UNICORN 1200

UNICORN FINANCIAL SOLUTIONS PTE LTD
538 Geylang Road #02-09
The Arizon Singapore 389493
Tel: (+65) 6887 3885
Website: www.unicorn.sg

23 June 2017

WELCOME TO THE PARTY, CHINA

Written by Ng Yi Xian

China's stocks, also known as A-shares, took a major step toward global acceptance after finally winning a long campaign for inclusion in a leading emerging markets benchmark. U.S. index provider MSCI said on 21st June 2017 Wednesday, that it would add a selection of Chinese equities to its Emerging Markets index. China was previously rejected for three years running.[1]

What The Decision Entails

A total of 222 large-cap, mainland stocks will be added to the index, and this will account for 0.73% of MSCI's flagship index. This is higher than the 169 stocks originally proposed and will be concluded via a two-phase process in May and August next year.[2] MSCI expects as much as $18 billion of global assets to move into Chinese equities initially, with the figure potentially ballooning to $340 billion in the long term should China eventually receive full inclusion of its equity markets.[1] A timeline for full inclusion of A-shares has not been set yet and this will be dependent on China's ability to align with international accessibility and trading standards.

China-related stocks currently make up 27% of MSCI's emerging markets index, but this consists of shares listed in Hong Kong (H-shares) and the U.S., including Chinese tech giants such as Tencent and Alibaba.[2]

What This Means for China

China's equity and bond markets are the second- and third-largest in the world, respectively, but foreigners hold less than 2 per cent of each.[2] This is because foreign investors have frequently raised concerns about China's weak corporate governance, how Beijing polices its stock markets, and the difficulties money managers face when repatriating funds on demand. These concerns were amplified by the authorities' heavy-handed response to the 2015 market crash, where at one point more than half of all stocks were suspended from trading and officials forced local institutions to contribute to a bailout fund.

MSCI's landmark decision on Wednesday could and should be read as a stamp of approval by global investors of the progress that China has made in reforming and opening of its capital markets. This includes the improved access to A-shares via the Stock Connect program that links Hong Kong with Shanghai and Shenzhen without subjecting investors to the same capital restrictions they would face when buying shares on the mainland using local currency.

The inclusion also marks a milestone in Beijing's efforts to draw more international funds into its markets. An estimated $1.6tn of investment funds that track the index are also obliged to buy the country's stocks.[2]

<u>What This Means to You</u>
We have always based our decision to invest in China on the attractive valuation of Chinese equities as a whole, and the promising long-term prospects of its economy. It is important to note that we are confident of your allocation into China due to the government's shrewd policy-making, and the reforms that Beijing is pursuing. We are still convinced that China is headed in the right direction, although it will be anything but a smooth ride.

This conviction is further strengthened when the Chinese Securities Regulatory Commission assured markets on 16th June 2017 that regardless of MSCI's decision, China will not alter its direction and pace of reform to make its capital markets more market-oriented.[3]

This is why we still advise a 10% allocation into China for your managed funds portfolio. It will present you with the opportunity to profit should Chinese markets climb during this period of uncertainty.

However, patience is required before desired results from your investments in China are realised and you should expect periods of high volatility that are commonly seen in Chinese equities.

While there is potential for future profit-taking from your exposure to Chinese equities**, we are more of the view that that there is little or no sound reason for the extension of a bull-run in the U.S., which will likely drag Chinese markets down when a correction eventually happens.** Hence, we have continued to keep 90% of your portfolio in cash and gold.

We remain cautious of a market correction and opt to stay on the sidelines at this juncture with a 10% China, 90% capital preservation allocation. We are happy to take this time to consolidate our resources while evaluating market developments diligently. This portfolio should present a value investor with the opportunity to acquire assets that are trading for less than their intrinsic values when the time comes.

<u>Inaction Versus Indifference</u>
We believe we are in the last leg of a bull market and this phase is often characterised by a quick and sharp rally in prices. People who rush into the market now buy at a high price and hope to sell at an even higher one. A value investor adopts a buy-low-sell-high approach instead. He or she knows that the best time to invest is when equity markets are down.

A value investor would also want to ensure that there is sufficient liquidity on hand to take advantage of the opportunities presented during a market correction. However, the main challenge for most investors during such a situation is precisely the opposite of that.

These investors either have a lack of funds because they are 'held up' in equities or other investments that have their prices depressed due to the market correction, or they have simply ignored the age-old advice of keeping some funds aside to serve as a valuable source of opportunity funds.

We are aware that we have been advising you to build up your cash and gold allocation for the past 2 years or so. You must be itching for action and wondering what we are waiting for. **Never mistake inaction for indifference.** Sometimes, the best thing to do in the realm of investing, is to stand pat -- and wait.

What we have done for you all this while is to tactically prepare you to take advantage of opportunities with this sizable war chest (of gold and cash) should a crisis occur. You stand to gain regardless of how the market performs, with the only consideration being the time horizon that you are investing for. Instead, a financial review with your consultant to assess your situation immediately, is strongly advised. This is the best advice to heed now, and the most critical decision you can make at this juncture.

Source

[1] – ‘A’ Shares Get MSCI Nod in Landmark Moment for China’s Markets
http://www.reuters.com/article/us-msci-indexes-idUSKBN19B325?il=0

[2] – China Gains Entry to MSCI’s $1.6tn Global Index
https://www.ft.com/content/f648b8f6-550f-11e7-80b6-9bfa4c1f83d2?mhq5j=e2

[3] – China Says MSCI Decision Will Not Derail Market Reforms
http://news.xinhuanet.com/english/2017-06/16/c_136371545.htm