China's economic recovery can resume, powered by strong consumption. Chinese stocks can benefit on stronger earnings and geopolitical clarity. (UBS)

Can China plays regain momentum?

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Investments linked to China have recently underwhelmed due to a softening in economic activity and geopolitical uncertainty. We still believe in China's consumer-driven growth recovery. Better earnings and geopolitical clarity can boost Chinese stocks.

Growth differentials versus developed markets should support EM bonds and stocks, while supply-demand imbalances can underpin commodities.

China-linked investments lagged on growth and geopolitics.

- Chinese equities underperformed other emerging market equities by about 7 percentage points over the last two months. Commodities fell back to March 2022 lows.
- Weaker April economic data made investors question China's economic outlook.
- A potential US executive order to limit outbound investment in sensitive high-tech Chinese sectors also dented sentiment.

But stronger consumption and an earnings catch up should support Chinese stocks.

- Retail sales climbed 18.4% year-over-year on stronger auto sales and further service sector reopening.
- We now see GDP growth of at least 5.7% this year, led by consumption growth of around 10% and resilient investments.
- First-quarter results so far have beaten the 15% y/y contraction reported in the last quarter of 2022, but lag behind the economic improvement.

We remain most preferred on Chinese and EM equities, EM bonds, and commodities.

- We expect 14% China earnings growth this year. MSCI China's forward price-to-earnings ratio of 9.8x is just 20% higher than last October's crisis trough.
- Within Chinese equities, we favor a barbell approach between reopening beneficiaries and sectors with high and resilient dividends (financials and utilities).
- We like commodities on the back of supply-demand imbalances. We're most preferred on EM bonds and equities due to better business and policy cycle dynamics versus the US.

Did you know?

- Since October 2022, a basket of global China beneficiaries has outperformed the global equity benchmark by around 10pps, even as Chinese stocks have relatively underperformed. We believe this reflects geopolitics weighing on investor sentiment.
- Internet companies that have announced first-quarter results so far have recorded around 60% y/y earnings growth on average. Managers are noting a promising sequential improvement from April.The government has set an official 2023 GDP target of "around 5%," prioritizing boosting domestic consumption.

Investment view

China's economic recovery can resume, powered by strong consumption. Chinese stocks can benefit on stronger earnings and geopolitical clarity. We are most preferred on EM bonds and equities, and commodities in our global strategy.

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