Macro Keys

Dark Skies Over China and the Impact on US Equities

Economics & Macro Strategy

Global

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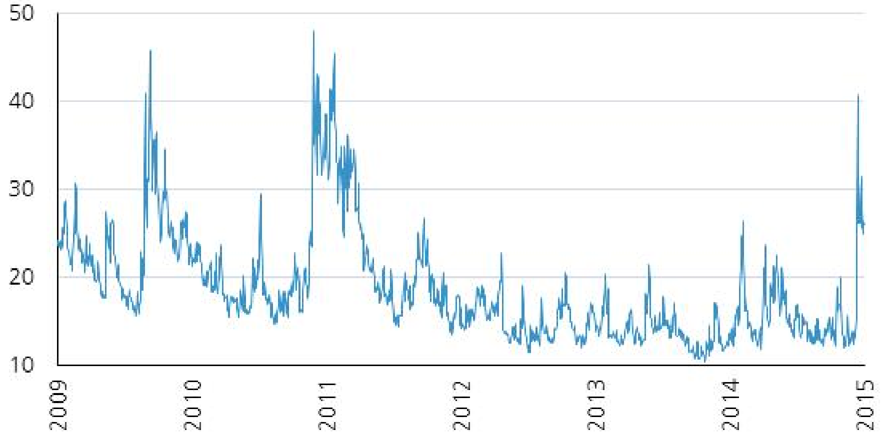
4% China GDP in 2016 – What If?

Uncertainty abounds with regard to China. The Summer's soft economic news alongside an equity market searching for stability in the aftermath of an historic plunge accompanied by a surprise currency devaluation on August 11, has reverberated to the US. The result is a market correction and a seismic shift, ending four years of exceptionally low volatility (Figure 1). While China Economist Tao Wang maintains her 6.5% GDP forecast for 2016, citing successes in policy stabilization and limited household exposure to equities (see 7/10, Macro Keys – China Through the US Looking Glass), the turbulence compels us to ask: What happens to US Equities if China GDP falls to 4% in 2016? From a top down perspective, the US' actual exposure to China is minimal – exports less than 1% of US GDP and revenue less than 1.5% of the S&P 500 total. The pressure to S&P 500 valuation would result from a spillover rerating in other markets; however both our Asian (see 9/2, APAC Equity Strategy, A deep dive into what's priced in) and European counterparts (see 8/26, Macro Strategy Key Issue – China risks for Europe: What is priced in?) believe much of the Dark Skies scenario is priced in. We see downside to S&P 500 valuation of an additional 1.6 multiple points which would equate the current correction to the pullback during the 2011 US Debt Ceiling Crisis/Economic Soft Patch.

'Crisis' = 'Danger' + 'Opportunity'

A common Western interpretation of the Chinese symbol for 'Crisis' is that it is a combination of two other symbols – 'Danger' and 'Opportunity.' With this in mind, we asked our North American analysts which of their stocks are most/least exposed to China and to what degree a Chinese "Dark Skies" scenario is priced in at present. We present their thoughts and compile two lists on page 7, stocks with generally lower China exposure where the 'Opportunity' stems from a perceived over-discounting of risk associated with Dark Skies and names where the 'Danger' is that China downside is insufficiently discounted.

Figure 1: VIX – The Storm After the Calm, 2015



Source: Bloomberg, UBS (VIX Index)

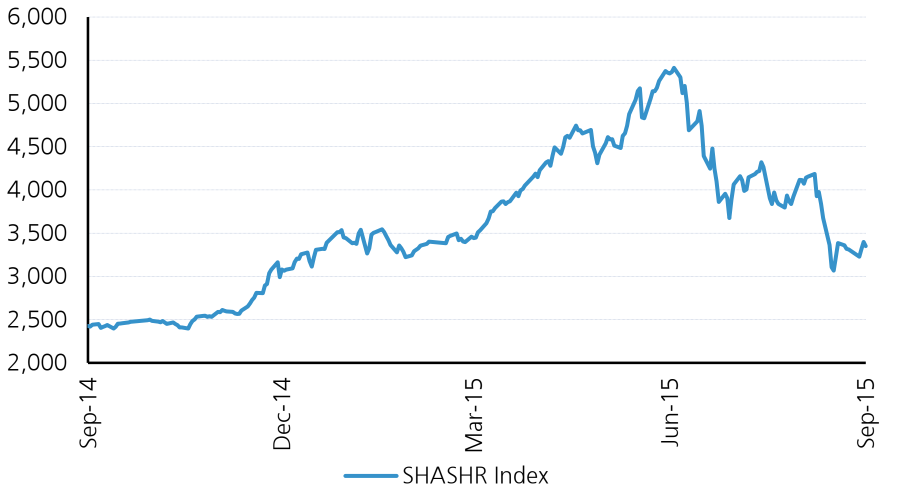
www.ubs.com/economics

4% China GDP in 2016 – What If?

Change frequently requires a discrete, identifiable catalyst.

What precipitated China's equity market top on June 12 (Figure 2)

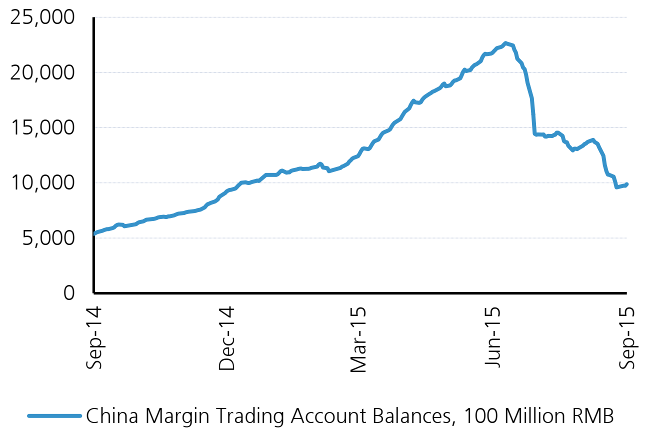
Figure 2: The Rise and Fall



Source: Bloomberg, UBS

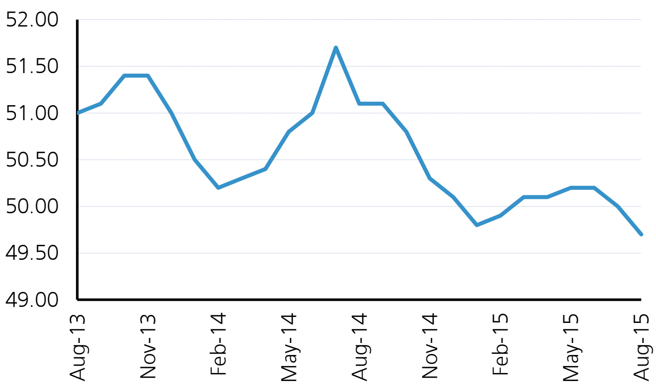
was not solely the build-up in margin trading accounts (Figure 3) nor the weakness in the economy which had been evident for some months (Figure 4).

Figure 3: To the Hilt and Back



Source: Bloomberg, UBS (CHMDBMT Index)

Figure 4: China Manufacturing PMI



Source: Bloomberg, UBS (CPMINDX Index)

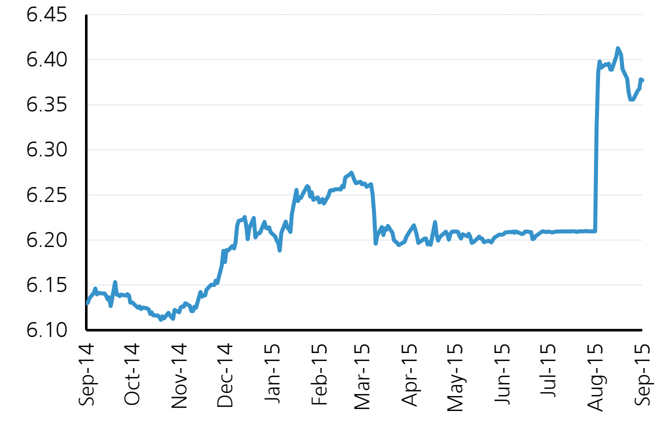
The spark in our view was a leading Index provider's decision to delay the inclusion of China A-shares in its emerging market index on June 9, with the aftermath a 45% selloff, exceeding the historic crash in US equities in 1987 (see 7/10 Macro Keys – China Through the US Looking Glass).

The uncertainty as to whether this China equity market crash would equate to economic circumstances seen in the US in the wake of the 1929 crash – a

Depression, or to the 1987 crash – barely an economic blip in a strong growth trajectory (Tao Wang's base case for China) is a debate to be played out over the course of 2015 and 2016.

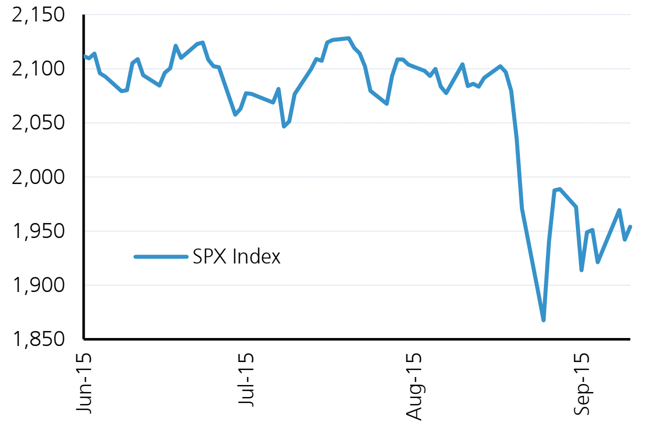
Chinese uncertainty thus became something the US equity market could no longer ignore – catalyzed by China's devaluing its currency on August 11 (Figure 5) with the result being the 13th correction in the S&P 500 of 5% or more since the bull market began in 2009, coming on the heels of the tightest trading range in years (Figure 6).

Figure 5: CNY/$ – A New Regime Begins…



Source: Bloomberg, UBS (CNY Curncy)

Figure 6: …and US Stocks Swoon



Source: Bloomberg, UBS (SPX Index)

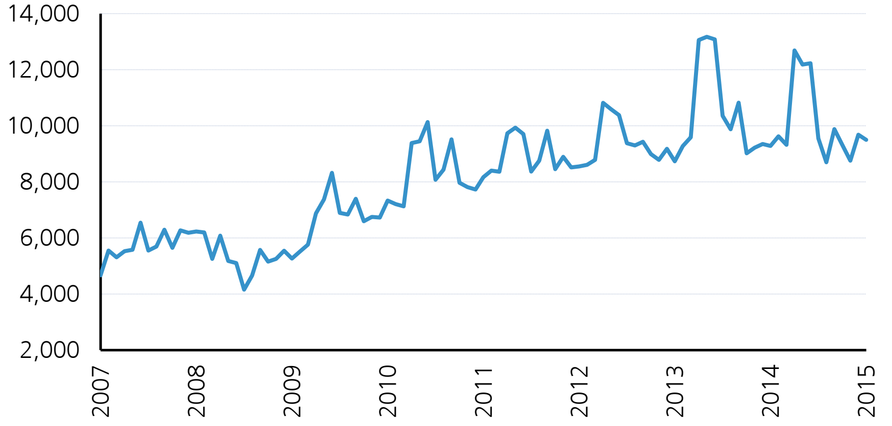
The intersection of persistent concern over China's growth path and the unknown of the Fed's reaction function as it prepares to begin raising interest rates is likely to cause US equity market volatility to remain elevated for the foreseeable future.

Amid all the volatility that carries the potential to signal economic weakness in China well in excess of forecast, we believe it prudent to ask "What happens to US Equities if China GDP falls to 4% in 2016?"

From a top down perspective, the real direct exposure to the US economy is minimal.

According to Chief US Economist Maury Harris, US exports to China are running at around a $110 Billion annual rate (after $124 Billion in 2014, Figure 7). This accounts for 0.6% of the US' $17.9 Trillion GDP (see 8/24 US Economic Comment – How Will US Respond To Foreign Turbulence). So even if a "Dark Skies" scenario were to result in a retrenchment to levels observed during the Financial Crisis (a $75B annual run rate) the haircut to GDP would be 0.2%. Second and third order negative effects on trade, but also positive effects on Energy prices and the pace of US monetary tightening (or lack thereof) would surely ensue; for purposes of this note, we regard these as largely countervailing forces.

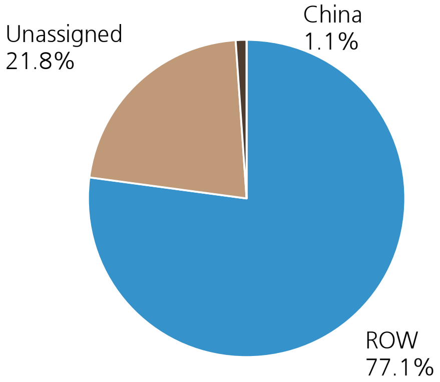
Figure 7: US Exports to China, $Millions, Monthly



Source: Bloomberg, UBS (TBEXCHNA Index)

As far as revenue impact on the S&P 500, China accounts for between 1 and 1.5% of total S&P 500 revenue (Figure 8) so even a revenue decline as severe as 20 – 30% were China GDP to fall to 4% in 2016 would carry minimal impact, 0.3 – 0.4% to total revenues.

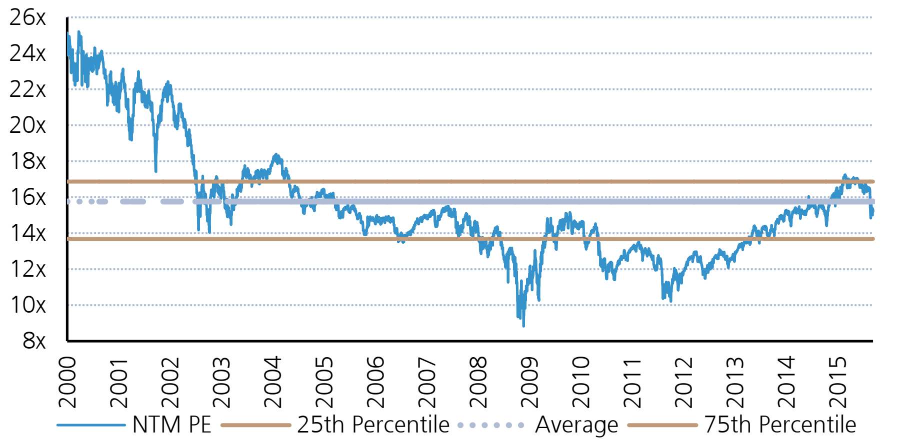
Figure 8: S&P 500 Revenue Exposure China vs Rest of World



Source: Bloomberg, UBS

Where we believe the fallout to a 4% China GDP in 2016 would lie with respect to US equity market prices would be in multiple compression to the S&P 500, where the NTM multiple has fallen from a recent peak near 17x to the current level of 15.3x (Figure 9), well below the average of the past 15 years.

Figure 9: NTM PE 2000 - 2015



Source: FactSet, UBS

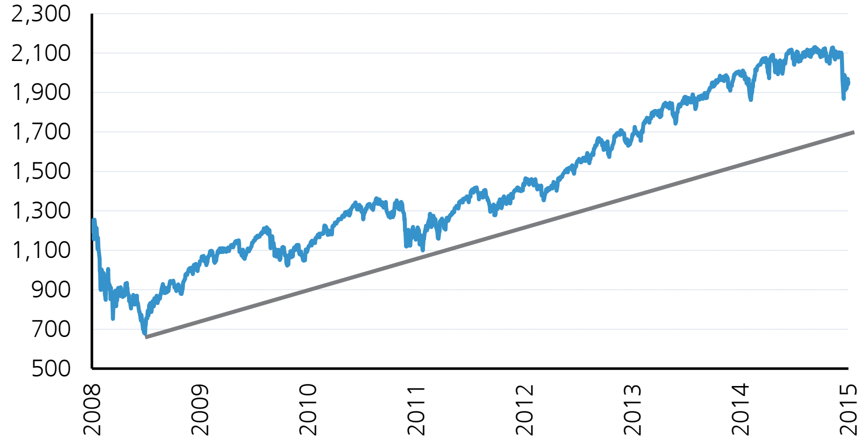
A profits recession in a China "Dark Skies" scenario is far more likely in APAC and, to a lesser extent, in Europe, as these regions' companies have far greater direct exposure to China.

Nevertheless, we believe that a further valuation discount to the S&P 500, returning it to its bottom quartile of valuation over the past 15 years – observations which include the Great Financial Crisis, US Debt Ceiling/Economic soft patch period of 2011, and the European peripheral existential ("Whatever it Takes") crisis of 2012 – would ensue.

At 13.7x NTM consensus estimate earnings of $127.71, downside to the S&P 500 could extend to 1,750, which would represent a pullback of 18% from the all-time high. Even with a hypothetical "earnings contagion" resulting in a flat YoY comparison to 2014 and 2015's consensus estimate of $118.92, 1,750 yields a multiple of 14.7x, a full turn below the average, and in an environment where the 10 year yield currently resides at 2.2%.

This downside scenario is consistent with 2011's US Debt Ceiling episode, a period where there was threat to the functioning of the US government, at a time when a "growth soft patch" (3Q2011 GDP was 0.8%) had already developed. The fact that 4% China GDP is not likely to carry systemic implications for the US itself, while Maury Harris projects US GDP growth of 2.8% in 2016, makes 1,750 a true tail risk, unlikely to end the 6 ½ year long bull market (Figure 10).

Figure 10: S&P 500 – Bull Wounded, Not Finished



Source: Bloomberg, UBS

What then are the Micro implications of a China "Dark Skies" scenario?

'Crisis' = 'Danger' + 'Opportunity': The Bottom-Up View

Despite the limited revenue exposure to China at the S&P 500 index level, the potential impact of a hard landing in China is unlikely to be evenly felt at the company level. For a more thorough understanding of the bottom-up impact on US equities of a "Dark Skies" scenario in China, we leveraged the expertise and breadth of our sector analysts asking them what the overall exposure to China is in their sector/industry in addition to identifying the most and least exposed stocks, and whether they believed a China "Dark Skies" scenario was (or was not) being priced in.

Judging from the commentary which follows on pages 8 -13, it is clear in some cases that a hard landing has essentially been priced in – thereby providing the upside if China indeed does avoid the downside scenario – while in the case of other stocks, further weakness hasn't yet been priced in and could be vulnerable to continued uncertainty and weakness in China.

We present on page 7 two lists of stocks; First, UBS Buy-rated stocks where Analysts view their companies to be minimally exposed to China and/or where the Risks of "Dark Skies" are priced in – such stocks, largely in Health Care, Technology and select Energy subsectors, represent upside Opportunity at current prices. Second, UBS Neutral- and Sell-rated stocks – consumer names prominently – most exposed to China or those where analysts perceive China "Dark Skies" to be insufficiently discounted, representing prospective sources of downside risk in the event China GDP falls to 4% in 2016.

Figure 11: Least Exposed and/or Risks Priced In

Ticker	Name	Sector	Analyst	UBS Rating	Upside to Price Target	Market Cap ($Bil)	Pull Back Since China Market Top (6/12/15)
BDX	Becton Dickinson and Co	Health Care	Jonathan P Groberg	Buy	23.5%	$28.43	-3.2%
QGEN	QIAGEN NV	Health Care	Jonathan P Groberg	Buy	21.0%	$6.13	6.2%
HOLX	Hologic Inc	Health Care	Jonathan P Groberg	Buy	14.2%	$11.10	5.6%
COG	Cabot Oil & Gas Corp	Energy	William A Featherston	Buy	30.2%	$9.54	-31.8%
NBR	Nabors Industries Ltd	Energy	Angeline M Sedita	Buy	67.8%	$3.35	-30.7%
PTEN	Patterson-UTI Energy Inc	Energy	Angeline M Sedita	Buy	72.3%	$2.14	-30.8%
HP	Helmerich & Payne Inc	Energy	Angeline M Sedita	Buy	56.0%	$5.53	-30.2%
UHS	Universal Health Services Inc	Health Care	A J Rice	Buy	23.2%	$13.35	3.4%
HCA	HCA Holdings Inc	Health Care	A J Rice	Buy	24.3%	$35.41	3.4%
CYH	Community Health Systems Inc	Health Care	A J Rice	Buy	47.6%	$6.16	-3.4%
LPNT	LifePoint Health Inc	Health Care	A J Rice	Buy	24.8%	$3.49	4.9%
THC	Tenet Healthcare Corp	Health Care	A J Rice	Buy	56.9%	$4.70	-9.0%
AAPL	Apple Inc	Information Technology	Steven M Milunovich	Buy	33.3%	$641.96	-11.5%
TEL	TE Connectivity Ltd	Information Technology	Amitabh Passi	Buy	29.5%	$24.24	-12.5%

Source: Bloomberg, UBS

Figure 12: Most Exposed and/or Risks Not Priced In

Ticker	Name	Sector	Analyst	UBS Rating	Upside to Price Target	Market Cap ($Bil)	Pull Back Since China Market Top (6/12/15)
TCK	Teck Resources Ltd	Materials	Brian T Macarthur	Neutral	72.1%	$3.88	-40.8%
X	United States Steel Corp	Materials	Matthew Murphy	Neutral	66.0%	$2.11	-41.1%
PG	Procter & Gamble Co/The	Consumer Staples	Stephen Powers	Neutral	20.0%	$185.36	-13.4%
CL	Colgate-Palmolive Co	Consumer Staples	Stephen Powers	Neutral	16.3%	$55.75	-6.6%
CAT	Caterpillar Inc	Industrials	Steven Fisher	Neutral	9.1%	$43.64	-17.6%
JOY	Joy Global Inc	Industrials	Steven Fisher	Neutral	11.5%	$1.75	-53.8%
WYNN	Wynn Resorts Ltd	Consumer Discretionary	Robin M Farley	Neutral	55.0%	$7.07	-32.2%
MGM	MGM Resorts International	Consumer Discretionary	Robin M Farley	Neutral	11.0%	$11.67	6.6%
LVS	Las Vegas Sands Corp	Consumer Discretionary	Robin M Farley	Neutral	11.7%	$37.11	-10.9%
ITT	ITT Corp	Industrials	Shannon O'Callaghan	Neutral	13.4%	$3.23	-15.0%
EMR	Emerson Electric Co	Industrials	Shannon O'Callaghan	Neutral	25.1%	$30.47	-22.2%
PNR	Pentair PLC	Industrials	Shannon O'Callaghan	Neutral	19.9%	$9.76	-12.7%
TGI	Triumph Group Inc	Industrials	David E Strauss	Sell	-3.2%	$2.34	-30.7%
BA	Boeing Co/The	Industrials	David E Strauss	Neutral	8.6%	$90.75	-6.5%
CHK	Chesapeake Energy Corp	Energy	William A Featherston	Sell	-34.1%	$5.05	-38.0%
MUR	Murphy Oil Corp	Energy	William A Featherston	Neutral	6.5%	$4.87	-35.1%
CVX	Chevron Corp	Energy	William A Featherston	Neutral	7.1%	$142.37	-24.2%
COP	ConocoPhillips	Energy	William A Featherston	Neutral	1.2%	$59.74	-23.7%
UA	Under Armour Inc	Consumer Discretionary	Michael Binetti	Neutral	4.0%	$20.74	18.3%
WMT	Wal-Mart Stores Inc	Consumer Staples	Michael Lasser	Neutral	17.0%	$205.56	-11.5%

Source: Bloomberg, UBS

Consumer

Restaurants

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Within our coverage universe, Yum! Brands has the largest exposure to China by a wide margin, including ~50% of sales and approximately 1/3 of operating profit, while McDonald's and Starbucks maintain relatively limited exposure and Dunkin' Brands and Restaurant Brands International have little exposure. For YUM, we recognize the potential for macro volatility to impact the China sales recovery, but thus far our channel checks indicate franchisees aren't seeing evidence yet that macro pressures have weighed on consumer demand – importantly similar sentiment was expressed even among franchisees from lower tier cities more directly linked to the industrial/manufacturing slowdown. Our YUM sum-of-the-parts analysis indicates that based on current prices and assuming our target multiple for the YUM Global franchisor business, implied valuation for the YUM China business is less than 3x EBITDA. We continue to view recent weakness as a attractive buying opportunity given margin-driven upside to consensus China profit estimates, low China sss expectations, & potential for strategic optionality.

Consumer Hardlines

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Within our coverage, Walmart is the only company that has a considerable retail presence in China, comprising an estimated ~5% of total sales or just under ~$20bn in CY'16. Our downside scenario assumes a ~10% hit to the company's China revenues in that year, bringing down total revenues by ~0.5%. We also assume -5 bps of additional operating margin pressure for WMT. Under this scenario, we estimate that a hard landing in China could negatively impact our FY'16 estimates by -$0.07, or -1.5%.

Consumer Apparel & Retail

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With the US softlines sector, Coach and Nike are the most exposed to ongoing consumer spending volatility in China. China is ~14% of total revenues for Coach and ~10% of total revenues for Nike, and we would note that China is one of the highest margin regions for both companies. On the cost side, a substantial amount of apparel and footwear is manufactured in China, which could benefit Nike (given ~32% of footwear units are manufactured in China) and to a lesser extent, Under Armour.

Gaming & Leisure

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The most exposed companies in our coverage are in the gaming sector, namely WYNN, MGM and Las Vegas Sands. We don't tie revenue forecast specifically to GDP rate as there are many factors impacting Macau growth rates, but to think about sensitivity of EBITDA and valuation to changes in China growth, we focused on changes in growth in the Macau market. A reduction in the current forecast of +6.7% growth in Macau market in '16 of 5% (to +1.7%) would have the following impacts:

- WYNN: potential impact to EBITDA of ~$100-120m and valuation by $13/share all else being equal.
- MGM: potential impact to EBITDA of $140m and valuation by $1/share all else being equal.
- LVS: potential impact to EBITDA of ~$240-260m and valuation by $3/share all else being equal.

Household Products

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Across our US Household and Personal Care and US Beverages coverage, four names have the most downside risk associated with a "hard landing" in China: EL, PG, KO, and CL. Each of these names derives 5-10% of their revenue from China, and a similar percentage of their profits. While PG, KO, and CL will likely see some offsets in 2016 from lower commodity prices and/or lower local production costs inside China, EL is less likely to similarly benefit – it has less inherent input cost exposure given 80+% gross margins, and manufactures the majority of its products domestically in the US (or in W. Europe). However, EL does have relative pricing power (more so than its peers), sells its products to less economically sensitive consumers, and is entering 2016 with a full innovation pipeline and plans for new door/distribution build-outs in China and other markets — all of which should serve as at least partial offsets to any macro slowing.

Energy

Oil Producers

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While the US E&Ps and Integrated Oils have modest direct exposure to China, the country's disproportionately large percentage of global oil demand growth means shifts in its growth rate have a very large impact on oil prices. From 2009-14, growth in Chinese oil demand accounted for 34% of global oil demand growth, although the rate of absolute YoY growth has slowed. While we forecast a pick up in demand growth this year due to low oil prices, we already expect a structurally lower rate of Chinese oil consumption growth going forward given slowing GDP, energy efficiency gains, and a shift in economic focus from more energy-intensive industrialization to the consumer. Nonetheless, a hard landing of 4.5% GDP growth would cause a slowdown in global demand growth for oil at a time the market is already over-supplied. As such, we would expect little recovery in oil prices from the current 2016 curve of $45/Bbl (grey sky) despite the recent downdraft and could see downside risk to $40/Bbl next year (black sky).

Under those scenarios, the most insulated oil and gas companies would be domestic-focused US natural gas producers with strong balance sheets such as Cabot Oil & Gas. Companies at greatest risk would be E&Ps with high financial and operating leverage to crude oil prices, including Chesapeake Energy, Marathon Oil and Murphy Oil. Under these low case scenarios, we would also expect investors to become increasingly concerned about the FCF deficits coverage for Chevron and ConocoPhillips.

Oil Services & Drilling

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The Oil Service & Drilling coverage universe has indirect exposure to China given high correlation to global crude prices, which would be negatively impacted by any prolonged decrease in Chinese growth expectations. In terms of direct exposure, National Oilwell Varco (NOV) has the most with ~9% of its 2014 revenues derived from China. Several of NOV's major customers include Chinese shipyards. Although NOV's revenues in 2016 from China are backed by firm contracts, in a hard landing scenario we do see some risk of backlog cancellations. The Diversified Service companies (SLB, HAL, BHI, WFT) have very little exposure to China (we estimate ~1%-2%) while the offshore drillers (RIG, DO, ESV, NE, RDC) and US land

drillers (NBR, PTEN, HP) have little to no exposure. However, all of the companies will be affected to some degree as a slower Chinese economy will lead to lower demand and thus lower global oil prices.

Financials

Within the financials space, most of the US domestic-focused companies have little to no exposure (other than second order effects/impact on global growth) – i.e. US regional banks. The situation is similar for REITs and the homebuilders, which have very little, if any) direct exposure to China.

Diversified Financial

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Within our coverage group there is very limited disclosure related specifically to China as most of the firms do not have meaningful businesses there due to government restrictions around capital markets (i.e. most operate via a JV). However, we estimate that China is roughly 10% of Asian revenues, which would mean Citi would be the most exposed to China but it would only amount to about 2% of total revenues. Most of the Asia/APAC revenues for our firms are derived from Japan, Singapore, Australia, etc. One could certainly argue there is a much greater second order impact on these firms but quantifying that would be so subjective that it would likely be of limited value.

Health Care

Similar to financials, most of the sector has very limited, if any, direct exposure to China. The majority of healthcare providers have virtually no Chinese exposure, while the hospital group should be highlighted as having no exposure given their focus on the domestic market here in the US. The same applies for biotech, with a slowdown in Chinese growth having no effect on either products or the supply chain in the space.

Pharmaceuticals

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US pharma's exposure to China is modest, with the exposure for Bristol, Lilly, Merck, and Pfizer ranging between 3-5% of revenues. Pfizer leads with 5%, and Merck is at the other end with 3%. We do not expect the exposure to be materially meaningful to the bottom line, as an aggressive assumption of 10% sales decline in China and no cost cutting to help offset lead to an EPS impact of just ~2-3 cents.

Industrials

Automotive

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While US auto dealers have no exposure to China, China represented 27% of global auto unit sales and about 22% of global auto revenue in 2014. Our black sky outlook (below) reflects a 5% decline in production and a 10% decline in OEM pricing.

China JV profits are about 15% of our Ford 2015 pre-tax profit estimate and about 30% of our GM pre-tax profit estimate. Note, North America represents over 100% of profits for both. The downside volume impact (-10% vs. base case) has a small impact on overall EPS (~2-3%); however, pricing headwinds are more concerning given the challenges in finding offsetting costs in the near term. If pricing falls 10% and sales decline 5%, we estimate the impact would lower GM net income by 11% and Ford net income by 6%. China was 15% of TSLA's 2014 GAAP sales; however, its downside exposure is limited given its higher income customer base and tight global capacity.

For suppliers, China represented ~9% of consolidated 2014 sales and ~12% of sales if JVs are fully consolidated; this likely increased slightly in 2015 due to FX re-measurements. In our report Is the Dragon More Bark than Bite?, we estimated that a 10% decline in China light vehicle sales represented a ~3% EPS hit for suppliers. We updated this analysis to reflect slightly higher base China mix after outsized growth in 2015, higher heavy truck downside risk (-20%), non-auto exposure (-5%), and more cautious view of JV profits. The updated result still only reflects an average ~4% EPS headwind for our bear case of -5% China production (down 10% from our current +5% assumption). In our recent report What are the implications of the China slowdown?, we provide a detailed sensitivity analysis for US and European supplier China profits. We highlight Buy-rated BWA and LEA as being well-positioned. BWA should benefit from significant backlog, and LEA is best insulated from a widening gap between domestic and JV.

Aerospace and Defense

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We expect China to represent ~12% of global new aircraft deliveries in 2016, and think the black sky scenario corresponds to roughly a 1/3 decrease in demand in China, or roughly 4% of total global new aircraft deliveries. For the commercial aftermarket which is driven by airline flying, every 100 bps change in GDP growth in Asia has historically corresponded to a ~170 bps change in passenger traffic. A decrease in China GDP growth of 250 bps would therefore imply traffic growth 400-500 bps lower. Since China represents just over 10% of global airline traffic volume, this would imply roughly 50 bps lower global flight activity and 50 bps lower aftermarket. The defense companies don't have meaningful exposure to China. Overall in the black sky scenario we see the biggest potential impact for SPR, followed by TGI/BA.

Diversified Industrial

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The Electrical Equipment – Multi Industry sector has a relatively small direct exposure to China at ~6% of sales on average, although our sector tends to be more sensitive to macroeconomic headwinds than the overall Chinese economy given its higher concentration in energy, infrastructure, and industrial businesses. While our current 2016 estimates assume a 2% average organic decline in China, we estimate growth could contract by as much as 12% on average under our black sky scenario. Nonetheless, given the small share of China sales, this downside scenario would only impact EE-MI sales by ~0.6% and earnings by ~1.2%, presuming that China's slowdown is mostly self-contained without significant spillover into other geographies (spillover into Europe and the U.S. could lead to an even greater negative impact). Moreover, we would expect wide ranging performance across the sector, with companies like DHR (due of its healthcare focus) still growing in China under this scenario, while energy/infrastructure focused EMR, PNR, and ETN would decline by >20%. EMR,

PNR, and ETN are the three stocks with the largest relative sales exposure, in our view. Conversely, we think the three least exposed stocks are LII, ROP, and TYC.

Materials

Basic Materials

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A China hard landing would negatively impact pricing and demand for most commodities, except to the extent that there are meaningful supply reductions. Offsetting lower demand, we expect that weaker Asian currencies could benefit some producers. We believe that uranium would be the least exposed commodity given significant contracted volumes while we believe that current gold price forecasts more closely reflect a hard landing scenario. The most exposed companies include financially or operationally levered producers such as FCX, NOR, TCKb while we believe CCO is least exposed.

Basic Metals and Mining

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A China hard landing would negatively impact pricing for most commodities, unless demand declines are offset by meaningful supply reductions. As a result, miners would see margins coming under pressure. In the US, the steel industry has moved to implement trade duties on unfairly traded steel products that could mitigate increased US import pressures, however we would still expect the industry to be impacted as raw material prices fall (potentially prompting further destocking) and potential Asian currency weakness drives a wider spread between US and Asian pricing. For coal producers, the coal export markets would remain extremely weak, although domestic coal would be relatively insulated given the contracted nature of the business and the somewhat limited influence of Asia on North American natural gas prices. Most exposed are financially or operationally levered copper producers including FM and HBM, as well as integrated steel producers X and AKS. Least exposed are mills with low-cost downstream oriented businesses including CSTM, NUE and STLD.

Chemicals

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During the 2009 Asia crisis the declines in NTM EPS estimates ranged from only 4% peak-to-trough for Ecolab (cleaning chemicals), to a decline into losses at commodity vinyls producer Georgia-Gulf (the predecessor to Axiall). None of our covered stocks benefitted. Supply chains are long and fragmented for many chemicals, and because chemicals are upstream, the degree of channel inventory contraction is often bigger in the short-term than the drop in end consumption.

During the financial crisis we saw volumes drop 40% peak-to-trough for some chemicals, when end consumption obviously only dropped a few percent. Channels often destock when oil declines (in anticipation of pass-thru of lower chemical prices), so it's possible inventories are already low due to the decline in oil that began in late 2014. Having a good sense of how much plastic is in inventories of finished cars (or parts, etc.) globally is impossible to know, for example. Many chemicals are hard to inventory (industrial gases for example), so destocking is limited to customers destocking their own products (such as steel, which uses oxygen). Margins will also obviously be affected by degree of destocking (since volume drives plant operating rates, which drives fixed cost absorption). Currency effects are typically larger for non-hydrocarbon chemicals, since oil is dollar

denominated globally. So hydrocarbon-based chemical pricing is loosely linked to the dollar (often with a significant time lag).

Paper & Forest Products

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The impacts from a slower China for US paper & forest are primarily secondary. For instance, lower demand for Canadian lumber might lead to volumes being redirected towards the USA, creating imbalance in the domestic market. China's biggest influence on the industry is raw materials: logs, pulp and wastepaper. In large part due to lower Chinese demand – Western log prices are off about 20% from their highs. Chinese pull on many parts of the sector has been declining for a prolonged period already.

Information Technology

IT Hardware

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Most IT Hardware names derive 5% or less of revenue from China. Although there could be incremental weakness, most already have seen softness as China emphasizes buying computing infrastructure from domestic vendors. For example, IBM has suffered about 18 months of double-digit declines and HP was forced to sell a majority stake in its enterprise business in China to Tsinghua Holdings. Apple is most exposed with 27% of revenue from Greater China, which provides about 60% of revenue growth. We estimate that in the downside scenario, Apple's earnings could be more than one dollar lower than our current estimate of $10.33 to end close to $9.00 per share. We assume total iPhone sales might be down 5% as economic weakness offsets consumer desire to trade up to iPhones in China.

Technology Equipment

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Within our coverage universe, TE Connectivity and Corning are amongst the companies with the highest exposure to China, at roughly 17% (UBSe) and 21% of sales, respectively, while most of the companies within our Data Networking universe have less than 5% of sales exposure to China. However, relative to the recent pull back in both TE and Corning share prices, we believe downside risks from China alone appear to be adequately reflected in their share prices. In the case of TE, we foresee potential downside risk from slower growth in China of $45m to our 2016 net income estimate, equating to $0.12/share or 3% of our FY16 EPS estimate of $4.20. Similarly, for Corning, we foresee downside risk to 2016 net income of about $30m, or less than $0.03/share and less than 2% impact to our base case 2016 EPS of $1.57.

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12-Month Rating	Definition	Coverage[1]	IB Services[2]
Buy	FSR is > 6% above the MRA.	45%	36%
Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	13%	20%
Short-Term Rating	**Definition**	**Coverage[3]**	**IB Services[4]**
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 30 June 2015.
1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category. 4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

KEY DEFINITIONS: Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months. **Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium). **Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation. **Short-Term Ratings** reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case. **Equity Price Targets** have an investment horizon of 12 months.

EXCEPTIONS AND SPECIAL CASES: UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; **Neutral:** Neutral on factors such as structure, management, performance record, discount; **Sell:** Negative on factors such as structure, management, performance record, discount. **Core Banding Exceptions (CBE):** Exceptions to the standard +/-6% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Company Disclosures table in the relevant research piece.

Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
AK Steel Holding Corp[16, 20]	AKS.N	Neutral (CBE)	N/A	US$2.76	10 Sep 2015
Apple Inc.[6c, 7, 16, 18a]	AAPL.O	Buy	N/A	US$112.57	10 Sep 2015
Axiall Corp.[8, 16]	AXLL.N	Sell	N/A	US$22.01	10 Sep 2015
Baker Hughes Inc.[6c, 7, 16]	BHI.N	Buy	N/A	US$53.68	10 Sep 2015
Becton Dickinson and Company[16]	BDX.N	Buy	N/A	US$135.20	10 Sep 2015
Boeing Co.[8, 16]	BA.N	Neutral	N/A	US$133.55	10 Sep 2015
BorgWarner Inc.[3b, 16]	BWA.N	Buy	N/A	US$43.74	10 Sep 2015
Bristol-Myers Squibb[6a, 6b, 6c, 7, 16, 18b]	BMY.N	Neutral	N/A	US$58.75	10 Sep 2015
Cabot Oil & Gas Corporation[16]	COG.N	Buy	N/A	US$23.05	10 Sep 2015
Cameco Corporation[16]	CCO.TO	Buy	N/A	C$18.20	10 Sep 2015
Caterpillar Inc.[6b, 7, 8, 16, 18c]	CAT.N	Neutral	N/A	US$72.42	10 Sep 2015
Chesapeake Energy Corp.[6a, 13, 16]	CHK.N	Sell	N/A	US$7.59	10 Sep 2015
Chevron Corp.[5, 6b, 7, 16]	CVX.N	Neutral	N/A	US$75.66	10 Sep 2015
Citigroup Inc[2, 4, 5, 6a, 6b, 6c, 7, 16, 18d]	C.N	Buy	N/A	US$51.07	10 Sep 2015
Coach Inc.[16]	COH.N	Buy	N/A	US$29.51	10 Sep 2015
Coca-Cola[5, 6b, 6c, 7, 16]	KO.N	Buy	N/A	US$38.42	10 Sep 2015
Colgate-Palmolive[2, 4, 6a, 13, 16]	CL.N	Neutral	N/A	US$61.93	10 Sep 2015
Community Health Systems[13, 16]	CYH.N	Buy	N/A	US$52.16	10 Sep 2015
ConocoPhillips[6c, 7, 16]	COP.N	Neutral	N/A	US$48.43	10 Sep 2015
Constellium NV[16]	CSTM.N	Buy	N/A	US$7.17	10 Sep 2015
Corning Inc.[16]	GLW.N	Neutral	N/A	US$17.61	10 Sep 2015
Danaher Corp[16]	DHR.N	Buy	N/A	US$86.05	10 Sep 2015
Diamond Offshore Drilling Inc.[16]	DO.N	Neutral	N/A	US$22.48	10 Sep 2015
Dunkin Brands Group[13, 16]	DNKN.O	Neutral	N/A	US$47.43	10 Sep 2015
Eaton Corporation PLC[6c, 7, 16]	ETN.N	Buy	N/A	US$55.86	10 Sep 2015
Ecolab[16]	ECL.N	Buy	N/A	US$110.44	10 Sep 2015
Emerson Electric Co[6c, 7, 16]	EMR.N	Neutral	N/A	US$46.37	10 Sep 2015
ENSCO PLC[13, 16]	ESV.N	Neutral	N/A	US$15.86	10 Sep 2015
Estée Lauder[16]	EL.N	Buy	N/A	US$76.01	10 Sep 2015
First Quantum Minerals Ltd.[20]	FM.TO	Buy (CBE)	N/A	C$7.68	10 Sep 2015
Ford Motor Co.[16, 18e]	F.N	Buy	N/A	US$13.73	10 Sep 2015
Freeport-McMoRan[2, 4, 5, 6a, 13, 16, 18f]	FCX.N	Buy	N/A	US$11.27	10 Sep 2015
General Motors Company[4, 6a, 6b, 6c, 7, 16, 18g]	GM.N	Buy	N/A	US$30.00	10 Sep 2015
Halliburton Co.[4, 13, 16]	HAL.N	Buy	N/A	US$37.58	10 Sep 2015
HCA Holdings[2, 4, 6a, 16]	HCA.N	Buy	N/A	US$85.28	10 Sep 2015
Helmerich & Payne Inc[16]	HP.N	Buy	N/A	US$51.29	10 Sep 2015
Hewlett-Packard[4, 6a, 6c, 7, 12, 16, 18h]	HPQ.N	Buy	N/A	US$27.33	10 Sep 2015
Hologic Inc[2, 16]	HOLX.O	Buy	N/A	US$39.39	10 Sep 2015
HudBay Minerals Inc.[16, 20]	HBM.TO	Buy (CBE)	N/A	C$6.56	10 Sep 2015
International Business Machines Corp.[6b, 6c, 7, 12, 16]	IBM.N	Neutral	N/A	US$146.20	10 Sep 2015
ITT Corporation[3a, 6c, 7, 16]	ITT.N	Neutral	N/A	US$36.14	10 Sep 2015

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Joy Global Inc.[16]	JOY.N	Neutral	N/A	US$17.94	10 Sep 2015
Las Vegas Sands Corp.[16]	LVS.N	Neutral	N/A	US$46.54	10 Sep 2015
Lear Corporation[6c, 7, 16]	LEA.N	Buy	N/A	US$106.55	10 Sep 2015
Lennox International Inc.[16]	LII.N	Buy	N/A	US$119.04	10 Sep 2015
LifePoint Health[16]	LPNT.O	Buy	N/A	US$78.55	10 Sep 2015
Lilly (Eli) & Co.[2, 4, 5, 6a, 6b, 6c, 7, 16]	LLY.N	Neutral	N/A	US$80.84	10 Sep 2015
Marathon Oil Corporation[16]	MRO.N	Buy	N/A	US$14.98	10 Sep 2015
McDonald's[16]	MCD.N	Buy	N/A	US$95.25	10 Sep 2015
Merck & Co.[4, 5, 6b, 6c, 7, 16]	MRK.N	Buy	N/A	US$52.72	10 Sep 2015
MGM Resorts International[2, 4, 5, 6a, 16]	MGM.N	Neutral	N/A	US$20.72	10 Sep 2015
Murphy Oil Corporation[13, 16]	MUR.N	Neutral	N/A	US$28.18	10 Sep 2015
Nabors Industries[2, 16, 20]	NBR.N	Buy (CBE)	N/A	US$10.13	10 Sep 2015
National Oilwell Varco[16, 18i]	NOV.N	Sell	N/A	US$39.25	10 Sep 2015
Nike Inc.[16]	NKE.N	Buy	N/A	US$110.38	10 Sep 2015
Noble Corporation[5, 16]	NE.N	Neutral	N/A	US$12.02	10 Sep 2015
Noranda Aluminum Holding Corporation[16, 20]	NOR.N	Sell (CBE)	N/A	US$2.86	10 Sep 2015
Nucor Corp.[16, 18j]	NUE.N	Buy	N/A	US$41.83	10 Sep 2015
Patterson-UTI Energy, Inc.[16]	PTEN.O	Buy	N/A	US$14.51	10 Sep 2015
Pentair Plc[5, 16, 18k]	PNR.N	Neutral	N/A	US$54.21	10 Sep 2015
Pfizer Inc.[6b, 7, 16, 18l]	PFE.N	Buy	N/A	US$32.62	10 Sep 2015
Procter & Gamble[2, 4, 6a, 6c, 7, 16, 18m]	PG.N	Neutral	N/A	US$68.32	10 Sep 2015
Qiagen NV[16]	QGEN.O	Buy	N/A	US$26.44	10 Sep 2015
Restaurant Brands International[16]	QSR.N	Neutral	N/A	US$37.35	10 Sep 2015
Roper Technologies[16]	ROP.N	Buy	N/A	US$159.04	10 Sep 2015
Rowan Companies Inc.[16]	RDC.N	Neutral	N/A	US$17.21	10 Sep 2015
Schlumberger Ltd.[16]	SLB.N	Buy	N/A	US$74.07	10 Sep 2015
Spirit AeroSystems Holdings[16]	SPR.N	Buy	N/A	US$51.57	10 Sep 2015
Starbucks[6c, 7, 16]	SBUX.O	Buy	N/A	US$55.37	10 Sep 2015
Steel Dynamics Inc.[16]	STLD.O	Buy	N/A	US$19.03	10 Sep 2015
TE Connectivity Ltd.[5, 6c, 7, 8, 16, 18n]	TEL.N	Buy	N/A	US$60.23	10 Sep 2015
Teck Resources Ltd.[16, 20]	TCKb.TO	Neutral (CBE)	N/A	C$8.89	10 Sep 2015
Tenet Healthcare[16]	THC.N	Buy	N/A	US$47.17	10 Sep 2015
Tesla Motors[13, 16, 18o]	TSLA.O	Sell	N/A	US$248.48	10 Sep 2015
Transocean Ltd.[5, 13, 16]	RIG.N	Neutral	N/A	US$14.82	10 Sep 2015
Triumph Group Inc[4, 6a, 6b, 7, 16]	TGI.N	Sell	N/A	US$47.50	10 Sep 2015
Tyco International PLC[2, 4, 6a, 6b, 6c, 7, 16, 18p]	TYC.N	Sell	N/A	US$35.73	10 Sep 2015
Under Armour, Inc.[16]	UA.N	Neutral	N/A	US$96.17	10 Sep 2015
United States Steel Corp[6b, 7, 13, 16]	X.N	Neutral	N/A	US$14.46	10 Sep 2015
Universal Health Services[16]	UHS.N	Buy	N/A	US$134.70	10 Sep 2015
Wal-Mart Stores[6c, 7, 16, 18q]	WMT.N	Neutral	N/A	US$64.12	10 Sep 2015
Weatherford International Ltd.[5, 6c, 7, 16, 18r]	WFT.N	Buy	N/A	US$9.85	10 Sep 2015
Wynn Resorts Limited[2, 4, 5, 6a, 13, 16]	WYNN.O	Neutral	N/A	US$69.67	10 Sep 2015

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Yum! Brands[13, 16]	YUM.N	Buy	N/A	US$79.90	10 Sep 2015

Source: UBS. All prices as of local market close.
Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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18o. A U.S.-based global equity strategist, a member of his team, or one of their household members has a long common stock position in Tesla Motors Inc.
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