

# Discipline pays off in China equities

Our focus on industry leaders creates a market storm shelter



We are disciplined and have long focused on industry leaders because of their long-term potential.

After selling off and largely underperforming major equity markets for the past 16 months, China has recently bounced back in a big way after the Shanghai lockdown was lifted. Investor sentiment has stabilized alongside economic and regulatory conditions, as evidenced by the positive inflows into Chinese equities year to date. Compared to the US and Europe, which are struggling under mounting inflationary pressure and fears of possible recession, China suddenly appears to be on better footing. Could this be a good time for investors to start tiptoeing back into Chinese equities?

### Economic lift powered by the people

To be clear, we are not surprised by the turn of events, even before the latest data on manufacturing and services sectors pointed to a recovery gaining momentum. Amid the worst of the lockdowns and logistics disruption, China's exports have mostly stayed the course, partly owing to the resilient spirit of the Chinese people and companies. Chinese entrepreneurs are determined and work hard to put out the most compelling products at the most attractive price points, even in these challenging times.

Our job as a fundamental stock picker is to identify those companies that we believe will become stronger, more competitive and better recognized around the world. We think there are still a lot of great Chinese companies that have that chance, especially since the recent market correction has cast aside some of the more unprofitable, less competitive companies (see chart below). There is often ample liquidity in a bull market to support a large number of companies, but once that excess is dried up and market returns to fundamentals, the companies that remained tend to be healthier and could move forward on more solid ground.

### Market returns to fundamentals and is less generous to unprofitable companies

Focus is shifting to companies with profitability  
Morgan Stanley Asia Unprofitable Tech index (%)



Source: Morgan Stanley Research, Bloomberg. Data as of end 16 June, 2022

We continue to believe that high quality companies with strong competitive advantage will deliver results in the long run.

#### **Lead with industry leaders**

And that's one of the main reasons that our strategies are centered around industry leaders. Although it's true that policy shifts so far have had a larger impact on industry leading companies, turning to their less competitive peers is not a sound solution. Why? To begin with, a company's standing in its industry is one of many factors we look at when making a decision to invest. Given the impact of policy shifts and regulatory grip in the last two years, we are aware and alert to the likelihood of an industry being targeted by regulators, but it has not altered our fundamental investing principles in the search for great companies.

We are disciplined and have long focused on industry leaders – for the most part the top two players in an industry in terms of market share – because of their long-term potential. Only the most competitive companies will survive changing market conditions, while the less competitive will not. It doesn't matter where the company is, but when the interests of the founders, management and shareholders align and when management is working for shareholders, you have the ingredients to make a great company. And chances are, a great company makes a great stock.

That said, our long held investing framework is more multidimensional than before, and we look at companies from many different angles. While we cannot predict what the future holds for certain companies, what we can do is to diversify the different risks including policy risk by investing across several companies and industries. Given our focus and the market's return to the fundamentals story, we continue to believe that high quality companies with strong competitive advantage will deliver results in the long run.

#### **A stock rebound in the making**

Before May, Chinese equities were beaten down to what we believe to be an unsustainably cheap level – about one deviation below their historical trading mean. Historically speaking, a period of market weakness tends to be followed by a strong rally, which appears to be what we are seeing today.

It's interesting that because of the economic slowdown, many Chinese companies are better positioned for a rebound. The slowdown forced companies to cut costs and operate on a healthier and leaner model, which contributed to a better-than-expected bottom-line earnings growth. If we take the slowdown as a blessing in disguise, some companies are now better set up to report strong earnings and perform in the long run once the economy recovers. And because a lot of high quality Chinese companies have been trading at extremely attractive prices, we believe Chinese equities could outperform their global peers in the medium term – despite more ups and downs that COVID flareups and rolling lockdowns could bring down the line.

**For marketing and information purposes by UBS. For global professional / qualified / institutional clients and investors.**

This document does not replace portfolio and fund-specific materials. Commentary is at a macro or strategy level and is not with reference to any registered or other mutual funds.

**Americas**

The views expressed are a general guide to the views of UBS Asset Management as of July 2022. The information contained herein should not be considered a recommendation to purchase or sell securities or any particular strategy or fund. Commentary is at a macro level and is not with reference to any investment strategy, product or fund offered by UBS Asset Management. The information contained herein does not constitute investment research, has not been prepared in line with the requirements of any jurisdiction designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith. All such information and opinions are subject to change without notice. Care has been taken to ensure its accuracy but no responsibility is accepted for any errors or omissions herein. A number of the comments in this document are based on current expectations and are considered "forward-looking statements". Actual future results, however, may prove to be different from expectations. The opinions expressed are a reflection of UBS Asset Management's best judgment at the time this document was compiled, and any obligation to update or alter forward-looking statements as a result of new information, future events or otherwise is disclaimed. Furthermore, these views are not intended to predict or guarantee the future performance of any individual security, asset class or market generally, nor are they intended to predict the future performance of any UBS Asset Management account, portfolio or fund.

**EMEA**

The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith, but is not guaranteed as being accurate, nor is it a complete statement or summary of the securities, markets or developments referred to in the document. UBS AG and / or other members of the UBS Group may have a position in and may make a purchase and / or sale of any of the securities or other financial instruments mentioned in this document.

Before investing in a product please read the latest prospectus carefully and thoroughly. Units of UBS funds mentioned herein may not be eligible for sale in all jurisdictions or to certain categories of investors and may not be offered, sold or delivered in the United States. The information mentioned herein is not intended to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. Past performance is not a reliable indicator of future results. The performance shown does not take account of any commissions and costs charged when subscribing to and redeeming units. Commissions and costs have a negative impact on performance. If the currency of a financial product or financial service is different from your reference currency, the return can increase or decrease as a result of currency fluctuations. This information pays no regard to the specific or future investment objectives, financial or tax situation or particular needs of any specific recipient.

The details and opinions contained in this document are provided by UBS without any guarantee or warranty and are for the recipient's personal use and information purposes only. This document may not be reproduced, redistributed or republished for any purpose without the written permission of UBS AG.

This document contains statements that constitute "forward-looking statements", including, but not limited to, statements relating to our future business development. While these forward-looking statements represent our judgments and future expectations concerning the development of our business, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from our expectations.

**UK**

Issued in the UK by UBS Asset Management (UK) Ltd. Authorised and regulated by the Financial Conduct Authority.

**APAC**

This document and its contents have not been reviewed by, delivered to or registered with any regulatory or other relevant authority in APAC. This document is for informational purposes and should not be construed as an offer or invitation to the public, direct or indirect, to buy or sell securities. This document is intended for limited distribution and only to the extent permitted under applicable laws in your jurisdiction. No representations are made with respect to the eligibility of any recipients of this document to acquire interests in securities under the laws of your jurisdiction.

Using, copying, redistributing or republishing any part of this document without prior written permission from UBS Asset Management is prohibited. Any statements made regarding investment performance objectives, risk and/or return targets shall not constitute a representation or warranty that such objectives or expectations will be achieved or risks are fully disclosed. The information and opinions contained in this document is based upon information obtained from sources believed to be reliable and in good faith but no responsibility is accepted for any misrepresentation, errors or omissions. All such information and opinions are subject to change without notice. A number of comments in this document are based on current expectations and are considered "forward-looking statements". Actual future results may prove to be different from expectations and any unforeseen risk or event may arise in the future. The opinions expressed are a reflection of UBS Asset Management's judgment at the time this document is compiled and any obligation to update or alter forward-looking statements as a result of new information, future events, or otherwise is disclaimed.

You are advised to exercise caution in relation to this document. The information in this document does not constitute advice and does not take into consideration your investment objectives, legal, financial or tax situation or particular needs in any other respect. Investors should be aware that past performance of investment is not necessarily indicative of future performance. Potential for profit is accompanied by possibility of loss. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

**Australia**

This document is provided by UBS Asset Management (Australia) Ltd, ABN 31 003 146 290 and AFS License No. 222605.

Source for all data and charts (if not indicated otherwise): UBS Asset Management.

The key symbol and UBS are among the registered and unregistered trademarks of UBS.



® [www.ubs.com/am-linkedin](http://www.ubs.com/am-linkedin)

© UBS 2022. All rights reserved.  
[www.ubs.com/am](http://www.ubs.com/am)

