

# China A Shares Inclusion: Don't Miss the Big Picture



**By Matthew Strauss & Gorlen Zhou, May 10, 2018**

As of June 2018, several onshore Chinese stocks – so-called A shares – will be included in the widely followed MSCI Emerging Markets Index and MSCI All Country World Index; but don't be swept up by the hype and marketing gimmicks surrounding the event. The move in and of itself is not a game changer, but it is an important reminder that China is changing the way global investors should think about their investment strategies.

## **The technical aspects**

Even though China's stock market ranks second in the world (after the U.S., based on market capitalization by country) the inclusion of China A shares into the MSCI Emerging Markets Index will be a gradual process, phased in over several years. The first step involves around 225 A shares with a partial inclusion factor<sup>1</sup> of only 5%, phased in during June and September this year. Their inclusion will have only a small impact on China's country weight in the MSCI Emerging Markets index as Chinese stocks listed in Hong Kong (e.g. Tencent Holdings and Galaxy Entertainment) and elsewhere (e.g. Alibaba and Baidu) already represent more than 28% of the index. According to MSCI, the initial inclusion will add only 0.73% to the Emerging Markets Index and 0.1% to the All Country World Index (see MSCI chart below). Full inclusion will take some time – in the case of South Korea, for example, it took six years and for Taiwan it took nine years; however, the direction of change is clear. Once fully included, China would represent more than 40% of the Emerging Market index. It's time to wake up global investors!

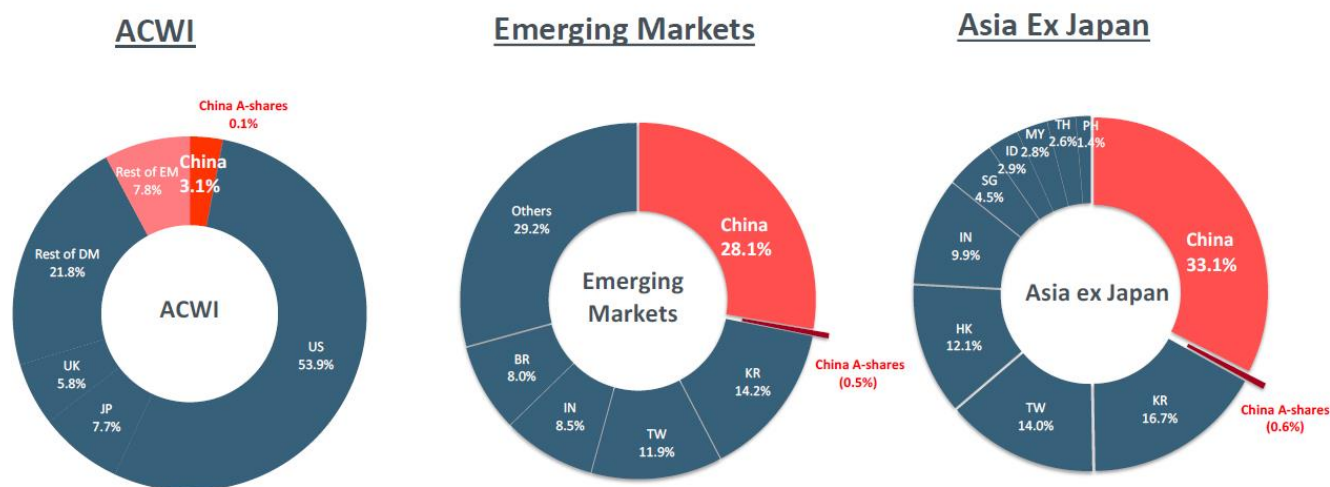
---

<sup>1</sup> The Partial Inclusion Factor will be used to represent the proportion of the Foreign Inclusion Factor (FIF)-adjusted market capitalization of China A shares included in the pro forma MSCI China Index.

# China A Shares Inclusion: Don't Miss the Big Picture



## *Pro forma weight of A Shares in MSCI World (ACWI) and Emerging Markets indexes*



Source: MSCI, May 2017

### What really matters

Even though the initial inclusion hardly registers on global indexes, it's yet another step towards the full opening of China's capital markets to foreign investors. The process continues to gain momentum – it started in 2002 with the introduction of the Qualified Foreign Institutional Investor (QFII) program (which allowed, on a selective basis, global institutional investors to invest in China's equity market but with numerous restrictions, including a fixed quota). This was followed in 2011 by the introduction of the Renminbi Qualified Foreign Institutional Investor (RQFII) – a less restrictive program than QFII. (In 2015, CI Investments/Signature became the first Canadian investor to register with this program). In 2014, Beijing introduced the cross-boundary investment channel Shanghai-Hong Kong Stock Connect (of which CI/Signature is currently a participant). And the proposed Shanghai-London Stock Connect is expected to kick-off later this year. The inclusion of A shares into the global MSCI indexes highlights Beijing's intention not only to grant more access to foreign investors, but also to integrate China's capital markets with others internationally.

### A more conducive investment environment

With the opening of China's capital markets to global investors, China's financial regulators have also been strengthening regulations to better protect investors and to improve corporate governance practices. In May 2017, regulators closed a loophole that had allowed substantial shareholders like company executives or insiders to sell their holdings through block trades. And in September 2017, China joined the Organisation for Economic Cooperation and Development's (OECD) Corporate Governance Committee to discuss the implementation of the G20/OECD Principles of Corporate Governance.

# China A Shares Inclusion: Don't Miss the Big Picture



Thus, if global investors have yet to pay attention to China before the inclusion of A shares, hopefully this will serve as a wakeup call to start allocating dedicated time and resources to understanding and becoming engaged with the fastest-growing investment destination in the world.

Striving to keep abreast of these critical developments within an interconnected financial and business world, Signature opened a Hong Kong office several years ago. Our aim is to maintain a relevant, up-to-date and on-the-ground understanding of the region to effectively manage our clients' global and Canadian investments.

***Matthew Strauss, CFA, is part of the Signature Asset Allocation Committee and co-manages the Signature Emerging Markets Fund with Eric Bushell, Signature's Senior Vice-President and Chief Investment Officer.***

***Gorlen Zhou, CFA, is Director of Research, Asia for Signature and is based out of the Hong Kong office.***

*This commentary is published by CI Investments Inc. It is provided as a general source of information and should not be considered personal investment advice or an offer or solicitation to buy or sell securities. Every effort has been made to ensure that the material contained in this commentary is accurate at the time of publication. However, CI Investments Inc. cannot guarantee its accuracy or completeness and accepts no responsibility for any loss arising from any use of or reliance on the information contained herein. This commentary may contain forward-looking statements about the fund, its future performance, strategies or prospects, and possible future fund action. These statements reflect the portfolio managers' current beliefs and are based on information currently available to them. Forward-looking statements are not guarantees of future performance. We caution you not to place undue reliance on these statements as a number of factors could cause actual events or results to differ materially from those expressed in any forward-looking statement, including economic, political and market changes and other developments. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.*