Today, Chinese firms are listed on a variety of exchanges in many parts of the world. Some firms operate predominantly in mainland China even though they may be publicly listed on exchanges in New York, Singapore or Hong Kong. China’s domestic A-share market is currently Asia’s largest equity market at roughly US$5 trillion in market size. This resource is designed to help investors better understand the diversity of China’s equity universe as well as the ways in which the various markets can be accessed.

**Overall Landscape of China’s Equity Market**

China’s investable universe consists of several different segments:

- **Red Chips**—Chinese companies that are listed in Hong Kong and incorporated in Hong Kong
- **H shares**—Chinese companies that are listed in Hong Kong but incorporated in mainland China
- **SAR (Hong Kong) companies**—Chinese companies listed in Hong Kong that derive the bulk of their revenues from conducting business in Hong Kong and/or mainland China. SAR companies are usually domestic Hong Kong-based companies run by Hong Kong management teams
- **Overseas Listed Chinese companies**—Chinese companies that are listed outside of China, mainly in the U.S. (American Depositary Receipts, or ADRs) or Singapore markets. These are often companies seeking either the prestige of being listed on the U.S. market or the ease of listing on the Singapore market
- **A shares**—Chinese companies that are listed on the country’s Shanghai and Shenzhen stock exchanges. A shares are open primarily to domestic investors or foreign institutional investors with a Qualified Foreign Institutional Investor (QFII) quota. A “Stock Connect” link between the Shanghai and Hong Kong stock exchanges, established in late 2014, has also relaxed restrictions that historically split the Chinese stock market between shares targeted at local investors and those available to international investors. Named the Shanghai-Hong Kong Stock Connect, the link allows mainland Chinese investors to purchase select Hong Kong and Chinese companies listed in Hong Kong, while also allowing foreigners to buy Chinese A shares listed in Shanghai in a less restrictive manner than before. However, it is important to note that still very few foreigners are exposed directly to the A-share market, where foreign holdings are less than 1% of total market capitalization
- **B shares**—Chinese companies that are listed on the Shanghai and Shenzhen stock exchanges, and available to both Chinese and non-Chinese investors. Contrary to A shares, B shares were created originally as a means for foreigners to participate in China’s domestic market

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**China’s Equity Market Universe**

September 2015
A-Share Overview—market structure and investor base

Many observers are familiar with the strong A-share market rally that occurred late in 2014. This came on the back of renewed enthusiasm over China’s market, given that there was substantial speculation about monetary easing policies. Taking into account the 40 million new stock accounts that were opened between June 2014 and 2015, many more individuals also began investing in China’s market, and many used leverage for the first time. In dealing with the rapid rise of its stock markets, authorities in China began to tighten the limits on margin financing in June 2015, which resulted in the beginnings of an A-share market correction.

Why has performance for the Shanghai and Shenzhen markets been so divergent?

As of September 8, 2015, the Shanghai Composite Index returned -1.99% year-to-date (YTD), while the Shenzhen index returned +23.06% YTD. So why has performance been so different?

Fundamentally, the characteristics of the Shanghai and Shenzhen markets differ widely. The Shanghai exchange is dominated by traditional state-owned enterprises (SOEs), namely, large financial institutions. Shenzhen on the other hand, has far fewer SOEs. Most of the top 10 largest companies of the Shenzhen exchange are privately run—a commonality throughout the entire exchange. Shenzhen also promotes the establishment of more private enterprises as can be seen from the introduction of its popular ChiNext board in 2009, which features smaller, more growth-oriented companies.

The Shenzhen and Shanghai exchanges also have differing sector profiles. For Shenzhen, the financials sector accounts for only 12% of the entire market, whereas for Shanghai, it accounts for over 36%. Developing and faster growing sectors, such as information technology and health care, account for 18% of Shenzhen’s market and 9% for Shanghai.

A-share market—marked by volatility?

Why has China’s A-share market been marked with such volatility? The key reason for this is particularly high retail investor participation. Individual investors account for almost 85% of China’s total domestic trading volume. Compare that with the far more developed Hong Kong market, where retail participation there is a mere 21%.

The main issue with such high retail participation is that the investment horizons of retail investors generally tend to be far shorter-term; and decision-making among the retail audience is more influenced by daily news flow. To deal with the issue of high retail participation, Chinese authorities are encouraging more institutional market participation. There has been continued growth among quotas (QFII and Registered QFII) aimed at allowing foreign institutional investors to deal in China’s domestic securities. This gradual push toward more institutional participation in the market may help to reduce the dependence on retail participation and help to minimize overall market volatility.
How does Matthews Asia go about accessing the A-share market?

For more than 20 years, Matthews Asia has been providing investors with access to opportunities created by China’s profound economic transformation. Matthews Asia has historically invested in China primarily via Chinese companies that are listed in Hong Kong and the U.S. For many years, our research process has also frequently included A-share listed companies. However, we started to invest in the A-share market only recently after gaining access to it by means of a QFII license in 2014.

Beside the QFII opportunity, there is also the Shanghai–Hong Kong Stock Connect program, which effectively allows Hong Kong exchange participants to invest in Shanghai (known as the northbound link) and also for mainland Chinese participants to invest in the Hong Kong markets (known as the southbound link).

In terms of investable markets, the QFII program grants access to both Shanghai and Shenzhen exchanges whereas the Shanghai–Hong Kong Stock Connect program, thus far, offers access to just approximately 590 companies on the mainland and about 200 companies in Hong Kong.

At Matthews Asia, we participate through both the QFII program and the Shanghai–Hong Kong Stock Connect program for some strategies to gain access to the A-share market because we feel that it provides us with more flexibility. The QFII quota remains integral to our process, at least for now, particularly because we are able to gain access to the Shenzhen exchange only through the quota. Overall, we are encouraged to find access to China’s A-share market continuing to improve.