

Chinese equities in 2018

UBS Asset Management

Bin Shi, UBS Asset Management's Head of China Equities, looks back on an outstanding year in 2017 and gives his **outlook for markets and strategy in 2018**.

2017 was a strong year for China equities

2017 was a strong year for Chinese equities with the economy performing better than expected and many stocks rising from low valuations. Through the year, many companies were re-rated and some Chinese companies delivered strong earnings growth.

Valuations remain reasonable

While valuations have risen, we are still optimistic on prospects for 2018 and believe valuations currently look reasonable compared to fundamentals. Different from previous years, fundamental factors have been behind the recent rise in the market and we see little reason for that to change in 2018.

Slower GDP, deleveraging policy not a concern

We aren't overly concerned about the possibility of slower growth in China during 2018. It's true that deleveraging is part of government policy in 2018 but private companies, most of whom have excellent cash flow and little or no debt, look like attractive opportunities. Old economy companies with high debt levels, will likely feel pressure.

Fundamental factors are driving performance

Health, IT and consumer sectors have their own fundamental growth drivers that are propelling growth as China undergoes profound economic and social changes and these drivers are largely unaffected by slight changes in China's macroeconomic statistics.

Take healthcare as an example, there is an undersupply of health services in China but demand is growing due to fundamental changes in China's economy and society, such as ageing population, increasing incomes, and changing lifestyle aspirations.

Spending on health remains low by international standards but this is changing as these fundamental factors play out. In fact, we have seen strong growth in industry revenues in recent years and we expect this to continue as health spending per capita increases and potentially exceeds levels in more developed economies.

New economy sectors are emerging; Chinese firms becoming more competitive

China's economy is seeing profound changes with many new sectors emerging from economic rebalancing that have great potential for growth over the long-term.

We have witnessed these changes first-hand from our numerous visits to companies in China. Chinese companies are attracting the talent, building the innovative capacity, and developing the products to compete globally.

Take our recent visit to a China-based pharmaceutical developer for example. At that company, world-class scientists previously at global rivals now lead their drug and product development. This shows the company has the potential to recruit the best talent that will soon deliver a range of advanced, globally competitive products.

Improving corporate governance in China will also promote investors' understanding of the Chinese companies. We believe that the quality of companies currently in the Chinese equity markets is much higher than before, and that raises the prospect of sustained performance in the markets over the longer term.

Onshore markets more accessible than ever; overseas investors increasingly active

As China's equity opportunity set changes, China's equity markets are becoming more accessible than ever. The launch of the Shenzhen-Hong Kong Stock Connect in late 2016, following the Shanghai-Hong Kong Stock Connect in 2014, has opened up a wide range of opportunities for overseas investors.

Overseas investors are allocating more capital to China's equity markets, with aggregate figures showing foreign investors' total holdings reached RMB 1.021 trillion at the

end of September 2017, a 50% increase from the RMB 656.2 billion recorded at the same point in 2016, according to data compiled by People's Bank of China.

Overseas investors will likely become more active in the market when 222 A-share stocks enter the MSCI benchmarks in June 2018. The 222 names to be included are all blue-chip companies and may get a boost in 2018 as overseas investors step up their capital allocations.

Optimistic on 2018, many opportunities in the market

So we are positive on the outlook for Chinese equities markets in 2018. We maintain that the profound changes playing out in China's economy are creating many attractive opportunities, particularly in 'new economy' sectors like healthcare, IT and insurance. Investors can be confident about the future because a changing China is offering significant opportunities for growth.

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