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# 10 things to know about China equities

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**Once largely out of reach to foreign investors, China's equity markets have opened up as the country's economy transforms. From Shenzhen and Hong Kong listings to the Nasdaq-like STAR board, Chinese companies are attracting significant investor capital. Here's what you need to know.**

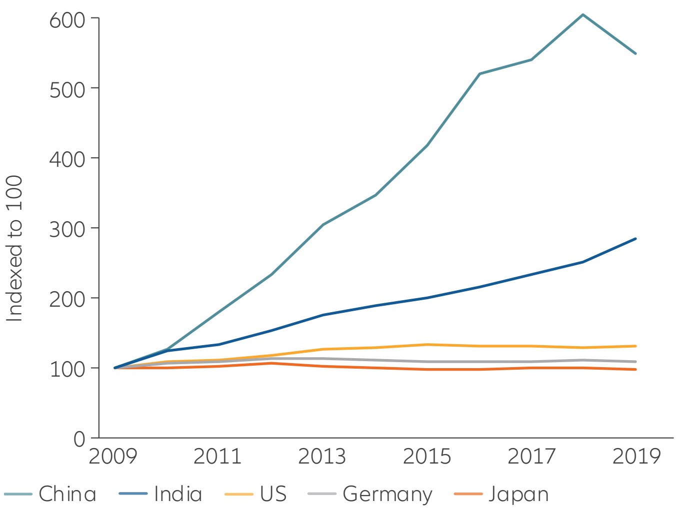
## 1 China's equity market is large and deep

China's capital markets have expanded significantly in recent years. The combined market capitalisation of the exchanges in Shanghai, Shenzhen and Hong Kong – plus US-listed American depositary receipts (ADRs) – is USD 18.8 trillion (see Exhibit 1). This is significantly higher than the USD 10 trillion market cap of euro-area equities.[1] Access to such a large market provides attractive opportunities for investors to gain further exposure to China's growth story.

## 2 China is investing in innovation – and innovative firms are benefiting

The outlook for China equities is underpinned by government investment in "new infrastructure" – foundational technologies such as artificial intelligence and electric vehicles. These are areas where China wants to reduce its reliance on foreign technologies and become a global leader – and Chinese companies have been benefiting. Case in point: the total number of annual patent filings in China grew more than 450% between 2009 and 2019 (see Exhibit 2), dwarfing the filings by the world's other top economies.

**Exhibit 2: annual patent filings of five largest economies**




Source: World Intellectual Property Organization. Data as at December 2019.

**Exhibit 1: major stock exchanges for China equities vs euro area**

| | Shenzhen A-shares | Shanghai A-shares | China stocks listed in HK | US-listed ADRs | Total | Euro area |
|---|---|---|---|---|---|---|
| Market cap (USD tn) | 5.3 | 7.1 | 4.9 | 1.5 | 18.8 | 10.0 |
| Number of stocks | 2,354 | 1,794 | 1,319 | 143 | 5,610 | 3,547 |

Source: Shenzhen Stock Exchange, Shanghai Stock Exchange, Hong Kong Stock Exchange, Bloomberg, Allianz Global Investors. Data as at 31 December 2020. The total figures are for comparison only. The stocks included may be listed in more than one exchange. Offshore China stocks are defined based on companies with ultimate parent domiciled in China. Suspended stocks, investment funds and unit trusts are excluded.

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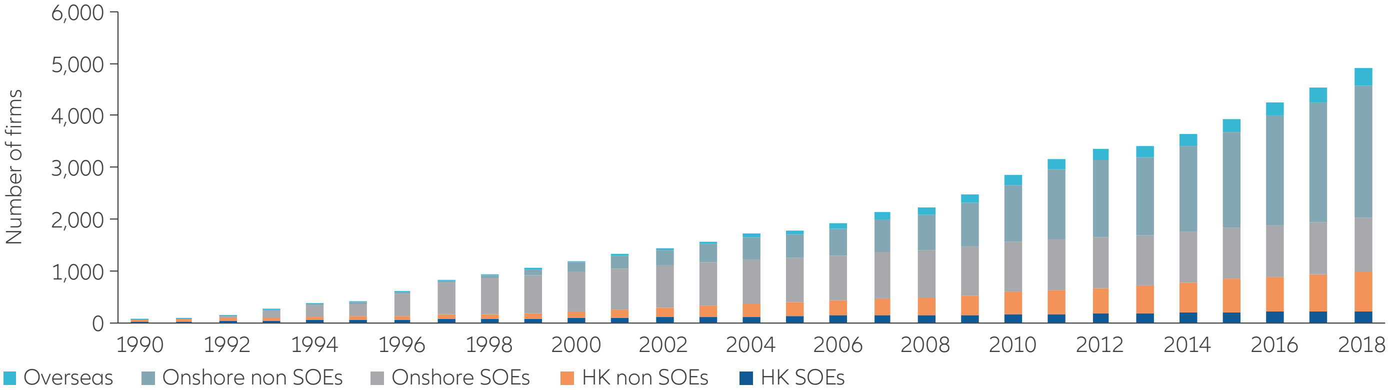
**Exhibit 3: China's equity market composition by company type and location**

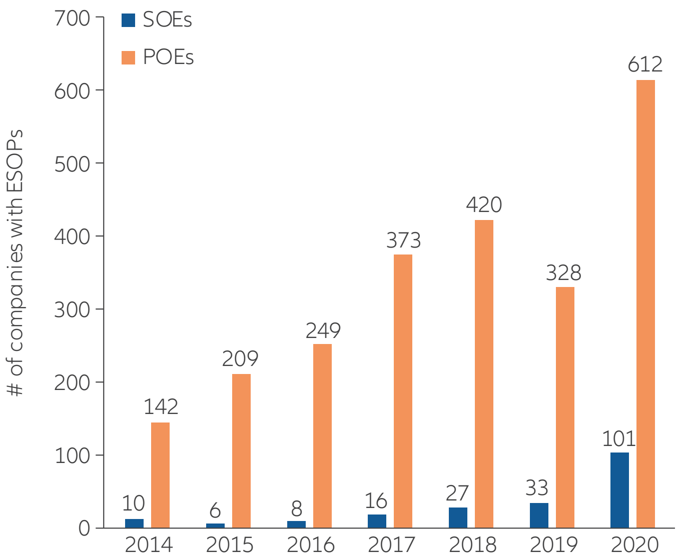



Source: Wind Data Service, Gavekal, Macrobond Financial. Data as at December 2019.

## 3 China's equity markets now resemble China's dynamic economy

China's state-owned enterprises (SOEs) once held outsized influence over the country's economy, but significant reforms drove down their share of GDP from 50% to 30% over the last 15 years. In addition, non-strategic SOEs – such as local consumer or technology businesses – are now behaving more like profit-seeking entities. China is also the youngest market regionally, meaning Chinese companies have been part of the region's major benchmark index for the shortest amount of time. It's an indication that much of the investment activity that previously took place in private and venture-capital markets is increasingly accessible to investors in listed equity markets. As Chinese equity indices have changed over time (see Exhibit 3), markets have become more dynamic and more reflective of where the economy is headed.

**Exhibit 4: number of China A-share companies with ESOPs**




Source: Wind. Data as at 30 November 2020.

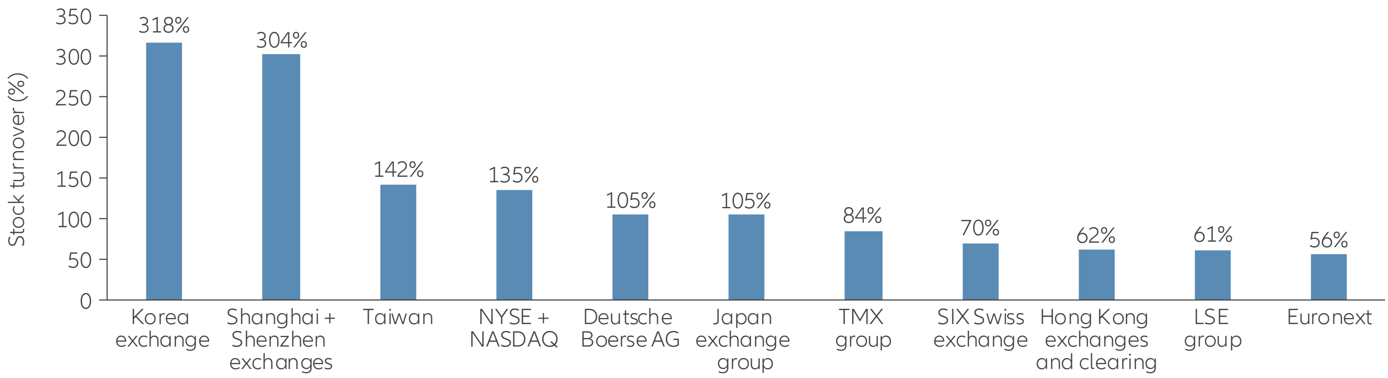
## 4 Corporate governance in China is improving

Some investors may have previously questioned China's corporate governance standards, but things are changing. Use of international auditors and accounting standards is growing, with every listed Chinese company required to file quarterly reports and end its fiscal year on 31 December. Moreover, an increasing number of state-owned and privately owned enterprises offer employee stock-ownership programmes (ESOPs; see Exhibit 4). This helps turns employees into shareholders with an active stake in the company's success.

## 5 China's markets can be highly liquid

Domestic retail investors in China dominate the market for A-shares and account for more than 80% of daily turnover.[2] (Markets with high turnover ratios are generally easier to trade because they're more liquid – meaning more investors are buying and selling.) With the investment culture in China focused more on momentum and short-term trading, the stock turnover ratio of China A-shares is among the highest in the world (see Exhibit 5).

**Exhibit 5: stock turnover of China A-shares vs other major markets**




Source: World Federation of Exchanges, Allianz Global Investors. Data as at 31 December 2020. Turnover is the total value of shares traded during the period divided by the average market capitalisation for the period.

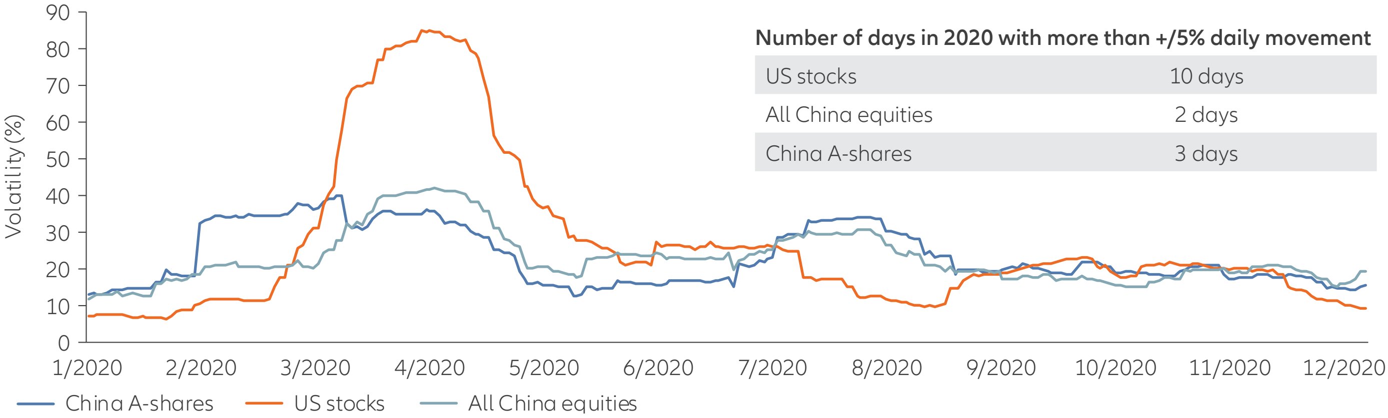
## 6 China's equity markets can be volatile, but so can markets in the US

Volatility in China's equity markets has sometimes been high – but perhaps surprisingly, during the peak of the pandemic crisis in 2020, China was less volatile than the US (see Exhibit 6). There were only three days, for example, when China's markets moved by more than 5% on a daily basis, compared with 10 days in the US. And while much of the current A-share trading activity is driven by retail investors, China's equity markets overall are likely to become more influenced by institutional investors over time. This should help push volatility levels closer to those of the so-called more developed markets.

## 7 China's equity markets aren't monolithic

China has many stock exchanges and share classes – reflective of the depth and breadth of its economy – and they all have their own important characteristics. Even within China A-shares, the different listing venues offer varying exposures to sectors, market caps and SOEs. Regional macroeconomic differences can also affect shares: for example, US market performance influences US-listed Chinese ADRs. The net effect of these differences can be seen in the wide dispersion of performance by stock exchange (see Exhibit 7). Investing across China's exchanges can bring additional diversification benefits, but knowing the nuances of the marketplace is key.

**Exhibit 6: rolling 30-day volatility in 2020 (US stocks vs China A-shares vs all China equities)**



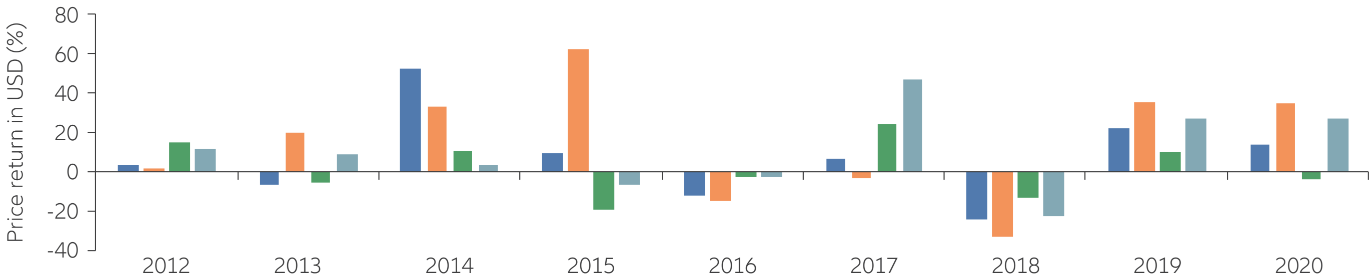

**Number of days in 2020 with more than +/5% daily movement**

| | |
|---|---|
| US stocks | 10 days |
| All China equities | 2 days |
| China A-shares | 3 days |

Source: Refinitiv DataStream, Bloomberg, Allianz Global Investors. Data as at 31 December 2020. Volatility figures are annualized. US stocks are represented by the S&P 500; all China equities by MSCI China; China A-shares by MSCI China A Onshore. For index definitions, visit S&P Global and MSCI. Past performance is not indicative of future performance. Investors cannot invest directly in an index.

**Exhibit 7: calendar-year return  for different China equity markets**

| | Shanghai-listed | Shenzhen-listed | HK-listed China stocks | US-listed China stocks | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Return dispersion | 13% | 27% | 49% | 83% | 12% | 51% | 20% | 26% | 39% |




Source: Thomson Reuters Datastream, Allianz Global Investors. Data as at 31 December 2020. Shanghai-listed stocks are represented by Shanghai SE Composite Index; Shenzhen-listed stocks by Shenzhen SE Composite Index; Hong Kong-listed stocks by Hang Seng China Enterprises Index; and ADRs by S&P/BNY Mellon China ADR Index. For index definitions, visit: China Securities Index Co.; Hang Seng Indexes; and S&P Dow Jones. Past performance is not indicative of future performance. Investors cannot invest directly in an index.

## 8 Chinese stocks don't move in lockstep with other equity markets

China A-shares have a correlation of 0.21 with global equities over the last 10 years (see Exhibit 8). That means China A-shares move in the same direction as global equities only 21% of the time. Or looked at another way, almost 80% of the time they move in a **different** direction. (In comparison, US and global equities have a correlation of 0.94[3].) Holding A-shares in a global portfolio may help generate a better risk-return profile. This could be particularly beneficial during steep market drops like those seen during the Covid-19 pandemic, when some highly correlated asset classes fell in tandem.

**Exhibit 8: correlation of A-shares with major equity markets**

| | China A-shares | HK-listed China stocks | APxJ equities | GEM equities | Japan equities | US equities | European equities | World equities |
|---|---|---|---|---|---|---|---|---|
| China A-shares | 1.00 | 0.58 | 0.48 | 0.45 | 0.25 | 0.15 | 0.20 | 0.21 |
| HK-listed China stocks | 0.58 | 1.00 | 0.84 | 0.79 | 0.44 | 0.23 | 0.41 | 0.38 |
| Asia Pacific Ex-Japan equities | 0.48 | 0.84 | 1.00 | 0.94 | 0.52 | 0.37 | 0.54 | 0.56 |
| Global emerging markets equities | 0.45 | 0.79 | 0.94 | 1.00 | 0.45 | 0.49 | 0.64 | 0.66 |
| Japan equities | 0.25 | 0.44 | 0.52 | 0.45 | 1.00 | 0.17 | 0.31 | 0.34 |
| US equities | 0.15 | 0.23 | 0.37 | 0.49 | 0.15 | 1.00 | 0.64 | 0.94 |
| European equities | 0.20 | 0.41 | 0.54 | 0.64 | 0.31 | 0.64 | 1.00 | 0.79 |
| World equities | 0.21 | 0.38 | 0.56 | 0.66 | 0.34 | 0.94 | 0.79 | 1.00 |

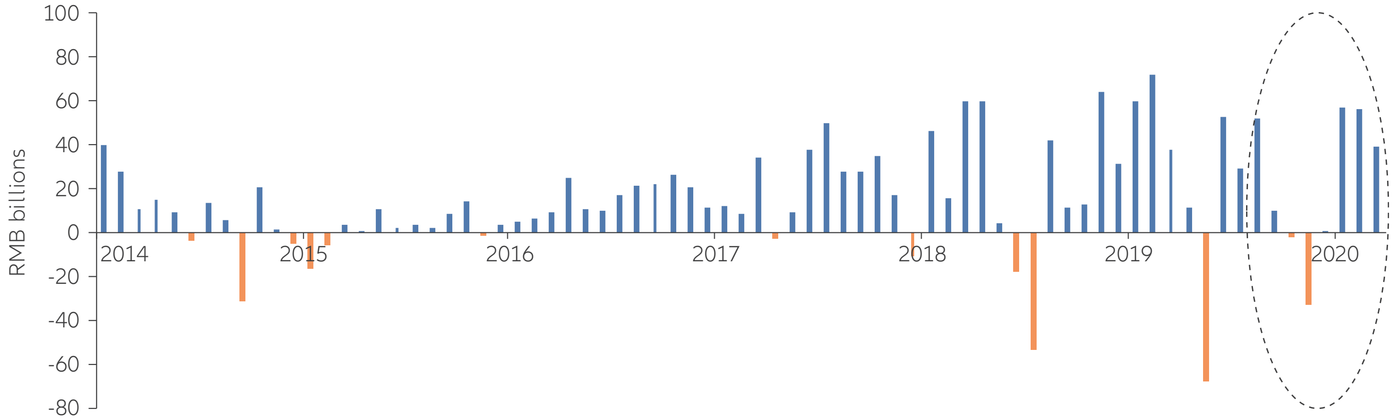
■ Low correlation ■ High correlation

Source: Bloomberg, Allianz Global Investors as at 31 December 2020. Correlation data is calculated based on historical return of respective MSCI indices for the past 10 years, using weekly USD return. China A-shares represented by MSCI China A Onshore Index; HK-listed China stocks by MSCI China Index; APxJ equities by MSCI AC Asia ex Japan Index; global emerging market equities by MSCI Emerging Markets Index; Japan equities by TOPIX Index; US equities by S&P 500 Index; European equities by MSCI Europe Index; world equities by MSCI World Index. For index definitions, visit: MSCI; Japan Exchange Group (TOPIX); S&P Global. Past performance is not indicative of future performance. Investors cannot invest directly in an index.

## 9 Foreign investors are increasingly attracted to China equities

The Shanghai and Shenzhen Stock Connect schemes that launched a little over five years ago helped integrate Chinese equities into the global financial system by making it easy to invest across borders. For example, investors outside of mainland China can use the Hong Kong exchange to buy A-shares in Shanghai or Shenzhen (known as a "northbound" trade). In "southbound" trades, mainland China residents use the Shanghai or Shenzhen exchanges to buy Hong Kong-listed stocks. Since the Shanghai Stock Connect opened in November 2014, Chinese equities have enjoyed 62 months of "northbound" inflows with only 13 months of outflows (see Exhibit 9). Notably, the ongoing inflows have occurred despite economic and political volatility, implying a fundamental shift towards greater global investment in China.

**Exhibit 9: monthly northbound buying via Stock Connect (RMB billions)**

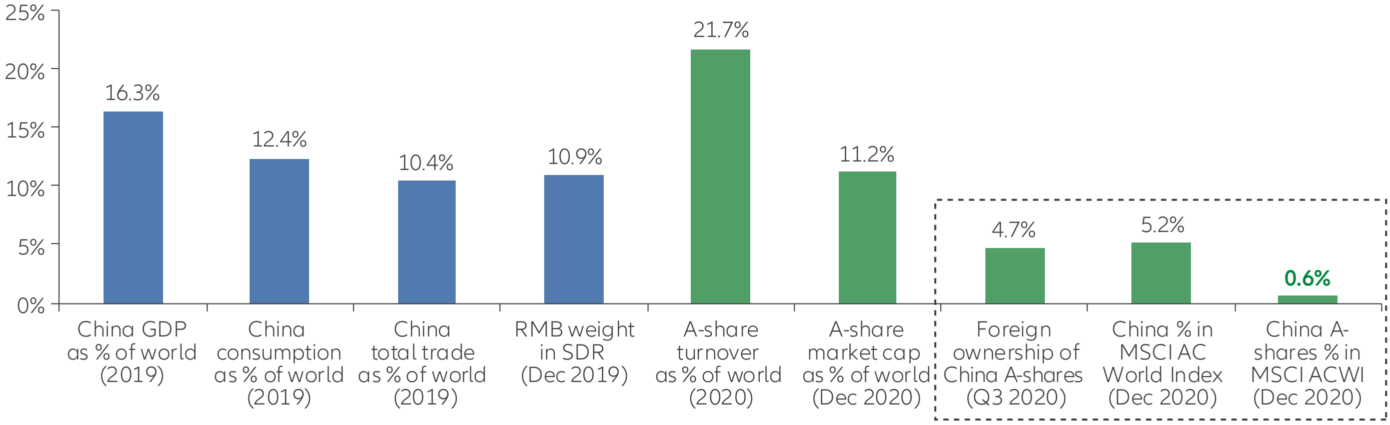



Source: Wind, Allianz Global Investors. Data as at January 2021.

## 10 Major global indices are adding large numbers of Chinese stocks

Some of the most prominent global stock indices – the benchmarks against which many investors measure their performance – have been adding Chinese stocks in increasing numbers. This reflects the growing importance of China to the global equity markets. It's likely also a sign that more foreign investment will be flowing into the region in the future. But compared with China's economic influence and market scale – it accounts for 16.9% of global economic output, among other factors – the country may still be under-represented on benchmark indices (see Exhibit 10). Investors may want to consider allocating more to China than benchmarks do.

**Exhibit 10: key statistics on China and China equities**




Source: Wind, Allianz Global Investors. Data as at January 2021.

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Data as at 31 December 2020

1. Source: European Central Bank as at 31 December 2019
2. Source: SSE, Wind, Bloomberg, Goldman Sachs Global Investment Research as at December 2017
3. Source: Bloomberg, Allianz Global Investors. Data as at 31 December 2020. Correlation data is calculated based on historical return of respective MSCI indices for the past 10 years, using weekly USD return. China A-shares represented by MSCI China A Onshore Index. GEM equities represented by MSCI Emerging Markets Index. US equities represented by S&P 500 Index. World equities represented by MSCI World Index. Investors cannot invest directly in an index.