Schroders Quickview: Cross-border stock trading bodes well for China reform path

Louisa Lo, Head of Greater China Equities

10 Apr 2014

Regulators in China today unveiled a pilot scheme that will allow cross-border stock investments between Shanghai and Hong Kong.

Following on from the recent spate of market-oriented reform, the scheme will see Hong Kong's developed financial markets and infrastructure being utilised to provide a strong platform and gateway for investments into and from China.

Mainland investors will be allowed to trade up to 10.5 billion renminbi daily (c.20% of daily traded value over the past year) in designated companies listed in Hong Kong. Meanwhile, international investors will be allowed trade up to RMB 13 billion daily (c.14% of daily traded value over the past year for the Shanghai Composite Index) to invest in designated Shanghai-listed firms. Constituents of select Shanghai Stock Exchange as well Hang Seng indices, as well as dual-listed A and H share companies are eligible for investment under this scheme.

This move is a positive signal for broader developments in China's financial market reforms, and may be seen as a reiteration of the Chinese government's stated intentions to steer its capital markets towards a gradual path of liberalisation. However, similar to broad reform directives announced at the Third Plenum in November last year, details on how this scheme will be administered will require further close monitoring. Implementation will take at least six months, as further details are to be unveiled.

The immediate beneficiaries of such a move include the listed stock exchange in Hong Kong, securities companies and brokers, who are expected to benefit from increased transaction volumes and new business opportunities resulting from this initial integration. There are also obviously broader long term implications for investors in Chinese equities. A material step demonstrating the Chinese authorities' market liberalisation efforts (in addition to recent moves to expand the existing QFII and RQFII program), this development can be expected to further facilitate the inclusion of China A shares, along with the pace of this inclusion, into the widely-watched MSCI Emerging Markets Index.

This closer integration of both the Hong Kong and China markets could also have an impact on individual stock prices where companies have dual A & H listings. Making it easier to arbitrage valuation differences across the two markets, we may see a narrowing of valuation discounts between A and H shares over time.

Mainland as well as international investors will also be provided with unique opportunities to buy into select blue chip stocks listed onshore in China as well as offshore in Hong Kong. Previously inaccessible, investors can now gain access to a wider range of investment opportunities. Mainland-listed consumer- and services-related sectors, for example, provide more options for international investors wanting to participate in China's consumption story, whilst companies with an international footprint listed in Hong Kong will offer diversified investment opportunities for mainland Chinese investors wanting exposure beyond Asia.

As Chinese authorities mull over the eventual amalgamation of both the onshore and offshore Chinese equity markets, which is likely still a number of years away, this gradual market liberalisation process may also be aimed at re-aligning the investing style of the domestic market – one that has been long associated with short term momentum-driven investing. By allowing international investors into onshore Chinese markets, this may over time bring about a more balanced and institutionalised mindset that is focused on fundamentals, including dividend yield and value.

Whilst there are a number of positives to take away from this cross-border scheme, and we are encouraged by the direction of reforms undertaken so far, our optimism for the longer term is also tempered by the ever-present awareness that implementation is key. Details and progress still need to be keenly monitored as China attempts to steer its economy and market through a number of challenges.

Related articles investor confidence Third Plenum China growth Louisa Lo Asia ex Japan Equities