# China’s stockmarket value indicators beginning to shine

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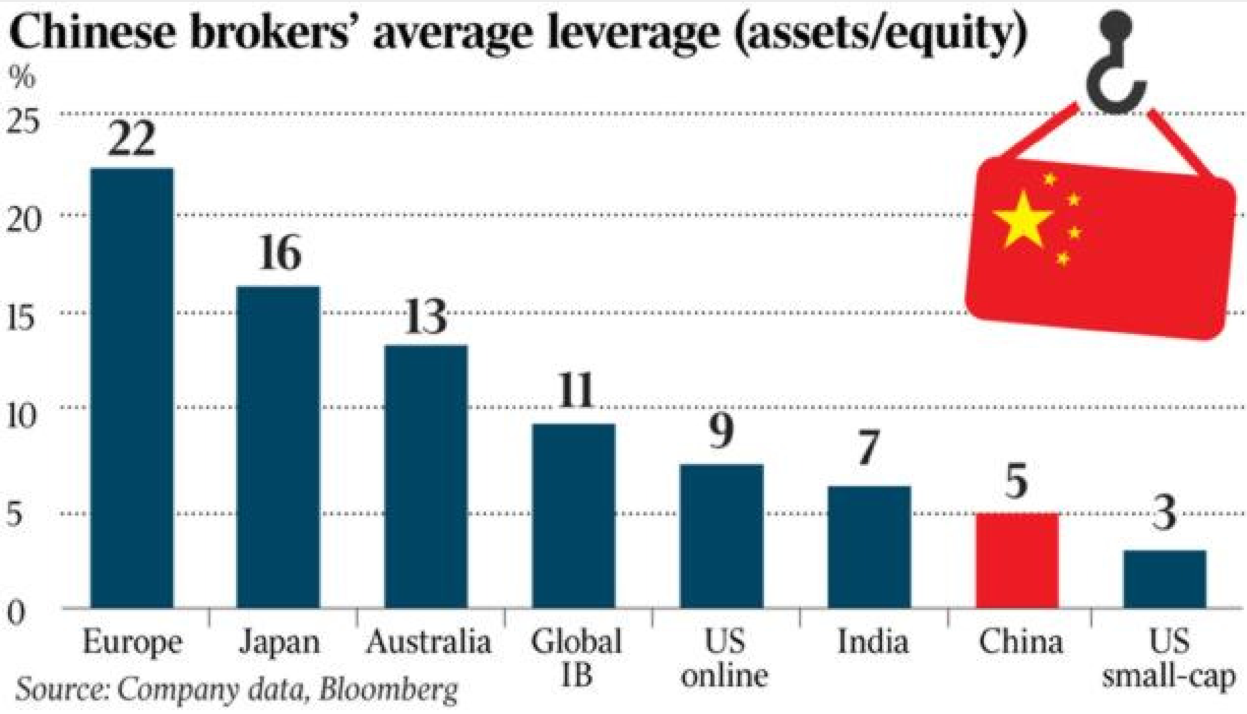


Leverage. Source: TheAustralian

**Eight years past the Great Recession, too many still confuse its cause with its effect.**

Confusing the levels of excessive leverage as the cause, it was, in fact, the misrepresentation and inaccurate pricing of risk in US credit markets that triggered the global “dystopia” that rippled throughout the global economy.

The significant amounts of gearing throughout US and European financial markets only amplified these ripples, which then became tidal waves in other OECD economies and even tsunamis in some emerging markets.

Acceptance of this “causal-nexus” is crucial for the global investor today, because any comprehension of where Chinese stock, bond, credit, commodity or real estate markets are currently at needs to be anchored against the backdrop of what happened last time excessive leverage was confused for the misrepresentation of risks.

For all of the noise made during July, the following concrete facts remain — Australian stockbrokers, as the graph highlights, remain more exposed to equity markets and are geared greater than their Chinese Hong Kong, H-share and mainland A-share counterparts.

Australian Ultra High Net Worth (UHNW) investors, who generally face global markets via global investment banks (Global IB), including those based in Switzerland, also interact with counterparties who are geared greater than current Chinese domestic broker participants.

These facts, viewed in isolation, do not deserve much attention but do become topical when we question whether China’s stockmarket retreat was a symptom of over-leverage or rather a natural pullback faced by any bull market cycle.

Since the end of the deep recession of 1973-1975, which was caused by the “Nixon Shock” — when president Richard Nixon unilaterally cancelled the direct convertibility of the US dollar to gold — and combined with the hyperinflation triggered by the 1973 OPEC crisis, global stock bull markets have faced a 44 per cent probability of seeing a 20 per cent or greater correction, driven by P/E retracements, with a key trailing P/E support level of 15 times.

Why these statistics are important today is that they help us assess whether China is undergoing such a correction and is not heading into a systemic bear market, as many have proposed.

Since the CSI300 retracement began early this month, the Shanghai and Shenzhen constituent entities still being quoted have been repriced at a forward P/E of 14.4 times and those excluding state-owned enterprise banks at 18.7 times, as of this week.

Albeit volatile, this market-driven retracement back to value-enhancing multiples should be interpreted as a sign that this is a collection of bourses representing entities that are expected to enjoy improving sequential growth for the remainder of this calendar year ... this is an important sign to see.

Shadow banking off-balance sheet leverage, which fronted this stockmarket volatility, has now been largely unwound.

Bank plus broker capital remains in place; adequate enough, even juxtaposed against the financial loss of 9 trillion yuan ($2 trillion) by free-float market capitalisation seen on Chinese bourses — CSI300, Hong Kong, ChiNext and Chinese companies quoted on US Exchanges via American Depository Receipts (ADRs) — since July 1.

It should be remembered that Chinese official banks still retain 53 trillion yuan in household domestic deposits and enjoy total balance sheets in excess of 220 trillion yuan, by declared and verifiable accounts.

The news this week that, for the first time since 1993, the People's Bank of China has been a net seller of euros should also be seen as a positive and supportive measure taken by this central bank. This demonstration that the PBOC will deploy its deep capital reserves to buttress select mainland markets only goes towards reassuring listed Chinese entities that the integrity of their listed market architecture will continue to be supported, amid "velocity" in local equity and fixed income markets.

The PBOC will favour stability in the yuan and use their $US3.7 trillion ($5 trillion) in reserves as needed.

As, historically, bull markets retracements take approximately four to six months to recover, the global investor and specifically, Australian UHNW investors who access China A-sharemarkets via 'Global IB' participants need to pay acute attention to which CSI300 constituents suffer "leverage overhangs" and which, particularly in the larger capitalisation spectrum, present value momentum.

The Chinese economy and respective stockmarkets are still developing and remain a command economy.

But why so many Australian market commentators continue to appear sour on China, both economically and in the investment universe, is because they still fail to identify how Australian investors can access these markets other than via loose proxies, such as listed Australian iron ore exporters or New Zealand dairy farmers.

This disconnect also goes a long way towards explaining why traditional Australian stockbroking models and financial planning networks are facing their death-knell and why Australian investors, smaller retail to very large UHNWs, are all actively investigating fresh investment advisory channels, which deliver asset allocations that properly reflect the globalised economy within which we now live.

These ASX 200-centric Australian advice channels fail to provide Australians guidance nor access to such examples as the Chinese Industrial, Shenzhen Inovance Technology (300124: CH), the healthcare giant Tasly Pharmaceutical (600535: CH) or, even in many instances, the Sino consumer discretionary darling, Jumei International (JMEI: US), which is listed in New York.

Eight years past the Great Recession, too many are still blaming markets and not their own business models for why the world is the way it is, but that is why it is so critically important that the global investor differentiates between objective guidance and biased disdain.

Remembering that CSI300 has gained 121 per cent from its June 2014 low, even after factoring in the retracement of July 2015, and understanding what and where the risks lie goes well towards helping us decide whether China is a bull on retracement or a bear about to slumber.

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