China H-Shares Poised for Bull Market on Stimulus Wagers

By Kana Nishizawa - Jul 28, 2014

Chinese stocks rose, lifting a gauge of mainland companies in Hong Kong more than 20 percent from this year’s low, as government stimulus boosts investor confidence in the world’s second-largest economy.

The Hang Seng China Enterprises Index (HSCEI), known as the H-share index, climbed 0.9 percent to 11,097.10 as of 2:33 p.m. in Hong Kong, set to enter a bull market after surging from an eight-month low on March 20. PetroChina Co. (857), the nation’s largest energy company, and Industrial & Commercial Bank of China Ltd., the top lender by market value, rallied during the period as the government pledged to open state-run industries to private capital.

China cut reserve requirements for some banks, accelerated infrastructure spending and loosened property curbs as Premier Li Keqiang seeks to keep growth from falling below his 7.5 percent target. While bears such as Bank of America Corp.’s David Cui say stimulus is delaying the economy’s shift toward a more sustainable model driven by consumption and services, Templeton Emerging Markets Group’s Mark Mobius said last week the rally may extend another 20 percent.

“Sentiment has turned in favor of growth and cheap valuations in the Chinese market,” said Khiem Do, who helps oversee about $60 billion as Hong Kong-based head of Asian multi-asset strategy at Baring Asset Management Ltd. The shares have “been lagging for a long time so they’re catching up with world markets. The policy changes in China are favorable.”

The Shanghai Composite Index advanced 2.4 percent today, with volume more than double its 30-day intraday average. The CSI 300 Index of the nation’s biggest firms added 2.8 percent, while the ChiNext index of smaller stocks increased 2.1 percent. Hong Kong’s Hang Seng Index gained 1.1 percent with volume 67 percent higher than its 30-day average.

Bocom, Shenyin Wanguo

Financial companies jumped in Hong Kong and the mainland today after a Reuters report that Bank of Communications Co. applied for a mixed-ownership trial and Shenyin Wanguo HK Ltd.’s parent agreed to an acquisition that would create China’s fifth-biggest brokerage by assets.

China’s H-shares posted the biggest losses worldwide at the start of the year amid concern a weakening property market would weigh on construction, consumer spending and local-government finances. The retreat left the Hang Seng China gauge valued at about the same level as its net assets, the lowest level...
in more than a decade.

A close in bull market territory, defined as a gain of at least 20 percent from a recent low, would mark the 26th such rally since Bloomberg began compiling the data in 1993. The gauge climbed an average 75 percent during those periods, over a mean 184 calendar days.

**Undervalued Shares**

“It’s one of the most undervalued markets, especially given the potential for a rebound in growth,” Nader Naeimi, the head of dynamic asset allocation at AMP Capital Investors Ltd., which manages about $131 billion, said on July 23. “You have a combination of growth rebounding, policy becoming more supportive and the share market valuations being extremely cheap.”

Premier Li said in June that authorities will “ensure” a minimum annual economic growth rate of 7.5 percent. The nation’s manufacturing industries expanded at the fastest pace in 18 months in July, according to a preliminary purchasing managers’ index from HSBC Holdings Plc and Markit Economics. Chinese industrial companies reported a 17.9 percent gain in earnings in June from a year earlier, the fastest pace since September.

**Exchange Link**

Investors in the mainland have been less optimistic than their international counterparts buying Chinese companies in Hong Kong. The Shanghai Composite Index (SHCOMP) has climbed 9.2 percent since March 20, lagging the Hang Seng China gauge by about 11 percentage points. The number of funded stock accounts on the mainland dropped to about 53 million on July 18, the lowest in four years.

The underperformance of China’s yuan-denominated shares has left companies with dual listings trading at a discount of about 8 percent on the mainland, relative to Hong Kong. The gap hit an eight-year low of 11 percent on July 23, according to the Hang Seng China AH Premium Index.

Investors including Robeco and Coutts & Co. anticipate that gap will narrow as an exchange link between Hong Kong and Shanghai makes it easier for money to move between the two bourses. The premium index showed the valuation gap narrowing at the fastest pace in three months today.

Hong Kong stock exchange has been “intensively” preparing for the stock connect, but it does not have an explicit start date yet, the bourse said in an e-mail today. The National Business Daily reported earlier the exchange link will start on Oct. 13.

**Excessive Optimism**

Investors should pare holdings of Chinese stocks traded in Hong Kong and in Shanghai as the rally is being driven by excessive optimism, Hao Hong, chief China strategist at Bocom International Holdings Co., said today.

Shenyin Wanguo HK surged 13 percent to HK$4.18 after parent Shenyin & Wanguo Securities agreed
to acquire Hong Yuan Securities for 39.6 billion yuan in stock. Other brokerages rallied amid high trading volume, with First Shanghai Investments Ltd. soaring 11 percent and Guotai Junan International Holdings Ltd. advancing 8 percent.

Bank of Communications jumped 5.1 percent to HK$5.75. The lender wants to sell more stakes to private investors as part of China’s economic restructuring, Reuters reported, citing two people familiar with the matter.

Hong Kong Exchanges & Clearing Ltd. (388) increased 3.6 percent to HK$169.20 after the starting date report of the equity link with Shanghai was reported. Goldman Sachs Group Inc. raised its target price on the stock to HK$188 from HK$167. China Coal Energy Co. advanced 5.8 percent to HK$4.73 to lead gains on the H-share gauge today.

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