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An improving outlook

Renewed government efforts to support the Chinese economy represent opportunity | UBS Asset Management

Bin Shi, Head of China Equities

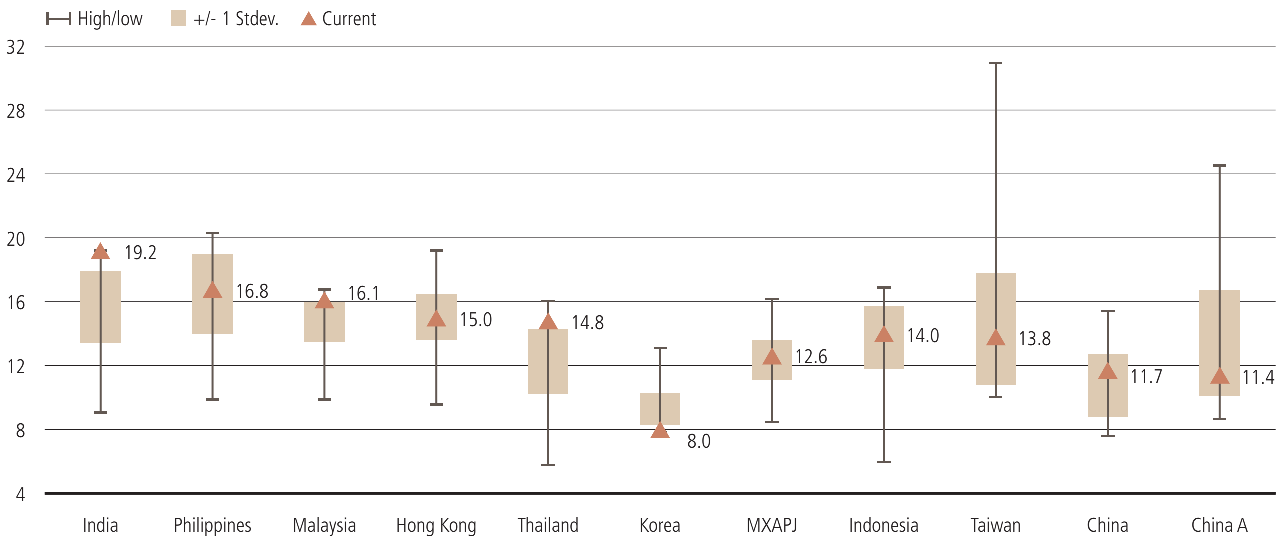
While 2018 has been a challenging year, we believe recent policy developments constitute a turning point for China's stock markets and that the current environment presents investors with an opportunity to add to their China equity allocations.

China's policy stance has changed
We moved to a more cautious stance to the market earlier in 2018. This decision was driven by the Chinese government's tough approach to broader regulation and to debt deleveraging in particular, as well as the US/China trade dispute.

But looking at a series of recent policy statements and news announcements, we believe there has been a significant change in the Chinese government's attitude, making a compromise on US/China trade issues more possible going forward. BMW's recently announced move to take majority control of its local joint venture with Brilliance Automotive, a China-based automaker, shows that the Chinese government has opened up key industrial sectors to investment from overseas companies, reversing a position of limiting investment into China that has been a key source of disagreement in the US/China trade dispute.

But policy changes haven't yet been fully absorbed by the market
Additionally, the Chinese government has reversed a series of tough policies introduced earlier in 2018, such as a social security tax and taxes on private equity investments, demonstrating a concerted effort to step up support for the economy.

Exhibit 1: 10 years' History: 12M forward P/E Ratio



Source: FactSet, MSCI, UBS Asset Management, data as of end September 2018.

These changes in domestic policy are highly significant because the government's previous policy attitude has hurt investor confidence and has been the biggest influence on the market this year. As noted earlier, some of these policy changes provide hope for a reduction in US/China trade tensions, which have also been a contributing factor to market volatility.

Though we have seen a lot of government announcements, we feel that the new policy support has not yet been fully understood or absorbed by the market. However, we believe it will positively impact investor sentiment going into 2019.

Significantly, the change in policy attitude, and the increased possibility of a resolution to trade issues, means that systemic risk in the Chinese equity market has diminished significantly.

We are putting cash to work
As such, we have turned more positive on the outlook for China equities.

During the first half of 2018 our cash levels increased because of weaker sentiment and heightened volatility in the market but recently we have deployed some of that cash.

Going forward, we expect to put more cash to work because we believe that current valuation levels in China's equity markets are attractive and we see many opportunities in which to invest.

Staying disciplined, focused on long-term winners
Though we have turned more positive on market prospects and we will likely be less defensive in our equity allocations in the near future, we'll remain disciplined in our investment approach.

We will maintain our focus on companies that we believe will deliver growth over the long-term. We continue to be positive on 'new economy' companies in sectors like consumer, IT, and healthcare.

We'll most likely add to sectors highly impacted by government regulations, like online gaming and education, because we expect some of these regulations to be relaxed in the future.

In summary, we think that investors have reason to be more optimistic on Chinese equities and, as we see an improving outlook for the market, we believe it is a good time for investors to take action.

This article is part of *Panorama: Investing in 2019*, UBS Asset Management's outlook for the year ahead. For the full publication and further insights, visit **ubs.com/panorama**.

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