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China share market's moment is now

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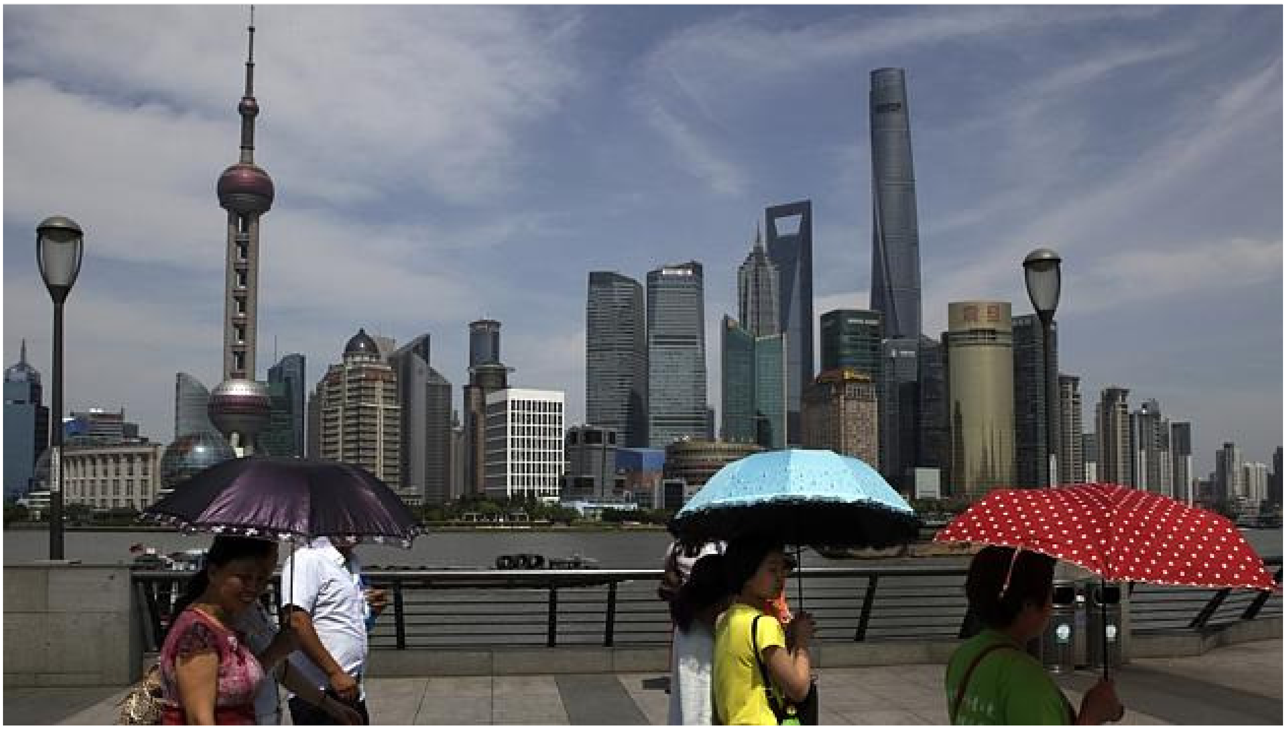

China's shift towards global economic integration will give astute investors a once-in-a-quarter-century opportunity. Source: AP

The Chinese CSI 300 — the nation's leading sharemarket index that is a composite of the Shanghai and Shenzen exchanges — has the real possibility of tripling or even quadrupling from current market valuations by or near 2020.

On May 9, the Morgan Stanley Composite Index (MSCI), arguably the world's most important global shares benchmark, announced "China's A-shares (are) on track for inclusion".

The announcement was greeted by many commentators as a negative.

It is, in fact, a positive, as it presents another huge and particularly timely opportunity for Australian investors to tactically position into a market with huge potential.

The delay of China's A-shares inclusion into specifically the MSCI Emerging Market, China and World Indices provides Australian wholesale investors another chance to astutely front-run the predictable eventuality that the Shanghai-Shenzhen CSI 300 will be represented throughout these important global benchmarks one day very soon.

MSCI indices matter — a lot.

This is because, as of June 30, 2014, they have $US9.5 trillion ($12.3 trillion) in known assets benchmarked against them.

Australian ultra high net worth global investors have been advised — at least by us — that this is the moment to take action and do so with conviction.

More than simply ringing the bell, this is a once-in-a-quarter-century opportunity that won't be repeated, at least not during this contributor's professional lifetime.

Stripping out the geopolitics and stereotypical noise surrounding China's ascent, such a step-change is plausible and makes a lot of sense when explained in the following light. The Chinese Communist Party's state-led model allowed its population to invest in real estate so China could continue its progression from developing to developed economic status over the past 15 years.

The excesses seen within what we refer to as shadow banking — off-balance sheet non-bank lending

— were permitted, primarily because this allowed a circuit breaker when domestic Chinese real estate investment overheated.

The CCP has now consciously opened a new gate for its citizenry to invest more easily — contrary to their own rhetoric — into the CSI 300 and other Chinese sharemarkets for two primary reasons.

The first is that China now wants advanced capital market architectures, just like we have in the OECD; and second — and more interestingly — it purposely wants to inflate its bourses, with very specific outcomes in mind for 2017, 2018 and beyond.

These forethought outcomes involve China's CSI 300, in the near future, joining the MSCI World indices, where, as discussed, they are not currently represented.

Until very recently, piercing the walls of these "iron curtain" capital controls has been near impossible — or at least not legal.

While the May 9 announcement explicitly said MSCI and the China Securities Regulatory Commission would form a working group to resolve "a few important remaining issues related to market accessibility", it is likely the CSRC, on direct instructions from the CCP, and more importantly President Xi Jinping, will not budge on these iron curtain controls until the following occurs.

What the CCP wants is an inflation of its sharemarkets' valuations. Only when this has happened, it would be fair to predict, would they then have plans to loosen these capital controls and progressively allow more foreign institutional investors to enter the mainland bourses. When this happens, CSI 300 prices will be far higher than they are now and these foreign institutional investors will be purchasing Chinese shares with fresh foreign capital, namely US dollars.

This is why now is a crucially important time for Australian global investors to pay particular attention to China and global affairs.

Remembering that these Chinese bourses aren't yet in MSCI World indices, when they achieve IMF "Special Drawing Rights" status sometime soon — which they will — it will further allow the convertibility of yuan to US dollars, even more foreign institutional capital will, by forced mandate, be directed towards the CSI 300.

The logic for this is simple. When China's bourses are then included in the MSCI World Index or any similar benchmark, then a plethora of global institutional passive investment managers, by mandate, must then purchase CSI 300 exposures, solely to satisfy their prescriptive portfolio guidelines.

The CCP knows this and is making every effort now to stoke bourses such as the CSI 300 to much higher levels.

Put simply, the delays will dissipate when the CCP and Xi believe the CSI 300 is at valuation levels they are comfortable with.

Coincidentally, it is the CCP itself, which as a significant stakeholder in a majority of state- owned enterprises stands to benefit when such new price levels are reached.

This is not a conspiracy, this is capitalism in practice — the US invented shadow banking and spent the past six years inflating their own bourses. Then the British, Swiss, Japanese and now the eurozone have followed suit.

Clearly short-term trading on the CSI 300 is like riding a wild tiger and at Larkin Group we have people watching this Chinese market on a full-time basis.

This is a truly exciting time for Australian UHNW investors, and rather than licking our wounds about former iron ore export levels, let us look forward towards 2020 and what could very likely be a golden, not iron, opportunity.

Separately, Australian SMSF investors should consider passive five-year "Rip Van Winkle" opportunities.

Waking up in 2020 to a CSI 300 index exposure priced quite differently than it is at present, could be a shrewder alternative than doubling down on currently rudderless ASX investments.

Larkin Group is a wholesale wealth adviser focusing on high-yielding global investments.

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