Manulife Asset Management

Market Note

4 March 2019

China A-shares move to centre stage

On 28 February 2019, MSCI announced that it would increase the weighting of China A-shares in its indexes from 5% to 20% in three stages (rather than two) and be completed by November 2019 (rather than August 2019). Furthermore, mid-cap China A-shares will now be included in the November 2019 tranche – this is much earlier than expected[1]. In this market note, Manulife Asset Management's (MAM) investment team explains how they are positioned to take advantage of the greater access to the China A-shares market and look at the opportunities it presents for global investors.

Increased access and investor opportunities

According to MSCI, the feedback from its consultation exercise indicated that international institutional investors would prefer to see the large-cap China A-share weighting increased in three stages rather than the two as initially proposed. This extension of the inclusion timeframe should alleviate potential execution pressures on the implementation dates. In addition, a significant proportion of investors also suggested that China-A mid-cap shares should be included in the MSCI Indexes jointly with the weight increase in large-cap shares to allow for a smoother implementation. This inclusion could provide additional alpha opportunities for investors.

On completion of this three-step implementation process, there will be 253 large-cap and 168 mid-cap China A-shares (including 27 ChiNext shares[2]) on a pro-forma basis in the MSCI Emerging Markets (EM) Index. In total, this represents a weighting of 3.3% for MSCI EM Index.

A-shares weighting after November 2019[3]:

- MSCI China Index: 10.4% (current weight: 2.5%)
- MSCI Zhong Hua Index: 7.8% (current weight: 1.9%)*
- MSCI Golden Dragon Index: 6.1% (current weight: 1.5%)*
- MSCI Asia ex-Japan Index: 4.0% (current weight: 0.9%)
- MSCI Emerging Markets Index: 3.3% (current weight: 0.72%)

**Manulife Asset Management estimates based on 10.4% MSCI China Index A-share weighting*

[1] MSCI: MSCI will increase the weight of China A shares in MSCI indexes, 28 February 2019.
[2] Most tech companies made their debut on ChiNext, which is positioned as China's "Nasdaq". The ChiNext board represents around one-fifth of the total China A-shares opportunity set in terms of number of stocks and free-float-adjusted market capitalisation. It has a larger free-float-adjusted market capitalisation than the Shenzhen main and SME boards.
[3] MSCI, December 2018.

Our views and positioning

Kai Kong Chay, Senior Portfolio Manager, Greater China Equities, believes that as the China A-shares market moves to full inclusion, we are presented with an opportunity for institutionalisation[4] as foreign participation increases in what is now a predominantly retail-driven market.

Chay thinks that this development could encourage a more disciplined approach towards investing, similar to that already seen in Taiwan and Korea (from partial to full inclusion in the MSCI Indexes). “MAM currently invests in the China A-shares market across a number of Strategies, providing us with exposure to the growth drivers of China that are not available outside of the A-shares space,” he observed. These companies include, but are not limited to, certain segments of the consumer, healthcare, and technology sectors. “We will continue to look for opportunities that offer strong, sustainable growth and trade at reasonable valuations.” Chay also expects these portfolio weightings to gradually rise as global indexes increase their exposure to China A-shares.

Winson Fong, Senior Portfolio Manager, thinks that the changes would be positive for our Greater Bay Area Growth and Income Strategy, which already includes Shenzhen-listed A-shares.

“Our keen interest in A-shares is driven more by their unique business models and improving management than the flow-factor originated from the MSCI inclusion,” said Fong. The investment team works closely with the investment professionals at MAM’s Beijing-based TEDA joint venture[5], who provide on-the-ground insights, policy updates and sector-specific development.

[4] The gradual domination by institutional investors, as opposed to individual or retail investors.

[5] Based in China, Manulife TEDA Fund Management Company Limited is a joint venture between Manulife (49%) and Northern International Trust (51%), part of the Tianjin TEDA Investment Holding Co. Ltd.

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