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Index Solutions newsletter: China – an efficient investment in the future

Head of Emerging Markets & Small Caps Index Solutions
Oliver Ferrari

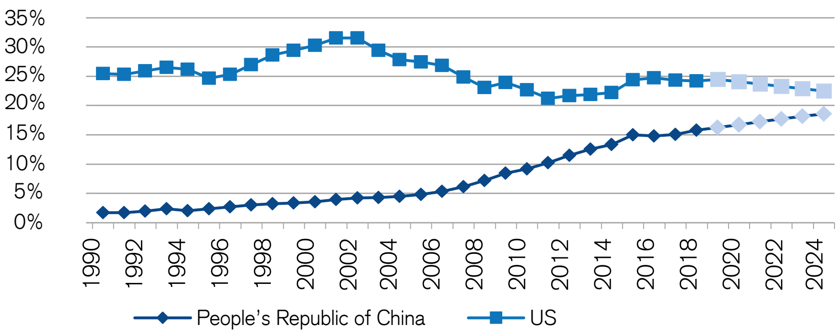
The door to the Chinese domestic shares market is opening ever wider to foreign investors. For a long time, the shares traded in Hong Kong dollars, US dollars and Singapore dollars were the only option for investing in Chinese shares. This has changed now that the Shanghai and Shenzhen stock exchanges offer foreign investors access to Chinese domestic shares traded in renminbi – known as A-shares – via Stock Connect. Read on to find out why everybody should have Chinese shares in their portfolio and get more information about our new index fund, the CSIF (Lux) Equity China Total Market. This fund is a highly cost-efficient and transparent way of being diversified with only a single investment in one of the world's most interesting equity markets.

Technology pioneers, megacities, and economic powerhouse – with almost 1.5 billion inhabitants and more than 100 cities with populations exceeding one million, China is a key component of the global economy. The Chinese equity market ranks second in the world in terms of market capitalization, with the local Chinese bond market in third place. The tenacity with which China is targeting or already occupies leading positions across various areas is impressive.

Underrepresented despite solid economic growth

China's population and its efforts to overtake the US as the world's biggest economic power are growing continuously. Between 2011 and 2013, China used more concrete than the US used in the entire 20th century. As a consequence of the construction boom, China now counts 15 cities with populations exceeding ten million. With 373 billionaires[1] and over 1.5 million millionaires, China ranks among the top ten countries with the most high net worth individuals. It therefore comes as no surprise that no other country's gross domestic product (GDP) is increasing as fast as China's (see following chart).

Share of global GDP – US and China



Source: imf.org/external/datamapper/PPPGDP@WEO/USA/CHN, data as of 30.06.2019

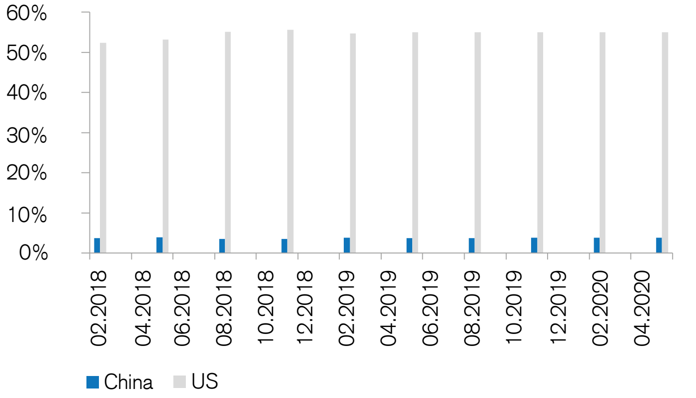
[1] The Wealth Report, Knight Frank, 2019.

A close look at annual growth rates underlines the strength of China's economic growth, which has led to a massive increase in China's share of global GDP. Even the current trade dispute will not be able to slow down China's economy in the long run. According to estimates from the International Monetary Fund, by 2030, China will have overtaken the US as the leading national economy.

It is therefore even more surprising that China continues to be underrepresented in the portfolios of many foreign investors. The same applies to global stock indices. Chinese equities currently account for a mere 3.8% of the MSCI All Country World Index (MSCI ACWI), while the US, as the world's largest economy, has a 55% weighting (see following chart).

A comparison of the market capitalization and GDP charts shows that China's market capitalization has not developed in line with GDP and is remaining at a low level.

MSCI ACWI market capitalization of China and the US



Sources: MSCI, Credit Suisse, data as of 30.06.2019[2]

China's weighting in the MSCI ACWI is being increased in a series of steps, the first of which was the addition of Chinese domestic equities (A-shares) to the index in May 2018. The capping of 2.5% of market capitalization in May will be increased in a second step to 20% by the end of November 2019. Nevertheless, China's weighting needs to be raised a lot more in order to correctly reflect the country's share of global GDP.

China has a lot going for it

The introduction of the Stock Connect and Bond Connect schemes, via which foreigners can access the Chinese domestic market without having to apply for a quota, shows the growing importance of Chinese shares in global portfolios. This evaluation is based on the following reasoning:

- The Chinese capital market's domestic focus is being increasingly relaxed, resulting in the removal of numerous barriers to entry for foreign investors.
- China is one of the world's leading market participants in the fields of technology and innovation – a fact reflected not only in China's capital market, but also in the growing international presence of Chinese investors.
- Chinese equities offer attractive diversification advantages in a portfolio as they have a comparatively low correlation with other markets.

This means that the time is right to seriously consider a securities investment in China.

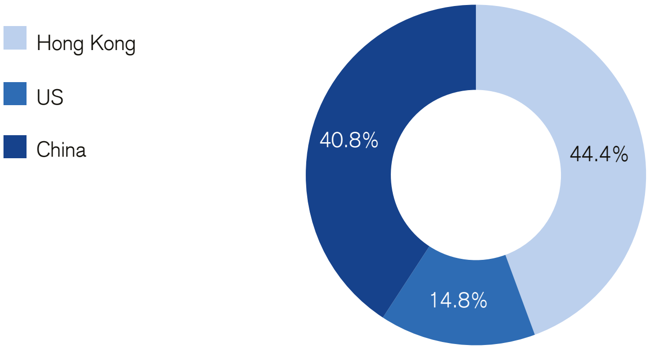
What all the abbreviations mean

The Chinese equity market can be roughly broken down into three segments:

- H-shares: Shares in mainland China-based companies traded in Hong Kong that can be bought without any restrictions by foreign investors. The first H-shares were issued as far back as 1993.
- N-chips: Shares of mainland China-based companies that are traded on the US Nasdaq. N-chips are predominantly technology companies and can be traded by foreigners without any restrictions.
- A-shares: Chinese domestic shares were originally reserved for Chinese investors. The launch of Stock Connect via Shanghai (2014) and Shenzhen (2016) made it possible for foreigners to purchase A-shares without having to apply for a quota. Many companies in China with a domestic focus have only issued A-shares.

In terms of volume, around 44% of the market value of the shares of mainland China-based companies are H-shares, around 15% are quoted in US dollars, and nearly 41% are A-shares (see following chart).

Listing country



Source: msci.com/msci-china-all-shares, data as of 30.06.2019

[2] The figures from 01.08.2019 are based on estimates based on previously announced index adjustments.

How do you invest in the Chinese equity market?
Foreign investors can invest in the Chinese equity market in numerous ways. One way is via the various exchange-traded funds (ETFs) – although most of them cover only parts of the Chinese equity market. For example, ETFs on the CSI 300 Index contain only A-shares, while ETFs on the FTSE China 50 contain only equities traded in Hong Kong.

Although the broadly based MSCI China Index contains shares from all three segments (H-shares, A-shares, and N-chips), A-shares are still currently capped at 10% of their market value. In addition, the index products currently available on the Chinese market are comparatively expensive.

The new CSIF (Lux) Equity China Total Market stands out by virtue of its reference index, the MSCI China All Shares Index. Unlike the MSCI China Index, the MSCI China All Shares Index already captures the full market value of A-shares, which makes it more future-oriented than other indices as it already factors higher A-share weighting in the MSCI China expected in the coming years.

With the exception of a few shares that together account for an index weighting of less than 1% and are currently not accessible to foreign investors via Stock Connect, the CSIF (Lux) Equity China Total Market fully replicates the MSCI China All Shares Index.

The index invests in almost 700 shares, making it the most diversified instrument in terms of MSCI methodology on the Chinese equity market. The new fund also features a low turnover and very low ongoing charges.

CSIF (Lux) Equity China Total Market (inception 19.08.2019)

Reference index	MSCI China All Shares
Bloomberg ticker	M1CNAL
Spread in favor of fund	Subscriptions: 0.34% Redemptions: 0.38%
Fund currency	USD
ISIN	LU1815001661
Local custodian bank	HSBC Hong Kong
Forecast ex-ante tracking error	0.15% p.a.
Annual turnover (one-sided)	5.7% (YTD 2019) 7.5% (2018) 6.7% (2017)

No investment without risks
Foreign investors had their reasons to shy away from Chinese equities in the past, having tended to be put off by uncertainty with regard to the government's economic strategy, bureaucracy, and limited transparency. Although there have been many positive changes in recent times, any replication of the MSCI China All Shares Index still involves the following challenges:

- Increased tracking error, as some shares are not tradeable via Stock Connect. As at the end of May 2019, they accounted for less than 1% of the index's market capitalization.
- Additional volatility, as the index is not based on a tradeable currency (offshore versus onshore currency). Although the liquid offshore currency (CNH) of relevance to the fund portfolio is equivalent one-on-one with the onshore currency (CNY) on which the index is based, there may be short-term differences in performance between the fund portfolio and index in the absence of a 100% connection.
- The index contains heavyweights such as Tencent and Alibaba (see following table).

MSCI China All Shares Index: top ten components	Index weighting
TENCENT HOLDINGS LTD (CN)	9.2%
ALIBABA GROUP HLDG ADR	8.2%
CHINA CONSTRUCTION BANK H	2.9%
PING AN INSURANCE H	2.4%
CHINA MOBILE	2.1%
KWEICHOW MOUTAI A	1.9%
ICBC H	1.8%
PING AN INSURANCE H	1.4%
BANK OF CHINA H	1.3%
CHINA MERCHANTS BANK A	1.2%
Total	**32.3%**

Despite risks that are not to be underestimated, for us one thing is clear: China is a topic of increasing importance. Investors aiming for contemporary portfolio diversification cannot afford to ignore the world's second-largest equity market. For investors lacking both the expertise and the time for labor-intensive security selection and investment processes, Credit Suisse Asset Management offers just the thing: an efficient and transparent product in the form of the CSIF (Lux) Equity China Total Market. It offers a way of representing the economic powerhouse that is China appropriately in a portfolio.

Would you like to find out more about Credit Suisse Index Solutions?
The entire CSIF umbrella (CSIF: Credit Suisse Index Funds) now covers 90 funds, of which 52 funds relate to share indices, 33 to bond indices, 4 to real estate indices and 1 that invests in physical gold. Our index funds can be used by institutional and private investors as strategic building blocks for a portfolio and for implementing tactical investment decisions. Our index funds are also used in mandates.

25 years
Clear and understandable investments

Credit Suisse Index Solutions has been specializing in indexed asset management since 1994 and is now the biggest provider of indexed funds and indexed mandates in Switzerland.

Our global center of competence based in Switzerland develops clear and understandable investments with due care and precision. Our qualified team of portfolio managers have many years' experience in the management of indexed portfolios.

Our clients can be assured of security at all times thanks to our state-of-the-art portfolio management and risk supervision systems. By entrusting index calculation, administration, and securities trading to carefully selected partners, we can ensure that our products are of high quality.

CREDIT SUISSE

CREDIT SUISSE ASSET MANAGEMENT (Switzerland) Ltd.
Team Product Specialists & PB Coverage
Sihlcity – Kalandergasse 4
8070 Zurich

Source: Credit Suisse, otherwise specified.
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