

▶ WHY STAR IS CRUCIAL TO CHINA'S CAPITAL MARKET REFORMS

China's capital markets have undergone significant changes since the commencement of the reforms and opening up-policy. The plan to introduce a new Science Technology & Innovation Board (STAR) is yet another show of commitment to deepen and strengthen the country's financial markets to make it an attractive financing option for Chinese enterprises, and one that offers investment opportunities for foreigners.

China's status as an economic powerhouse and the world's second largest economy is indisputable. For China to continue to grow as a modern market economy, an efficient and stable financial sector is a prerequisite. There have been various measures over the years to vitalise the financial markets such as the Stock Connect, Bond Connect and the inclusion of onshore Chinese A-shares by index builder, MSCI and FTSE.

Still, there have been persistent issues with the Chinese A-share market - high volatilities, overly regulated, inefficient Initial Public Offering (IPO) and exit mechanism, lack of new economy names, etc. To solve these issues, the government has carried out a series of reforms which nevertheless have been proved to be ineffective. The new Science Technology & Innovation Board (STAR),



Michelle Qi

Chief Investment Officer – Equities
Eastspring China WOFE

announced first by President Xi at the China International Import Expo, and then further emphasized at the Central Economic Work Conference, represents the central government's determination to deepen the capital market reforms.

More recently, the Vice President, Liu He, head of China Securities Regulatory Commission (CSRC), Yi Huiman, and Shanghai government officials together announced the inception of STAR on June 13th. Officials from Shanghai Stock Exchange further confirmed that the first batch of companies will get listed on STAR within two months.

STAR'S DIFFERENTIATING EDGE VERSUS TRADITIONAL STOCK MARKETS

▶ **A relaxation on listing requirement**

In terms of financials, there is no longer a need for a three-year track record of positive earnings; in terms of company structure, it allows those

structured as variable interest entities (VIEs) or with multi-share classes to get listed. This will help to attract more new economy names to list on the onshore market.

➤ **A reform in trading mechanism**

Price limits will be expanded from +/-10% to +/-20%, with no limits in the first five trading days. If this goes smoothly, it will serve as a testbed for a potential reform of the trading limits on the traditional boards. On the traditional boards, the current cap on share price fluctuations on the first day of trading is 44% and subsequently 10% a day.

➤ **A higher quality stock pool**

STAR will adopt a registration-based system in contrast with the lengthy approval-based system on the current boards. The leading underwriters will also have to be the cornerstone investors which will motivate them to bring forward high quality companies. In addition, STAR will run a stricter exit mechanism to maintain a quality stock pool on an ongoing basis.

➤ **A transformation of market pricing**

While on traditional boards most IPOs are priced with a cap valuation of 23x price-to-earnings, STAR will impose no limit and let the market determine the issuance price instead. The Green-shoe mechanism will also be applied to reduce the price volatility post IPO.

➤ **A higher bar for participants**

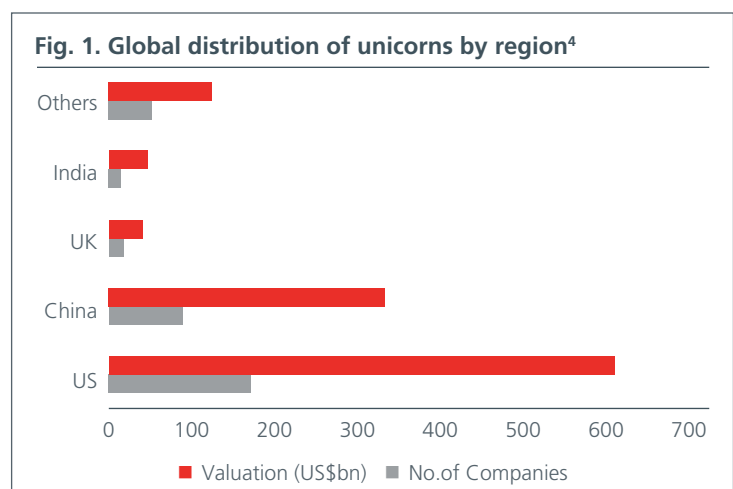
Only institutional investors as well as those retail investors with rich investment experience (>2 years) and certain assets under management (>Rmb500k) are allowed to participate in STAR. This shows regulators' clear intention in reducing volatilities where the strong presence of retail investors on traditional boards is believed to be one source of market ups & downs.

A PLATFORM FOR CHINA'S GROWING NUMBER OF UNICORNS

China has already set a target to become a world leader in artificial intelligence (AI) by 2030². This STAR is thus aimed at attracting and financing innovative companies (those in areas of high-end equipment, biotechnology & health care, IT, new materials, renewable energy, energy saving and environmental protection) that will drive China's future AI competitiveness.

In fact, unicorns³ and startups are burgeoning in China. According to a research report⁴, the global number of unicorns as of May 2019 totaled 346 with the US having a dominant share of 49.7%. This is followed by China, who boasts 89 unicorns (or 25.7% of total). The United Kingdom and India rank third and fourth.

The new STAR will become a platform for such unicorns to list and raise funds at home. Moreover, the latest trade spat with the US and the US curbs on its Chinese technology companies may push Chinese government to extend more support to the domestic high-tech firms, i.e. provide greater access to funding through STAR.



ECONOMIC AND INVESTMENT IMPLICATIONS

Due to STAR's national-strategic importance, the Chinese government will do its best to ensure all reforms be carried out in an effective manner. Furthermore, if STAR proves to be successful, some of the reforms/experience (i.e. market pricing, wider trading limits) may be extended to the traditional boards at a later stage.

For corporates, this will mean greater access to funding. It will help to rebalance the economy from an indirect-financing to a direct-financing mode; the gearing ratio of Chinese corporates have been much higher than that of US over the years. In terms of percentage of GDP, however, the non-financial corporate debt of US and China was 143% and 74% respectively as at end of 2018.

For equity investors, these reforms result in a larger investable universe. It will not only attract more global investors into the onshore market but also provide more investment options for onshore institutional investors such as the pension funds and asset managers, to diversify their investments for a better risk-return profile.

Disclaimer

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

Singapore and Australia (for wholesale clients only) by Eastspring Investments (Singapore) Limited (UEN: 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.

Thailand by TMB Asset Management Co. Ltd. Investments contain certain risks; investors are advised to carefully study the related information before investing. The past performance of any fund is not indicative of future performance.

Indonesia by PT Eastspring Investments Indonesia, an investment manager that is licensed, registered and supervised by the Indonesia Financial Services Authority (OJK).

Malaysia by Eastspring Investments Berhad (531241-U).

United States of America (for institutional clients only) by Eastspring Investments (Singapore) Limited (UEN: 199407631H), which is incorporated in Singapore and is registered with the U.S Securities and Exchange Commission as a registered investment adviser.

European Economic Area (for professional clients only) and Switzerland (for qualified investors only) by Eastspring Investments (Luxembourg) S.A., 26, Boulevard Royal, 2449 Luxembourg, Grand-Duchy of Luxembourg, registered with the Registre de Commerce et des Sociétés (Luxembourg), Register No B 173737.

United Kingdom (for professional clients 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 (UEN: 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**.

The views and opinions contained herein are those of the author on this page, and may not necessarily represent views expressed or reflected in other Eastspring Investments' communications. 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. Reliance upon information in this posting is at the sole discretion of the reader. Please consult your own professional adviser before investing.

Investment involves risk. 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. Data from third party sources may have been used in the preparation of this material and Eastspring Investments has not independently verified, validated or audited such data. Where lawfully permitted, 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.



A member of Prudential plc (UK) 