	15%	16%	17%		6	4.4	61	21	1.1	22
688598 CG	KBC Corp. Ltd. Class A	Commodity Chemicals	2.6%	8%	28%	22%	√	12	3.2	63	19	0.8	33
688188 CG	Shanghai Friendess Electronics	Electronic Equipment & Instruments	2.6%	13%	21%	17%	√	10	4.8	18	33	1.3	32
300357 CS	Wolwo Bio-Pharmaceutical	Pharmaceuticals	2.4%	11%	21%	22%		10	3.8	17	40	1.9	27
603127 CG	Joinn Laboratories	Life Sciences Tools & Services	2.4%	5%	33%	20%	√	15	4.4	57	27	1.2	30
300487 CS	Sunresin New Materials	Commodity Chemicals	2.3%	6%	46%	18%	√	4	3.7	33	28	1.5	21
688200 CG	Huafeng Test & Control Technology	Semiconductor Equipment	1.9%	13%	31%	14%	√	18	3.2	43	24	1.0	32
300777 CS	Sinofibers Technology	Commodity Chemicals	1.9%	9%	72%	18%		5	3.3	48	26	1.2	28
003031 CS	Hebei Sinopack Electronic Technology	Electronic Components	1.9%	13%	33%	10%		6	2.9	26	61	2.3	30
688019 CG	Anji Microelectronics Technology	Semiconductor Equipment	1.8%	21%	44%	13%	√	8	2.2	36	34	2.0	34
300775 CS	Xi'an Triangle Defense	Aerospace & Defense	1.7%	4%	36%	15%	√	5	2.9	44	18	0.7	34
300035 CS	Hunan Zhongke Electric	Industrial Machinery	1.4%	6%	85%	11%	√	8	2.1	73	9	0.4	39
688696 CG	Chengdu Xgimi Technology	Consumer Electronics	1.4%	5%	25%	34%	√	14	1.8	30	16	0.7	29
300613 CS	Fullhan Microelectronics	Semiconductors	1.2%	20%	34%	12%	√	7	1.7	40	14	0.7	25
300767 CS	QuakeSafe Technologies	Construction Materials	1.1%	3%	105%	11%	√	9	1.7	17	18	0.5	68
300841 CS	Kanghua Biological Products	Biotechnology	1.1%	5%	43%	28%	√	7	2.0	22	9	0.7	19
300567 CS	Wuhan Jingce Electronic	Electronic Equipment & Instruments	1.1%	16%	9%	14%	√	7	2.2	33	31	1.3	60
688016 CG	MicroPort Endovascular MedTech	Health Care Supplies	1.1%	17%	30%	20%	√	6	2.1	35	21	0.9	30
300638 CS	Fibocom Wireless, Inc.	Communications Equipment	1.1%	11%	33%	21%	√	13	1.7	20	14	0.6	30
300394 CS	Suzhou TFC Optical Communication	Communications Equipment	1.0%	10%	26%	18%	√	14	1.5	23	16	0.9	26
300653 CS	Yantai Zhenghai Bio-Tech	Biotechnology	0.9%	8%	23%	21%		4	1.1	24	21	0.9	37
300481 CS	Puyang Huicheng Electronic Material	Specialty Chemicals	0.9%	7%	21%	18%	√	6	1.1	53	13	0.6	27
002810 CS	Shandong Head Group	Commodity Chemicals	0.9%	4%	35%	22%	√	5	1.2	33	13	0.5	31
300811 CS	POCO Holding	Electronic Components	0.9%	6%	38%	13%	√	5	1.4	13	24	0.8	38
300401 CS	Zhejiang Garden Bio-chemical High-tech	Pharmaceuticals	0.9%	6%	34%	17%		4	1.3	38	10	0.5	31
300685 CS	Amoy Diagnostics	Biotechnology	0.9%	16%	18%	18%	√	7	1.5	13	24	1.1	29
603666 CG	Yijiahe Technology	Industrial Machinery	0.8%	13%	27%	22%	√	4	1.1	22	8	0.4	26
Average				10%	43%	17%			4.6	62	22	1.0	31
Aggregate									182	2,482	19	0.7	29

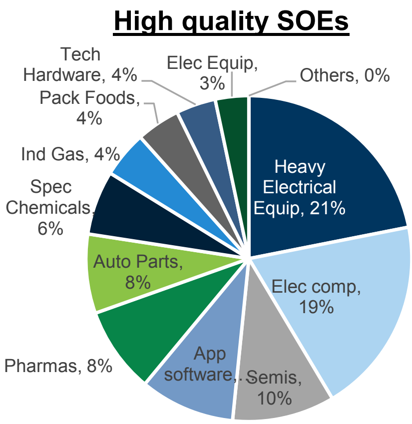
Notes: Prices as of Nov 14, 2022; Valuation items are I/B/E/S consensus. Stocks that are not eligible for Northbound Stock Connect have been excluded. ^Basket is market cap-weighted while weights of individual stocks are capped at 5%. ^^"√" indicates companies have conducted management incentive plans since 2016

Source: Wind, FactSet, IBES, Goldman Sachs Global Investment Research

(3) High-quality SOEs: The emphasis on and pursuit of "Common Prosperity" will likely strengthen under the new leadership, boding well for select SOEs that might be deemed as strategically- or socially-important by policymakers. As such, we screen for SOEs with a relatively strong growth and profitability profile, and SOEs that are better positioned to generate superior equity returns based on their: 1) R&D intensity and R&D

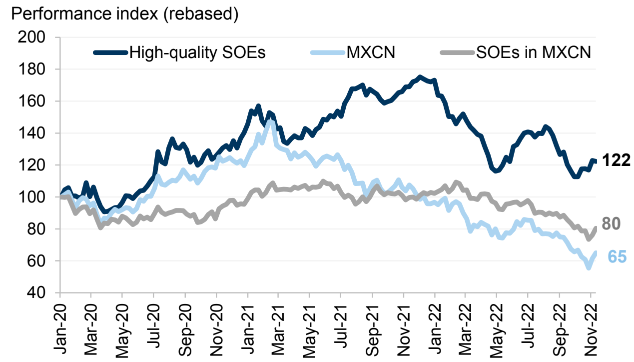
expense growth, and 2) focus on aligning shareholders' and management's interests (e.g., have a stock incentive plan), both of which have been key explanatory factors for their outperformance empirically.

Exhibit 53: High-quality SOEs, on our defintion, are quite well represented outside of the Financials, Energy, and Telecom sectors



Source: FactSet, Goldman Sachs Global Investment Research

Exhibit 54: High-quality SOEs have meaningully outperformed the benchmark and their SOE peers



Source: FactSet, MSCI, Goldman Sachs Global Investment Research

Exhibit 55: A list of SOEs with a relatively strong growth and profitability profile

Ticker	Name	Industry Group	R&D intensity (past 3y avg)	Revenue CAGR (2021-23E)	ROE (past 3y avg)	If management incentive plans^	Listed Mkt Cap (US$bn)	6M ADVT (US$mn)	23E PE (x)	22E PEG (x)	2022-24E EPS CAGR (%)
			>3%	*>10%*	*>10%*	√	*>0.5bn*	*>5mn*		*<2x*	*> 10*
A list of SOEs with high R&D intensity, revenue CAGR, ROE and with management incentive plans											
600406 CG	NARI Technology	Capital Goods	6%	12%	14%	√	24	94	19	1.5	17
002179 CS	AVIC Jonhon Optronic Tech	Tech Hardware	10%	20%	15%	√	14	73	24	1.2	25
000661 CS	Changchun High & New Tech	Pharma	7%	19%	26%	√	11	188	11	0.6	23
002920 CS	Huizhou Desay SV Automotive	Automobile	11%	33%	14%	√	10	102	28	1.0	39
688396 CG	China Resources Microelectronics	Semis	8%	16%	12%	√	9	55	20	1.3	18
000733 CS	Zhenhua Science & Tech	Tech Hardware	8%	27%	13%	√	9	100	16	0.7	29
600845 CG	Shanghai Baosight Software	Software	11%	20%	17%	√	8	24	21	1.0	25
002430 CS	Hangzhou Oxygen Plant Group	Materials	3%	11%	13%	√	5	29	18	0.9	24
600378 CG	Haohua Chemical Science & Tech	Materials	8%	10%	11%	√	5	12	25	1.9	15
600298 CG	Angel Yeast	Food Bev	4%	13%	21%	√	5	51	17	1.0	20
000066 CS	China Greatwall Technology	Tech Hardware	8%	20%	10%	√	4	44	27	1.5	20
688568 CG	Geovis Technology	Software	14%	37%	14%	√	2	5	24	0.9	34
300747 CS	Wuhan Raycus Fiber Laser Tech	Tech Hardware	7%	18%	14%	√	2	21	18	0.5	47
002643 CS	Valiant	Materials	8%	18%	10%	√	2	19	10	0.6	23
600171 CG	Shanghai Belling	Semis	10%	12%	15%	√	2	88	16	0.6	30
300188 CS	Xiamen Meiya Pico Information	Tech Hardware	18%	12%	10%	√	1.4	11	20	0.9	24
300087 CS	Winall Hi-Tech Seed	Food Bev	4%	25%	14%	√	1.3	39	23	0.8	28
002057 CS	Sinosteel New Materials	Materials	6%	46%	10%	√	1.1	42	11	0.4	34
603060 CG	China Testing & Certification	Comm & Prof Svcs	8%	17%	14%	√	1.0	5	16	0.9	22
300772 CS	Zhejiang Windey	Capital Goods	4%	12%	15%	√	0.9	75	12	0.9	22
Average			8%	20%	14%	-	6	54	19	1.0	26
Aggregate			-	-	-	-	118	1,080	18	0.8	23

*Notes: Prices as of Oct 20, 2022; Valuation items are I/B/E/S consensus. GS Ratings: B=Buy, N=Neutral, and * indicates the Asia Pacific Conviction List. ^"√" indicates companies have conducted management incentive plans since 2016*

Source: FactSet, IBES, Goldman Sachs Global Investment Research

Sector allocation: Tilting toward consumer and aligning with policy

In a nutshell, we'd emphasize **a consumer tilt in our sector allocation** in anticipation of the eventual reopening in 2Q23, and at the same time, maintain strategic exposures to areas that are favorably linked with long-term policy trends. Notable changes to (and continued views of) our sector recommendations are as follows:

Exhibit 56: Reopening and policy alignment are two key themes driving our sector allocation recommendations

Allocation	MXCN industry groups	22-24E EPS CAGR	23E P/E (X)	23E P/B (X)	23E PEG	Return sensitivity to policy (%ile ranking)^	Return sensitivity to CAI growth (%ile ranking)^^	Return sensitivity to retail sales growth (%ile ranking)^^	Return YTD	Valuation z-score^^^	SOE% within industry group	Exposure to "Common Prosperity" & "Little Giants"	Policy Score (in Percentile) ^^^^^
Overweight	Consumer Durables	20%	17.7	3.3	0.8	5%	52%	96%	-33%	-1.0	0%		18%
	Consumer Svcs ↑	211%	27.8	1.9	0.8	95%	84%	36%	8%	-0.4	2%		94%
	HC Equip & Svcs ↑	16%	15.7	1.7	0.8	-	16%	52%	-18%	-0.6	24%	LG	-
	Retailing	19%	16.1	2.0	0.7	47%	64%	88%	-26%	-2.3	1%		76%
	Semis	25%	17.6	2.8	0.8	79%	92%	92%	-26%	-1.3	14%	CP & LG	85%
Marketweight	Autos ↓	76%	24.4	1.9	0.4	58%	96%	84%	-49%	-0.4	9%		88%
	Capital Goods	14%	7.6	0.8	0.6	79%	48%	40%	-25%	-1.2	50%	CP & LG	12%
	Div Financials	18%	6.5	0.6	0.3	58%	80%	28%	-34%	-1.2	83%		65%
	Food Bev	18%	19.6	3.8	1.2	21%	72%	68%	-28%	-1.3	60%	CP	24%
	Insurance	19%	5.1	0.6	0.3	21%	56%	48%	-19%	-1.3	46%		0%
	Media ↓	22%	17.3	2.0	0.8	58%	40%	72%	-35%	-2.0	0%		41%
	Pharma Biotech	75%	43.3	3.7	0.7	11%	60%	80%	-30%	-1.2	5%	CP & LG	47%
	Real Estate ↑	10%	6.9	0.7	0.5	79%	36%	8%	-32%	0.0	44%		100%
	Transportation	-14%	7.4	0.9	-	74%	28%	44%	-24%	-1.1	60%		82%
	Utilities	16%	8.2	0.9	0.5	32%	20%	60%	-34%	-2.0	77%		59%
Underweight	Banks	7%	3.4	0.4	0.3	47%	12%	12%	-18%	-2.0	96%		71%
	Energy ↓	-4%	5.1	0.6	7.2	32%	32%	16%	11%	-1.6	95%		53%
	Materials	16%	8.1	1.2	0.5	32%	76%	24%	-25%	-0.3	55%	CP & LG	35%
	Tech Hardware ↓	19%	12.8	1.7	0.7	11%	88%	76%	-42%	-1.2	18%	CP & LG	29%
	Telecom	10%	12.9	0.6	1.3	-	24%	32%	-8%	-1.2	17%		6%

Note: ^based on overall score of policy scorecard (see Appendix), higher score indicates higher sensitivity to policy easing across 5 dimensions - financial condition, macro, property, regulation and Covid; ^^based on monthly relative return (to MXCN) sensitivity vs. CAI growth (mom change on qoq)/retail sales growth (mom sa, lag 1-mon); ^^^z-score vs. 5-year historical average; ^^^^top 6 industry groups in the full "Common Prosperity" Universe or the full "Little Giants" List. ^^^^^higher percentile indicates more accommodative policy stance.

Source: FactSet, MSCI, Factiva, Goldman Sachs Global Investment Research

Overweights

- **Consumer services (from MW to OW)**: This sector comprises Hotels, Restaurants, and Theme Parks that are favorably exposed to the reopening consumption boost. Valuations are at mid-cycle (24m P/E) and many underlying stocks could return to profit-making in 2023 if reopening materializes.
- **Medical Equipment & Services (from MW to OW)**: This appears one of the most defensive sub-industries in the Healthcare sector given its domestic-revenue orientation and limited reliance on advanced US technology. Localization and reopening are also demand tailwinds.
- **Online Retailing (Stay OW)**: Relaxation of Covid restrictions should improve e-commerce traffic/volume. Key constituents with dual-listing in the US and HK could become Southbound eligible in the months ahead. Valuations are at a historical low, with the sector trading at 35% cash/market cap and cash-rich companies returning capital to shareholders.
- **Semis (Stay OW)**: The sector is denominated by Renewables-related companies (Solar, Wind) as most large-cap semiconductor names have been excluded from the benchmark due to US sanctions. It's arguably one of the clearest policy beneficiaries given China's focus on green energy, energy security, and technology independence. We favor Power Storage and Solar over Wind and EV supply chain.

Marketweights

- **Autos (from OW to MW):** Electric Vehicles (EV) sales momentum could decelerate to 20% in 2023 (from more than 100% up so far this year) on our analysts' estimates due to fading fiscal impulse, rising competition, and falling utilization. Investors should focus on industry positioning and product cycle to identify outperformers in the sector.

- **Developers (from UW to MW):** While we expect another challenging year for the housing market from land sales to completion, the Developer sector is now dominated by SOE or quasi-SOE players which have significantly stronger credit and liquidity profiles compared to their pure POE peers. The 16 measures recently announced by the authorities are also helpful to price out the left-tail risks in valuations.
- **Media (from OW to MW):** Advertising revenues could stay soft until the economy picks up steam in 2H23 although gaming approvals could accelerate for large players next year. At similar absolute and relative (to their ranges) valuations, we prefer E-Commerce platforms over advertising-exposed cohorts within the broad TMT sector.

Underweights

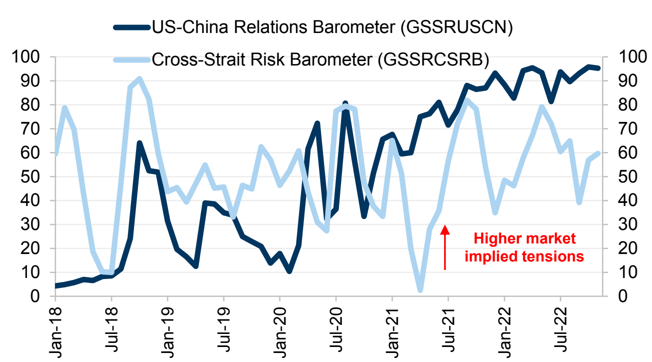
- **Banks (Stay UW):** Depressed valuations (fP/E at 3x and P/B at 0.3x) are not a convincing reason to turn positive as our analysts' earnings are 4pp below consensus on compressing NIM and rising NPL pressures amid the property downcycle. Room for earnings management from provisioning could be limited and the potential for capital raising could be a valuation overhang.
- **Energy (from MW to UW)**: Earnings have risen to recent-year highs in 2022 on surging oil prices but will likely decline in 2023 as global demand softens and recession risks loom. We like Coal more than Oil on a better supply/demand outlook.
- **Tech Hardware (from MW to UW):** Weak industry fundamentals on the back of local and global demand headwinds and constraints for technological upgrading due to US export control warrant a cautious stance on the sector. Within the sector, we like companies that are exposed to the auto supply chain than the smartphone/PC industry.

Risks: Many things could go wrong, but most are well-known to markets

Geopolitical tail risks are not priced at tailed probabilities

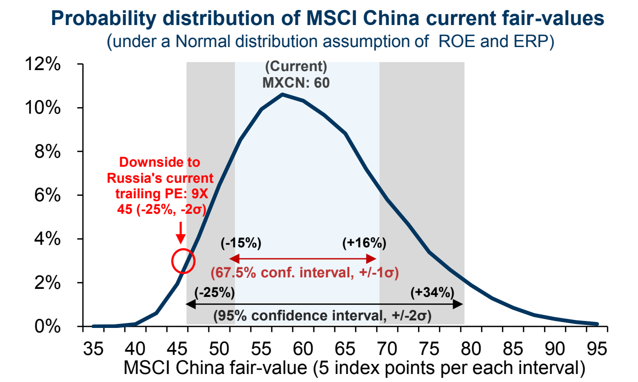
- **Geopolitical tensions relating to China** continue to dominate our recent conversations with investors globally, with our US-China Relations Barometer and Cross-Strait Barometer both hovering at elevated levels relative to their recent-year ranges. These suggest the concerns are quite well discounted in stock prices, barring the materialization of extreme scenarios.
- While it is almost impossible to predict geopolitical events ex-ante, we'd argue that given China's economic and financial markets size and their linkages with the rest of the world, any potential direct or secondary sanctions on China due to geopolitical conflicts would have **considerably greater repercussions for the global economy** via the economic, supply-chain, and financial market channels than is the case with Russia – where disruptions are predominately concentrated in commodity trade and markets.
- We estimate that Chinese equities may have already **priced in a roughly 2.5% probability that left-tail scenarios** (proxied by Russia's current index PE), possibly related to further escalation in geopolitical tensions or significant disruptions of capital flows (investability), could prevail assuming market risk premium and corporate profitability for China are normally distributed in our probability-weighted fair-value model.

Exhibit 57: Geopolitical concerns seem high based on equity market pricing



Source: Goldman Sachs Global Investment Research

Exhibit 58: Chinese equities may have already priced in a roughly 2.5% probability that left tail scenarios (proxied by Russia's current index PE) could materialize



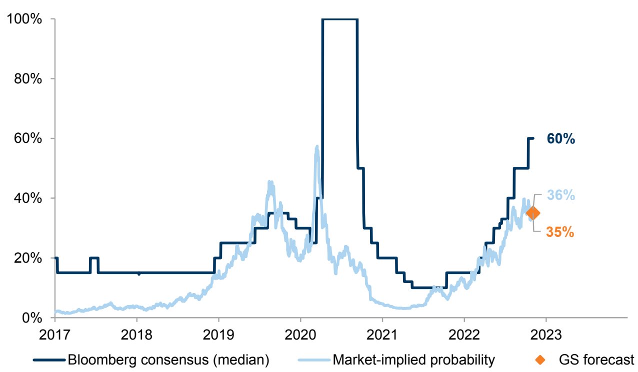
Source: FactSet, MSCI, Goldman Sachs Global Investment Research

A narrow path to avoid US/global recession

- Our economists' base case remains that **a US/global recession could be avoided in 2023,** although the path to that outcome appears a narrow one given still-high inflation in absolute terms and a strong labor market in the US, which underpin their moderately more-hawkish-than-consensus US hiking cycle expectations. In a recession scenario, our model shows that it could reduce the fair P/E for MSCI China by around 1 PE point mainly via the growth and currency channels, everything else being equal.

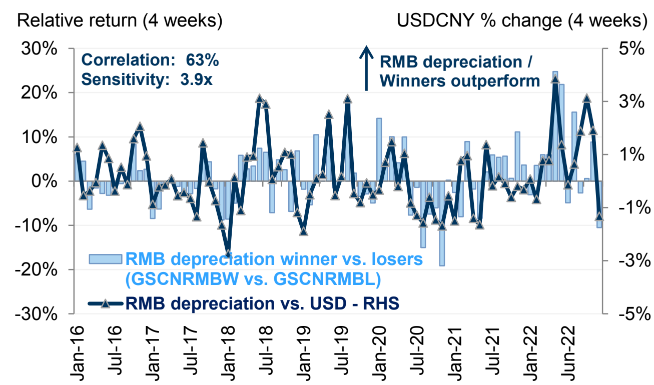
- The tightening US policy cycle could put further near-term appreciation pressures on the US Dollar but our economists expect the broad US Dollar to soften somewhat in 2H23, supporting their view that **USDCNY could strengthen to 6.9 by end-23** from around 7.1 at the moment. In the equity market, we would look to our Rmb depreciation winners and losers portfolios to express our currency views for hedging or tactical trading purposes.
- With Chinese equity valuations at fairly depressed levels vs. historical ranges and global comps, the market's sensitivity to shocks of global growth risk and further tightening in global financial conditions may be less significant than would otherwise be the case. In other words, **domestic factors (reopening, policy easing, property cycle) should be more influential to equity valuations and performance.**

Exhibit 59: US recession risk is rising per market pricing and Bloomberg consensus expectation



Source: Haver Analytics, Datastream, Worldscope, Bloomberg, Goldman Sachs Global Investment Research

Exhibit 60: Investors could express their FX views via our Rmb depreciation winners/losers in the equity market



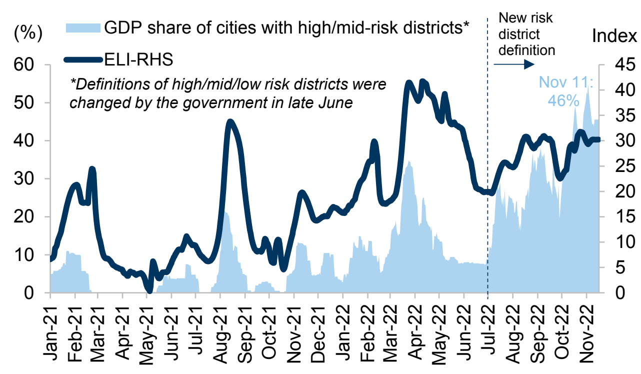
Source: FactSet, Bloomberg, Goldman Sachs Global Investment Research

Covid resurgence and/or delay in reopening

- Since the 9% correction in the week after the conclusion of the Party Congress, **MSCI China has rallied 25% largely on increasing reopening optimism** despite rising reported domestic Covid cases. While actual reopening may not arrive until 2Q23, the equity market could trade well on signs of Covid policy relaxations and clarity of the reopening roadmap, potentially gaining 15% from current prices in a full-reopening scenario on our estimate.
- However, if reopening doesn't materialize in 2023 or is pushed back due to rising infection or an unexpected twist of virus mutation, the **potential downside to equities could also be meaningful** (15%). For now, it looks like the reaction function from policymakers has changed marginally, moving from zero Covid at all cost to balancing Covid controls at minimum economic disruptions as evidenced by the relatively stable Effective Lockdown index (ELI) but rising share of the Chinese economy designated as high-risk areas.
- **Key signposts to monitor** to frame the reopening roadmap include the vaccination rate for the elderly population, accessibility to affordable and effective (mRNA) vaccines and Covid pills, availability of sufficient medical resources, and (changes in)

official communication to the general public on Covid policy/social implications.

Exhibit 61: The economic disruptions have stabilized depsite rising Covid cases and affected areas in recent weeks



Source: Goldman Sachs Global Investment Research

Exhibit 62: Reopening boost could translate into 14% incremental index upside via the earnings and valuation channels

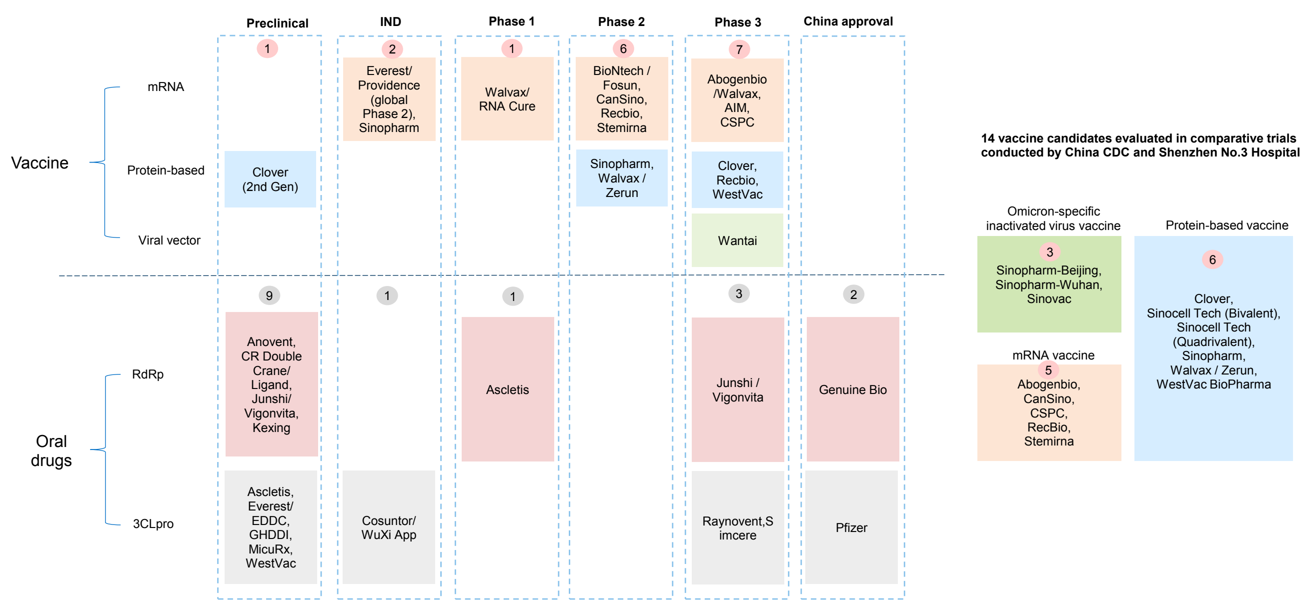
Impact of China reopening on MSCI China EPSg/fPE/Index upside

Scenario		2023 China real GDP growth^	2023 MXCN EPSg^^	2023 MXCN fPE^^^	MXCN Index upside^^^^
Upside	*Reopening in 2023Q2 + boost to activity starts immediately*	+0.9pp	13% (+5pp)	11.2x (+2pp)	+36% (+7pp)
Baseline	***Reopening starts in 2023Q2***	**4.5%**	**8%**	**11.0x**	**+29%**
Downside	*Delayed reopening*	-1.8pp	-2% (-10pp)	10.6x (-4pp)	+15% (-14pp)

Note: ^please refer to Global Economics Analyst | Risks to Growth in Europe and China: Mostly Downside, Oct 17, 2022; ^^EPSg was derived from based on two-step macro model on SPSg and Net Margin; ^^^fPE was derived from top-down macro model; ^^^^based on 12-month index target, as of Nov 4, 2022

Source: MSCI, FactSet, Goldman Sachs Global Investment Research

Exhibit 63: Landscape of COVID-19 vaccines and oral drug treatments in China



Source: Company data, NHC

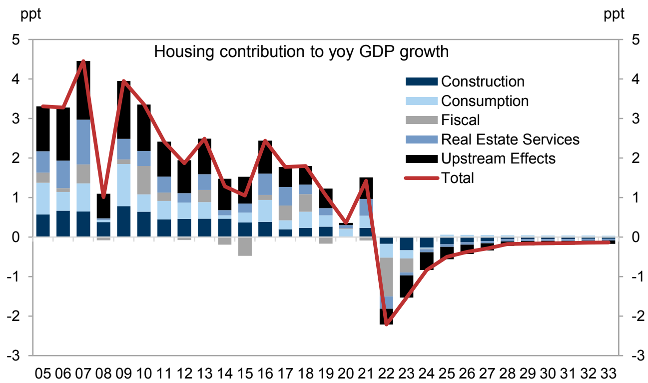
Property risk: A bumpy deleveraging, but not systemic

- The (prolonged) slowdown in the US$60tn domestic housing market continues to pressure activity growth in a broad-based manner considering the **intricate linkages of housing activity to the economy** (20-25% of GDP): GS economists expect the property market to slow GDP growth by about 1.5pp in 2023. The risks/concerns were mainly confined to private developers early in the downcycles but have subsequently expanded to supply-chain players (constructors), SOE developers (credit risk), homebuyers (mortgage boycott), and commercial banks (capital loss).
- Our banks and property analysts estimate that the potential asset writedown loss (after asset liquidation) for the whole system could amount to Rmb12tn in a harsh scenario, and Rmb740bn of capital injection is needed to carry out existing

unfinished projects owned by cash-crunch private developers over the next 12 months.

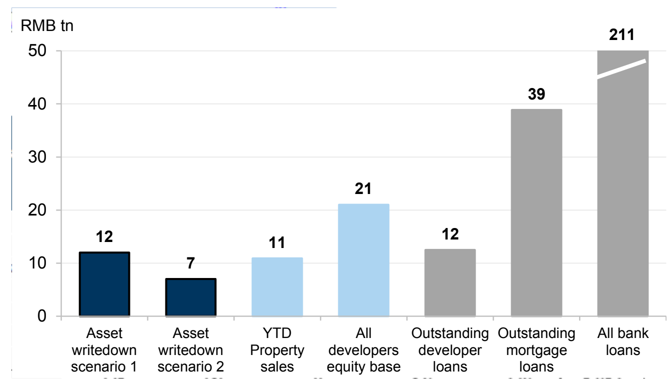
- While these potential losses are significant in notional terms, they **look manageable relative to the size of the banking system and government's balance sheet**.

Exhibit 64: We expect the ongoing property downturn to be a multi-year growth drag



Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 65: Our residual value analysis for POEs facing high liquidity pressure's assets by 2022E



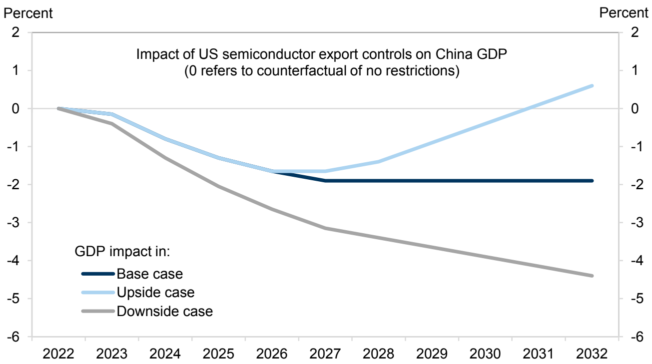
The price discounts are based on our understanding of market practices and transactions in the industry. Pending any further public disclosures on its assets, we note the realized discount level could be very different from our assumptions here.

Source: NBS, Wind, Gao Hua Securities Research

US technology control measures could accelerate localization timetable

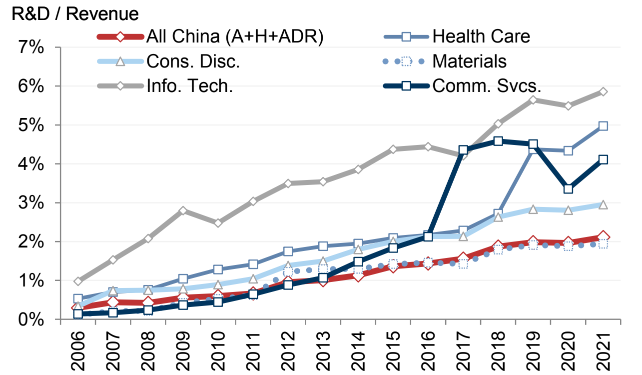
- On October 7, the US government significantly expanded controls on the export of sensitive technologies to China, with a focus on cutting-edge semiconductor chips and the key equipment, software, and services necessary to produce them. Our economists estimate ~1/4pp drag on China's GDP next year, albeit with high uncertainty, with the **drag likely increasing to about -1.7pp of GDP by 2026**, relative to the level of output that would prevail in the absence of any US controls (i.e. 0.4pp over the next 4 years).
- The implications on equities are equally consequential, potentially impacting tech product supply/demand in the short term, and China's technological upgrading aspiration and trend growth in the longer run. The restrictions probably mean that **technology localization, capex in the technology supply chain, and R&D investment will likely accelerate and intensify** than would otherwise be the case.

Exhibit 66: Potential economic drag likely to peak in the middle of the decade



Source: Goldman Sachs Global Investment Research

Exhibit 67: R&D intensity has been rising in China, a prerequiste for Chinese companies to move up the value-added curve and improve China's technology independence

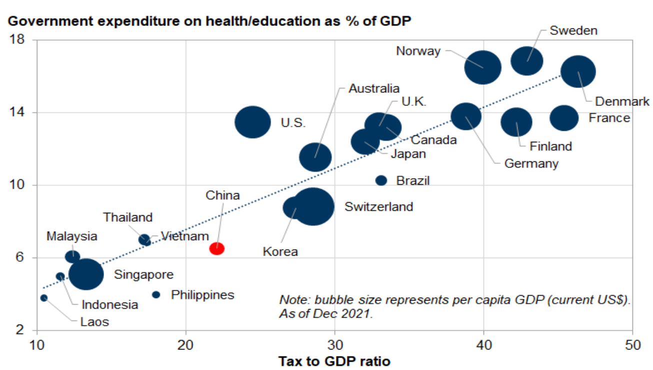


Source: Wind, FactSet, Goldman Sachs Global Investment Research

Socialism vs capitalism

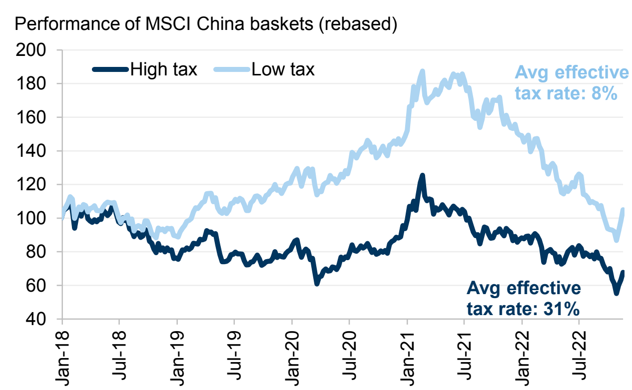
- It is out of the scope of this report to discuss the ideology of socialism, but if we simply look at it from a social welfare standpoint, the potential for China to expand/deepen its social safety net seems significant given its **low welfare (public) spending on a global basis**.
- As such, we see scope for broader and better coverage to be funded by higher taxes, as China also has lower tax/GDP ratios vs its global peers. In this vein, companies, mostly in the private sector, that have **enjoyed low corporate income taxes would be impacted disproportionately** if their tax burden were to rise, especially considering their outperformance over the years.

Exhibit 68: Higher social welfare expenditures in China could lead to higher taxes



Source: OECD, World Bank, Goldman Sachs Global Investment Research

Exhibit 69: Companies with low income taxes would be impacted disproportionately if their tax burden were to rise, especially considering their outperformance over the years

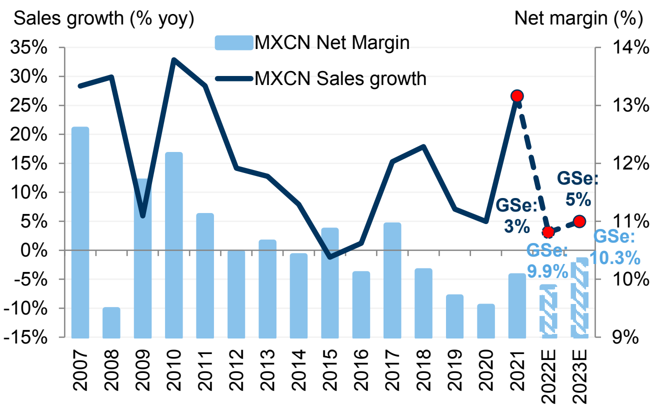


High/low tax: top/bottom 5 stocks within each GICS sector ranked by 5Y average effective tax rate.

Source: MSCI, FactSet, Goldman Sachs Global Investment Research

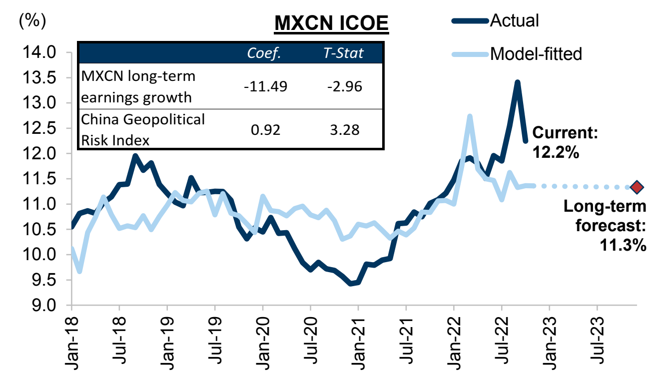
Appendix

Exhibit 70: We forecast topline to grow 5% in 2023 while net margin could improve moderately from low absolute levels



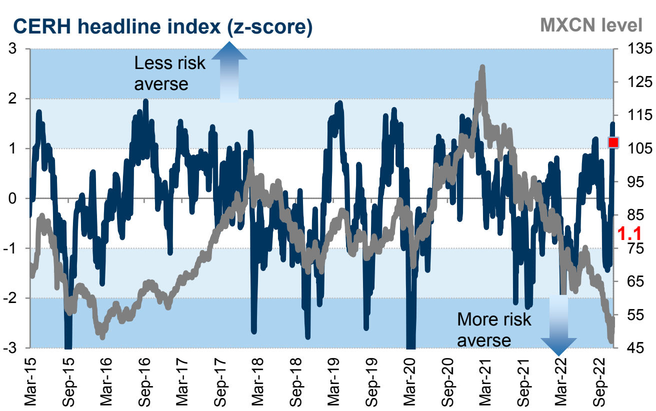
Source: MSCi, FactSet, Goldman Sachs Global Investment Research

Exhibit 71: Currently market implied COE is higher than what growth and geopolitical factors would suggest



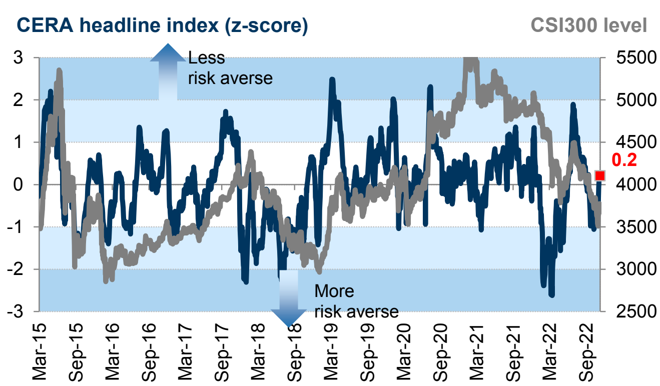
Source: MSCI, FactSet, Goldman Sachs Global Investment Research

Exhibit 72: Risk appetite has recently improved in the Offshore market on rising reopening hopes...



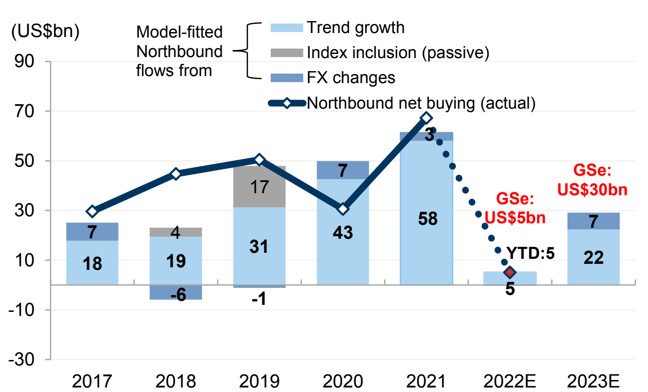
Source: FactSet, MSCI, Bloomberg, Goldman Sachs Global Investment Research

Exhibit 73: ...while that has remained broadly neutral in A shares



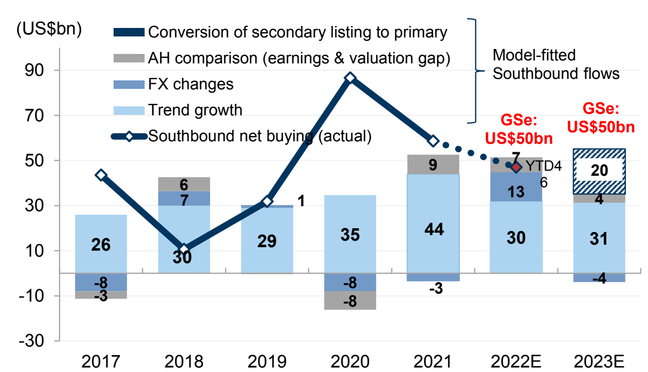
Source: FactSet, Wind, Bloomberg, Goldman Sachs Global Investment Research

Exhibit 74: We lower our Northbound flow forecast for this year from US$25bn to US$5bn, but expect US$30bn inflows in 2023



Source: Goldman Sachs Global Investment Research

Exhibit 75: We forecast US$50bn Southbound inflows in 2023E, helped by potential buying into new Southbound inclusion of dual-listed companies



Source: Goldman Sachs Global Investment Research

Disclosure Appendix

Reg AC

We, Kinger Lau, CFA, Timothy Moe, CFA, Si Fu, Ph.D. and Kevin Wang, CFA, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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