China Trading Boom That Marked End of Past Rallies Is Back

By Bloomberg News - Nov 26, 2014

The surge in Chinese equity trading that coincided with market peaks in 2009 and 2010 is back again after the Shanghai Composite (SHCOMP) Index jumped to a three-year high.

The 30-day average daily value of shares changing hands on the Shanghai exchange exceeded 200 billion yuan ($32.6 billion) for the first time in four years on Nov. 25, after rising threefold in the past six months, according to data compiled by Bloomberg. Turnover last breached this level on Nov. 9, 2010, the same day the Shanghai Composite began its slide into a 38 percent bear market. The previous surge came on Aug. 7, 2009, two days after the start of a 23 percent retreat.

“It’s a good chance we’re at a market top right now,” David Cui, the China strategist at Bank of America Corp. (BAC) who’s ranked No. 1 by Institutional Investor magazine, said by phone yesterday. “Based on the experience since the global financial crisis, surging volumes each time marked a temporary top for the market.”

Jumps in trading may signal market peaks because they reflect too much investor “euphoria” toward stocks, according to Cui. The Shanghai Composite has climbed 23 percent this year, sending valuations to a 20-month high, as the city’s exchange link with Hong Kong opened the market further to foreign investors and the central bank unexpectedly cut interest rates for the first time since 2012.

Trading History

The rally has left the Shanghai Composite trading 33 percent above its last bear-market nadir on Dec. 3, 2012. The gauge posted average bull-market gains of 41 percent since 2008, with bear-market retreats averaging 33 percent, according to data compiled by Bloomberg. The index rose 1.4 percent to 2,604.35 yesterday, the highest level since August 2011.

Trading on the Shanghai bourse is almost twice as high as the five-year average and about 29 percent more than turnover on the New York Stock Exchange. The value of shares changing hands on the Chinese bourse climbed to a record 330.9 billion yuan on Nov. 11 and was about 316 billion yuan yesterday.

The Shanghai Composite rose 0.6 percent to 2,619.31 at 10:44 a.m. local time, with trading 53 percent higher than the 30-day average for this time of day.
Chinese stocks have kept rallying since Bank of America’s Cui said in July that they were poised to decline, and after he reiterated that view in September. While he says shares may “do things defying fundamentals for a while,” the strategist is sticking to his pessimistic stance because he says corporate debt levels are rising and China still suffers from excess capacity in some industries.

**Rate Cut**

There are good reasons for the surge in trading, said Wu Kan, who helps oversee about $3.3 billion as a money manager at Shanghai-based Dragon Life Insurance Co. Initial public offerings and the central bank’s interest-rate cut are luring money back into the stock market, he said.

Mainland IPOs have posted an average first-day gain of 43 percent this year amid regulatory pressure to prevent overvalued listings. The People’s Bank of China lowered its benchmark one-year lending rate by 0.4 percentage point to 5.6 percent effective Nov. 22, and banks including JPMorgan Chase & Co. predict the cut will be followed by further reductions to support economic growth.

“There will still be more leeway to go for the market because the overall monetary policy has slightly changed to support growth,” said Kelvin Wong, a Hong Kong-based analyst at Bank Julius Baer & Co., which has about $296 billion under management. “At least for the near term, the market should continue to edge up.”

**Overbought Market**

There are signs, aside from the surge in trading, that the Shanghai Composite’s rally has gone too far, too fast. The gauge’s 14-day relative strength index climbed to 79.6 yesterday, the highest level since July and above the threshold of 70 that some traders use as a signal that gains are poised to reverse.

The equity gauge is valued at 9.6 times estimated earnings for the next 12 months, the highest level since March 2013, according to data compiled by Bloomberg. That’s 11 percent more expensive than the three-year average.

While the Shanghai market is “overbought,” the timing of the peak may depend on whether the nation’s central bank cuts interest rates further, said Hao Hong, managing director of China research at Bocom International Holdings Co. in Hong Kong.

“Technically it doesn’t look good,” he said. “But we may need to wait before selling because we could be soon getting another cut.”

For Cui, even lower interest rates won’t make China attractive.

“We have too much leverage, too much capacity and these things are getting worse, not improving,” he said. “Rate cuts and loosening will just release more liquidity into the housing
market and speculative activities. I don’t think that will help China’s long-term growth prospects.”

To contact Bloomberg News staff for this story: Allen Wan in Shanghai at awan3@bloomberg.net; Zhang Shidong in Shanghai at szhang5@bloomberg.net.

To contact the editors responsible for this story: Michael Patterson at mpatterson10@bloomberg.net Richard Richtmyer.