China Equity Strategy

Green shoots emerging?

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China

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Macro and bottom-up data showing improving fundamentals

Recent macro data showed some improvement with 1Q26 GDP growth of 5% YoY, at the top end of the government's annual target, and export growth also beating expectations at 15% YoY. From a bottom-up perspective, we also see sequential improvement, with business capex intentions improving (see note), industrial enterprise profits returning to 15% YoY growth and some life coming back to the property market and segments of consumption (e.g. hotels and catering). Notwithstanding events around the Strait of Hormuz which still pose downside risks to Chinese equities in an absolute sense, the improving fundamentals and China's relative resilience to energy shocks could see it perform better vs other regions near term. In the next 2 months, we see potential upside for both A-shares and H-shares, but for different reasons, with A-shares potentially benefiting more from solid industrial profit growth and H-shares (HSTECH in particular) potentially benefitting from relief in the case of a resolution of the anti-trust investigation into Trip.com, lessening competition in food delivery and the potential launch of the new DeepSeek and Hunyuan models.

Valuation and flows supportive for further upside

With the recent rally in the US and certain other Asian markets, MSCI China valuation is looking appealing again, trading on 0.5 std. dev. below the historical average relative to MSCI World. Both our monthly positioning data (see Figure 22) as well as flow data from EM countries (Figure 23) suggest foreign funds have sold out of EM markets in Feb and March around the time of the Iran conflict, and while investors have come back during recent weeks, positions are likely to remain lighter compared to prior to the Iran conflict. As such, there may be further upside to China's equity market should the Iran conflict be resolved, particularly as we see signs of improving fundamentals.

Near-term risks skewed to the upside, particularly for HSTECH

We think risks are skewed to the upside for HSTECH in the next 2 months as: 1) HSTECH is now close to the level of the end of Jan 2025, just before the "DeepSeek moment"; 2) potential benefit from relief in the case of a resolution of the anti-trust investigation into Trip.com; 3) potential for renewed optimism towards the Chinese internet sector from new DeepSeek and Tencent LLM (Hunyuan) model launch ; 4) EV demand may see some upside if oil prices stay higher for longer; 5) further commentary on food delivery competition easing in upcoming quarterly results; and 6) US President Trump's planned state visit to China in mid-May might ease concerns around US-China relations and result in commercial deals between Chinese and US companies. We would also watch for signs of shifting AI narrative - we have seen HSTECH correlate highly with the US software index (represented by IGV US) and it seems to have recovered recently (Figure 28). For A-share companies, 1Q26 earnings should also be decent given strong industrial profit growth in January and February - historically there is a high correlation of A-share non-financial companies' earnings with industrial profit.

Some inflation challenges remain, but China likely to be relatively better placed

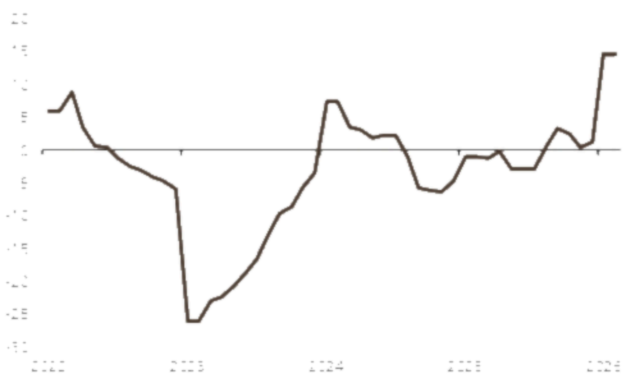
As global energy and commodity prices rise due to the Iran conflict, this could put some pressure on company margins in the coming quarters. That said, this is a global challenge and we do believe that the relative impact on Chinese companies will be less compared with other regions given: 1) ample strategic oil reserves, 2) lower usage of oil and gas in energy consumption and electricity production, 3) greater renewable and EV penetration, and 4) higher inflation could result in a change in inflation expectations and pull China out of deflation (see our note here). We continue to advise investors to have a balanced portfolio given the Iran conflict (see Figure 31) and our most preferred sectors include AI Tech hardware, power equipment and non-ferrous metals.

Improvements in macro backdrop

Recent domestic macro conditions may have been overshadowed by heightened geopolitical uncertainty in the Middle East. Nevertheless, several key macro indicators point to an improving underlying trend:

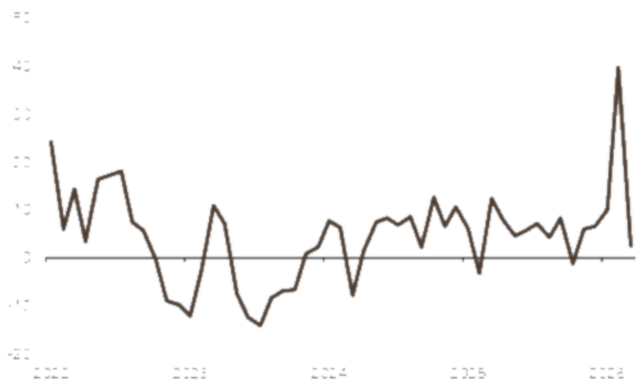
- Industrial profits accelerated substantively to 15% YoY in Jan–Feb 2026, marking the strongest growth since 2022;
- Resilient export growth despite the tariff impact since 2025 and recent geopolitical uncertainty;
- Retail sales held up well in 1Q (up 2.4%, faster than 4Q 1.7%), even against a high base from last year;
- High frequency property sales data showed sequential improvement, nevertheless there remain question marks over the sustainability of the recovery;
- PPI's turning less negative, suggesting faster nominal GDP growth. Historically there is a high correlation of listed company revenue growth and PPI.

Figure 1: China industrial enterprise profit YoY



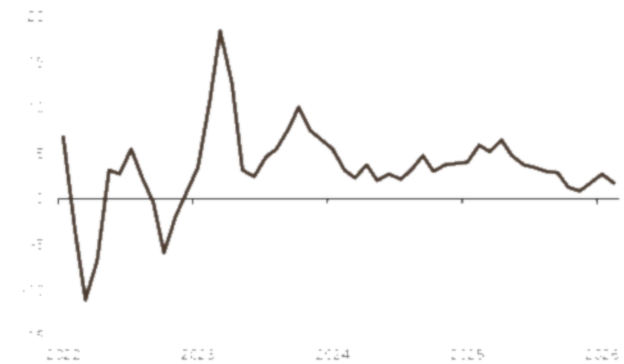
Source: CEIC, UBS

Figure 2: China export YoY



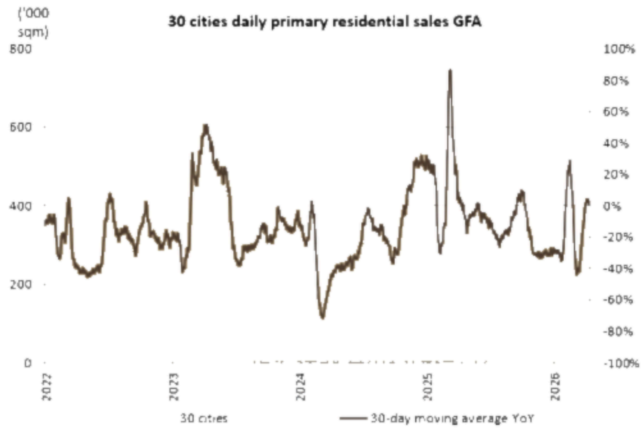
Source: Bloomberg, UBS

Figure 3: Retail sales YoY



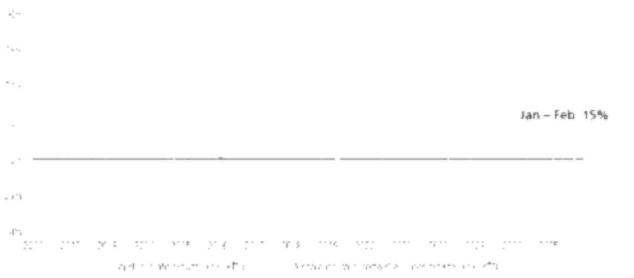
Source: CEIC, UBS

Figure 4: Primary residential property sales YoY



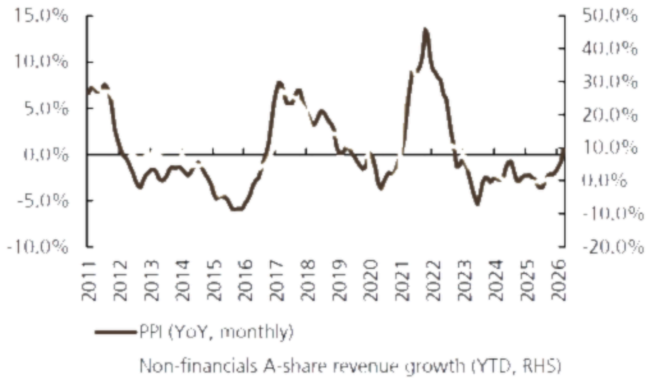
Source: Wind, UBS

Figure 5: A share non-financials earnings growth vs industrial enterprise profit YoY



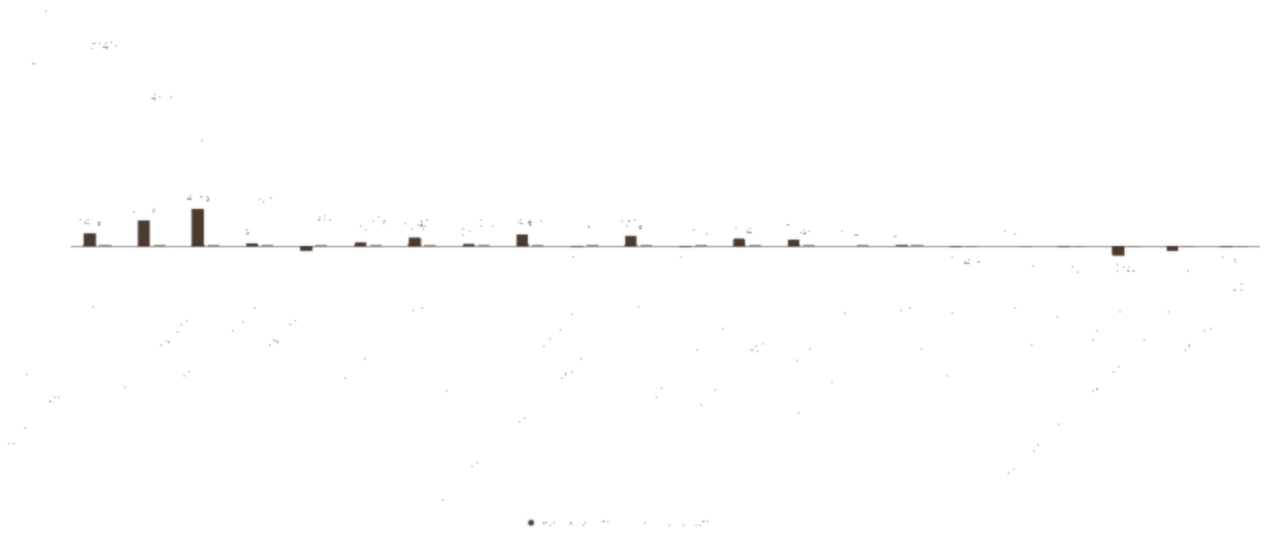
Source: Wind, CEIC, UBS

Figure 6: China PPI YoY vs A share non-financials revenue growth



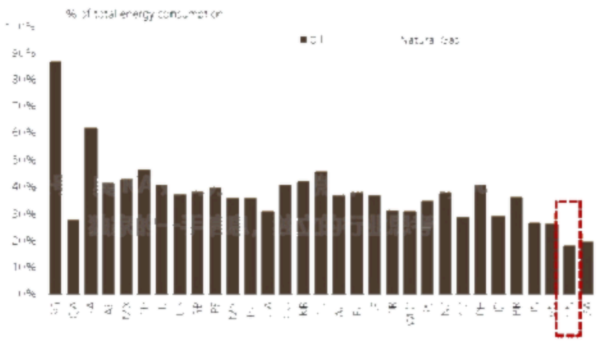
Source: NBS, UBS

Figure 7: 2026 Jan – Feb industrial revenue and profit growth by sector



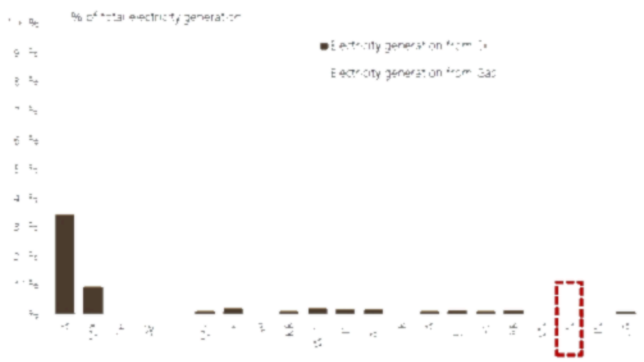
Source: NBS, UBS

Figure 8: Oil and gas as % of total energy consumption by economy



Source: Energy Research Institute, UBS

Figure 9: Oil and gas as % of total electricity generation by economy



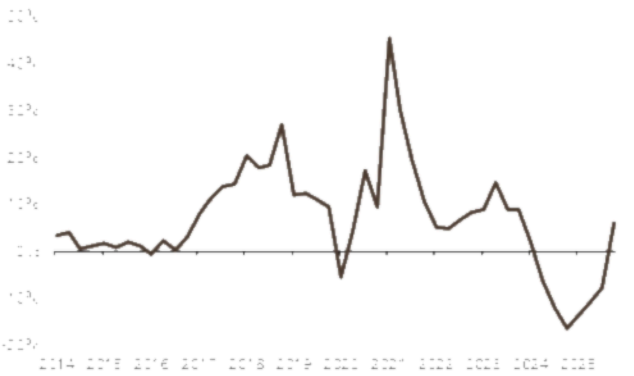
Source: Energy Research Institute, UBS

Bottom-up data also pointing to sequential improvement

From a bottom-up perspective, company data and guidance are also pointing to a more favourable outlook:

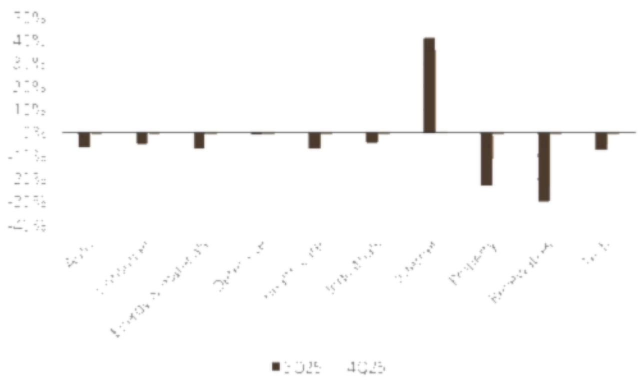
- Capex intentions seemed to be improving based on feedback from automation companies, and capex declines have eased in the most recent quarter;
- Improvement in the tourism sector with hotel RevPAR and domestic airfare up 4% and 22% YoY respectively;
- China Merchants Bank mentioned positive volume growth for on-line credit & debt card usage, for the first time in years;
- Robust growth in domestic excavator and HDT sales (we expect double-digit growth for these in 2026E);
- Moutai raised its ex-factory price by 9%, for the first time since Oct 2023.
- The worst of the competition among food delivery platforms seems to be behind us with companies guiding to lower losses going forward;
- Sportswear companies (Li Ning/ Anta) guided for better-than-expected revenue growth for 2026.

Figure 10: A-share non-financials quarterly capex growth



Source: FactSet, UBS

Figure 11: Trailing capex growth by sector

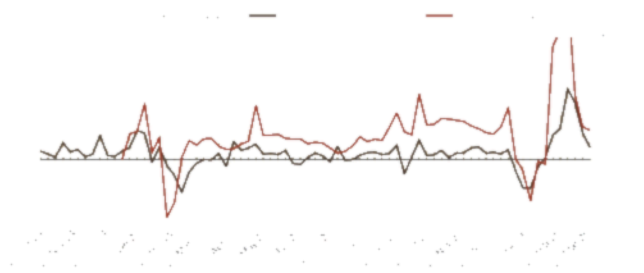


Source: FactSet, UBS, Based on MSCI China companies disclosures

Figure 12: China hotel RevPAR YoY

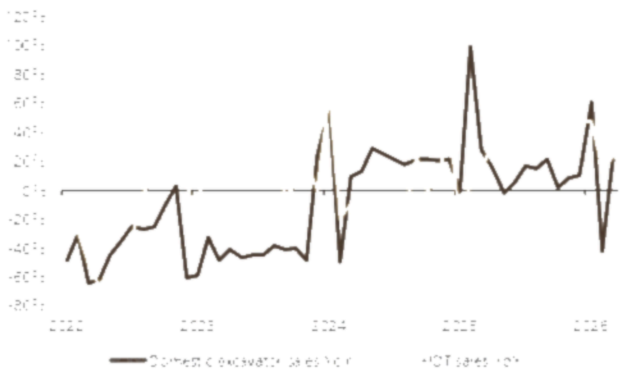
Source: STR

Figure 13: China weekly domestic air seat capacity, pax volume and airfare YoY



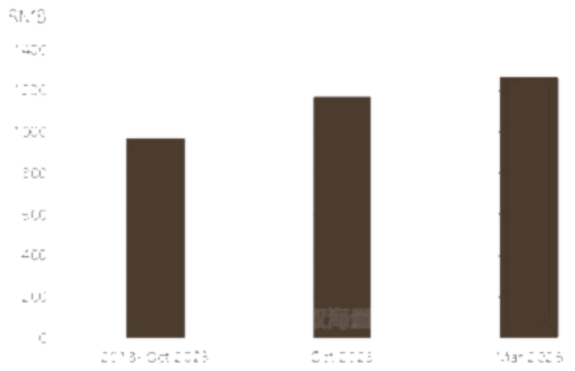
Source: Flight Master

Figure 14: Domestic excavator and heavy-duty truck sales YoY



Source: CEIC, UBS

Figure 15: 53% vol.500ml Fetian Moutai liquor ex-factory price



Source: Company announcement

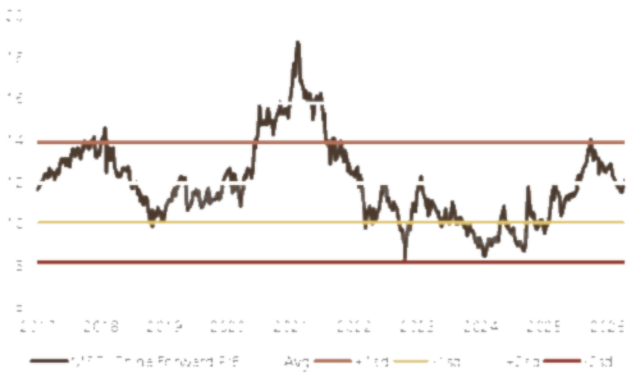
Figure 16: 1Q26 earnings result by sector so far

Sector	No. of companies reported	% weighting in MSCI China	Revenue growth	Earnings growth
Overall	**36**	**100%**	**16%**	**31%**
Financials	2	18%	-1%	-28%
Non-financials	34	82%	16%	33%
SOE	8	26%	6%	9%
Non-SOE	28	74%	28%	63%
Upstream	16	9%	32%	66%
Downstream	19	36%	5%	8%
Downstream (ex-property)	19	34%	5%	10%
Insurance	0	4%	N/A	N/A
Banks	0	9%	N/A	N/A
Internet	0	38%	N/A	N/A
Industrials	1	3%	74%	117%
Tech	7	5%	27%	91%
Energy & materials	15	6%	23%	85%
Consumer	3	13%	-17%	52%
Renewables	1	2%	52%	49%
Healthcare	3	6%	-2%	4%
Auto	1	5%	26%	2%
Defensive	3	3%	1%	-4%
Other Financials	1	2%	-17%	-15%
Property	1	3%	8%	-32%

Source: FactSet, UBS, note due to small sample size, the numbers can be quite volatile.

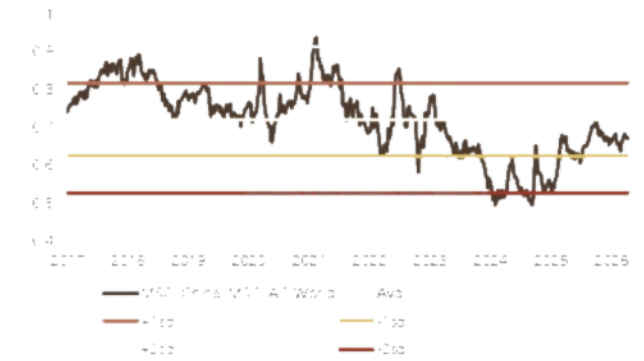
Foreign funds have exited EM in general in recent months

Figure 17: MSCI China forward P/E



Source: FactSet, UBS

Figure 18: MSCI China forward P/E relative to MSCI AC World



Source: FactSet, UBS

Figure 19: MSCI China trailing dividend yield

Source: FactSet, UBS

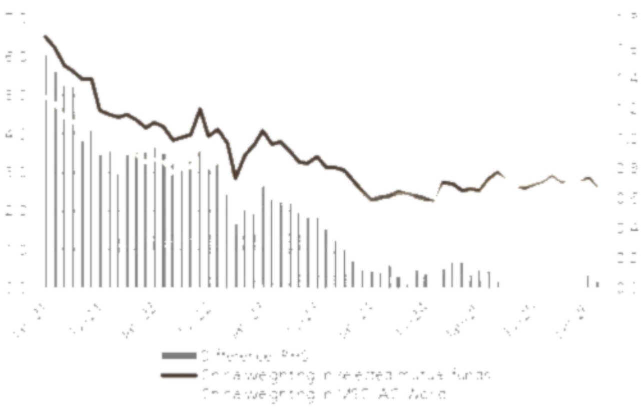
Figure 20: MSCI China forward FCF yield

Source: FactSet, UBS

Figure 21: Quarterly northbound net inflows

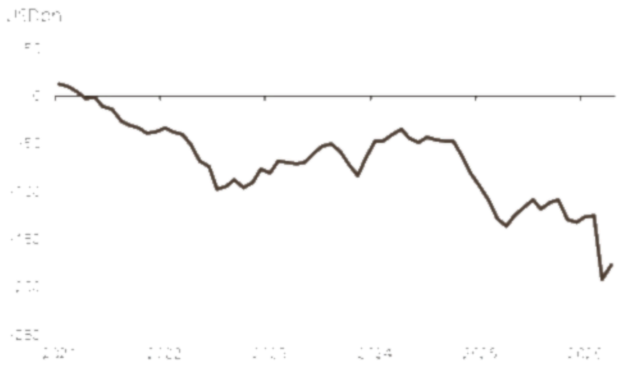
Source: Wind, UBS

Figure 22: Mutual fund positioning in Chinese equity (% of equity portfolio)



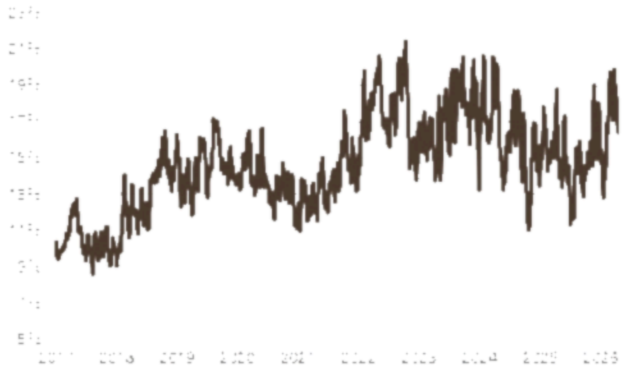
Source: FactSet, UBS Note: Data up to Feb 2026 A sample of c.900 funds reporting on monthly basis are included in this universe

Figure 23: Cumulative net inflows into EM ex-China equity markets



Source: Bloomberg, UBS Note: Brazil, India, Indonesia, Korea, Malaysia, Philippines, South Africa, Taiwan, Thailand are included. Last data point up to 21 Apr 2026 Data shown in monthly frequency

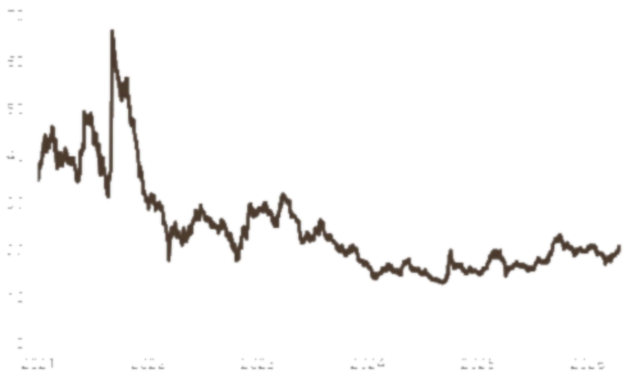
Figure 24: HK short selling turnover as % of total (7DMA)



Source: Bloomberg, UBS

HSTECH trading close to pre-DeepSeek levels

Figure 25: HSTECH forward P/E

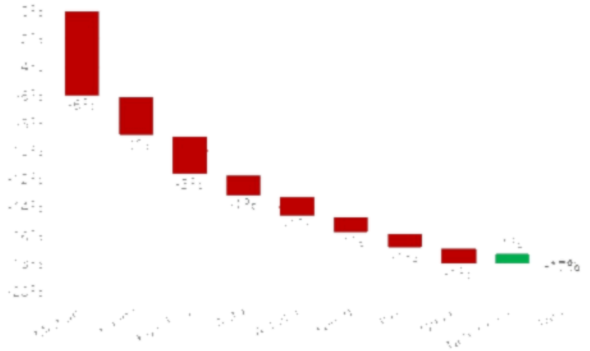


Source: FactSet, UBS

Figure 26: HSTECH share price performance

Source: FactSet, UBS

Figure 27: FY26 3-month consensus earnings revision breakdown for HSTECH

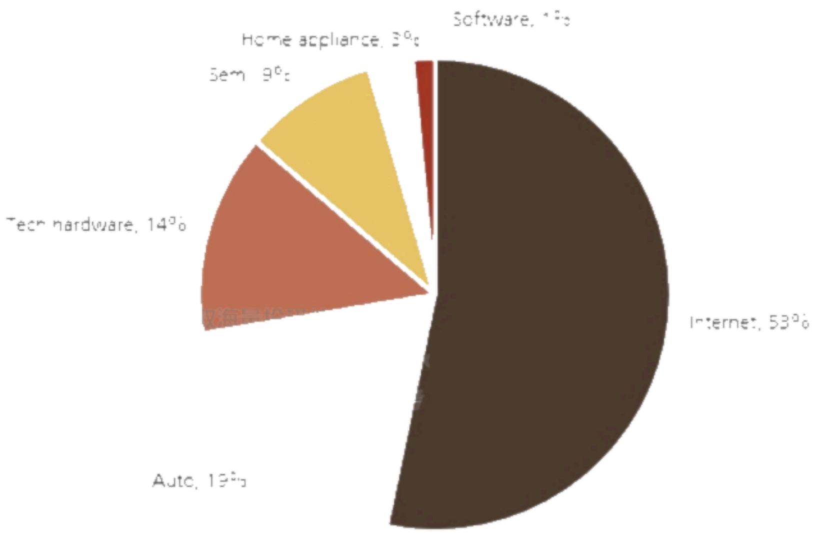


Source: FactSet, UBS

Figure 28: HSTECH vs US software companies

Source: FactSet, UBS

Figure 29: HSTECH sector weighting



Source: FactSet, UBS

Sector preferences and model portfolio

Figure 30: Sector preferences

Most preferred	Least preferred
Tech hardware	Construction
Brokers	Auto OEM
Internet	Software
"Going Abroad" stocks	Consumer
Copper & Gold	Property
Electrical equipment	

Source: UBS

Figure 31: Model portfolio

Most preferred names										
Stock Code	Company name	Lead analyst	UBS rating	Last close	Price target	FY26 P/E	UBSe FY26 EPS growth	UBSe vs consensus FY26 earnings	Forward div yield	YTD return
9618 HK	JD.com - H	Kenneth Fong	Buy	118.60	187.00	8.5	5%	13%	3%	11%
9888 HK	Baidu	Wei Xiong	Buy	120.50	165.00	14.8	-31%	-3%	2%	-6%
3606 HK	Fuyao Glass	Nora Min	Buy	62.25	93.00	13.3	17%	3%	5%	-6%
601688 CH	Huatai Securities - A	Frank Zheng, CFA	Buy	19.08	27.36	9.4	13%	-3%	4%	-18%
2899 HK	Zijin Mining Group - H	Sharon Ding	Buy	36.86	57.00	10.4	63%	11%	3%	6%
002371 SZ	NAURA Technology Group	Jimmy Yu	Buy	475.00	565.80	51.5	21%	-15%	0%	4%
0700 HK	Tencent Holdings	Kenneth Fong	Buy	495.40	780.00	13.7	10%	2%	1%	-16%
GDS O	GDS	Sara Wang	Buy	43.16	62.00	N/A	N/A	220%	0%	24%
300750 SZ	Contemporary Amperex Technology	Paul Gong	Buy	438.90	500.00	21.9	24%	0%	2%	21%
600183 CH	Shengyi Technology	Jimmy Yu	Buy	74.95	85.00	N/A	N/A	4%	3%	6%
1072 HK	Dongfang Electric Corporation	Ken Liu	Buy	43.12	68.00	N/A	N/A	18%	2%	66%
002837 SZ	Shenzhen Envicool Technology Co., Ltd	Sara Wang	Buy	100.68	160.00	N/A	N/A	39%	0%	-3%
0883 HK	China National Offshore Oil Corporation	Amily Guo	Buy	27.68	37.80	6.3	46%	14%	6%	26%
1211 HK	BYD Company Limited	Paul Gong	Buy	103.40	128.00	21.2	23%	-6%	1%	12%
2359 HK	WuXi AppTec	Chen Chen, PhD	Buy	122.60	154.10	19.1	-15%	0%	2%	24%
002532 SZ	Tianshan Aluminum Group	Bei Wang	Buy	17.67	23.00	9.0	58%	-1%	6%	12%
002714 SZ	Muyuan Foods	Nina Jiang	Buy	43.49	60.50	53.1	-71%	40%	4%	-12%
YAZG S	Yangzijiang Shipbuilding	Kunjun Li	Buy	4.19	5.10	8.6	20%	9%	6%	21%
603606 SS	Ningbo Orient Wires & Cables	Yishu Yan	Buy	65.91	78.00	24.4	47%	-5%	1%	12%
002648 SZ	Zhejiang Satellite Chemical	Amily Guo	Buy	27.38	36.80	10.9	59%	-6%	3%	50%
2259 HK	Zijin Gold International	Sharon Ding	Buy	160.10	283.00	18.0	101%	-7%	1%	16%
002850 SZ	Shenzhen Kedali Industry	Nora Min	Buy	205.87	268.00	23.0	40%	4%	1%	33%

Source: UBS estimates, FactSet consensus

Valuation Method and Risk Statement

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.