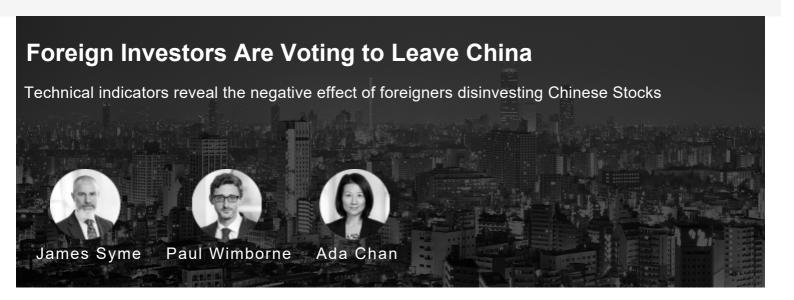


# News



#### 09 Feb 2024

Benjamin Graham famously said, "In the short run, the market is a voting machine, but in the long run, it is a weighing machine." In recent months, we have seen a powerful voting effect in Chinese equities without any obvious sign that the weighing effect is having a meaningful impact.

To see this more clearly, it is important to understand how Chinese equity markets are structured. China has possibly the most complicated equity market structure in the world, with listings split between the mainland, Hong Kong, and overseas.

China has three domestic stock exchanges, dominated by Shanghai (the others are Beijing and Shenzhen), principally for domestic investors. The shares on the exchanges are predominantly Renminbi-denominated A shares, making the equity markets largely subject to Renminbi liquidity and interest rates. Because of capital controls, domestic investors have limited access to other equity markets, including Hong Kong.

Foreign investors primarily have access to Hong Kong Dollar-denominated H shares listed on the Hong Kong Stock Exchange. Because of the currency peg, these are subject to a combination of Hong Kong Dollar and US Dollar liquidity and interest rates. Some Chinese companies are only listed in A shares, some only in H shares, and some are dual-listed.

Further complicating the landscape is Connect, a tightly controlled mechanism for foreign investors to access A shares via Hong Kong. Finally, there are Chinese companies listed on other capital markets,

of which US-listed ADRs have been the most important. Since sanctions began in 2018 and the resultant decoupling, there has been an aggressive move to delist Chinese ADRs and they are less important than they used to be.

The voting mechanism at play in Chinese equities is the aggressive selling by foreign investors across the Chinese equity landscape. There are a number of ways that this can be seen in data. One is simple market returns. In the year to the end of January 2024, the MSCI EM ex-China Index returned +10.4% in USD terms, compared to a -27.7% return from the HKSE China Enterprise Index and a -17.1% return from the Shanghai Composite Index (the main indices for H shares and A shares respectively).

Relatedly, an index of the premia that dual-listed A shares trade at to their H share counterparts has been steadily rising since 2018, but in the year to end January jumped from 34.5% to 56.8% as foreign investors sold shares with the same underlying fundamentals more aggressively than domestic investors. This selling can also be seen in the flows through Connect, with foreigners selling USD 1.4bn of A shares through Connect in January 2024 alone.

In the index fund space a similar pattern can be seen, with the main MSCI EM Index seeing its net asset value decline from USD 26.3bn to USD 17.0bn in the year to January, while the MSCI EM ex-China index saw its net asset value increase from USD 3.3bn to USD 9.3bn, as investors fled Chinese equities.

Finally, and as previously noted, valuations of Chinese stocks are well below both their peers in emerging markets and their own valuation history. Chinese equities, particularly H shares, are extremely cheap across the board. However, with the current negative newsflow and sentiment, and with foreign investors 'voting' to abandon China, there is insufficient capital 'weighing' these apparent value opportunities. The 'long-run' in Graham's quote seems, for now, to extend past our investment horizon, and we remain cautious on China and underweight the market while the current environment continues.

#### Disclaimer

Professional investors only. This is a marketing communication. Please refer to the fund prospectus and to the KIID / KID before making any final investment decisions. The investment promoted concerns the acquisition of shares in a fund or the investment strategy and not the underlying assets. Past performance is no guarantee of future performance. 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. The information contained herein including any expression of opinion is for information purposes only and is given on the understanding that it is not a recommendation. The information in this article does not constitute, or form part of, any offer to sell or issue, or any solicitation of an offer to purchase or subscribe for any funds or strategies described in this article; nor shall this article, or any part of it, or the fact of its distribution form the basis of, or be relied on, in connection with any contract.

# **Related Articles**

## Elections Set the Agenda for 2024

Elections in Russia and the US may be very different in both form and substance, but they will set the tone for emerging markets in what will be a year of elections worldwide

### India's Digital Miracle

India's digital revolution and its journey to become the world's third-largest economy

Read More

20 December 2023

### Keeping Positive but Realistic

As India revels in its growth, will high valuations prove resilient amidst the shifting landscape?

Read More

13 December 2023

#### From Desert Sands to Investment Oasis

A Closer Look at how One Sheikh's Reforms Transformed the UAE

Read More

20 November 2023

## Rising Chinese Stars

Uncovering China's Overlooked Growth Stories Amidst Market Volatility

Read More

13 November 2023

## Legal

This website is issued and approved in the UK by J O Hambro Capital Management Limited, which is authorised and regulated by the Financial Conduct Authority. Registered office: Level 3, 1 St James's Market, London SW1Y 4AH. Registered in England and Wales under No: 2176004. Issued in the European Union by JOHCM Funds (Ireland) Limited which is authorised by the Central Bank of Ireland. Registered office: Riverside One, Sir John Rogerson's Quay, Dublin 2, Ireland. J O Hambro is a registered trademark owned by and used under licence from Barnham Broom Holdings Limited. JOHCM® is owned by J O Hambro Capital Management Limited. Telephone calls may be recorded.

© 2022 J O Hambro Capital Management Limited.All rights reserved.