China Equities: First 8 things investors need to know

May 2021

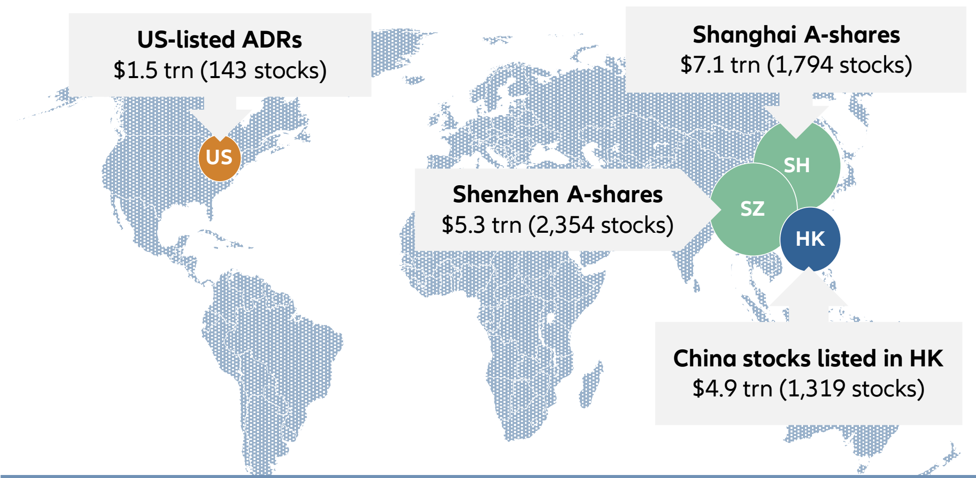
China's equity markets have opened up as the country's economy transforms. From Shenzhen and Hong Kong listings to the Nasdaq-like STAR board, Chinese companies are attracting significant investor capital. Here are eight things to help investors learn about China equities.

1 Relatively large equity opportunity set

China's capital markets have expanded significantly in recent years. The combined market capitalisation of the exchanges in Shanghai, Shenzhen and Hong Kong – plus US-listed American Depositary Receipts (ADRs) – is around USD 19 trillion (see Exhibit 1). This is significantly higher than the USD 10 trillion market cap of euro-area equities.

China A-shares (the Shanghai and Shenzhen markets) account for approximately 70% of all China stocks. Put another way, not investing in China A-shares means missing out on 70% of the opportunities. Even within China A-shares, the different listing venues offer varying exposures to sectors and market caps. Investing across China's exchanges can bring different exposures.

Exhibit 1: Stock exchanges for China equities (in USD)



China equities – Total: $18.8 trillion (5,610 stocks)

Euro-area equities – Total: $10 trillion (3,547 stocks)

Source: Shenzhen Stock Exchange, Shanghai Stock Exchange, Hong Kong Stock Exchange, Bloomberg, Allianz Global Investors, as of 31 December 2020.

The total figures are for comparison only, the stocks included may be listed in more than one exchange. Offshore China stocks are defined based on companies with ultimate parent domiciled in China. Suspended stocks, investment funds and unit trusts are excluded.

Allianz Global Investors

2 An economy driven by an increasingly dynamic private sector

Historically China's economy was driven by spending and employment at large State Owned Enterprises (SOEs) but significant reforms drove down their share of GDP from 50% to 30% over the last 15 years. According to a paper from the World Economic Forum on 7 May 2019 the private sector, often expressed by the numbers 60/70/80/90, is contributing 60% of China's GDP, 70% of innovation, 80% of urban employment and 90% of new jobs. China's policies are also encouraging a dynamic, startup culture which it hopes will incubate tech success.

3 The STAR market for tech and science startups

China has established a new Nasdaq-like board, **the STAR market (known as The Shanghai Stock Exchange Science and Technology Innovation Board)**. Innovation will be a key driver for China's continued growth. The STAR market provides a platform for China to continue to shift its economy towards more technology and innovation-led businesses.

The STAR market, which streamlined listing requirements, are facilitating the growing number of tech-driven IPOs. After launching in July 2019 with 25 names, the market had grown to 269 listed companies as of 11 May 2021. As shown in Exhibit 2, the sector breakdown of the STAR market shows a tech and biomedicine emphasis.

Exhibit 2: STAR market – Sector breakdown (number of listed companies as of 11 May 2021)

53	Biomedicine
17	Energy conservation and enviromental protection
53	High-end equipment
10	New energy
91	New generation IT
35	New materials
10	Other
269	**TOTAL**

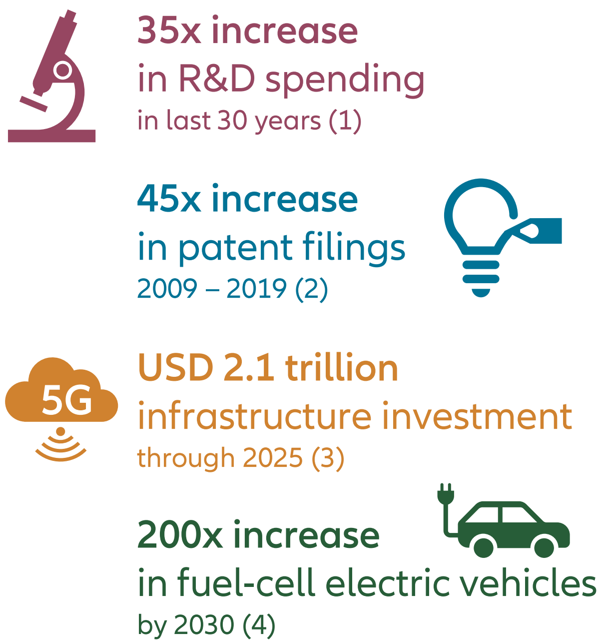
Source: SSE STAR market (http://star.sse.com.cn/en)

At the time of writing this paper, there are around 560 companies at different stages of the IPO registration pipeline. The FTSE already has plans in place to include the STAR market in its equity indices, although MSCI has not yet detailed how it will treat the new market.

4 New infrastructure

One of the important consequences of rising trade tensions between the US and China has been a strengthening of Beijing's resolve to be self-reliant in innovation-driven and strategically important industries. Irrespective of trade tensions, China is determined to develop a 21st century economy built on "new infrastructure" as part of the "Made in China 2025" policy. Key industries benefiting from this include artificial intelligence, 5G, cybersecurity, alternative energy, electric vehicles, semiconductors and other sectors leading the change.

Exhibit 3: R&D and innovation



Source:
(1) OECD, AllianzGI Global Economics & Strategy. Data as of 2018
(2) World Intellectual Property Organization, December 2019
(3) Goldman Sachs, July 2020
(4) Belfer Center for Science & International Affairs, July 2020

5 The "youngest" in Asia

China is the youngest market regionally, reflecting the dynamic nature of China's corporate universe. This means Chinese companies have been part of the region's benchmark index constituents for the shortest amount of time. Based on the MSCI All Country Asia Pacific ex Japan Index, the average onshore stock in China has been listed for only seven years, whereas the average stock in other markets has been listed for over 20 years.

6 Steady foreign inflows

The Shanghai and Shenzhen Stock Connect schemes that launched a little over five years ago allow investors outside of mainland China to buy A-shares in Shanghai or Shenzhen via the Hong Kong exchange (known as a "northbound" trade). Since the Shanghai Stock Connect opened in November 2014, Chinese equities have enjoyed 62 months of "northbound" inflows with only 13 months of outflows. Notably, the ongoing inflows have occurred despite macro headwinds including political volatility caused by rising trade tensions between the US and China.

7 Lower correlation with global equities

China A-shares have a correlation of 0.21 with global equities over the last 10 years as of 31 December 2020. That means China A-shares move in the same direction as global equities only 21% of the time. Or looked at another way, almost 80% of the time they move in a different direction. In comparison, US and global equities have a correlation of 0.94. Holding China A-shares in a global equity portfolio may therefore add diversification benefits.

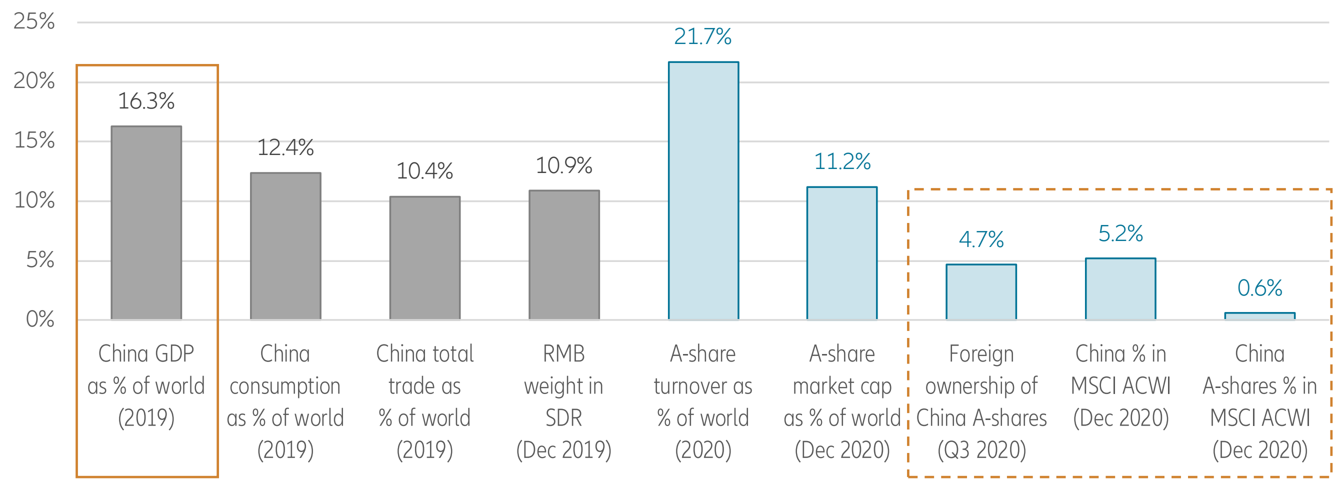
8 A mismatch between China's scale and its index weight

China's increasing weight in key benchmarks such as the MSCI All Country World Index (ACWI) is accelerating the institutionalisation of its market. However, when comparing with China's economic influence and market scale (accounting for 16% of global economic output among other factors), China may still be under-represented in benchmark indices (see Exhibit 4). Further, investors replicating an index's China allocation are underweight some of the fastest growing Chinese companies, specifically the young, dynamic tech and "new infrastructure" firms discussed earlier.

Is your portfolio properly accessing the China's equity opportunity set?

Our research suggests that index tracking may not always be the appropriate approach to China investing. For a more balanced approach to China or a portfolio to better reflect the full China opportunity set, investors may want to consider allocating more to China A-shares than benchmarks do or carving out an even larger standalone All-China equity allocation.

Exhibit 4: Key statistics on China and China equities



Source: Wind, Allianz Global Investors. Data as at January 2021.

This document is for use by qualified Institutional Investors (or Professional/Sophisticated/Qualified Investors as such term may apply in local jurisdictions).

This document or information contained or incorporated in this document have been prepared for informational purposes only without regard to the investment objectives, financial situation, or means of any particular person or entity. The details are not to be construed as a recommendation or an offer or invitation to trade any securities or collective investment schemes nor should any details form the basis of, or be relied upon in connection with, any contract or commitment on the part of any person to proceed with any transaction.

Any form of publication, duplication, extraction, transmission and passing on of the contents of this document is impermissible and unauthorised. No account has been taken of any person's investment objectives, financial situation or particular needs when preparing this content of this document. The content of this document does not constitute an offer to buy or sell, or a solicitation or incitement of offer to buy or sell, any particular security, strategy, investment product or services nor does this constitute investment advice or recommendation.

The views and opinions expressed in this document or information contained or incorporated in this document, which are subject to change without notice, are those of Allianz Global Investors at the time of publication. While we believe that the information is correct at the date of this material, no warranty of representation is given to this effect and no responsibility can be accepted by us to any intermediaries or end users for any action taken on the basis of this information. Some of the information contained herein including any expression of opinion or forecast has been obtained from or is based on sources believed by us to be reliable as at the date it is made, but is not guaranteed and we do not warrant nor do we accept liability as to adequacy, accuracy, reliability or completeness of such information. The information is given on the understanding that any person who acts upon it or otherwise changes his or her position in reliance thereon does so entirely at his or her own risk without liability on our part. There is no guarantee that any investment strategies and processes discussed herein will be effective under all market conditions and investors should evaluate their ability to invest for a long-term based on their individual risk profile especially during periods of downturn in the market.

Investment involves risks, in particular, risks associated with investment in emerging and less developed markets. Any past performance, prediction, projection or forecast is not indicative of future performance. Investors should not make any assumptions on the future on the basis of performance information in this document. The value of an investment and the income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested.

AdMaster ID: 1652832

Allianz
Global Investors