TheWall

NEWS

China A-shares a potential long-term play on MSCI index

BY KUEK SER KWANG ZHE

The gradual inclusion of the 222 large-cap Chinese stocks (China A-shares) on the MSCI Emerging Markets index is expected to have minimal benefit for retail and institutional investors — whether through direct investment or actively and passively managed funds — in the short term. But it could be positive for them in the long term if China continues to liberalise its economy and financial markets, say investment experts.

Gary Lim, regional fund manager of Apex Investment Services Bhd, says the limited impact is because China A-shares only make up 0.73% of the weightage of the index for now. While the inclusion on the MSCI Emerging Markets index, starting June next year, could attract new inflows into the A-shares (as more than US$10 trillion worth of active and passive assets globally are benchmarked against the index), the size of the inflows may not be significant.

"The market estimates that it will attract about US$17 billion to US$18 billion of new inflows into the A-share market. This is not significant as it is only about 1.3 times the daily turnover of the market," says Lim.

He says fund houses that have taken an interest in China A-shares have already invested in the market via various channels. These include the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect, Qualified Foreign Institutional Investor (QFII) Scheme and Renminbi Qualified Foreign Institutional Investor (RQFII) Scheme.

"The turnover of the A-shares market doubled last year, indicating that investors have already positioned themselves for the inclusion. Large fund houses have already invested in China A-shares and introduced funds dedicated to the market."

REUTERS

SAIC Motor is among the 222 large-cap stocks to be included on the MSCI index

Vasu Menon, vice-president and senior investment strategist for wealth at OCBC Singapore, also says the inflows into China A-shares will not move the market by a lot. "It is estimated that it will attract between US$11 billion and US$20 billion, which is not a lot compared with the daily turnover of about US$65 billion," he notes. He concurs with Lim that large fund houses have already invested in A-shares through various channels.

In a media commentary, Helen Wong, chief executive for Greater China at HSBC, says the MSCI's decision to include A-shares on its Emerging Markets index is a pivotal moment for global investment in China's capital markets. "While the initial weighting is relatively small, this is the start of a process through which Chinese equities will achieve prominence in global investors' portfolios that reflects the size and significance of China's domestic stock market and economy. It will also provide impetus for the continuing internationalisation of the renminbi as a global investment currency."

She adds that the successful launches of the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect paved the way for the MSCI inclusion, and China's commitment to liberalising global access to its markets will continue to create exciting opportunities for investors.

On June 20, MSCI Inc announced that it would gradually add the mainland China stocks onto its MSCI Emerging Markets index. This inclusion comes after three failed attempts.

According to MSCI's press release, the decision to do so was due to the broad support it received from international institutional investors it consulted with. This is also a result of "the positive impact on the accessibility of the China A-share market of both the stock connect programme and the loosening by Chinese stock exchanges of pre-approval requirements that can restrict the creation of index-linked investment vehicles globally".

The large-cap stocks that will be added onto the index include financial giants such as the Bank of China, China Merchants Bank and Ping An Insurance, according to MSCI. Other names include Tsingtao Brewery, SAIC Motor Corp Ltd and Suning Commerce Group.

MSCI Inc's decision to include A-shares on the index has drawn criticism from some market players. One of the main reasons is that the Chinese capital markets have seen heavy intervention from the government in recent years.

"In fact, the China A-share market has experienced the highest number of trading suspensions in the world," says Menon.

In January last year, China's stock markets saw trading suspended when the Shanghai Composite 300 Index shed 6.9% following the release of weak manufacturing data. The Shenzhen Composite Index fell by more than 8%.

Three days later, trading was again suspended as the indices continued to plunge and the government called on large brokerage firms to support the markets. The move was criticised by institutional investors as they were unable to pull their funds out of the markets.

However, Menon welcomes the inclusion of the A-shares on the MSCI Emerging Markets index as there have been improvements in the past 12 months as the Chinese government reviewed its trading suspension mechanism. The index will not include the large-cap stocks that have been suspended.

POSITIVE IN THE LONG TERM

Lim says investors should consider their exposure to Chinese stocks in the long term. He is positive on the country as it gradually opens up and liberalises its capital markets to meet international standards and make them more market-centric.

He adds that MSCI is essentially offering a carrot by having China's capital markets integrate with the global market. By doing so, the Chinese government will have an incentive to reform its capital markets.

"Only a small percentage of China's stock markets is held by foreign investors and the pressure put on the government by foreign investors could be minimal. There is also the possibility that A-shares could be removed from the index if its markets do not meet MSCI's standards. This has happened to Pakistan before. However, the inclusion provides China with an incentive to be more market-centric," says Lim.

He says there are positive signs that China will continue to reform its capital markets to meet international standards, which can be seen from the actions of President Xi Jinping at recent international events. For instance, Xi warned that the global economy could be at risk due to protectionist measures following the Brexit referendum — in stark contrast to the anti-globalisation and anti-trade rhetoric of US President Donald Trump.

Xi also announced China's support for the Paris climate agreement while Trump said the US would withdraw from the accord.

Menon remains positive on China for the long term. He says Xi has made a lot of effort to reform the Chinese economy and open its capital markets to global investors. The QFII and RQFII Scheme, together with the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect, were implemented under his leadership.

"It is hard to tell if these will go on when there is a change in the leadership of China's Communist Party. But as long as Xi implements all the necessary measures during his tenure and builds up momentum, things will likely be on track," says Menon.

However, it will probably take a long time for Xi to reform and open up China's markets. "He is tackling issues such as the country's huge debt and property bubble. If he fully opened up the capital markets very quickly, it could trigger a massive capital outflow. This would hamper the government's efforts to solve the big issues," says Menon.

He adds that it could take up to 10 years for the full inclusion of China's markets on the MSCI Emerging Markets index. He points out that Taiwan and South Korea took about a decade for their markets to be fully included on the index.

"The full inclusion will see China's markets take up about 28% of the index's weightage," says Menon. ■

KENNY YAP/THE EDGE

Menon

CHINA H-SHARES WILL BENEFIT

The H-shares of some of the dual-listed companies domiciled in China may benefit from the inclusion of China A-shares on the MSCI Emerging Markets index, says Gary Lim, regional fund manager at Apex Investment Services Bhd.

"Some companies in China dual-listed their shares in China and Hong Kong. It is the same companies being listed, but there is a gap between the valuation of the A-shares (which are listed on the Chinese markets) and H-shares (which are listed on the Hong Kong market). For instance, the Industrial and Commercial Bank of China's H-share is about 15% cheaper than its A-share [as at June 23]," he says.

"Thus, when there are more investors looking into A-shares, they could see that some of the companies are also listed on the Hong Kong market and that the H-shares are traded at a lower price than the A-shares. So, investors could opt to buy the H-shares of these companies. On top of that, the H-share market is less volatile as the A-share market is dominated by retail investors."

Lim

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QUOTE OF THE WEEK

When a man is in love or in debt, someone else has the advantage.
▸ Bill Balance

SimplyCJ

BY ONG SHI JIE

A major disruptor

Does the financial industry need people anymore? From the surveys that I have seen on delivering superior service experience in the financial industry, our sales and service people can be the strongest evidence of this. But they can also be the weakest link.

Customers are increasingly disenchanted by how impersonal banking can be. Their common grouse is that bankers tend to put their own interests before those of their clients.

However true that may be, it has given the opportunity for technology to prove that it can do a better job. There is a rising concern globally that not enough people receive the financial advice they need at affordable prices.

In Malaysia, getting a relationship manager to work with your portfolio requires that you first seed your account with RM200,000 to RM500,000, depending on the bank you choose. This by no means guarantees the quality of advice that you receive.

Humans come hardwired with cognitive biases that often result in suboptimal financial decisions. We love to agree with people who agree with us. We put a great deal of weight on previous events, believing that they somehow influence future outcomes, and overlook other potentially important information. And we believe that we are more knowledgeable and skilful than we actually are.

Relationship managers are just as human as their clients and subject to such biases. Throw in factors such as financial incentives and it is easy to understand why we are seeing a strong case for fully automated investment services.

Relying on computers to make trades is not new. There are thousands of hedge funds out there making trades with the help of computer models. This typically involves "quants", or financial engineers who build huge statistical quantitative models that are rule-based and dictate the trading or investment strategy of the fund.

The thing about these quant models is that they can be somewhat static and, as markets change, they may not work as well as they have in the past. It is what I call driving forward with your rear-view mirror.

Where progress has been made in recent years is that funds have moved towards true machine learning — artificial intelligence (AI) systems can distil large amounts of data and improve themselves. Imagine a continuous loop where systems automatically recognise changes in market trends and patterns and adapt their models accordingly.

Where things have become even more futuristic is the use of AI to run companies without any human input. In April last year, the investing community was in a flurry about something called the DAO — an investment company with no board, no CEO and not a single human employee.

The decentralised autonomous organisation was a venture capital fund. In place of analysts and fund managers, there was only code. Clearly, this captured the fascination of investors as the DAO set the record for the largest crowdfunding campaign in history by raising US$150 million.

If computers can control investment companies, does this mark the end of human financial experts? The greatest contribution technology can make for the retail industry is not to replace human financial managers. Rather, it is to create access to the kind of financial advice that could make a material difference in their lives. As interesting a concept as the DAO is, it is a niche concept supported by internet currency.

AI can play a role in providing real-time, contextual and meaningful feedback on our money habits, especially when we are spending our hard-earned income. Can it serve as our inner voice of reason before we succumb to consumerism? Can it be our personal financial assistant, reminding us about things like we have some miles earned on our credit card, which we can use for an upgrade on a much-needed holiday? Can it remind us of things like my child has spent her allowance way faster than she should have (and that it is time to have that heart-to-heart talk about budgeting) and suggest relevant articles?

Will we see the day when an app that can grab all the important information around us the way a Fitbit does for runners who want to improve their performance? With the current pace of technology, I think we are not too far away from seeing this become a reality.

Ong Shi Jie (CJ) is head of integrated marketing and analytics at OCBC Bank (M) Bhd