China Equity Strategy

A fresh start after deleveraging - Drivers, headwinds, and crowdedness

Equity Strategy

China

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Deleveraging nearing the end; steady A-share rally may continue within 2026

Major global equity markets and tech sectors fell sharply in July 2026. We attribute A-share weakness mainly to a cooling tech narrative and rising inflation risks, amplified by rapid deleveraging and crowded positioning. The A-share market has stabilised and rallied since August, amid rebounding global tech stocks and continued net inflows into ETFs, while deleveraging is nearing the end (report). We expect the rally to continue through 2026, albeit at a measured pace, supported by: 1) a sustained earnings recovery, with Q2–Q3 2026 growth likely exceeding Q1 and margins potentially expanding; 2) gradual household asset reallocation and hedge fund/ETF inflows driving re-rating; 3) the UBS global equity strategy team's positive tech view, as AI demand shifts from thematic trading to verifiable revenue and order growth; and 4) lower implied volatility in tech, signalling reduced tail risks and crowded-trade unwinding.

What factors could hinder the rally in the near term?

Although tech may remain a key global equity theme, geopolitical risks and volatility in US Treasury yields and oil prices could affect interest-rate-sensitive valuations through inflation expectations, US dollar liquidity and risk appetite. Any AI discussion at a China-US leaders' meeting could also shape expectations for global value chains and supply-chain stability. Meanwhile, mutual funds (MFs), already substantially overweight tech (report), are unlikely to add further. Potential break-even redemptions could also cap the A-share rally, with tech-focused active MFs that expanded rapidly in Q226 facing greater pressure after the rebound. Although the broader tech sector's turnover share has eased from its peak, it remains historically high. A rapid near-term return of leveraged funds is unlikely, as re-risking takes time.

Tactical style and sector allocation

Expecting a steady market rally, we favour growth. However, persistent uncertainty around the global tech narrative supports allocating to value, especially high-dividend sectors benefiting from continued insurer inflows. Further macro easing in China could create selective opportunities in pro-cyclical sectors, while recovering industrial earnings warrant attention to cyclicals. Ample liquidity and high turnover support small/mid-caps, but sector ETF expansion favours industry leaders and limits further small/mid-cap outperformance, suggesting more balanced relative returns versus large-caps. We recommend overweighting electronics, telecoms, machinery, non-ferrous metals, chemicals, electrical equipment and non-bank financials.

Our top A-share picks under UBS-S coverage

Stock code	Name	Rating	Mkt cap (Rmb 100mn)	Last price (Rmb)	Price Target (Rmb)	Upside	Avg. daily t/o (RMB 100mn)	EPS growth 2026E	EPS growth 2027E	PE 2026E	PB 2026E
688825.SS	CXMT	Buy	39,192	58.60	70.00	19%	306.14	6667%	126%	26.64	15.41
002371.SZ	NAURA Technology	Buy	5,062	697.51	800.00	15%	88.37	23%	71%	74.56	11.50
600150.SS	CSSC	Buy	2,617	34.78	52.00	50%	33.22	139%	29%	13.44	1.64
600309.SS	Wanhua Chemical	Buy	2,450	78.04	126.00	61%	29.24	53%	15%	12.71	1.98
600176.SS	China Jushi	Buy	1,729	43.20	58.00	34%	106.34	158%	82%	20.41	4.54
600584.SS	JCET Group	Buy	1,341	74.93	135.00	80%	159.83	72%	53%	49.83	4.30
300866.SZ	Anker Innovations	Buy	665	124.10	155.00	25%	5.10	24%	24%	21.00	5.50
002850.SZ	Kedali	Buy	487	177.30	268.00	51%	11.56	40%	38%	19.80	3.22
688686.SS	OPT	Buy	166	136.00	176.00	29%	3.19	35%	47%	65.78	5.18
605060.SS	Allied Machinery	Buy	102	42.31	135.00	219%	2.70	42%	65%	32.94	3.79

Source: Wind, UBS-S estimates. Note: Data as of 28 August 2026.

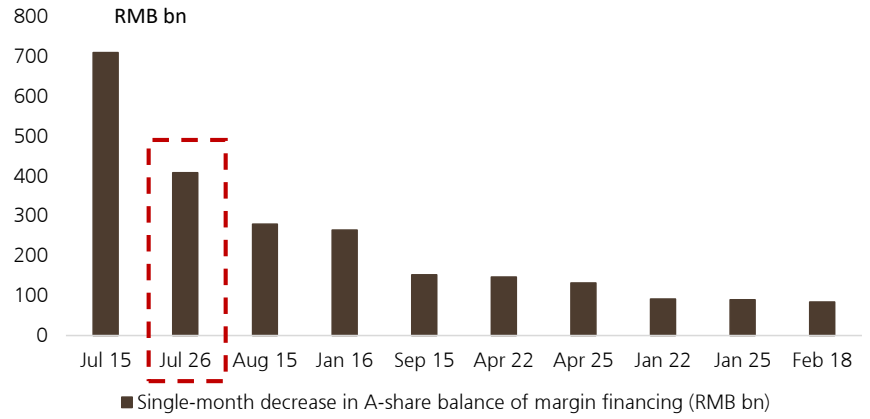
This report has been prepared by UBS Securities Asia Limited. **ANALYST CERTIFICATION AND REQUIRED DISCLOSURES, INCLUDING INFORMATION ON THE QUANTITATIVE RESEARCH REVIEW PUBLISHED BY UBS, BEGIN ON PAGE 17.**

A-share market becoming range-bound after sharp correction in July

Major global equity markets and tech sectors corrected sharply in July 2026. Nasdaq 100, KOSPI, Nikkei 225, STAR 50, and ChiNext indices fell 6.6, 22.2, 8.1, 25.9, and 23.0ppt in July, respectively. We mainly ascribe global tech corrections to the cooling tech narrative and rising inflation risks, while rapid deleveraging and previously elevated trade crowdedness further amplified the correction pressure.

The balance of margin financing in the A-share market has declined rapidly after reaching an all-time high of Rmb3.01trn on 25 June. We note a sharp decrease of Rmb408bn in the aggregate balance of margin financing in July, the second-largest monthly decline on record, surpassed only by the Rmb709.2bn reduction in July 2015. The decline also exceeded the drawdowns seen during the August 2015 market sell-off, the January 2016 circuit breaker episode, the April 2022 COVID-19 resurgence, and the April 2025 escalation in China-US trade tensions. The margin financing balance of the greater tech sector (including electronics, telecoms, computers and national defence) also shrank substantially, with a decrease of Rmb206.6bn in July from end-June.

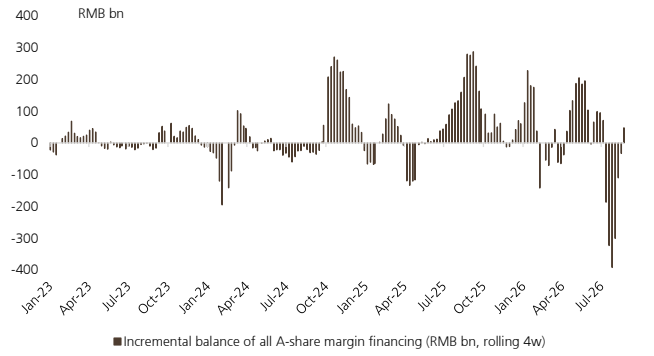
Figure 1: Historical top-10 single-month decreases in A-share balance of margin financing



Source: Wind, UBS-S

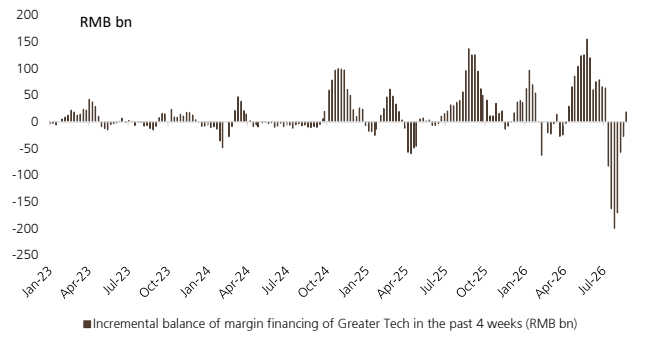
We note a sharp Rmb408bn decline in the aggregate balance of margin financing in July, the second-largest monthly decline on record, surpassed only by the Rmb709.2bn reduction in July 2015. The decline also exceeded the drawdowns seen during the August 2015 market sell-off, the January 2016 circuit breaker episode, the April 2022 COVID-19 resurgence, and the April 2025 escalation in China-US trade tensions.

Figure 2: A-share market's rolling four-week incremental balance of margin financing



Source: Wind, UBS-S; Note: Data as of 27 August 2026.

Figure 3: Greater tech sector's rolling four-week incremental balance of margin financing

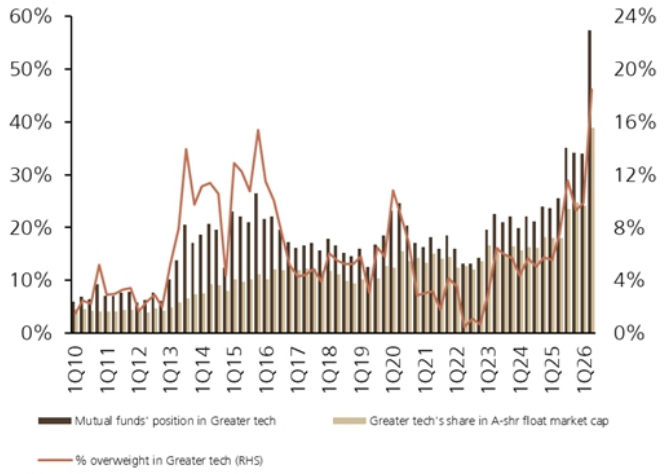


Source: Wind, UBS-S. Note: Greater tech sector includes electronics, telecom, computers and national defence. Data as of 27 August 2026.

Besides, elevated positioning crowdedness in some sectors such as electronics and telecoms amplified short-term volatility in end-Q226. In MFs' Q2 reports, we note a significant rise in MFs' overweight ratio in the greater tech sector to an all-time high of 18.5%, not only exceeding the previous peak of 16.2% in Q415, but also nearing the

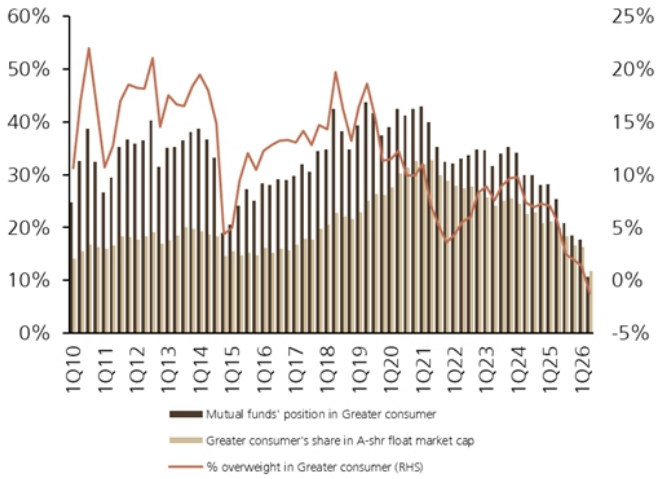
historical peak of 22.8% for the greater consumer sector in Q310. We define actively managed track funds as those where at least seven of the 10 largest holdings are from a specific sector and their combined weighting tops 50%. We note the size of actively managed tech track funds has expanded rapidly as a share of total actively managed MF assets since Q225, to a record high of 27.5% in Q226, well above the share of actively managed consumer track funds in 2019.

Figure 4: MFs' overweight ratio in the greater tech sector rose sharply in Q226



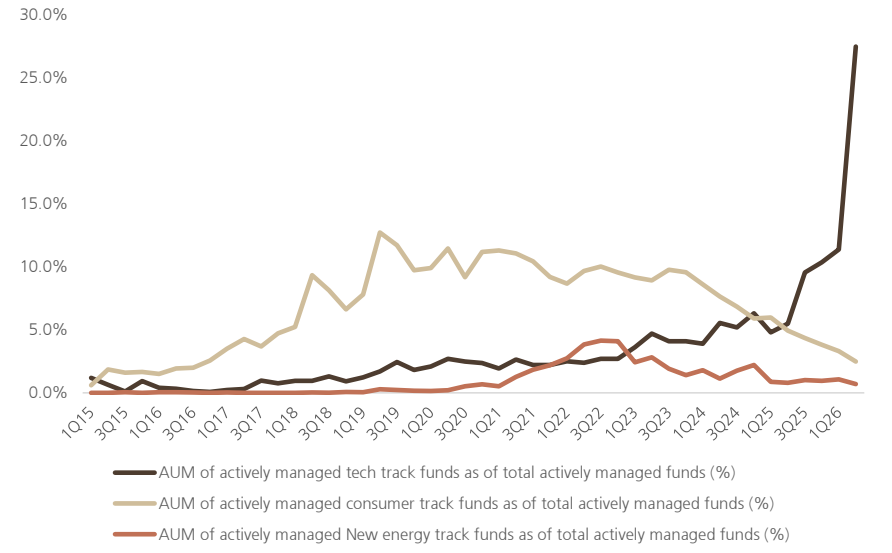
Source: Wind, UBS-S estimates. Note: The greater tech sector includes electronics, telecom, computers and national defence.

Figure 5: MFs' position/overweight ratio in the greater consumer sector



Source: Wind, UBS-S estimates. Note: The greater consumer sector includes agriculture, food and beverage, healthcare, home appliances, textile, light manufacturing, social services, commercial trade, beauty treatments and conglomerates.

Figure 6: AUM of actively managed tech, consumer and new energy track funds as % of total actively managed funds



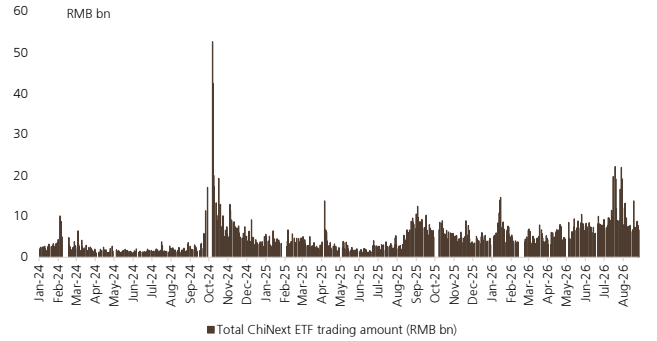
Source: Wind, UBS-S estimates. Note: We define actively managed track funds as those where at least seven of the ten largest holdings are from a specific sector and their combined weighting tops 50%. Tech funds cover electronics, telecoms, computer and national defence. Consumer funds cover agriculture, food and beverage, healthcare, home appliances, textile, light manufacturing, social services, commercial trade, beauty treatments and conglomerates. New energy funds cover electrical equipment, utilities and autos.

We define actively managed track funds as those where at least seven of the 10 largest holdings are from a specific sector and their combined weighting tops 50%. We note the size of actively managed tech track funds has increased rapidly as a share of total actively managed MF assets since Q225, to a record high of 27.5% in Q226.

Nonetheless, positive factors are building up. The A-share market has shown signs of stabilisation and recovery since August, becoming range-bound. First, the global tech sector has rebounded notably. Meanwhile, a number of long-term investors publicly expressed a bullish view on the A-share market. On the evening of 19 July, China Chengtong and China Reform Holdings, two state-owned capital operating companies,

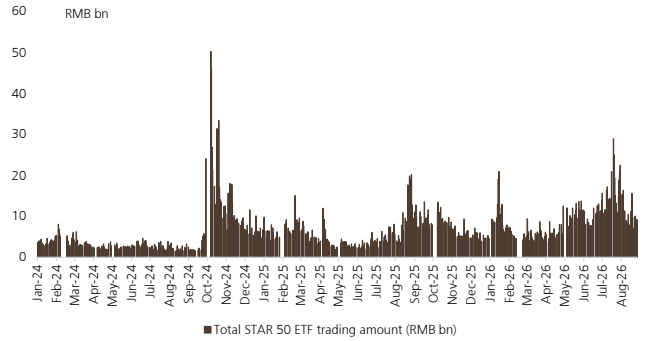
announced that they remain firmly optimistic about China's capital market. Many insurers also reiterated their commitment to helping stabilise the capital market. We note that turnover of some broad-based ETFs expanded rapidly during the recent sharp market pullback, followed by sustained large-scale net inflows over several subsequent trading days. Unlike the 2024-25 episode, when large net inflows mainly went to CSI 300 ETFs, recent net inflows have been spread across CSI 300 ETFs, ChiNext ETFs and STAR 50 ETFs.

Figure 7: Daily turnover of ChiNext ETFs



Source: Wind, UBS-S. Note: Data as of 27 August 2026.

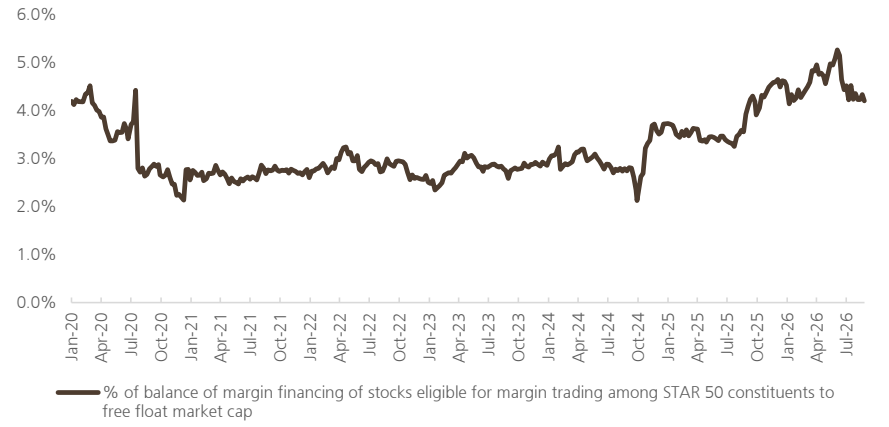
Figure 8: Daily turnover of STAR 50 ETFs



Source: Wind, UBS-S. Note: Data as of 27 August 2026.

Following the rapid decrease in the balance of margin financing in July, the balance of margin financing as a percentage of free-float market cap across sectors is at historically reasonable levels in our view (see note). As of 27 August 2026, the balance of margin financing of STAR 50 constituents eligible for margin trading represented 4.2% of free-float market cap, slightly below the 5.0% level for the overall A-share market. Similarly, the balance of margin financing as a percentage of free-float market cap for ChiNext edged down over the past quarter, only slightly above the broader market in absolute terms.

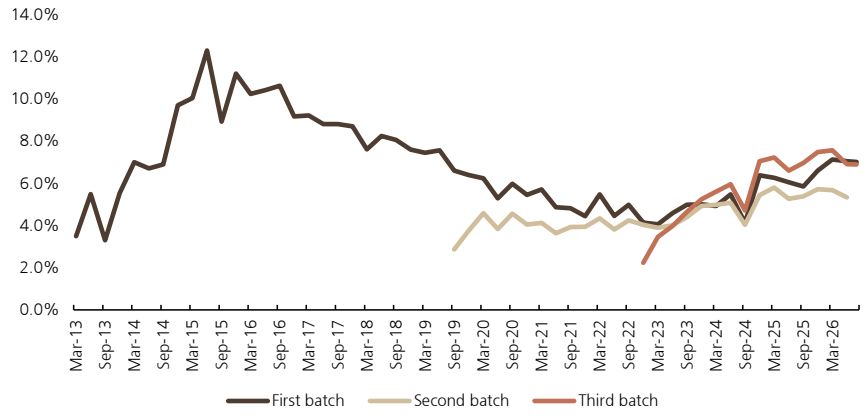
Figure 9: Balance of margin financing as a % of free-float market cap for STAR 50 constituents eligible for margin trading



Source: Wind, UBS-S. Note: Data as of 27 August 2026.

As of 27 August 2026, the balance of margin financing of STAR 50 constituents eligible for margin trading represented 4.2% of free-float market cap, slightly below the overall A-share market's.

Figure 10: Balance of margin financing as a % of aggregate free-float market cap for three batches of ChiNext stocks (classified by the date they became eligible for margin trading)



Source: Wind, UBS-S. Note: First batch consists of ChiNext stocks that were eligible for margin trading before 2Q19; Second batch consists of stocks that became eligible between 2Q19 and 3Q22; Third batch consists of stocks that became eligible after 3Q22.

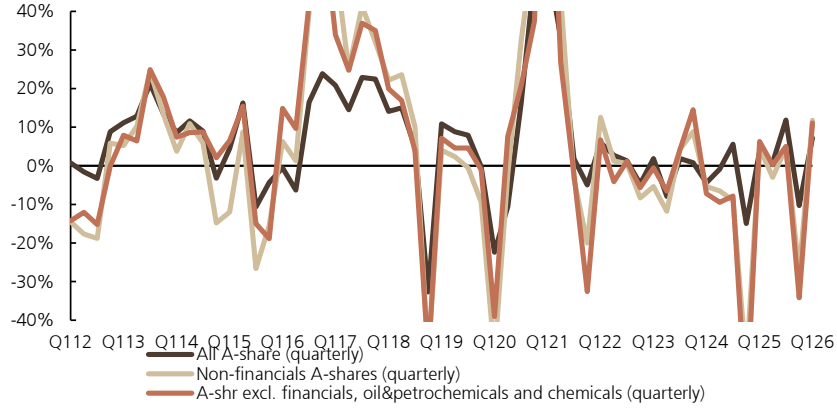
We divide ChiNext stocks eligible for margin trading into three batches and calculate the ratio of balance of margin financing to the aggregate free-float market cap of each batch. We found the ratios dropped mildly in the past quarter, which was 7.1%/5.3%/7.2% for the first/second/third batch, only slightly above the broader market.

The market rally may continue at a steady, measured pace

For the remainder of the year, we expect the A-share market to extend its rebound, albeit at a moderate pace. Four key factors underpin our constructive market view: 1) the ongoing recovery in A-share earnings; 2) the prospect of further net inflows from a broad range of investors; 3) a still-supportive global tech sector narrative; and 4) the decline in implied volatility across the tech sector.

We project full-year A-share earnings growth to rise to 11% in 2026, up from 3.9% in the prior year, with Q2/Q3 earnings growth likely set to outpace Q1. Aggregate A-share earnings registered 7.2% YoY growth in Q126, while non-financial sectors delivered an 11.8% YoY earnings expansion. If nominal GDP growth picks up alongside rising inflation, top-line growth for A share companies is likely to improve correspondingly.

Figure 11: Aggregate A-share earnings growth (quarterly YoY)

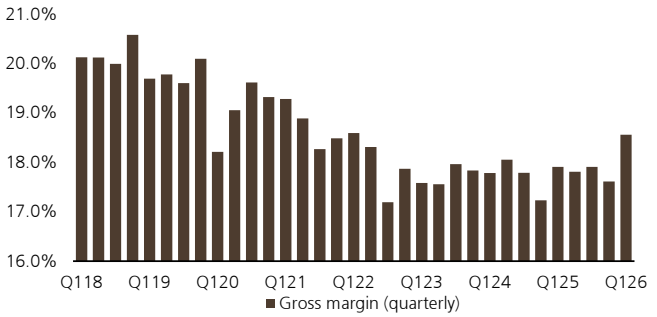


Source: Wind, UBS-S estimates

Alongside the acceleration in revenue growth, profit margins have also continued to expand. In our view, A-share margin expansion is primarily driven by two structural themes: going global and anti-involution initiatives. On one hand, an increasing number of globally competitive Chinese companies are expanding into overseas markets. This is not only unlocking new revenue streams, but also improving the revenue mix, enhancing economies of scale, and strengthening pricing power in selected high-value-

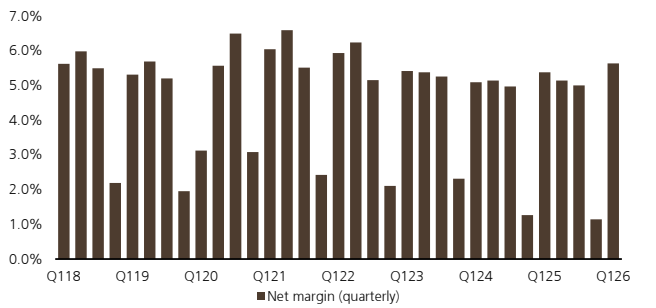
added segments. On the other hand, domestic anti-involution policies and industry self discipline could curb excessive and disorderly competition. This fosters an optimised supply landscape and restores pricing discipline, potentially lifting corporate gross margins and overall earnings quality.

Figure 12: Non-financial A-share quarterly gross margin



Source: Wind, UBS-S estimates

Figure 13: Non-financial A-share quarterly net margin

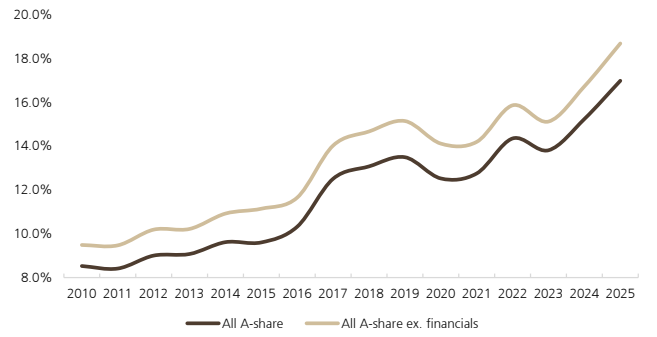


Source: Wind, UBS-S estimates

We note overseas revenue exposure among A-share companies has trended higher in recent years. In 2025, overseas revenue for non-financial A-share firms climbed further to 18.7%, nearly doubling from 9.5% in 2010. Given that overseas businesses generally command higher profit margins, rising overseas revenue contributions provide a meaningful boost to A-share firms and their overall earnings. We aggregated data for non-financial A-share firms disclosing overseas operations and compared historical domestic versus overseas margin profiles. The results show that gross margins from overseas businesses consistently outperform those from domestic operations. The margin gap widened to 2.8ppt in 2025, from 2.2ppt in 2024.

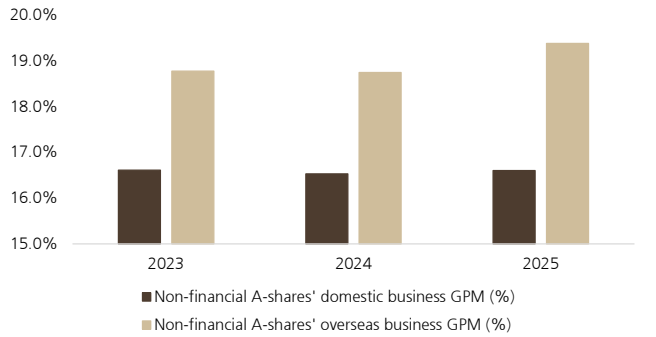
At the sector level, we found that 20 out of 31 sectors recorded higher gross margins for overseas businesses relative to domestic operations in 2025. Among them, media, healthcare, machinery, computer, non-ferrous metals, telecom and electronics posted a domestic overseas gross margin premium of over 7ppt.

Figure 14: Overseas revenue contributions for all A-shares continue to rise



Source: Wind, UBS-S estimates. Note: The CSRC does not mandate disclosure of overseas revenue. In 2025, 3,858 A-share companies disclosed their overseas revenue, while 1,666 did not

Figure 15: Domestic vs overseas GPM for non-financial A-shares that disclosed overseas revenue



Source: Wind, UBS-S estimates. Note: Data aggregated from non-financial A-share companies reporting overseas revenue. The top 5 business segments were included. Total reporting companies: 3,689 in 2023, 3,745 in 2024 and 3,818 in 2025

Figure 16: A-share companies' domestic overseas gross margin comparison (by sector)

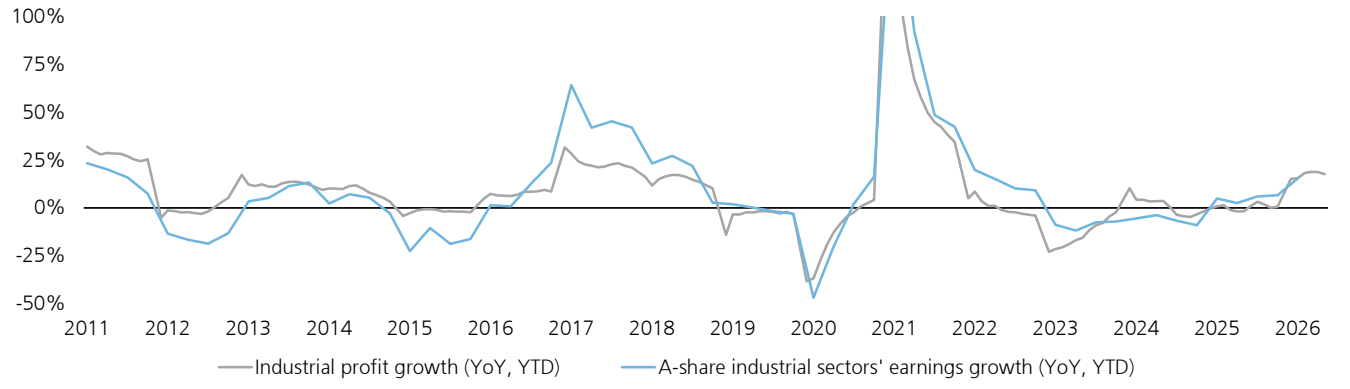
	Overseas GPM (%)			Domestic GPM (%)		
	2023	2024	2025	2023	2024	2025
Real estate	1.4%	9.2%	10.1%	13.6%	12.6%	12.9%
Computer	35.3%	31.1%	35.3%	24.9%	23.0%	24.2%
Commercial trade	12.1%	12.9%	15.0%	14.2%	13.9%	14.4%
Machinery	27.5%	27.6%	28.8%	18.6%	17.7%	17.1%
Electrical equipment	23.0%	22.0%	21.0%	17.7%	14.7%	15.0%
Construction	10.3%	10.0%	9.8%	10.9%	11.0%	10.9%
Building materials	22.7%	5.9%	25.0%	16.0%	18.4%	20.5%
Home appliances	24.0%	23.0%	23.1%	26.9%	25.4%	24.5%
Textile	22.7%	23.4%	22.9%	22.9%	22.6%	24.0%
Agriculture	11.2%	12.2%	13.0%	5.6%	10.9%	10.5%
Electronics	17.3%	17.4%	17.9%	16.0%	11.4%	10.8%
Conglomerates	19.3%	19.0%	19.3%	10.1%	11.0%	14.4%
Utilities	20.3%	20.1%	16.9%	17.4%	18.8%	21.2%
Healthcare	41.1%	43.1%	48.1%	28.9%	29.0%	27.4%
Auto	18.1%	19.7%	19.0%	15.0%	15.1%	14.9%
Environmental protection	25.3%	25.9%	24.1%	25.1%	26.1%	25.6%
Petrochemicals	8.5%	6.3%	7.1%	1.6%	2.7%	2.9%
Non-ferrous metals	14.3%	18.0%	19.8%	9.4%	9.2%	11.4%
Telecom	31.3%	28.4%	32.7%	26.4%	25.7%	24.8%
Transportation	4.8%	4.5%	4.5%	4.7%	5.0%	4.9%
Media	57.1%	53.6%	55.7%	30.4%	29.9%	29.3%
Chemicals	18.1%	17.6%	17.7%	14.7%	14.3%	14.1%
Social services	27.8%	27.1%	25.4%	20.6%	18.9%	21.5%
Light manufacturing	25.7%	25.0%	24.7%	20.3%	19.7%	18.4%
National Defence	17.0%	5.5%	20.1%	20.5%	20.0%	14.1%
Food and beverage	29.2%	29.2%	27.8%	49.4%	51.9%	58.3%
Coal	13.4%	14.6%	25.7%	18.0%	16.1%	19.7%
Beauty treatments	40.2%	38.4%	38.4%	52.9%	55.7%	49.3%
Steel	10.8%	7.7%	10.9%	5.5%	4.3%	6.8%

Source: Wind, UBS-S estimates. Note: Data aggregated from non-financial A-share companies reporting overseas revenue. The top 5 business segments were included. Total reporting companies: 3,689 in 2023, 3,745 in 2024 and 3,818 in 2025

Recent July macro prints point to softening momentum in GDP-correlated indicators including industrial output and services activity, which may pose headwinds to Q3 performance and full-year growth targets. Nevertheless, UBS-S China macro team believes weak data is not entirely negative; it may strengthen the case for further policy support. With policymakers attaching high priority to economic stability and regulatory tightening likely set to ease marginally, fiscal disbursement could accelerate, and monetary policy may stay accommodative to underpin growth.

From a bottom-up perspective, recently, profits of industrial enterprises above a certain size have picked up markedly. In 7M26, these enterprises' profits rose 17.6% YoY. Computer, communications and other electronic manufacturing companies saw a substantial 105.0% YoY profit expansion. Meanwhile, upstream sectors also delivered robust earnings growth in 7M26: non-ferrous metals, mining, coal mining posted profit growth of 74.9%/34.9%/50.4% YoY respectively; oil & gas extraction swung to profitability with 15.4% YoY profit growth in the period. Historically, industrial enterprise profit data released by the NBS demonstrates a strong correlation with earnings of A-share industrial sectors. We believe improving Q2 industrial profit growth signals further earnings recovery for A-share companies.

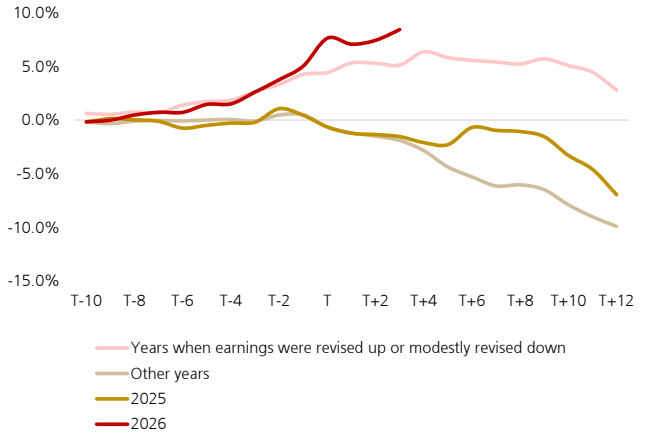
Figure 17: Industrial enterprise profit growth (NBS) vs. earnings growth of A-share industrial sectors



Source: Wind, NBS. Note: A-share industrial sectors include coal, light manufacturing, food & beverage, textiles, building materials, chemicals, healthcare, steel, non-ferrous metals, machinery, national defence, auto, electrical equipment, computer, telecom, electronics, home appliances, utilities and oil & petrochemicals.

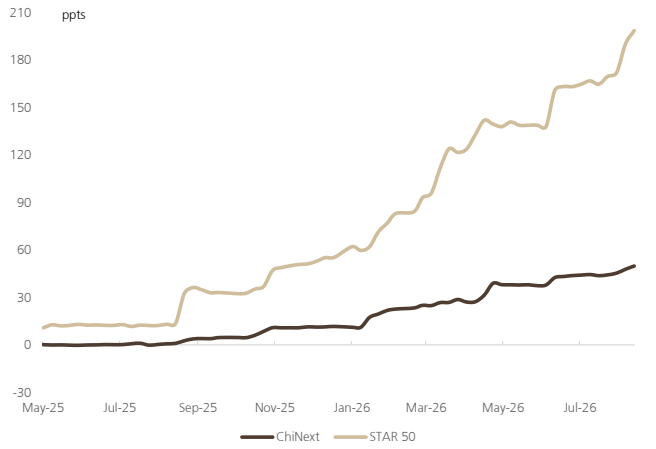
Notably, consensus earnings estimates have continued to see upward revisions lately. Since 2014, consensus earnings forecasts for the CSI 300 have generally been revised downward as the year progresses. That said, in years with robust earnings backdrops such as 2017, 2019 and 2021, consensus forecasts for the CSI 300 continued to be upgraded during the first half. Recent data shows a marked upward revision to the CSI 300's 2026 earnings forecast, following a trajectory similar to historical periods of sustained upgrades. We therefore believe A-share earnings growth could accelerate in the remainder of 2026. At the sector level, consensus 2026 earnings forecasts for information technology, materials, property and energy have each been raised by more than 20ppt over the past six months. Upward revisions have been even more pronounced for tech-heavy major indexes such as the ChiNext and the STAR 50, whose consensus earnings forecasts have been raised by 50ppt and 200ppt, respectively, since May 2025.

Figure 18: Consensus earnings revisions for CSI 300 (2014-2026F)



Source: Go-goal, UBS-S. Note: T refers to market earnings growth expectations for CSI 300 by Go-goal in April of each year – eg, T month in 2023 refers to April 2023; years when expectations were revised up or slightly down include 2017, 2019 and 2021.

Figure 19: Consensus estimates for 2026 earnings growth of ChiNext Index and STAR 50 Index have seen continuously upward revisions

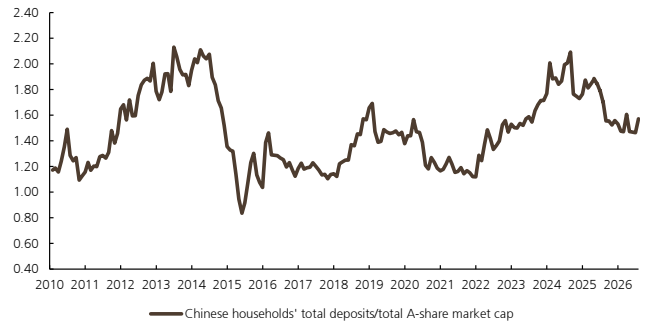


Source: Go-goal, UBS-S

Besides the A-share earnings recovery and macro policy loosening, we think the scope for various sources of capital to further increase their A-share allocations also merits attention from investors. We think factors such as (but not limited to) reallocation of household savings, the continued boom in new hedge fund issuances, the gradual return of margin financing and the structural development of ETFs are all likely to bring meaningful incremental liquidity to A-shares, supporting a steady re-rating of the A-share market.

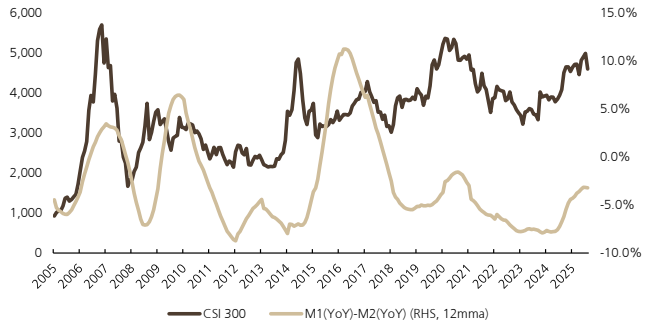
In our note How might the A-share market be affected should savings of Rmb55-60trn come due? we noted signs of Chinese households' savings reallocations into the stock market from H225. As of July 2026, the ratio of Chinese households' total renminbi deposits to total A-share market cap has fallen from a high of 2.09 in August 2024 to 1.57, albeit still slightly above the historical average of 1.48. Meanwhile, we note China's 'M1-M2' gap has been rising since Q225.

Figure 20: Ratio of Chinese households' total deposits to total A-share market cap



Source: Wind, UBS-S

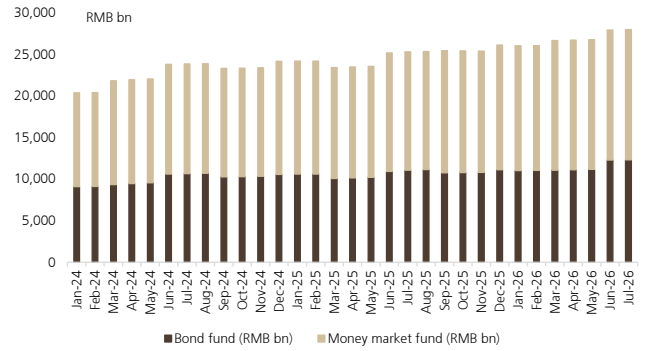
Figure 21: CSI 300 vs the 'M1-M2 gap



Source: Wind, UBS-S. Note: Statistical scope adjustments retroactively applied from January 2024; earlier data follows the old statistical scope.

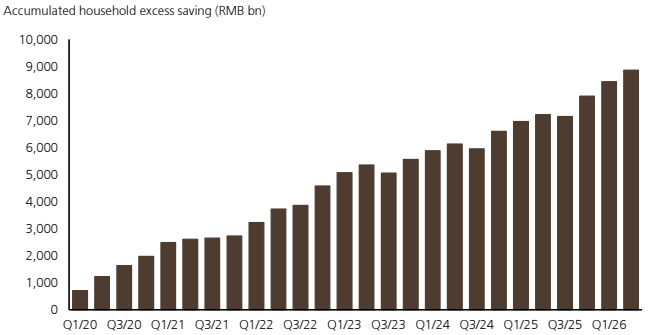
From a medium- to long-term perspective, the reallocation of Chinese households' savings should be slow and gradual. As of end-July 2026, China's bond and money market funds totalled Rmb28.0trn in combined AUM, up Rmb2.7trn YoY. Additionally, as per estimates by UBS-S' China economists, excess savings of Chinese households have further climbed to Rmb8.9trn in Q226, indicating that Chinese households maintain a strong preference for precautionary savings. All these pieces of evidence indicate that large-scale reallocation of Chinese households' deposits is yet to materialise. In our view, as the recognition of A-shares as a wealth reservoir for Chinese households gains traction and the wealth effect gradually improves, Chinese households' savings will likely progressively enter the stock market more through indirect channels (insurance, bank wealth management, "fixed income+", etc.).

Figure 22: AUM of bond funds and money market funds



Source: Wind, UBS-S

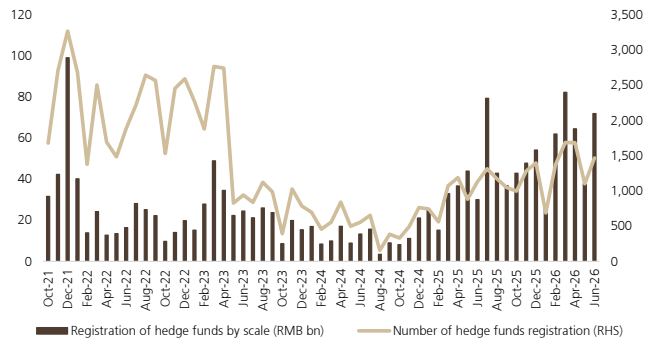
Figure 23: Chinese households' excess savings have kept climbing



Source: CEIC, UBS-S estimates

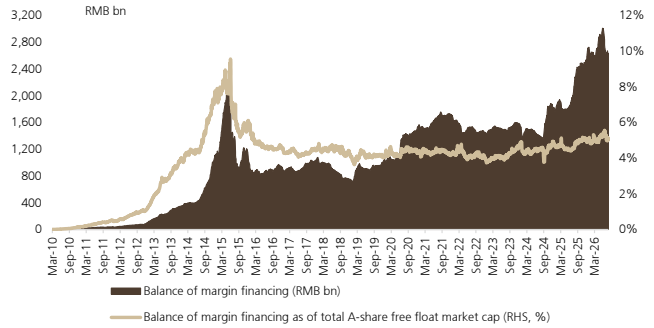
In addition to the gradual reallocation of Chinese households' deposits, the continued increase of new hedge fund registrations also provided strong support to A-shares in H126. The total scale of newly registered hedge funds reached Rmb346bn in H126, up 88% YoY. Moreover, after a rapid decline in July 2026, the overall balance of margin financing of the A-share market has recently stabilised and rebounded. As of 27 Aug 2026, the balance of margin financing of A-shares stood at Rmb2.64trn, up only Rmb109.2bn/Rmb42.8bn from the levels at end-2025/end-Q126. The balance of margin financing of A-shares has only rebounded Rmb47.3bn month to date in August. In contrast, the rebound in A-share stock prices has been stronger than the pace of margin financing recovery. This indicates that the earlier deleveraging was relatively thorough. In our view, should the global tech theme resume its upward trend in the rest of 2026, the scale of newly registered hedge funds in China could remain at a relatively high level, and leveraged capital is likely to gradually flow back into A-shares.

Figure 24: Hedge funds—number of registrations and scale



Source: Wind, UBS-S

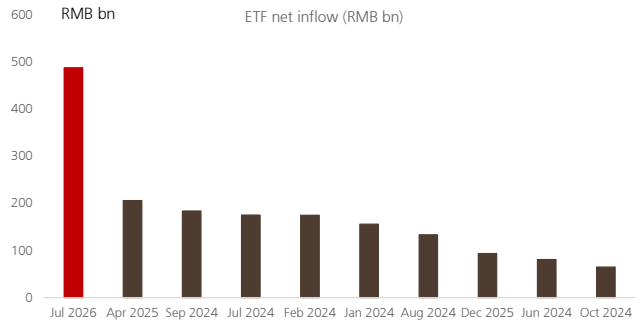
Figure 25: A-share balance of margin financing and as % of the A-share market free float



Source: Wind, UBS-S. Note: Data as of 27 August 2026

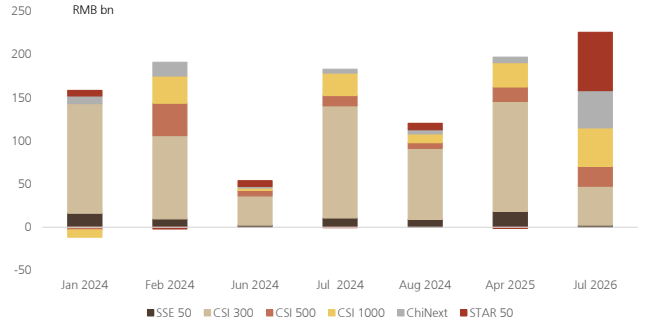
ETFs have also emerged as an important source of capital in the A-share market, given their structural development in recent years, and their role as a market stabiliser during periods of market stress should not be overlooked. In July 2026, we note the net inflow of all A-share ETFs reached Rmb487.1bn, setting a record and far surpassing levels seen in previous high-volatility periods in history—for instance, the monthly net inflow of Rmb205.5bn in April 2025 amid the escalation of the China-US trade conflict, the net inflow of Rmb183.4bn following the 24 September 2024 policy pivot, the combined net inflow of Rmb308.3bn in July-August 2024 during subdued A-share market sentiment, and the combined net inflow of Rmb330.5bn in Jan-Feb 2024 amid the A-share liquidity crisis. It is worth noting that during this round of A-share market correction (July 2026), the ChiNext Index and STAR 50 ETFs attracted a combined net inflow of about Rmb110.7bn, with their share of the overall A-share ETF net inflows much bigger than in the previous six rounds.

Figure 26: Top 10 months in terms of monthly A-share stock ETF net inflows (from 2024 to present)



Source: Wind, UBS-S

Figure 27: Net inflows into major broad-based index ETFs in the A-share market during periods of market stress



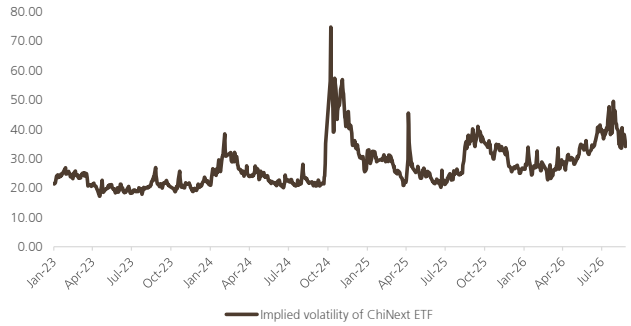
Source: Wind, UBS-S estimates

As for the tech sector, UBS's global equity strategy team remains optimistic about the tech narrative. AI demand is shifting from thematic trade to verifiable revenue and order growth. The team believes the latest round of earnings reports shows strong growth in cloud segments of Microsoft, Amazon, and Google, with rapidly rising order backlogs, which indicates that cloud service providers' capex is not merely driven by ahead-of-demand capacity build-outs, but are responding to genuine and monetisable demand. Meanwhile, compute power supply remains a growth bottleneck, implying a portion of AI cloud revenue is being deferred by capacity constraints, rather than being held back by weak demand. Although elevated capex weighs on short-term free cash flow, operating cash flow can still support the investment cycle, and valuations relative to growth remain near multi-year lows. Therefore, as long as AI-related revenue, orders, and cash flow continue to materialize, the global tech sector still has room for valuation recovery and earnings upward-revision. Given the strong correlation between the performance of the A-share tech sector and the global tech stocks, we think the A-share tech sector looks well positioned to benefit from a recovery in risk appetite toward

global tech names.

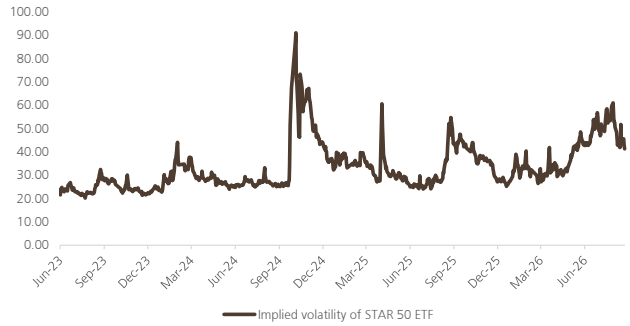
Lastly, we note the implied volatility of major tech index ETFs in the A-share market fluctuated upward in Q226. During the A-share market correction in July, the implied volatility of related ETFs rose further, at one point surpassing the readings seen during the escalation of the China-US trade dispute in April 2025. However, since the start of August, the implied volatility has retreated from the previous highs. We believe that as the A-share market gradually stabilises after a sharp correction, tail risk and trading crowdedness have been released.

Figure 28: Implied volatility of the ChiNext Index ETF



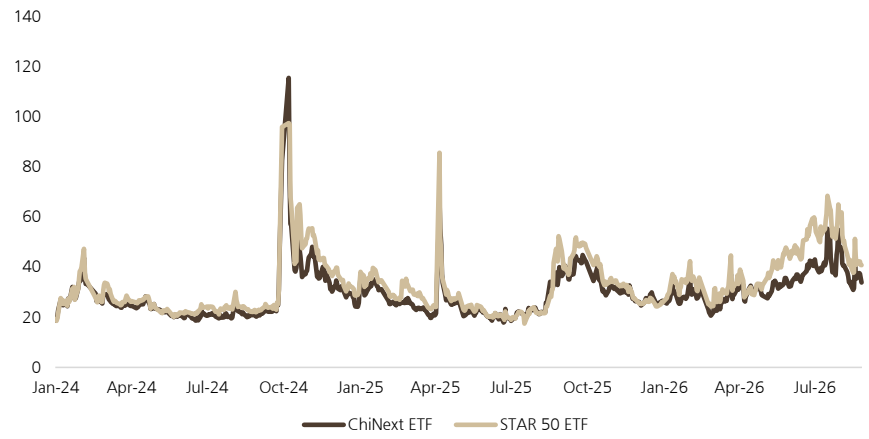
Source: Wind, UBS-S. Note: Data as of 27 August 2026.

Figure 29: Implied volatility of the STAR 50 ETF



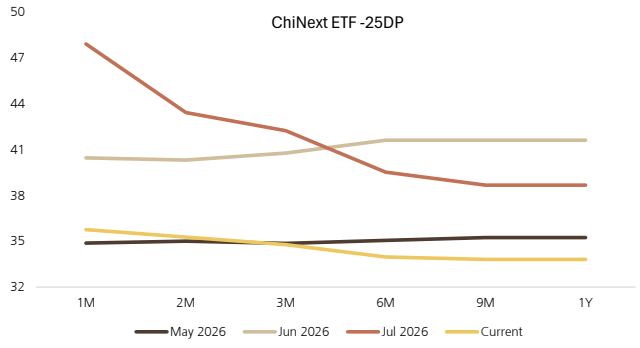
Source: Wind, UBS-S. Note: Data as of 27 August 2026.

Figure 30: Implied volatility of the one-month 25-delta put options on the ChiNext ETF / STAR 50 ETF



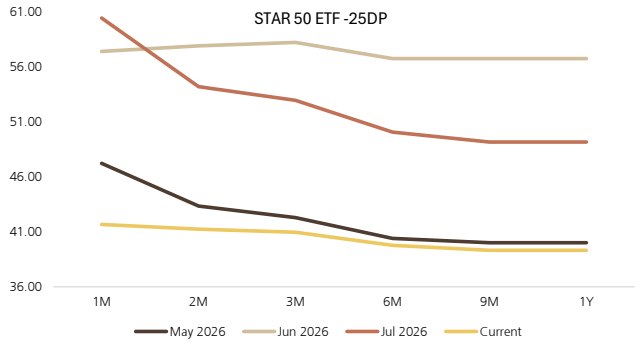
Source: Wind, UBS-S. Note: Data as of 27 August 2026.

Figure 31: Term structure of the implied volatility of the one-month 25-delta put options on the ChiNext ETF



Source: Wind, UBS-S. Note: Data as of 27 August 2026.

Figure 32: Term structure of the implied volatility of the one-month 25-delta put options on the STAR 50 ETF



Source: Wind, UBS-S. Note: Data as of 27 August 2026.

What factors could hinder any rebounds in the short term?

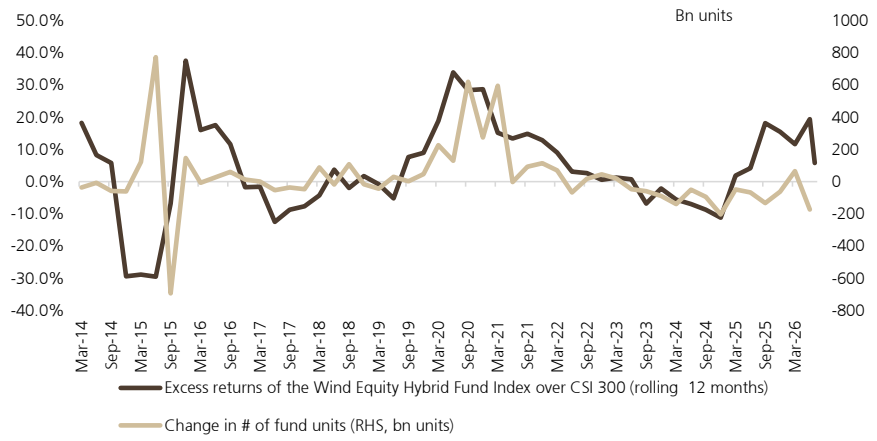
Although we believe the global tech story will likely remain the main investment theme this year, geopolitical uncertainty warrants close attention from investors in the short term. On the one hand, changes in US Treasury yields and oil prices could affect inflation expectations, US-dollar liquidity and global risk appetite, thereby influencing the valuations of interest-rate-sensitive tech stocks, especially AI and semi sectors as they have longer duration, as well as earnings expectations that depend heavily on future growth. In addition, if potential meetings between the Chinese and US presidents cover key issues such as AI-related competition and cooperation, regulation of open-source models, access to advanced computing power, and market access for optical modules, this could significantly affect expectations for the global AI value chain, tech roadmap choices, and the stability of cross-border supply chains.

Redemptions by MF investors after they return to breakeven could be another near-term factor curbing any market rebounds. As noted above, MF allocations to specific sectors including electronics and telecom as of end-Q226, had already touched historical peaks, suggesting potentially limited upside to MFs' tech positions. Some of the investors who purchased MFs during the market upswing in May-June may opt for redemption in the current round of market rebound after recouping their losses. This could put the A-share market under some selling pressure in the short term.

We note that new issuance of actively-managed MFs have usually lagged behind their NAV performance in history. In 2025, the size of actively-managed MFs contracted by over 300bn units over the year, even though equity-biased hybrid funds as a whole outperformed the CSI 300 Index. We believe this reflected redemptions by investors who incurred losses between H2-2021 and 24 September 2024 when a market rally kicked off, as their holdings gradually returned to breakeven or moved into profit over the past year.

Greater-tech-focused funds that expanded rapidly in Q226, may face greater redemption pressure in the near term. In AUM terms, actively managed tech track funds rose to Rmb1.4216trn as of end-Q226, from Rmb481.4bn as of end-Q126.

Figure 33: Equity-biased hybrid fund index's excess return relative to CSI 300 vs changes in units of actively managed equity funds (on a quarterly basis)

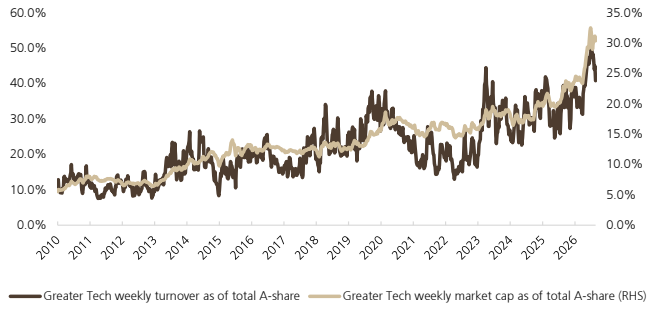


Source: Wind, UBS-S estimates. Note: Data as of 21 August 2026.

Trading data shows the greater tech sector as a percentage of weekly turnover for all A-shares remains high at 40.7% currently, although declining from the historical peak of 49.7% in early July. Also for the greater tech sector, the balance of margin financing as a percentage of the free-float market cap has pulled back to 5.3% recently, from 6.0% in mid-July. In our view, the deleveraging process may be drawing to a close or have already ended; yet, we think it is unlikely for leveraged investors to flow back to the greater tech

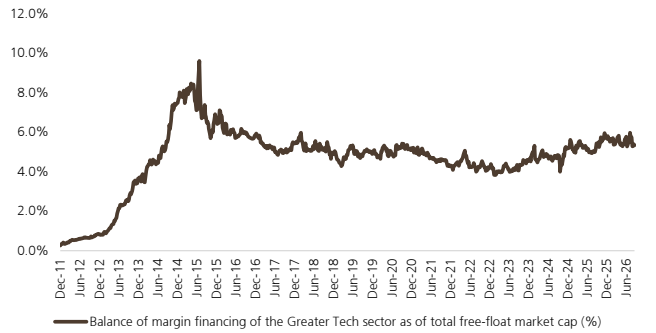
sector any time soon. Overall, such investors may remain cautious, as a recovery in risk appetite could take time.

Figure 34: Greater tech sector as % of weekly turnover for all A-shares vs as % of market cap for all A-shares



Source: Wind, UBS-S. Note: The greater tech sector includes electronics, telecom, computer and national defence. Data as of 27 August 2026.

Figure 35: Greater tech sector: balance of margin financing as % of free-float market cap



Source: Wind, UBS-S

Tactical style and sector allocation

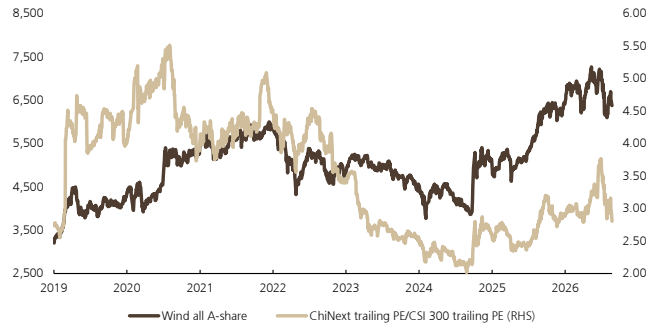
Under the classic style-allocation framework: 1) The degree of outperformance by 'growth' is closely related to the general course of the stock market. During market upswings, investors broadly follow the 'growth' style for its higher beta in pursuit of excess returns. In such periods, 'growth' often outperforms the 'value', 'stable' and 'cyclical' styles. 2) Cyclicals' outperformance over defensives is often accompanied by improving industrial profit. 3) Small caps generally outperform large caps in an environment of accommodative liquidity, rising market activity and greater participation by retail investors. We also find that small caps' outperformance over large caps is partly driven by an increase in market turnover.

Under our baseline scenario of a steady market rebound, we prefer the 'growth' style. However, given the lingering uncertainty about the global tech story, it remains necessary to allocate a portion to 'value', particularly high-dividend sectors as they should benefit from ongoing inflow from insurers. As of Q226, China's insurers held stocks worth Rmb6.4trn in total. In H126, insurers netted an inflow of Rmb290bn into A-shares, based on our estimates. In addition, if investors turn more optimistic about further policy easing, we think they may selectively build positions in pro-cyclical sectors, including consumer.

We like 'cyclical' against the backdrop of a recovery in the PPI and industrial earnings. We believe small-mid caps tend to get out in front when the market remains ample in liquidity and stays high in turnover. However, the continued expansion of sector and thematic ETFs should benefit sector leaders, potentially reining in any further significant outperformance by small-mid caps. Therefore, we expect the relative performance between large caps and small-mid caps to be more balanced this year than last.

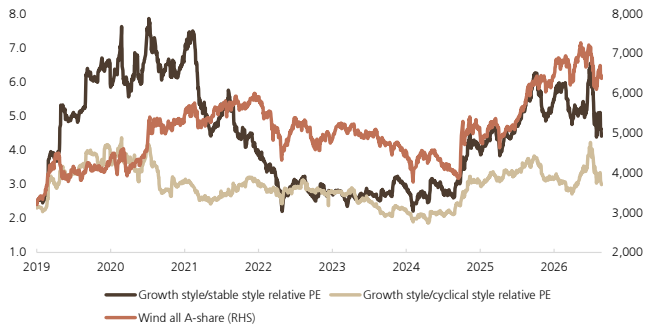
In our report Gauging market styles: Incremental fund inflow perspective, we did a deep-dive into how incremental fund inflow will affect market styles. In the short run, we view ETFs, hedge funds and insurers as the most vital sources of incremental funds as the A-share market goes to the next stage.

Figure 36: ChiNext's valuation relative to CSI 300's vs Wind All A-share Index



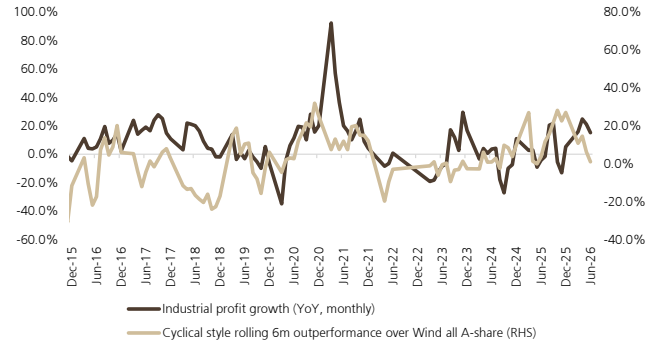
Source: Wind, UBS-S. Note: Data as of 24 August 2026.

Figure 37: Growth style's valuation relative to stable and cyclical styles' vs Wind All A-share Index



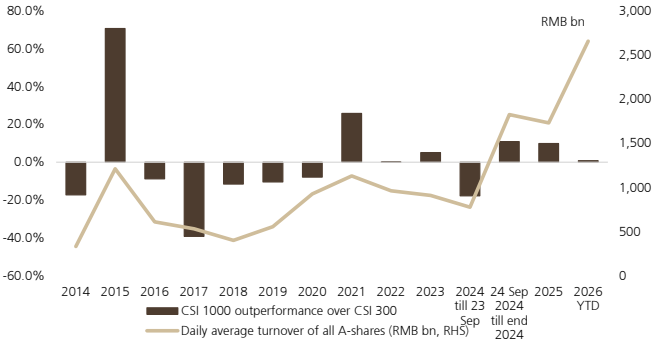
Source: Wind, UBS-S. Note: Data as of 24 August 2026.

Figure 38: Degree of outperformance by cyclical style over Wind All A-share Index vs YoY profit growth for China's industrial enterprises above a certain size (on a six-month basis)



Source: Wind, UBS-S

Figure 39: Degree of outperformance by CSI 1000 over CSI 300 vs average daily turnover in A-share market



Source: Wind, UBS-S. Note: Data as of 24 August 2026.

Figure 40: Thoughts on tactical A-share sector allocation

Overweight	
Electronics	In the short term, the semiconductor sector could see rising fundamentals, driven by the inventory and AI innovation cycles. In the longer term, semiconductor companies with independent IP rights and global competitiveness may be quality plays in China's hard technology development.
Telecom	Leaders in sub-sectors including optical modules and Internet of Things delivered strong earnings, driven by booming AI computing power demand and wide adoption of the industrial internet. This sector could continue to ride the tailwind of the government's new infrastructure policies.
Machinery	Automation, machine tools, and industrial robots benefit from the dual drivers of capital expenditure recovery and domestic substitution in Chinese industrial enterprises, while profitability is expected to improve. Meanwhile, the overseas expansion of construction machinery continues to be strong.
Non-ferrous metals	UBS expects copper and aluminum prices to continue an uptrend in 2026, as demand could outgrow supply, driving down inventory. UBS is positive on the lithium sector on a demand recovery, an improving inventory structure and stabilising medium-term capex.
Chemicals	Anti-involution progress and the exit of overseas capacities could accelerate the bottoming out of this sector. For sub-sectors including PTA, silicone and glyphosate, earnings and inventory are currently low but utilisation is likely to pick up. We also like sub-sectors such as amino acids, with high industry concentration and improving supply-demand.
Electrical equipment	Policy tailwinds, continued cost declines and strong power demand from AIDCs could bolster the development of BESS. The solar sector could benefit from progressing anti-involution.
Non-bank financials	Active trading in the A-share market and high margin trading scale are expected to drive growth in brokerage, credit, and investment banking businesses for securities firms; Insurance liabilities remain stable, and the equity market warming is expected to improve investment returns. Currently, brokerage and insurance valuations remain at historical lows, and fundamental recovery and valuation recovery are expected to resonate.

Source: UBS-S

Our preferred A-share names

Figure 41: Our preferred A-share names within UBS-S coverage

Stock code	Name	Rating	Mkt cap (Rmb 100mn)	Last price (Rmb)	Price Target (Rmb)	Upside	Avg. daily t/o (RMB 100mn)	EPS growth 2026E	EPS growth 2027E	PE 2026E	PB 2026E
688825.SS	CXMT	Buy	39,192	58.60	70.00	19%	306.14	6667%	126%	26.64	15.41
002371.SZ	NAURA Technology	Buy	5,062	697.51	800.00	15%	88.37	23%	71%	74.56	11.50
600150.SS	CSSC	Buy	2,617	34.78	52.00	50%	33.22	139%	29%	13.44	1.64
600309.SS	Wanhua Chemical	Buy	2,450	78.04	126.00	61%	29.24	53%	15%	12.71	1.98
600176.SS	China Jushi	Buy	1,729	43.20	58.00	34%	106.34	158%	82%	20.41	4.54
600584.SS	JCET Group	Buy	1,341	74.93	135.00	80%	159.83	72%	53%	49.83	4.30
300866.SZ	Anker Innovations	Buy	665	124.10	155.00	25%	5.10	24%	24%	21.00	5.50
002850.SZ	Kedali	Buy	487	177.30	268.00	51%	11.56	40%	38%	19.80	3.22
688686.SS	OPT	Buy	166	136.00	176.00	29%	3.19	35%	47%	65.78	5.18
605060.SS	Allied Machinery	Buy	102	42.31	135.00	219%	2.70	42%	65%	32.94	3.79

Source: Wind, UBS-S estimates. Note: Data as of 28 August 2026.

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.