INVESTOR SUMMIT KEY TAKE-A-WAYS

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# Are we ready for China?

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From an international investor's perspective, China has long presented an anomaly: equity market returns there have lagged far behind that spectacular growth rate. Yet according to Jeff Shen, Managing Director, Co-CIO of Active Equity and Co-Head of Systemic Active Equity for BlackRock, who spoke at the 2018 BlackRock Canada Investor Summit in Toronto recently, the case for a fresh look at Chinese stocks – and standalone exposure to the world's second largest equity market – is getting stronger.

## A large, liquid and largely untapped market

Most international exposures to Chinese equities are through the Hong Kong Exchange and so-called H-shares. Yet China A-shares – which trade on the Shanghai and Shenzhen exchanges – comprise a "much larger and more interesting" market, Shen said. At a capitalization of about US$8 trillion, the A-share market is still a fraction of the U.S. (~US$30 trillion), but more than twice the size of the Hong Kong market. A-shares are also highly liquid – they trade at just less than half the volume of the U.S. today, Shen noted, or above US$50 billion a day.

Of this large, liquid market, international investors hold only about one percent. "There is really no other market where non-domestic investors hold so little," Shen said. "And it just happens to be the second-largest and second-most-liquid in the world." He added that because the A-shares market has largely been "walled off," its correlation to the rest of the world is extraordinarily low.

## Government, A-shares open up

The reasons for lagging Chinese stock performance are complex, from structural constraints that made onshore equity markets relatively inefficient, to the fact that China's investment-led growth left little for cash distributions to shareholders. Now, however, Beijing is pushing to liberalize the economy and shift to consumption-led growth.

Equity markets might be entering a new phase, and they are "opening up as we speak," noted Chen. International investors can now trade A-shares as if they were Hong Kong-listed stocks through the Stock Connect program, and



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in June, global index company MSCI is slated to include the A-shares market in its benchmark Emerging Markets and All Country World indices. While the initial inclusion will be fairly small (comprising about 0.75 percent of global equities by November 2018), it could have implications for international investment into China over the longer term.

"We're increasingly seeing investors trying to get in front of this" trend, said Shen, adding that over time, "this could be as big as the overall emerging market."

## Risks, but huge opportunities

In a market with 100 million retail investors who trade 80 percent of the volume, investing in A-shares can be unpredictable. "You can be the most rational investor in the world," noted Shen, "but if those 100 million disagree with you, you might be out of luck." Offsetting the risks, however, is the huge potential of China's economic growth and transformation.

Big Data analysis techniques such as natural language processing (NLP) are allowing new insights into China's economy and markets, and raise the potential to generate alpha. For example, Shen noted that NLP shows the conversation around China (including Premier Xi Jinping's address to the 19th Communist Party of China Congress last year) has shifted from a finance orientation to being dominated by the Internet, Big Data and innovation – areas in which China's future growth potential might well be grounded as its economy shifts from investment to consumption.

"You can't ignore China," contended Chen. "China is too big to ignore."



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