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# Tariff risks remain despite reprieve for China's internet sector

20 February 2025, 3:30 pm MYT, written by UBS Editorial Team

**The MSCI China index has staged an impressive surge that has outpaced the S&P 500 since mid-January, largely on a revival of the tech sector. However, we note that tariff risks remain, and China's domestic issues have not been fully resolved. We would avoid adding broad exposure to China's equities but expect the internet sector to outperform as the multi-year regulatory crackdown appears to be over. We also remain bearish on the CNY and prefer to be long USDCNY for 7.50 by 2H, which yields a positive carry of 2% per annum.**

The recent surge in the MSCI China index (MXCN), outperforming the S&P 500 by some distance, might prove tempting for investors against a backdrop of tariff uncertainty. Over the last few weeks, the Trump administration has backed off from four different tariff proposals that it had threatened: on imports from Colombia, Mexico, Canada; and goods worth under USD 800. The VIX equity volatility index has also declined from a late-January intraday high of 22.50 to around 15.50 currently.

Since their respective mid-January troughs, the MXCN has outperformed the S&P 500, rising around 22% versus 5%. That this was in the wake of the DeepSeek reveal, and largely on the back of a strong rise in China tech stocks, might well tempt investors to further their efforts on their China exposure to ride this latest outperformance.

Although we have long warned that policy accommodation and attractive valuations warranted a Neutral view (even as the MXCN underperformed the S&P in 2024), we would urge investors to think twice before adding more broad-China

exposure. Instead, we would note that the reasons for not going beyond Neutral are still in place, and investors should continue to overlay the Neutral China view with a more granular tactical skew toward internet stocks.

**Remain Neutral on tariff risks.** We acknowledge some positive near-term catalysts for the broad China market—improving fundamentals in the core internet segments (e-commerce, gaming, advertising), policy support, and reasonable valuations—and raise our MXCN targets to 75 in June and 77 in December. Nevertheless, we stay Neutral given the uncertainty over US tariffs and policies. For one, it should be noted that the four suspended tariffs could easily become active again. Additionally, tariffs on China's exports could be raised further. China's economy is also not past its own internal issues—consumption and investment sentiment remain soft, with policy support still tepid.

Indeed, this halting recovery has seen the MXCN stage two surges in the last 12 months, only to be mostly reversed both times, shortly after. The first episode from April to August 2024 saw the MXCN rise 20.2% before falling 15%; the second episode from September 2024 to January 2025 saw a 39.8% surge followed by a 21.2% retracement. Even as the tech sector soaks up the limelight for now, investors should remember that defensive sectors like financials, utilities, and energy provide dividend income that can help stabilize portfolios in times of volatility.

**China internet sector to outperform.** While the revelation of DeepSeek's cost effectiveness helped spark the current surge in China tech stocks, we think that the supportive tone at the recent private sector symposium underpins its likely sustained outperformance. We think the symposium marks the end of the regulatory crackdown that began in 2020. President Xi's endorsement of the role that tech and private sector firms will play in driving future economic growth suggests that the government is satisfied with the current regulatory environment and has returned to focusing on collaborating with leading internet firms. This could potentially remove the biggest drag on the sector's overall growth prospects and planned investment, as well as market sentiment on the sector. We thus see the China internet sector as Attractive and expect it to deliver around 15% returns through 2025 and recommend focusing China exposure on select internet names. However, rallies beyond our targets should be used to trim and diversify exposure.

**Long USDCNY to buffer against tariff risks.** We maintain a bearish view on the yuan amid global tariff uncertainty. We had until recently preferred to express this by going long INRCNY to enjoy the 4.4% per annum carry. However, the recent change in the RBI governor seems to have also brought a less interventionist approach to managing the INR, which has led to an increase in volatility. We thus now prefer to go long USDCNY instead, and see the pair moving to 7.50 by 2H2025. This long-USDCNY position also offers a decent positive carry of 2% per annum.

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