**China stocks in trading halt – what to consider?**

09 July 2015



Turbulent financial market dynamics in recent weeks have demonstrated the importance of turning down the noise, diversifying widely and adopting an active approach to asset allocation. In this article, we address the situation in Europe and China and what this means for investment markets.

Over the past month China’s share market has suffered sharp price falls approaching -30% for the Shanghai Composite Index. However, those investors who have been invested in the market for the past year have still generated positive returns of approximately +70%. For those investors who have only recently invested, this price correction has clearly had a dramatic negative impact.

In response, the People's Bank of China said it would directly assist the China Securities Finance Corporation (CSFC), a provider of margin financing, in guaranteeing adequate liquidity for brokerages. Meanwhile, the country's insurance regulator said that qualified insurers may increase their ratio of equity assets to 40%, from 30% previously, by buying blue-chip stocks. All short-selling — the practice of betting that stocks will fall — has been banned, and Chinese media has rushed to reassure citizens. All of this activity indicates that the Chinese Government will do what it takes to stabilise the situation.

**What does this mean for the Chinese economy and Chinese shares?**

Our view is that this is a significant price correction for the Chinese share markets rather any ominous sign for China’s economic growth. It’s also important to remember that the Chinese share market is characterised by more volatility than we’re used to in developed markets. Although the falls are large, the recent gains have been much larger and sentiment could turn very quickly.

Apart from its impact on short-term market sentiment, at this stage the volatility it is unlikely to have a more in-depth effect on markets. The reasons for this are as follows:

1. **Most Chinese consumers have limited exposure to China’s share market:** It’s worth highlighting that the average Chinese retail investor has only around 10% of their assets in shares. Compare this to US investors who have around 50% of their assets in shares.
2. **The share market sell-off is not showing any signs of liquidity or banking stress:** Corporate bond markets have remained well behaved, and interbank liquidity has, in fact, improved.
3. **China’s central bank cut its key interest rates again in June:** This should help support economic growth over the next year. Policy reflation in China is far from over.
4. **China’s residential property market is stabilising:** The property market recorded a second month of modest price gains in June.
5. **The Chinese economy is not in a recession:** China‘s business surveys such as the Purchasing Manager Indices suggest that China’s real economic growth is still running around the 6.5% pace. Fundamentals are still sound, and the recent correction has not had any impact on company earnings.

**What does this mean for Australian shares?**

The turmoil in China has had an impact on other financial markets, and in recent days we’ve seen falls in the Australian share market as well as in US shares. It’s important to note that if the correction in China had been triggered by real signs of economic stress, then the impact on Australian shares could be long-lasting.

We believe that Australia is still on track to record modest 2.5% real economic growth in 2015. A lower Australian dollar will be beneficial to Australian exporters, and lower Australian interest rates, which has helped the housing sector record robust gains in construction activity.

**What does this mean for global listed real estate, global listed infrastructure and Asian equities?**

The share market volatility has also impacted global listed real estate, global listed infrastructure and Asian equity markets. As reflected in the minutes by the FOMC yesterday, central banks will be watching the situation in Greece and China carefully. Should turmoil continue into September, then the chances of the US hiking rates in September will be low. This would likely have a supportive effect on asset classes such as global listed real estate and global listed infrastructure which perform relatively well in a low interest rate environment.

**Is the situation in Greece worsening?**

We expect that more uncertainty regarding Greece, and the threat of a flow on to other Eurozone countries, is likely to keep markets on edge in the short-term. However, the risk of contagion is likely to be limited as the rest of Europe is now in far stronger shape than was the case in the 2010-12 Eurozone crisis. In addition, defence mechanisms against contagion are now stronger. As a result, we don’t see the Greek debacle derailing the European or global economic recoveries. So while the correction in shares looks like it might go further in the short-term, the broad rising trend in markets is likely to continue.

**Could the situation in China and Greece combined have a more substantial impact?**

Central banks will be watching the situation in China and Greece carefully, and will be ready to act together to ensure that any negative flow-on effect to economic fundamentals is stemmed. It’s important to note that the situation now is different to 2012 when European authorities were in disagreement about how to respond to markets.

**A buying opportunity for Chinese stocks**

In terms of our views on asset allocation, we currently see the sharemarket correction in China as a buying opportunity for Chinese stocks. While there has been a significant readjustment in valuations, the earnings backdrop for Chinese companies remains good. We remain confident that there will also be aggressive support from central banks to stem any negative impact to economic fundamentals.

**About the Author**

**Nader Naeimi**, **Head of Dynamic Asset Allocation.**

With over 16 years’ experience in Australia’s financial markets, including 12 years as part of AMP Capital’s Investment Strategy and Economics team, Nader’s responsibilities include analysis of key economic and market factors influencing global markets.