Enhancing Portfolios with Chinese Equities

How global equity portfolios can benefit from China's economic growth

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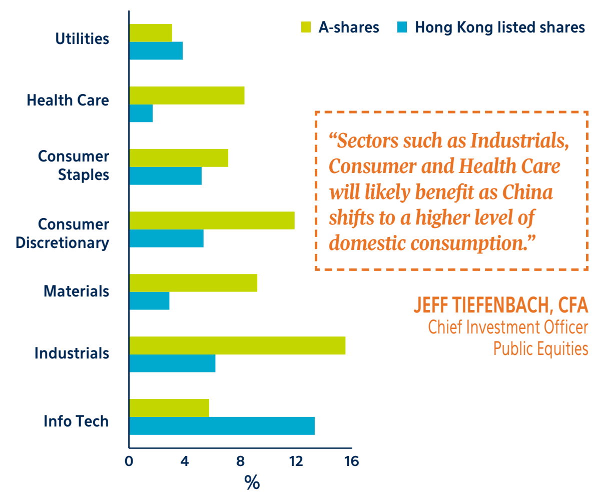
China has experienced a remarkable transformation and is on pace to be the world's largest economy in the next decade. Given this growing importance in the global economy, China is becoming a necessary component of any global equity allocation. While the benefits of an allocation to China are evident, the methods for investing in Chinese equities deserve further exploration.

What does the investment landscape look like for Chinese equities?

The two main categories of Chinese equities are A-shares and Hong Kong listed shares, which account for 60% and 35% of total Chinese equities, respectively.[1] Today, most international investors gain exposure to China through Hong Kong listed shares as they have historically been easier to access. However, A-shares have become increasingly important for global investors who want to benefit from the strength of China's domestic economy while accessing a broader opportunity set for enhanced return and more effective diversification. (see figure 1).

Figure 1: China A-Shares provide better exposure to rising consumerism in China



"Sectors such as Industrials, Consumer and Health Care will likely benefit as China shifts to a higher level of domestic consumption."

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Source: Greystone analysis based on MSCI sector weightings as of July 31, 2014.
Note: Financials, Energy and Telecom are excluded from figure 1.

Why should China A-Shares be considered for Global Equity portfolios?

The addition of A-shares to a global portfolio can provide attractive risk-return benefits. Due to factors such as foreign ownership and foreign exchange controls, China A-shares have had relatively low correlation with other major markets. Because of this

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[1] MSCI China Indexes, July 2014.

low correlation, the addition of A-shares to a portfolio can increase the return and/or lower the volatility of the portfolio. Additionally, the A-share market is relatively inefficient compared to other global markets, which can provide opportunities for active investors.

As government reforms make the Chinese equity markets more accessible to foreign investors, A-shares are expected to become part of recognized benchmark indices. A recent report by MSCI suggests that if all investment barriers were removed, A-shares could represent up to 14% of the MSCI Emerging Markets Index and 2% of the MSCI All Country World Index.[2] This could result in investors looking at A-shares in concert with key markets such as Japan, Germany and the U.S.

Can foreign investors buy A-Shares?

To invest in A-shares, foreign investors must either obtain a Qualified Foreign Institutional Investor (QFII) license or invest through a QFII license-holder. In April 2014, the Shanghai-Hong Kong Stock Connect pilot program was announced. When finalized it would give foreign investors access to domestic Chinese equities without quota. The program is designed to give investors access to a subset of Chinese domestic securities and will have liquidity provisions attached to it.

As with most emerging markets, government involvement, corporate governance and accounting standards are generally considered to be evolving and lag the standards found in developed markets. The China Securities Regulatory Commission continues to take steps to improve corporate governance and the structure of the capital markets. Over time, this should benefit all investors.

[2] MSCI: "A" Opening to the Great Wall, December 2012.

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Greystone Managed Investments Inc.

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[1] As at Jun 30, 2018.
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