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Chinese stock market collapse creates opportunities

People have been asking us what the sharp fall in the Chinese stock market means for SKAGEN`s equity funds. Kristoffer Stensrud, portfolio manager of emerging markets fund SKAGEN Kon-Tiki, answers.

How do the developments in China affect SKAGEN Kon-Tiki?
They have relatively little effect on the fund. SKAGEN Kon-Tiki has long maintained a low weighting in Chinese stocks. During the boom in April and May we chose to reduce our holdings in overvalued stocks and thus further reduced our exposure. The number of Chinese stocks (international H-stocks) currently constitutes around 6.6% of the fund, versus around 25% for the MSCI Emerging Markets Index.

What do you see happening in China going forward?
It is far from certain how the Chinese economy will develop. No one thought that the transition from a trade and investment-driven economy to a service-dominated, environmentally friendly economy would be pain-free. We are seeing the effect of the shift now. The market value of H-stocks is back to where it was at the beginning of the year, so it should be possible to start finding undervalued Chinese stocks again.

What will be the consequences overall?
Stockbrokers, banks and new equity barons will feel the effects most. Those that sold on the way up are now left with cheap cash and are happy. Fundamentally speaking there won't be a huge impact, except that monetary policy will be loosened even more than expected. This will be good for debt-ridden companies and property speculators. Share ownership in China is not so widespread that it will create problems that weren't there before the stock market began its decline.

What are the opportunities for finding investments in China now?
It is during times of recovery that one should be careful; during times of decline one should be bold. We have seen dramatic events of this type before, most recently in 2007. They are mainly due to the markets being regulated in a clumsy way; the authorities did too little with the margin regulations on the way up and then panicked on the way down. The upturn in the local market was due to a liquidity bubble, and when the companies became too expensive and the liquidity dried up, that triggered a decline. Situations such as these do not inspire faith, which means that the discounts are significantly larger than usual. This will in turn create new opportunities.

Because of the suspension in trading and little opportunity for investors to hedge and short sell, trading moved from A-shares to H-shares. With a trading volume in Hong Kong that constitutes a tenth that of mainland China, the result is a given. The difference between A- and H-shares will be record-high – which should again create good buying opportunities for long-term investors like SKAGEN.