The liberalisation of the Chinese equity market is a milestone

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The performance of Chinese equities in the first half of 2018 was a subdued one. The relevant indices were in negative territory across the board. However, now the tide might be turning. Some 230 Chinese A-shares have joined the important MSCI indices. Share prices have rebounded from year-lows. Gabriela Tinti, Fund Manager of ESPA STOCK GLOBAL EMERGING MARKETS, explains the relevance of the new A-shares to your portfolio and the general perspectives of the Chinese equity markets.

Gabriela Tinti, Fund Manager of ESPA STOCK GLOBAL EMERGING MARKETS

[post_poll id="7246″]**At the beginning of June, some 230 Chinese A-shares were taken into the global index MSCI. The weighting will be further increased on 1 September. Why is this widening of the investment universe so important?**

The so-called A-shares are participations in Mainland Chinese companies that are quoted on the stock exchanges in Shanghai and Shenzhen. While foreign institutional investors have been able to buy such A-shares in the past, they had to do so as "qualified foreign institutional investor" (QFII), a status handled very restrictively. Only largely capitalised Chinese companies had been listed in Hong Kong (H-shares) for a while and had therefore been open to investment by anyone. The MSCI index has so far only admitted the A-shares that are already traded via the stock exchange platforms Shanghai-Hongkong-Connect or Shenzhen-Hongkong-Connect and that are not subject to QFII regulations. These platforms were being set up from 2014 onwards in order to open the market further to foreign investors and to facilitate their access to the capital market. From September, the investable portion of A-shares in the MSCI index will double. These are shares we can also buy for the ESPA STOCK GLOBAL EMERGING MARKETS fund.

Does this opening of the Mainland stock exchanges to foreign investors mean that the market will generally benefit?

The liberalisation of the market is a milestone. According to some estimates this step could trigger an inflow of up to USD 22bn worth of capital into Mainland China. More importantly, the weighting of A-shares in the MSCI indices will be gradually growing. This also allows us to reach certain conclusions with regard to the economy. In order to keep investors, China will have to further liberalise its economy, because the country needs foreign investors in order to ensure growth in quality. At the moment, only 2% of the A-shares market is held by foreign investors. You can therefore picture the potential.

The price development of the retail-heavy A-Share-Index is significantly more volatile than the HANG SENG-Index in Hong Kong. Note: Past performance is not indicative of future development.

What benefits do A-shares offer to investors? Why are they so important?

The Chinese A-share market is already the second-largest capital market in the world in terms of market capitalisation and liquidity, behind the NYSE. A-shares facilitate investments that would not be possible with H-shares or ADRs*. We are for example talking about smaller high-tech companies or sectors that benefit from the growing middle class and its consumer behaviour. That market is not where the big fish are. The share of small- and mid-caps is significantly higher than in other indices.

*ADRs (American Depository Receipts) are traded at the stock exchange in lieu of shares. They are certificates issued by US banks that hold the underlying shares in custody.

Should one now invest in Chinese equities, or is it advisable to wait?

I cannot personally issue a buy recommendation for shares. Interested investors would have to decide for themselves on the basis of their investment goals and risk appetite. I can only point out a few key parameters. The valuation of Chinese equities is currently at a 5Y low. The price/book value ratio of 1.7x for A-shares (as of June 2018; source: Bloomberg) is extremely low. Earnings increased on average by 13.8% in the first half of 2018. We saw particularly high growth at companies in the energy and commodities sector. Of course, there are many question marks: if the trade war between the USA and China continues to escalate, the damage will be noticeable for both sides and will also come with ramifications on the Chinese stock exchanges.

Investors expecting the further liberalisation of the Chinese capital market to create momentum can for example invest in the ESPA STOCK GLOBAL EMERGING MARKTES fund. Chinese equities currently account for 35% of assets under management of this fund. At 75%, Asia makes up the lion's share of this portfolio.

Legal note:

Prognoses are no reliable indicator for future performance.

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