DeepSeek & AI: Who will win this race?

A Chinese startup's release of DeepSeek's R1 large language model (LLM) sent shockwaves through the global tech industry and markets. The Hang Seng (HSI) and Hang Seng Tech (HSTECH) indices soared +18.6% and +33.3% YTD, outperforming the S&P500 and Nasdaq indices.

Is this the beginning of an AI renaissance in China? Will the narrative for the US shift and how will US maintain its tech supremacy?

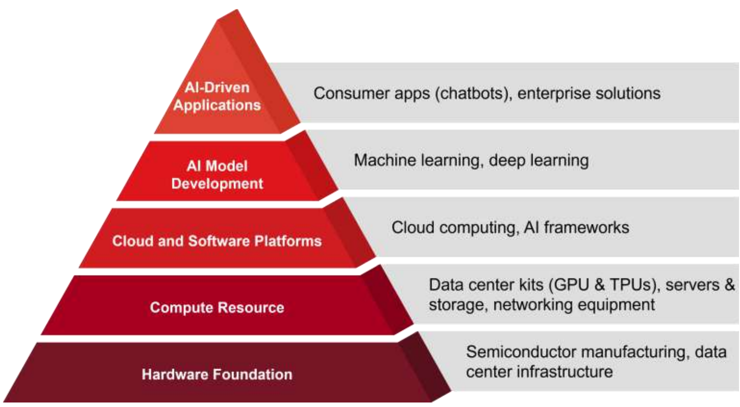
Key Summary:

1. **The AI arms race between US-China is intensifying** as the emergence of DeepSeek and the likes has thrown a curveball at the US. However, **the evolution of AI models will lift all boats, in our view.**

2. We believe **the valuation gap between China and US tech stocks would narrow** as technologies like DeepSeek's model breakthrough could level the playing field and see capex catch-up.

3. **US tech stocks could continue to trade at a premium** given the conducive regulatory support, sustainable business models, superior ROEs, and ultimately, global market trust.

Figure 1: AI supply chain beneficiaries



Source: CIMB CIO Office

1. Why is the world so caught up with DeepSeek?

A technological breakthrough. DeepSeek was able to achieve industry-matching results with **lower capital intensity (under USD6m), less advanced chips** and **is open-source**. Its success is an indication of China's growing resilience and technological self-sufficiency despite US policies aimed at limiting its progress.

Precursor of more to come. We expect **more AI models, software and applications to proliferate and emerge**. The rapid rollouts of AI models imply a **1) wider audience, 2) accelerate consumption and adoption** given lower input costs**, 3) faster integration (into AI PCs and smartphones),** and 4) the **potential to transform industries** from defense to healthcare and education etc.

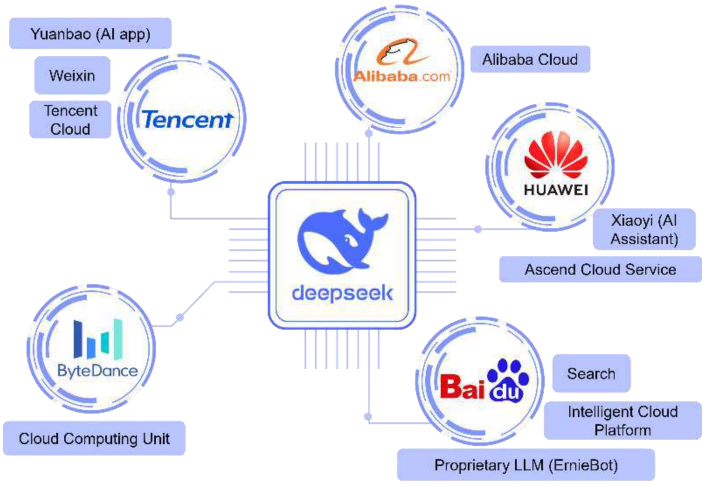
This proliferation will drive **rapid hardware upgrades** and a **massive demand for computing power** ranging from data center capacity to AI workloads, benefiting the AI supply chain (Figure 1).

A strategic signal from China. Its launch was timed to **coincide with high-profile events in the US**, i.e. Trump's inauguration and the USD500bn Stargate project announcement. It also aligns with China's **Next Generation Artificial Intelligence Development Plan where it aims to be a global AI leader by 2030.**

2. China: The beginning of an AI renaissance?

We believe DeepSeek has propelled China to the **forefront of an AI renaissance, positioning it as a serious competitor to the US.** With cheaper AI training and inference costs, and an open-source model, DeepSeek will **fuel rapid innovation, strengthen China's AI ecosystem** and **reduce its reliance on US** - critical amid chip restrictions.

Figure 2: The race to embrace DeepSeek



Source: CIMB CIO Office, various media sources

Alibaba, China's e-commerce giant and largest cloud service provider, saw **AI-related revenue surge by triple digits** for **six consecutive quarters**. It is making an **unprecedented RMB380bn yuan (USD52bn) investment in cloud computing and AI infrastructure over the next 3 years**, outpacing its total capex in the past decade.

Though still in its early days, **adoption is surging across industries** with Chinese tech giants, telcos, automakers, healthcare and brokerages **rapidly integrating DeepSeek's LLM into their products** (Figure 2).

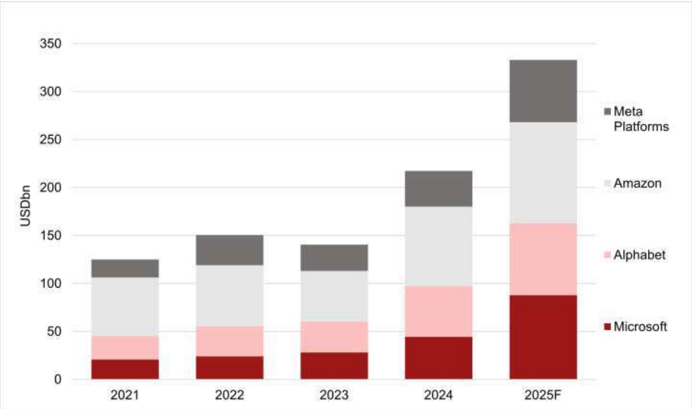
In our view, this **signifies a shift in China's narrative as a serious contender to the US in the AI race**. We expect an **acceleration in AI adoption** with more Chinese tech giants **ramping up AI investments** and a **boost in AI-driven earnings growth.**

3. US: How will it maintain tech supremacy?

Capex: A linchpin to maintain lead? The success of DeepSeek which seemingly narrowed the technological gap between US and China could trigger the **US' big tech to shift its spending priorities** to capex efficiency, data dominance, and software innovation.

In 2025, Microsoft, Amazon, Meta, and Alphabet are set to pour in over USD300bn in AI investments (up from USD228bn in 2024), driven by strategic advantages and a compute power supply constraint. Additionally, President Trump announced a USD500bn private sector-led Stargate project for building US data centers. **While these investments do not guarantee US tech supremacy, they prepare companies to meet the insatiable demands for advanced innovation and compute power** which are key to staying competitive.

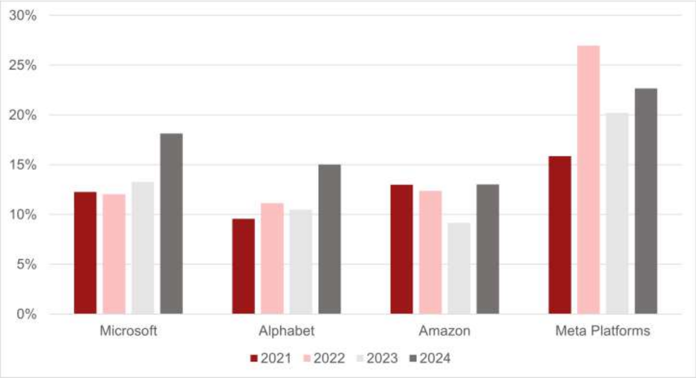
Figure 3: Big tech capex



Source: Bloomberg, CIMB CIO Office

Monetisation pressure is on. The exact monetization from AI has been challenging to quantify as **AI exists as part of a suite of products, not a standalone.** It is however notable that **revenue has been growing as a percentage of capex spending** across all big tech companies (Figure 4). We see **more monetization opportunities ahead** as US' big tech companies have integrated DeepSeek's model into their own platforms, enhancing their AI offerings and better utilization of its computing power capacity.

Figure 4: Capex intensity (Capex over revenue ratio)



Source: Bloomberg, CIMB CIO Office

Regulatory support is key. Besides capital spending, the **regulatory framework plays a pivotal role in securing the US' tech supply chain and countering the rapid rise of AI among its global rivals**. These regulations, such as the CHIPS Act and the AI Diffusion Rule (Figure 5), are not merely guidelines—they are powerful tools to shape the future of technological dominance.

In a bold move, President Trump signed the **"America First Investment Policy" Executive Order (EO)**, a sweeping directive aimed at curbing Chinese investments in US' most critical sectors and restricting US funds from investing in the Chinese high-tech sectors, signaling a new era of fierce competition and a fight for technological supremacy.

Figure 5: US' regulatory framework

Aspect	CHIPS Act	AI Diffusion Rule
What is it?	Passed in 2022 to boost US domestic product of semiconductors	Proposed in Jan 2025 to control access of US made advanced AI chips and tech
Main goal	Reduce reliance on foreign made chips	Limit access of advanced chips to key rivals ie China
How would this work	USD52.7bn in subsidies and incentives to build chip fabs in US	Limit the number of chips a country receives, based on tiering, while rivals get none
Who benefits?	US chip companies ie Intel and TSMC; have economic benefits, driving job growth	US tech firms and allies ie Japan, South Korea
Who is restricted?	No direct restrictions	Strategic rivals China and Russia

Source: CIMB CIO Office

4. Mind the Valuation Gap

The rise of China's Tech Titans? DeepSeek's breakthrough **sparked a resurgence in Chinese large-cap tech stocks**, mirroring the US' Magnificent 7's AI rally after ChatGPT's launch in November 2022. Our analysis shows that the Mag 7 stocks surged an **average of +211% over two years** with significant earnings upgrades and multiples rising from 30.3x to 39x PE. In contrast, key Chinese tech stocks have risen **an average of 34% in the past month** purely driven by multiples expanding from 18.9x to 26.5x PE. If China follows the **US AI rally playbook** and delivers earnings surprises, there is still **significant room for further re-rating.**

Figure 6: Mag 7 stock performance

Stock	Share price as at 30 Nov 2022 (USD)	Current share price (USD)	Total return (%)	Historical FY23 PE (x)	FY25F PE (x) - Current
Nvidia	16.92	126.63	648%	39.0	28.5
Tesla	194.70	302.80	56%	34.7	104.6
Microsoft	255.14	397.90	56%	26.7	30.3
Alphabet	101.45	177.37	75%	19.1	19.6
Meta	118.10	657.50	457%	15.3	25.1
Amazon	96.54	212.80	120%	53.7	30.8
Apple	148.03	247.04	67%	23.7	33.7
Average			**211%**	**30.3**	**39.0**

Source: Bloomberg as at 26th February 2025

Figure 7: China tech titans stock performance

Stock	Share price as at 27 Jan 2025 (HKD)	Current share price (HKD)	Total return (%)	FY25F PE (x) - as at 27 Jan 25	FY25F PE (x) - Current
Alibaba	87.25	136.90	57%	10.3	14.6
Tencent	395.60	501.50	27%	15.0	18.9
Baidu	84.75	88.85	5%	8.7	9.3
JD.com	157.30	168.10	7%	9.4	9.8
SMIC	38.15	57.40	50%	42.7	68.4
BYD	274.80	389.80	42%	15.3	21.1
Xiaomi	37.10	56.30	52%	30.9	43.2
Average			**34%**	**18.9**	**26.5**

Source: Bloomberg as at 26th February 2025

Valuation gap to narrow. The HSTECH's valuation vs Nasdaq has narrowed after the rally but **remains undervalued at 19x forward PE** relative to its 5-year mean PE of 24x, for 29% projected earnings growth. We **expect this to further narrow** as China closes the AI technology gap, although US regulatory policies may limit HSTECH's valuations from surpassing the Nasdaq. Should the HSTECH re-rate to mean, this implies an **index level of 7,177 (18% potential upside).** In the **previous tech rally** in late 2018 to early 2021, the HSTECH **surged by +170%** before regulatory crackdowns reversed the trend.

Meanwhile, the Nasdaq currently trades at 28x forward PER, below its 5-year mean PER of 30x, for 31% projected earnings growth. **However, US' technology stocks performance could be under pressure in the near term** as investors reassess capex efficiency and AI monetization pace. However, we think US' tech landscape would remain highly competitive which would further drive earnings growth, supportive of valuations.

Figure 8: HSTECH v Nasdaq PER Valuations

Source: Bloomberg as at 26th February 2025

5. Key Recommendations

ETFs

1 Invesco S&P 500® Equal Weight Tech ETF
2 CSOP Hang Seng technology index
3 iShares Future AI and technology ETF
4 E Fund CSI Artificial Intelligence ETF

	Equities	Key Reasons to Own
China		
1	**Tencent**	Leading internet company with a strong ecosystem, poised to benefit from more AI integration. We expect games revenue to remain strong with continuous shifts to higher-margin products to drive earnings growth.
2	**Sunny Optical**	Leading global supplier of camera lenses and modules for smartphones and automotive. It benefits from a smartphone upgrade cycle and increased demand from domestic handset subsidies. Growth in AI-powered smartphones and AI-driven automotive technologies to drive demand for advanced camera modules.
3	**Trip.com**	Leading online travel platform poised to benefit from strong travel demand. AI tools are deployed to manage 80% of domestic call centers. AI usage is expected to improve margins over the long term with increased efficiency as it expands globally.
U.S.		
1	**Microsoft**	Market leader in OS for PCs. We like it for its resilient earnings driven by its high margin, recurring revenue business model. Upside to growth will increase in subscription costs as it embeds more AI solutions within its services.
2	**Alphabet**	Largest search engine and video streaming provider and has the fastest growing cloud platform, Google Cloud. Well-positioned to grow its digital advertising business further as AI helps to drive engagement and content.
3	**Amazon**	We like it for its potential to grow via two of the fastest growing business ie e-commerce (with 200m Prime members) and AWS its high-margin cloud computing segment.

Source: CIMB CIO Office

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