CHINA CRISIS

AVIVA INVESTORS
July 2015

Key points

- China's equity market has crashed
- The authorities have taken drastic action to arrest the decline
- We see the long-term potential China has to offer
- But valuations of domestic equities remain excessive
- Chinese companies listed in Hong Kong are more attractively valued

William Ballard[1]

Head of Emerging Market & Asia Pacific Equities

Will joined Aviva Investors in 2009 and is responsible for Emerging Markets & Asia Pacific Equity Strategies. Previously, Will worked at Royal Bank of Canada in their Global Arbitrage Trading division. Before this, he was a fund manager at Henderson Global Investors.

Despite recent falls, Chinese domestic equities still look overvalued and a cautious approach is warranted says William Ballard

After an unprecedented run over the past two years, China's domestic equity market has suffered a dramatic correction. Since its peak on June 12, the Shanghai Composite Index has fallen nearly 30 per cent. The Chinese authorities have taken drastic action to stem the slide in share prices by introducing a plethora of emergency measures. Some of the more conventional measures the Chinese authorities implemented include the relaxation of lending rules, the restriction of IPOs, and short selling. The more extreme measures that temporarily halted the market rout surprised even seasoned international investors. Domestic investors with stakes in excess of five per cent in any one company have been blocked from selling their stakes for the next six months. Since the start of this week, around 1,300 companies have voluntarily suspended trading in their own shares.

Long-term impact of intervention unclear

China is in the midst of a period of transformational change as it moves to rebalance its economy to a path of longer-term structural stability. The opportunities offered for investors within this huge and changing market should not be underestimated, but neither should the risks. The unprecedented level of intervention has shown initial signs of stabilising the domestic equity market. The question now is whether there will be a longer-term impact.

Mindful of valuation discrepancies

The emerging-market equity funds all have a substantial, long standing underweight position in China. As long-term investors, we can see potential. However we are mindful of the disconnect between the bubble-like valuations of some domestic equities and the more attractive valuations found in Chinese companies listed in Hong Kong or offshore. Furthermore, we are aware of the headwinds companies face from the continued slowing of the domestic economy.

[1] Investment professionals listed are members of AIA participating affiliate, Aviva Investors Global Services ("AIGSL").

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