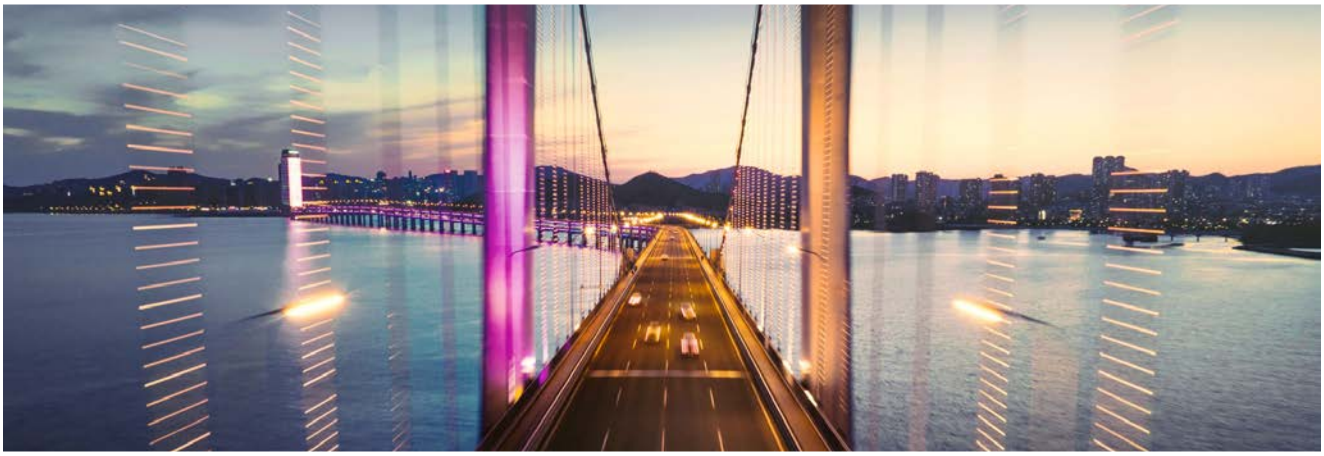
August 2025

China Bonds: Diversification potential beyond the Dollar

Strategic Allocation in a Shifting Global Paradigm

UBS (Lux) Bond SICAV – China Fixed Income (RMB)



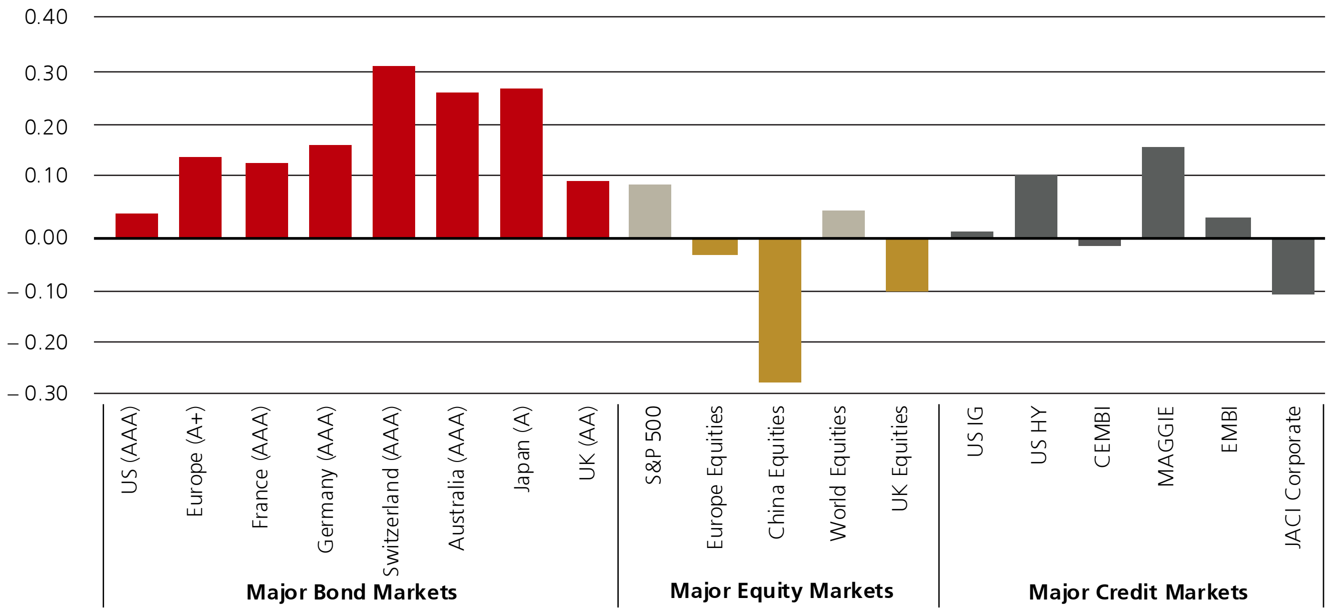
1. A significant under-allocated Asset Class
China's onshore bond market, valued at over USD 25 trillion, is the second largest globally, yet remains significantly under-owned by foreign investors, with foreign ownership stood at below 3%. This is notably lower than the 10% weight of the China subindex in the J.P. Morgan Government Bond Index-Emerging Markets Global Diversified (GBI-EM GD). This market offers significant room for global participation. It has already been included in the JP Morgan, FTSE Russell, and Bloomberg global government bond indices since 2019 because of the scale and full accessibility. The market comprises several major sectors:

- **Chinese Government Bonds (CGBs):** The most liquid and benchmarked instruments.
- **Policy Bank Bonds (PBBs):** issued by quasi-sovereign entities i.e. China Development Bank, Export-Import Bank of China and Agricultural Development Bank of China.
- **Local Government Bonds (LGBs):** Issued by provincial and municipal governments.
- **Agencies:** China Railway and Central Huijin
- **Corporate Credits:** central/local SOEs (state-owned enterprises) and POEs (private-owned enterprises).

Within the CNY-denominated fixed income market, CGBs and PBBs dominate the widely used Bloomberg China Aggregate Index, with both accounting for >65% of the index weighting. Although the CGBs and PBBs are dominating the CNY bond market, there are significant alpha generation opportunities in credit selection and sector allocation outside of these two categories. Sectors such as SOEs and offshore CNH/USD bonds provide notable yield pickup over CGB and Policy Banks.

Source: Wind, UBS Asset Management. Data as of end June 2025

2. Positioning your portfolio for resilience and balanced risk-reward
The Onshore CNY bonds exhibit low correlation with global fixed income markets, offering a barbell effect against riskier assets, thanks to the different interest rate and economic cycle of China from other major economies. During periods of global rate volatility, such as the 2021 - 2023 sell-off in US treasury bonds (USTs), China Government Bonds returned +3% in USD terms while USTs fell -12%, underscoring the defensive characteristic of CGBs. The historical data clearly show that increasing CNY bonds in any global investment portfolio will have the benefit to improve its resilience during market volatility and as a result, its risk-reward profile. Such low correlation enhances portfolio resilience and supports strategic allocation for reserve managers seeking diversification with reasonable return.



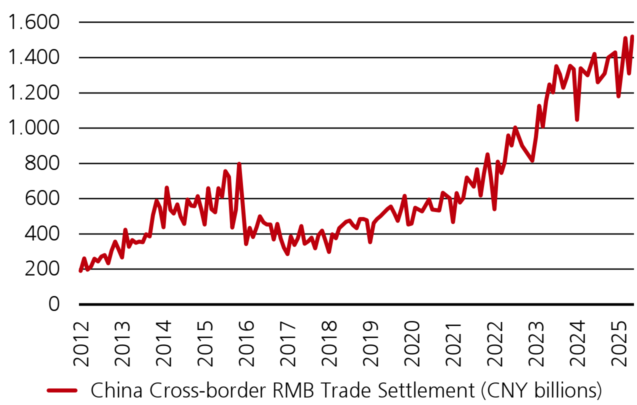
Past performance information is not indicative of future performance. If the currency of a financial product or financial service is different from your reference currency, the return can increase or decrease as a result of currency fluctuations.

Source: Bloomberg Finance L.P. Data as of end June 2025. For illustrative purposes only.
Note: Correlations are made to the China bond market, represented by Bloomberg Index I08271CN. Major equity markets are represented by the following indexes: (S&P 500) Bloomberg code: SPX:IND; Europe Equities represented by EURO STOXX 50 Index, Bloomberg code: SX5E:Ind; China Equities: represented by Shanghai Stock Exchange Composite Index. Bloomberg code: SHCOMP; World Equities represented by MSCI World Index, Bloomberg code: MXWO; UK Equities represented by FTSE 100 Index, Bloomberg code: UKX. Based on monthly return data.

3. China has stabilized for better quality growth
Despite cyclical headwinds, China's economy has shown signs of stabilization. China's 2Q25 GDP growth remained solid at 5.2% yoy, and overall macro growth in 1H exceeded the full-year government target of around 5%. Policy support and easing measures have helped anchor investor sentiment, particularly in the property sector. This backdrop supports continued demand for high-quality fixed income instruments.

4. RMB has been performing
The RMB is increasingly supported by structural tailwinds including China's persistent current account surplus, disciplined FX reserve management, and rising global demand amid de-dollarization. The RMB is increasingly positioned as a regional anchor currency, supported by macro and policy tailwinds. During recent market volatility and policy uncertainty under the Trump administration, CNY has appreciated 1.89% against USD in 1H 2025.

Cross border RMB trade settlement



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In the most recent 31st Reserve Manager Survey (RMS) conducted by UBS Asset Management, central banks continue to add to their Euro and RMB positions, which underscores the significance of RMB from a portfolio perspective.

Why invest in UBS China Fixed Income Fund?

A "pure-play" & actively managed strategy with prudence

100% IG strategy with pure exposure to high-quality Chinese government and government-related bonds.
– Yield to maturity: 1.92% vs benchmark 1.70% in CNY
– Duration: 6.28yr vs benchmark 5.90yr
– Average credit rating: A

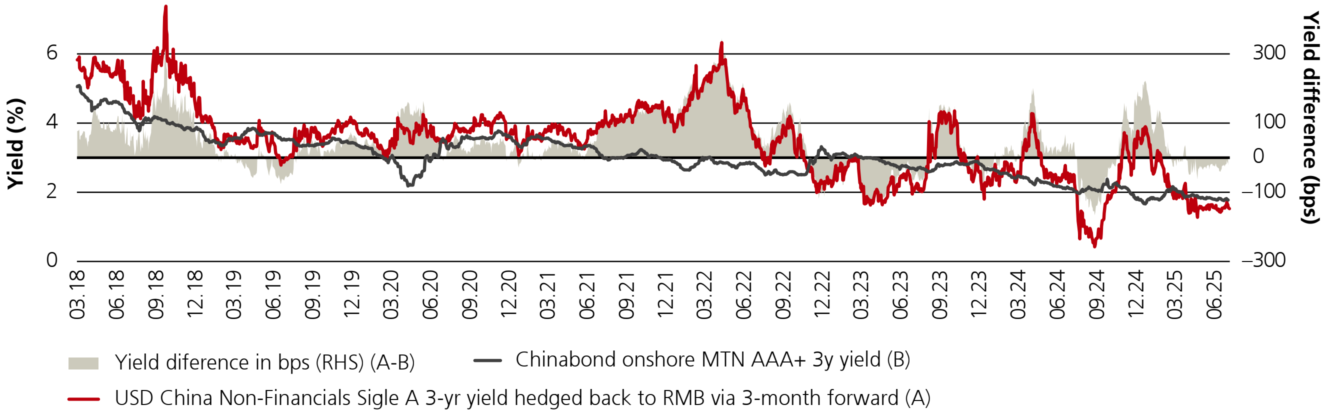
The shown yield-to-maturity is calculated as of end June 2025 and does not take into account costs, changes in the portfolio, market fluctuations and potential defaults. The yield to maturity is an indication only and is subject to change.

Source: UBS Asset Management. Data as of end June 2025.

Actively managed across duration, sector, and issuer selection. It maintains a core allocation to high-quality CGBs and policy bank bonds, while selectively investing in agencies and central SOEs for yield enhancement. The strategy is benchmarked against the Bloomberg China Aggregate whole market Index but is not constrained by it, allowing for tactical flexibility and active return generation.

Prudent credit selection to capture credit alpha opportunities with zero default history in the fund, supported by an experienced team of portfolio managers and credit analysts.

Value added through tactical allocation between onshore CNY bonds and offshore CNH & USD bonds based on relative value changes, leveraging the team's over 20 years' experience in both China onshore fixed income and offshore Asian credit market. The recent relaxation of Southbound Bond Connect has enabled onshore non-bank financial institutions (i.e. asset managers, insurance companies and securities firms) to access the CNH market through Southbound Bond Connect, leading to a strong demand of CNH bonds. There is also notable yield pick-up for CNH bonds vs CNY bonds for the same issue with similar tenor. Hedging Chinese issuers' USD bonds to CNH could create yield enhancement from time to time. The Bloomberg USD China Non-Financials Single A 3-year yield shows yield differentials ranging from -150 to +300 bps by hedging offshore USD bonds into CNH, presenting periodic opportunities for active allocation.



Yield is not guaranteed.

Source: WIND, Bloomberg Finance L.P. Data as of 21 July 2025

Risk Management is paramount. Despite LGB comprising >17% of the index, we maintain our underweight due to liquidity concerns, although we started to have some allocations within the sector such as Guangdong local government bonds, which is the largest Tier-1 province in China, and has a strong macro-fundamental profile with high liquidity. The fund excludes LGFVs (local government financing vehicles) entirely due to structural illiquidity.

Long-standing investment expertise
We have invested in China's fixed income market since 2010. The portfolio is managed by seasoned fixed-income investment professionals, with an average experience of over 18 years. Under the leadership of Raymond Gui (lead portfolio manager of the China Fixed Income fund and Head of Portfolio Management for Asia Fixed Income), this fund has won several Accolades. Most recently, it has been awarded the Yinghua Awards (Overseas Fund) 2023 in the three-year Yinghua Awards – Greater China Fixed Income category.

Source: CHINAFUND, https://www.chnfund.com/article/AR20231205113319868249 18

Frequently asked questions

1. Why an actively managed fund instead of CGB?
The evolving Chinese bond market presents inefficiencies and opportunities best captured through active management. Tactical allocations to central SOEs and offshore CNH/USD bonds offer yield enhancement over passive sovereign exposure. The fund's dynamic strategy, backed by deep research and market insight, aims to deliver stable income and capital gains amid China's easing cycle. As of end June 2025, the UBS China Fixed Income strategy has delivered an annualized gross outperformance of 29 bps over the Bloomberg China Treasury 5–7 Years Index.

2. Where do we see investment opportunities & risk within the universe?
We see value in selected high-quality credits of **central state-owned enterprises (SOEs)**. While central SOEs could technically be considered corporate credits, they tend to have some direct or indirect linkages to the government. As quasi-sovereign and high-quality credits, they provide good yield enhancement over CGBs and policy bank bonds.

Our fund has no positions in **local government financing vehicles (LGFVs)** which account for around 1-2% of the entire universe. As LGFVs tend to be more illiquid instruments, they do not fit the fund's profile.

We recommend exercising caution further down the credit curve. We think that the current yield advantage of lower-rated bonds in sectors such as weaker local SOEs, LGFVs and private companies is not high enough to justify the credit risk. Credit spreads in these sectors, especially in lower quality categories, have approached historical tights.

Sector breakdown: UBS China Fixed Income Fund vs Index (China Aggregate)

Sector	MV%	MV% (Index)	UW/OW
Government National	29.32%	37.78%	-8.45%
Government Policy Banks	26.71%	30.21%	-3.50%
Agencies (China Railway & Central Huijin)	6.90%	0.74%	6.17%
LGBs	13.29%	17.64%	-4.35%
Central SOEs	20.76%	9.15%	11.61%
Local SOEs	0.00%	0.00%	0.00%
Corporates	1.71%	4.49%	-2.78%
Cash	1.30%	0.00%	1.30%
Total	100.00%	100.00%	0.00%

Past allocations are not indicative of future allocations or performance.

Source: UBS Asset Management. Data as of end June 2025. For illustrative purposes only. Past allocations are not indicative of future allocations or performance.

Opportunities

- This diversified bond portfolio can be used to participate in the opportunities in the China fixed income market, as well as exposure to Chinese Yuan
- The strategy is actively managed across duration, yield curve, sector and security selection in accordance with market conditions. This allows the portfolio to be dynamically adjusted throughout market cycles
- The portfolio manager is not tied to the benchmark (Bloomberg China Aggregate Index in CNY) in terms of investment selection or weight.

Risks

- Emerging markets are at an early stage of development which can typically involve a high level of price volatility and other specific risks such as lower market transparency, regulatory hurdles, corporate governance and political and social challenges. Corresponding risk tolerance and capacity are required
- All investments are subject to market fluctuations
- The strategy can invest in less liquid assets that may be difficult to sell in the case of distressed markets
- Every strategy has specific risks, which can significantly increase under unusual market conditions. The strategy can use derivatives, which may result in additional risks (particularly counterparty risk)

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