

## OUR TAKE ON RECENT CHINESE MARKET VOLATILITY

Chinese A-share markets started 2016 on a volatile note, dropping 7% on the first trading day of the year and again yesterday, triggering a trading halt through a new circuit breaker. Yesterday's fall which affected other markets and currencies was triggered after the People's Bank of China's move to lower the renminbi's (RMB) mid-point rate spooked investors. This has since prompted the Chinese stock exchanges to suspend the circuit breaker mechanism.

It would seem as though China gets negative press every day, but we think these two events may be overhyped. There is no denying that China is facing headwinds, as key macroeconomic data indicate, but as long-term investors, we are not unduly concerned about the events. Here's why:

1. In some ways, the market gyrations **should have been expected**, partly fueled by concerns that a six-month ban on share sales by significant shareholders, implemented last July, will expire today. In addition, the **Chinese A-share market is dominated by retail investors (accounting for over 80% of the trades in the A-share market)**, who tend to be short-term and speculative in nature. This likely exacerbated the sell-off.
2. In the latest development, the Shanghai and Shenzhen stock exchanges have scrapped the circuit breaker, after realising that the mechanism triggered more fear and panic than the intended stability. It appears that **Chinese authorities are still experimenting with ways to curb market volatility—but they are learning quickly** and are not afraid to throw out or rework new measures that fail.

In addition, the **China Securities Regulatory Commission yesterday issued new guidelines to limit the amount of shares that significant shareholders can sell**. These two moves may inject some calm into the markets and ease speculative selling.

Circuit breakers can be useful in containing panic. However, China's circuit breaker triggers 15-minute trading halts when stocks swing by 5%, and a full-day halt after a 7% fall—a **range that may have been a tad narrow**. In comparison, in the US, a 7%/12% swing effects a 15-minute halt, while a 20% decline stops daily trading.

3. **China H-shares remain attractive versus A-shares:** The MSCI China Index currently trades at a 12-month forward price-to-earnings (P/E) ratio of 8.1x<sup>1</sup>—back to levels before the 14 American Depository Receipts (ADRs)<sup>2</sup> were added to the index in end-November. In comparison, the CSI 300 Index is trading at a forward P/E of 10.6x<sup>1</sup>.

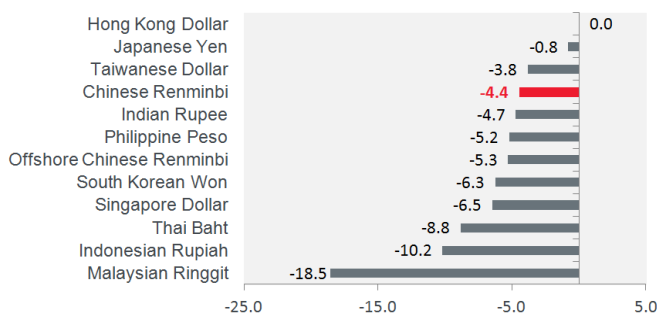
Fig 1: Chinese H-shares currently trade at discount to A-shares



Source: <sup>1</sup>Bloomberg, as of 7 January 2016. <sup>2</sup>18 Chinese stocks were added to the MSCI China Index on the close of trading on November 30, 2015, 14 of which are ADRs, including Alibaba Group Holding, Baidu, Ctrip.com, Netease.com, JD.com and Vipshop Holdings.

4. The **RMB's depreciation in 2015 has been less steep than that of major Asian currencies**. Even with yesterday's fall, it is still among the best-performing currencies in Asia and emerging markets. Also, with China's ongoing capital account liberalisation and gradual shift towards a less managed exchange rate, further RMB devaluation may come as no surprise.

Fig 2: Asian Currencies' Performance in 2015 (%)



Source: Bloomberg, 31 December 2015. Based on spot returns.

5. We believe **structural reforms will continue to progress in 2016 and beyond**. The government has set out to tackle overcapacity and promote manufacturing in China, and has made headway in reforming state-owned enterprises, among others. **Reforms may aid a recovery in cyclicals**, which have underperformed defensives over the past few years. **As China continues to loosen monetary, fiscal and property policies to help boost aggregate demand, China could see a cyclical recovery** from stronger credit creation.

Fig 3: China Cyclicals vs Defensives Price Index (USD)



Source: Credit Suisse, 7 January 2016. Aggregated by MSCI China universe. Rebased on 31 December 2005.

For more information contact: [content@eastspring.com](mailto:content@eastspring.com) | T: +65 6349 9100

This document is produced by Eastspring Investments (Singapore) Limited and issued in:

**Singapore and Australia** (for wholesale clients only) by Eastspring Investments (Singapore) Limited (Company Reg. No: 199407631H), which is incorporated in Singapore, is exempt from the requirement to hold an Australian financial services licence and is licensed and regulated by the Monetary Authority of Singapore under Singapore laws which differ from Australian laws.

**Hong Kong** by Eastspring Investments (Hong Kong) Limited and has not been reviewed by the Securities and Futures Commission of Hong Kong.

**United Arab Emirates** by Eastspring Investments Limited which has its office at Precinct Building 5, Level 6, Unit 5, Dubai International Financial Center, Dubai, United Arab Emirates. Eastspring Investments Limited is duly licensed and regulated by the Dubai Financial Services Authority (DFSA). This information is directed at Professional Clients as defined by the Conduct of Business rulebook of the DFSA and no other person should act on it.

**United States of America** (for institutional clients only) by Eastspring Investments (Singapore) Limited (Company Reg. No. 199407631H), which is incorporated in Singapore and is registered with the U.S Securities and Exchange Commission as a registered investment adviser.

**Luxembourg** (for institutional and professional investors only) by Eastspring Investments (Luxembourg) S.A., Grand-Duchy of Luxembourg.

**United Kingdom** (for institutional and professional investors only) by Eastspring Investments (Luxembourg) S.A. - UK Branch, 125 Old Broad Street, London EC2N 1AR.

**Chile** (for institutional clients only) by Eastspring Investments (Singapore) Limited (Company Reg. No: 199407631H), which is incorporated in Singapore and is licensed and regulated by the Monetary Authority of Singapore under Singapore laws which differ from Chilean laws.

The afore-mentioned entities are hereinafter collectively referred to as Eastspring Investments.

This document is solely for information purposes and does not have any regard to the specific investment objective, financial situation and/or particular needs of any specific persons who may receive this document. This document is not intended as an offer, a solicitation of offer or a recommendation, to deal in shares of securities or any financial instruments. It may not be published, circulated, reproduced or distributed without the prior written consent of Eastspring Investments.

Past performance and the predictions, projections, or forecasts on the economy, securities markets or the economic trends of the markets are not necessarily indicative of the future or likely performance of Eastspring Investments or any of the funds managed by Eastspring Investments.

Information herein is believed to be reliable at time of publication but Eastspring Investments does not warrant its completeness or accuracy and is not responsible for error of facts or opinion nor shall be liable for damages arising out of any person's reliance upon this information. Any opinion or estimate contained in this document may subject to change without notice.

Eastspring Investments (excluding JV companies) companies are ultimately wholly-owned / indirect subsidiaries / associate of Prudential plc of the United Kingdom. Eastspring Investments companies (including JV's) and Prudential plc are not affiliated in any manner with Prudential Financial, Inc., a company whose principal place of business is in the United States of America.