China Equity Strategy

Implication of US rate hike on Chinese equity markets

Equity Strategy

China

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Market impact has been mixed historically

While historically US interest rates had a negative correlation with Chinese equities performance, i.e. a higher US interest rate tends to lead to worse share price performance, the relationship is not constant and the overall Chinese equity performance tends to be driven more by domestic conditions than external rates (e.g. 2015/16 was impacted by share market deleveraging while 2022 benefitted from re-opening). A-share market tends to be less impacted vs the H-shares given the latter tends to be more affected by external fund flows (Figure 6). There seemed to be more consistency within the sector performances with the domestic focused sectors (i.e. consumption and internet) tending to outperform during the rate hike cycle. On the other hand, data centers, biotech and brokers tend to underperform during those periods. No change to our overall market or sector calls as of yet as our US economists are not expecting a prolonged rate hike cycle (see Jonathan's note here).

Higher oil price and US rate hike places Chinese equities in a better light regionally

The higher oil price and US rate hikes do make Chinese equities somewhat more attractive vs other regions (see Sunil's note here) given:1) lower reliance on oil for energy production, 2) foreign fund flows have less impact on A-share markets, 3) consumers are less impacted by higher oil prices due to increasing EV penetration and controlled price pass through mechanism. Nevertheless, the overall consumption environment in China remains lackluster and foreign active positions are already the highest in the last 5 years which could hamper near term share market performance.

Sector implications from US rate hikes?

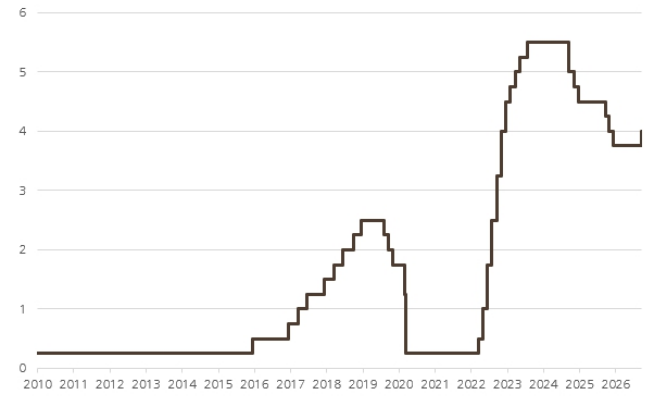
We have reviewed the sector experiences in the previous two episodes when the US started raising official interest rates. Generally speaking, the following sectors tend to underperform during the rate hike cycles: 1) data centers, 2) CRO and biotech, 3) brokers and select export-oriented sectors such as shipping and wind power equipment. This does make sense given biotech, CRO's and data centers tend to rely on US dollar funding while global trade cycle generally tend to be negatively impacted by higher US interest rates. On the other hand, the sectors that tend to be more resilient included internet and domestic consumer names, i.e. the more domestically focused sectors. That said, during the previous rate hike cycles in 2016 and 2022, consumer names benefited from a strong domestic consumption recovery while is is not the case this time around.

Preferences remain unchanged

We continue to prefer a barbell strategy. Our preferences in the tech space include memory, fab and semi-cap equipment. Outside of tech, our preferences include banks, non-ferrous metals and going abroad stocks. In the near term, rate hike expectations could hamper some of the going abroad stocks' performances - we would view such declines as buying opportunities.

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Figure 1: US Fed fund rate (upper limit)



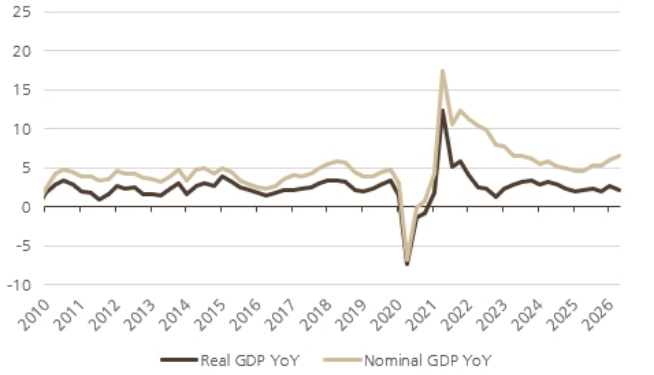
Source: Bloomberg, UBS

Figure 2: USD Index



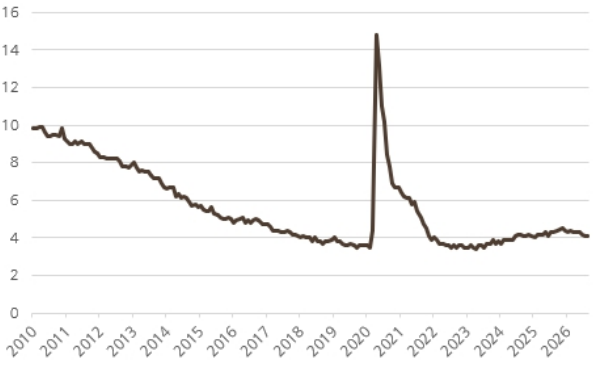
Source: FactSet, UBS

Figure 3: US real and nominal GDP YoY



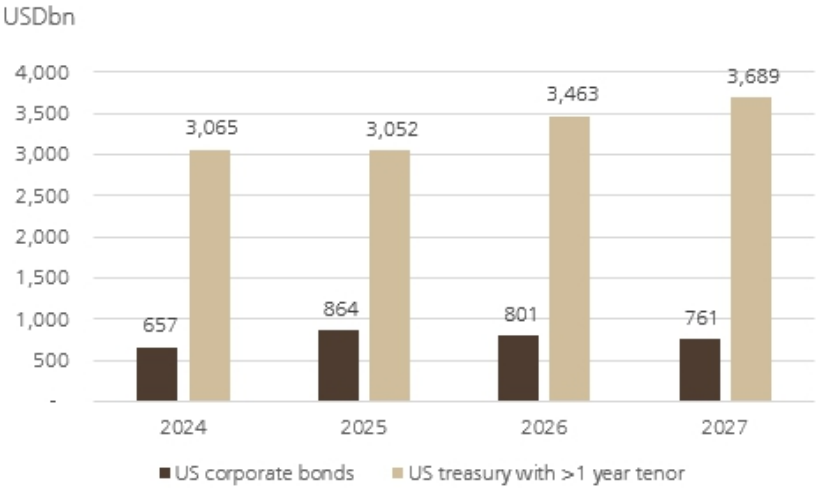
Source: CEIC, UBS

Figure 4: US unemployment rate



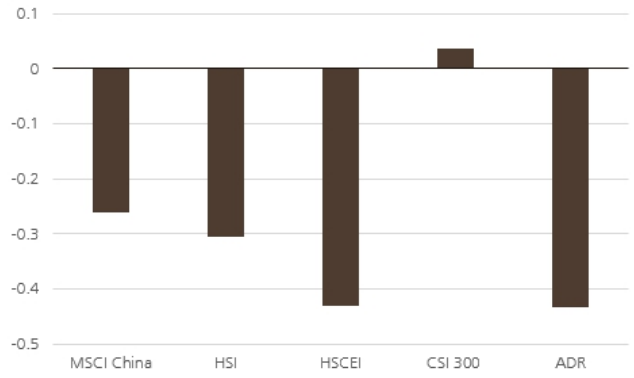
Source: CEIC, UBS

Figure 5: US corporate bond and treasury maturity profile



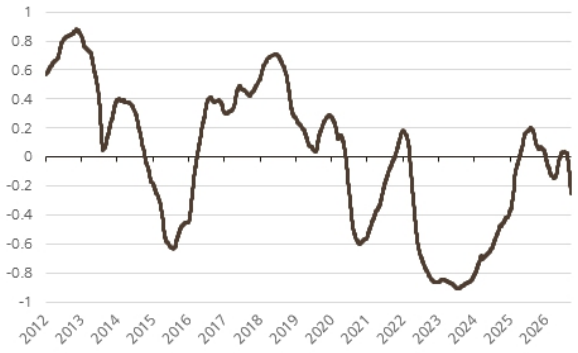
Source: Bloomberg, UBS

Figure 6: Corelation of US 10Y yield with different market indices



Source: FactSet, UBS Note: Data since 2010

Figure 7: Rolling 2Y correlation of MSCI China and US 10Y yield



Source: FactSet, UBS

Figure 8: Index performance during different phases of previous rate hike cycles

1st quarter after rate hike

Start date	12/17/2015	3/15/2022	
End date	3/17/2016	6/14/2022	Average
MSCI China	-6%	17%	6%
HSI	-6%	14%	4%
HSCEI	-9%	20%	5%
CSI 300	-17%	6%	-5%
ADR	-9%	35%	13%
S&P 500	0%	-12%	-6%

2nd quarter after rate hike

Start date	3/17/2016	6/14/2022	
End date	6/16/2016	9/13/2022	Average
MSCI China	-2%	-10%	-6%
HSI	-2%	-8%	-5%
HSCEI	-4%	-10%	-7%
CSI 300	-1%	-3%	-2%
ADR	-8%	-2%	-5%
S&P 500	2%	5%	4%

3rd quarter after rate hike

Start date	6/16/2016	9/13/2022	
End date	9/15/2016	12/13/2022	Average
MSCI China	18%	3%	11%
HSI	16%	1%	9%
HSCEI	14%	0%	7%
CSI 300	5%	-4%	0%
ADR	20%	-3%	8%
S&P 500	3%	2%	3%

4th quarter after rate hike

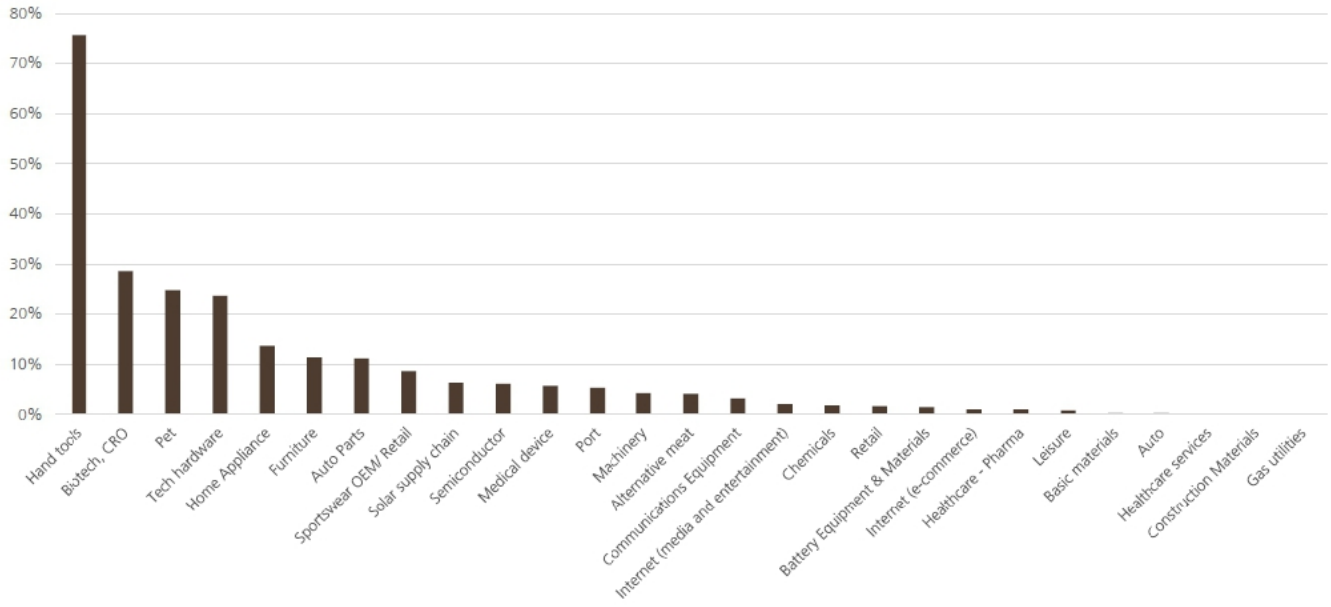
Start date	9/15/2016	12/13/2022	
End date	12/15/2016	3/14/2023	Average
MSCI China	-8%	-1%	-5%
HSI	-5%	-2%	-4%
HSCEI	-1%	-3%	-2%
CSI 300	3%	1%	2%
ADR	-10%	-1%	-6%
S&P 500	5%	-2%	1%

Current cycle vs previous cycle

Start date	12/17/2015	3/15/2022		2/27/2026
End date	12/15/2016	3/14/2023	Average	9/16/2026
MSCI China	0%	7%	4%	-11%
HSI	1%	5%	3%	-7%
HSCEI	-2%	5%	2%	-7%
CSI 300	-11%	0%	-6%	-5%
ADR	-10%	27%	8%	-20%
S&P 500	11%	-8%	1%	10%

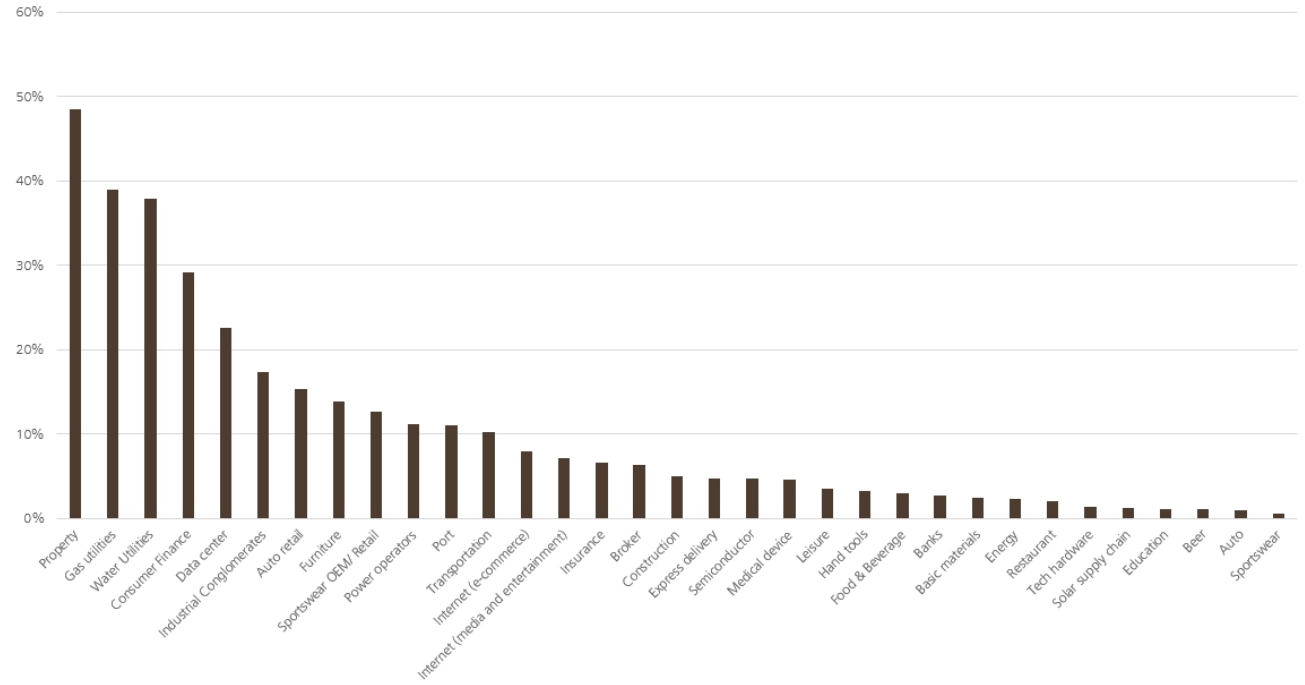
Source: FactSet, UBS

Figure 9: Revenue exposure % in the US by sector



Source: UBS estimates. Note: Numbers are revenue weighted. Sectors with no US exposure are not shown. This is based on a previous UBS analyst survey that we have conducted. See the note here.

Figure 10: USD/HKD denominated debt as % of market cap by subsector



Source: FactSet, UBS

Figure 11: Subsector performance relative to MSCI China during different phases of previous rate hike cycles

First quarter after rate hike

Start date	12/17/2015	3/15/2022	
End date	3/17/2016	6/14/2022	Average
Education	5%	206%	106%
Consumer finance	N/A	18%	18%
Restaurant	19%	14%	16%
Internet (E-commerce)	-18%	45%	14%
Auto	-19%	36%	8%
Internet (Media & entertainment)	-8%	23%	7%
Energy	-10%	22%	6%
Auto retail	-11%	20%	5%
Gas utilities	-12%	21%	5%
Leisure	-3%	5%	1%
Express delivery	2%	-3%	0%
Pharma retail	-28%	22%	-3%
Baijiu	-9%	3%	-3%
Auto parts	-17%	10%	-4%
Health care service	-19%	11%	-4%
Furniture	-3%	-6%	-4%
Hog	-8%	-3%	-5%
Sportswear	-17%	6%	-6%
Beer	-17%	5%	-6%
Property	-16%	5%	-7%
Food & beverage	-10%	-5%	-7%
Telecom	-9%	-6%	-8%
Basic materials	-14%	-2%	-8%
Truck	-13%	-3%	-8%
Personal product	-22%	6%	-8%
EV Battery & materials	-13%	-5%	-9%
Home appliance	-13%	-6%	-9%
Banks	-13%	-6%	-10%
Internet (Online game)	-26%	5%	-10%
Insurance	-21%	-2%	-11%
Biotech, CRO	-17%	-7%	-12%
Transportation	-20%	-4%	-12%
Power operator	-22%	-3%	-12%
Construction materials	-19%	-6%	-12%
Chemicals	-25%	-1%	-13%
Construction	-26%	-1%	-13%
Airline airport	-23%	-5%	-14%
Machinery	-27%	-1%	-14%
Solar supply chain	-19%	-11%	-15%
Grid	-20%	-11%	-15%
Broker	-31%	-1%	-16%
Pharma	-19%	-13%	-16%
Shipping	-33%	-1%	-17%
Medical device	-24%	-10%	-17%
Tech hardware	-24%	-13%	-19%
Aerospace & defense	-27%	-10%	-19%
Wind power equipment	-32%	-5%	-19%
Softw are	-29%	-9%	-19%
Semiconductor	-29%	-20%	-24%
Data center	-41%	-10%	-26%

Second quarter after rate hike

Start date	3/17/2016	6/14/2022	
End date	6/16/2016	9/13/2022	Average
Express delivery	32%	8%	20%
Furniture	31%	8%	20%
EV Battery & materials	37%	1%	19%
Internet (Online game)	43%	-7%	18%
Education	14%	19%	16%
Auto parts	22%	8%	15%
Airline airport	8%	21%	15%
Restaurant	4%	23%	14%
Baijiu	24%	2%	13%
Pharma retail	19%	6%	13%
Solar supply chain	18%	7%	13%
Beer	13%	7%	10%
Home appliance	13%	5%	9%
Basic materials	18%	0%	9%
Aerospace & defense	1%	16%	9%
Tech hardware	16%	-1%	8%
Hog	0%	15%	7%
Leisure	2%	12%	7%
Power operator	6%	7%	7%
Food & beverage	13%	-1%	6%
Chemicals	15%	-2%	6%
Telecom	3%	9%	6%
Softw are	11%	0%	5%
Medical device	4%	6%	5%
Semiconductor	9%	1%	5%
Wind power equipment	1%	8%	5%
Machinery	-2%	11%	4%
Insurance	2%	6%	4%
Broker	9%	-1%	4%
Gas utilities	4%	2%	3%
Sportswear	-6%	12%	3%
Pharma	5%	1%	3%
Health care service	3%	3%	3%
Grid	4%	1%	2%
Internet (E-commerce)	6%	-4%	1%
Personal product	5%	-4%	0%
Property	-3%	3%	0%
Banks	4%	-5%	0%
Internet (Media & entertainment)	12%	-12%	0%
Energy	0%	-1%	-1%
Transportation	-5%	3%	-1%
Auto	8%	-10%	-1%
Construction materials	1%	-5%	-2%
Biotech, CRO	1%	-5%	-2%
Construction	-7%	0%	-3%
Shipping	0%	-7%	-4%
Truck	2%	-10%	-4%
Data center	-6%	-9%	-8%
Auto retail	-17%	-26%	-22%
Consumer finance	N/A	-26%	-26%

Third quarter after rate hike

Start date	6/16/2016	9/13/2022	
End date	9/15/2016	12/13/2022	Average
Pharma retail	-3%	39%	18%
Medical device	35%	-5%	15%
Education	14%	9%	12%
Auto retail	23%	-4%	9%
Internet (E-commerce)	19%	-5%	7%
Internet (Media & entertainment)	13%	-5%	4%
Leisure	4%	4%	4%
Express delivery	17%	-10%	4%
Restaurant	-2%	9%	3%
Sportswear	20%	-14%	3%
Truck	4%	-3%	1%
Pharma	0%	1%	0%
Insurance	0%	-1%	-1%
Beer	2%	-3%	-1%
Telecom	2%	-6%	-2%
Internet (Online game)	15%	-18%	-2%
Airline airport	-8%	3%	-2%
Biotech, CRO	0%	-7%	-3%
Grid	6%	-15%	-5%
Property	2%	-12%	-5%
Construction	-3%	-7%	-5%
Semiconductor	1%	-14%	-7%
Construction materials	0%	-14%	-7%
Health care service	-7%	-8%	-8%
Food & beverage	-7%	-8%	-8%
Softw are	-14%	-2%	-8%
Home appliance	-2%	-15%	-8%
Banks	-6%	-11%	-8%
Tech hardware	-2%	-15%	-8%
Transportation	-10%	-7%	-9%
Gas utilities	-5%	-15%	-10%
Shipping	-6%	-14%	-10%
Chemicals	-1%	-20%	-11%
Machinery	-9%	-14%	-11%
Auto	2%	-25%	-11%
Personal product	-9%	-14%	-11%
Baijiu	-10%	-13%	-12%
Furniture	-6%	-17%	-12%
Broker	-9%	-15%	-12%
Aerospace & defense	-2%	-22%	-12%
Auto parts	2%	-28%	-13%
Data center	-6%	-20%	-13%
Basic materials	-12%	-15%	-14%
Energy	-7%	-20%	-14%
Wind power equipment	-4%	-24%	-14%
Power operator	-6%	-23%	-15%
Solar supply chain	-9%	-30%	-20%
Hog	-12%	-29%	-21%
EV Battery & materials	-32%	-25%	-28%
Consumer finance	N/A	-35%	-35%

Fourth quarter after rate hike

Start date	9/15/2016	12/13/2022	
End date	12/15/2016	3/14/2023	Average
Express delivery	200%	-3%	98%
Construction	22%	17%	20%
Telecom	-7%	38%	15%
Internet (Online game)	-1%	26%	12%
Energy	9%	15%	12%
Basic materials	11%	11%	11%
Softw are	-3%	25%	11%
Restaurant	13%	8%	10%
Truck	7%	13%	10%
Baijiu	10%	10%	10%
Machinery	7%	12%	9%
Semiconductor	13%	6%	9%
Sportswear	8%	10%	9%
Furniture	7%	10%	9%
Grid	6%	10%	8%
Beer	0%	16%	8%
Pharma	12%	3%	8%
Chemicals	9%	6%	8%
Education	-3%	18%	7%
Construction materials	10%	5%	7%
Home appliance	7%	7%	7%
Transportation	5%	8%	6%
Tech hardware	-1%	14%	6%
Power operator	-1%	12%	6%
Banks	3%	7%	5%
Wind power equipment	8%	0%	4%
Broker	2%	6%	4%
Aerospace & defense	1%	6%	4%
Health care service	-8%	14%	3%
Internet (Media & entertainment)	-7%	13%	3%
Solar supply chain	-3%	9%	3%
Insurance	3%	2%	2%
Hog	-5%	10%	2%
Auto parts	0%	4%	2%
Airline airport	-4%	8%	2%
Food & beverage	2%	2%	2%
Medical device	-2%	3%	1%
Leisure	-2%	2%	0%
Biotech, CRO	-2%	2%	0%
Shipping	0%	-1%	0%
Gas utilities	-6%	4%	-1%
Auto	3%	-4%	-1%
Personal product	-7%	4%	-1%
EV Battery & materials	-2%	-4%	-3%
Property	-1%	-6%	-4%
Consumer finance	N/A	-4%	-4%
Auto retail	-6%	-3%	-5%
Data center	-16%	1%	-8%
Internet (E-commerce)	-3%	-10%	-6%
Pharma retail	-10%	-20%	-15%

Source: FactSet, UBS. Note: the bottom ranked sectors in all 4 quarters are shaded in red

Figure 12: Subsector performance ranking in the subsequent four quarters of rate hike cycle

Sector	1st quarter	2nd quarter	3rd quarter	4th quarter	Avg
Express delivery	11	1	8	1	5
Education	1	5	3	19	7
Restaurant	3	8	9	8	7
Internet (Online game)	29	4	16	4	13
Beer	19	12	14	16	15
Telecom	22	22	15	3	16
Baijiu	13	9	37	10	17
Furniture	16	2	38	14	18
Sportswear	18	31	10	13	18
Leisure	10	18	7	38	18
Pharma retail	12	10	1	50	18
Internet (Media & entertainment)	6	39	6	30	20
Basic materials	23	14	43	6	22
Home appliance	27	13	27	21	22
Truck	24	47	11	9	23
Internet (E-commerce)	4	35	5	49	23
Auto parts	14	6	41	34	24
Energy	7	40	44	5	24
Airline airport	37	7	17	35	24
Health care service	15	33	24	29	25
Food & beverage	21	20	25	36	26
Insurance	30	28	13	32	26
Pharma	42	32	12	17	26
Construction	36	45	21	2	26
Software	48	23	26	7	26
Chemicals	35	21	33	18	27
Medical device	44	24	2	37	27
Auto retail	8	49	4	47	27
Grid	40	34	19	15	27
Semiconductor	49	25	22	12	27
Machinery	38	27	34	11	28
Gas utilities	9	30	31	41	28
Tech hardware	45	16	29	23	28
Hog	17	17	48	33	29
Banks	28	38	28	25	30
Construction materials	34	43	23	20	30
Property	20	37	20	45	31
EV Battery & materials	26	3	49	44	31
Power operator	33	19	46	24	31
Auto	5	42	35	42	31
Transportation	32	41	30	22	31
Solar supply chain	39	11	47	31	32
Aerospace & defense	46	15	40	28	32
Biotech, CRO	31	44	18	39	33
Broker	41	29	39	27	34
Personal product	25	36	36	43	35
Wind power equipment	47	26	45	26	36
Consumer finance	2	50	50	46	37
Shipping	43	46	32	40	40
Data center	50	48	42	48	47

Source: FactSet, UBS



Figure 13: Subsector performance during the previous rate hike cycles

Start date	12/17/2015	3/15/2022	
End date	12/16/2016	3/15/2023	Average
Express delivery	412%	-2%	205%
Education	35%	357%	196%
Restaurant	42%	71%	57%
Furniture	40%	0%	20%
Internet (Online game)	30%	6%	18%
Telecom	-8%	44%	18%
Beer	2%	32%	17%
Leisure	5%	29%	17%
Internet (Media & entertainment)	13%	20%	17%
Pharma retail	-18%	48%	15%
Sportswear	7%	22%	14%
Baijiu	20%	5%	13%
Internet (E-commerce)	-2%	20%	9%
Energy	-4%	19%	8%
Airline airport	-21%	35%	7%
Home appliance	14%	-3%	6%
Medical device	9%	0%	4%
Auto parts	12%	-4%	4%
Construction	-12%	19%	4%
Truck	3%	2%	3%
Gas utilities	-12%	17%	3%
Basic materials	6%	-1%	2%
Health care service	-23%	25%	1%
Insurance	-12%	12%	0%
Pharma	2%	-3%	-1%
Food & beverage	3%	-6%	-2%
Auto	-1%	-8%	-5%
Grid	-2%	-9%	-6%
Chemicals	0%	-12%	-6%
Software	-28%	16%	-6%
Machinery	-24%	12%	-6%
Banks	-6%	-8%	-7%
Tech hardware	-7%	-10%	-9%
Transportation	-23%	6%	-9%
Construction materials	-4%	-13%	-9%
Power operator	-17%	-2%	-9%
Property	-16%	-5%	-10%
Hog	-18%	-5%	-11%
Biotech, CRO	-12%	-11%	-12%
Semiconductor	-3%	-21%	-12%
Aerospace & defense	-22%	-7%	-14%
Solar supply chain	-9%	-21%	-15%
Broker	-24%	-6%	-15%
Personal product	-27%	-3%	-15%
Auto retail	-12%	-21%	-16%
EV Battery & materials	-11%	-25%	-18%
Wind power equipment	-23%	-14%	-19%
Shipping	-31%	-13%	-22%
Data center	-53%	-29%	-41%
Consumer finance	N/A	-47%	-47%

Source: FactSet, UBS

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.