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Matthews Asia

Matthews Asia Q&A

What Investors Should Know about MSCI's Decision on China A-Shares

What does the MSCI's planned inclusion of China's select domestic A-shares into its Emerging Market Index mean for investors? Matthews Asia's China Team offers insights in this long-awaited development.

IS MSCI'S INCLUSION OF CHINA A-SHARES A POSITIVE DEVELOPMENT?

Yes, we are encouraged by the latest MSCI move. Over the past four years, China has been making significant efforts to further open its capital markets. In our opinion, China's A-share market has simply been too big to be overlooked by global investors. It is the second-largest equity market in the world, both in terms of market capitalization and turnover. Until now, the structure of MSCI indices have been lacking in their representation of China's overall markets.

HOW COULD THIS BENEFIT INVESTORS?

With China's A-share markets no longer ignored, foreign investors can take advantage of the unique opportunity to participate directly in companies that are benefiting from one of the most dynamic economies in the world. This MSCI decision will allow 222 of China's large-capitalization domestic A-share stocks to be gradually included into the Emerging Market Index, starting in June 2018. The number of stocks represents approximately 0.73% of the weight of the Emerging Market Index. In recent years, we have witnessed the evolution of China's A-share market—not only in terms of the number of listed companies, which have been growing substantially, but also in overall quality. We've seen the overall regulatory and corporate governance environment make strides, and seen accessibility improve with schemes such as the "Stock Connect" programs of the Shanghai and Shenzhen stock exchanges.

WHAT LED THE MSCI TO DECIDE ON INCLUDING THESE STOCKS?

In recognizing China's recent significant efforts to meet MSCI criteria and further open up the capital markets, the index company said, "MSCI is very hopeful that the momentum of positive change witnessed in China over the past years will continue to accelerate." It added that further inclusion of China A-shares "will be subject to a greater alignment of the China A-shares market with international market accessibility standards, the resilience of 'Stock Connect,' the relaxation of daily trading limits, continued progress on trading suspensions, and further loosening of restrictions on the creation of index-linked investment vehicles."

HOW OLD IS CHINA'S A-SHARE MARKET?

Started in 1992, China's A-share market is still relatively young. Undoubtedly, there are still challenges and improvements to be made. The overall market is currently dominated by retail investors. Trading could be volatile and government intervention can be heavy-handed. However, we are encouraged by the strong potential and opportunities in the A-share market, and believe that long-term investors can benefit from exposure into A-shares.

HOW MUCH EXPERIENCE DOES MATTHEWS ASIA HAVE WITH CHINA A-SHARES?

Matthews Asia has extensively studied and invested in China's domestic A-share companies for many years. In 2014, our firm was awarded a Qualified Foreign Institutional Investor (QFII) license and quota that enabled us to invest directly into China's domestic securities market, including the market for China A-shares. We have also participated in A-shares via the "Stock Connect" programs, which in recent years have linked the Shanghai and Shenzhen stock exchanges to the Hong Kong Stock Exchange and enabled foreign investors to buy A-shares with fewer restrictions than under the QFII schemes.

We continue to be attracted by the fundamentally sound merits of many local companies listed in China. However, we realize that many quality A-share companies in growing industries can be priced at very rich valuation multiples, which makes our experience of carefully vetting them critical. We truly believe that long-term investors can benefit from exposure to A-shares.

At Matthews Asia, our focus has always been on taking a fundamental approach to finding leading A-share companies poised to benefit from the country's structural shift toward its domestic economy.

—Matthews Asia China Investment Team

Disclosure and Notes

The MSCI Emerging Markets Index captures large and mid-cap representation across 23 Emerging Markets (EM) countries. With 833 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. Indices are unmanaged and it is not possible to invest directly in an index.

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