In Case You Missed It: CSOP's Weekly China Wrap Up

Evergrade moves on Vanke takeover attempt

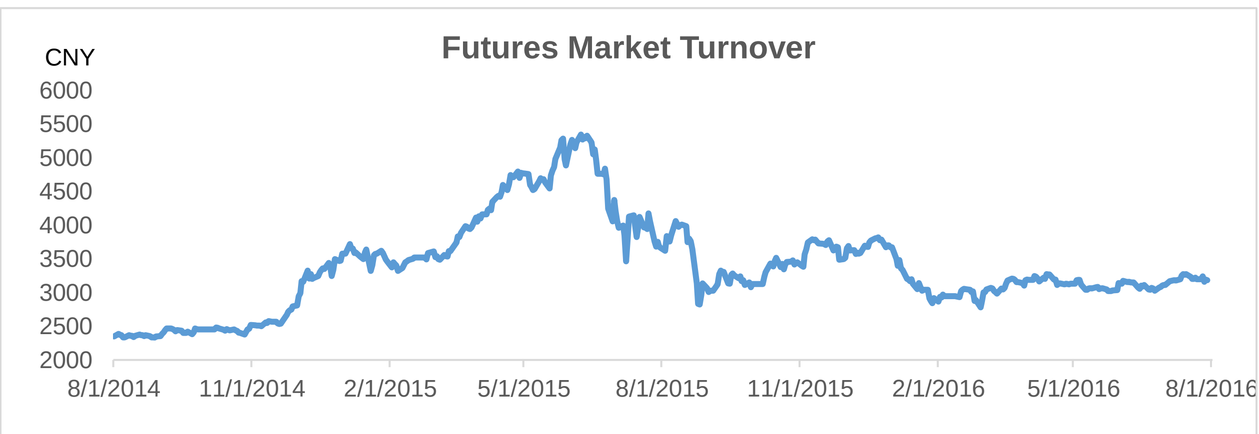
The ongoing battle for control over Vanke, China's largest homebuilder, took another turn today as reports emerged that Evergrande had self-funded a purchase of 4.68% of Vanke A-Shares for RMB 9.1 billion. In the unexpected move, China's second largest property developer paid RMB 17.62 per share, joining Baoneng (25% stake), China Resource (15.24%) and Anbang Insurance (7.01%) as Vanke's largest shareholders.

The purchase comes in the aftermath of Baoneng's unsuccessful attempts to secure majority control last week, a maneuver frowned upon by regulators. Evergrande's entry into the mix adds an element of intrigue, as it remains unclear whether they will side with Baoneng or offer their loyalties to Vanke's existing leadership. Despite the purchase's strategic potential, Evergrande's economic logic is nonetheless sound. Evergrande's outlay represents another example of investors chasing blue-chip A-Shares due to their low relative valuations and solid fundamentals. To contextualize, A-Shares on the FTSE 50 are trading 8.98 P/E, compared to 20.33 on the S&P500 and 53.46 on the ChiNext index of small/mid cap technology firms.[1,2]

Plans announced to loosen restrictions on stock index futures, reversing 2015 restrictions

The China Financial Futures Exchange announced plans to loosen restrictions on stock-index futures. The moves seek to reverse a slew of rule changes in mid-2015 that tightened position limits, increased margin requirements, and launched police probes into short selling activity. In response to the restrictions, trading slowed to a crawl; according to Wind, turnover plummeted nearly 50% on a futures market that was previously the world's most active.

Thursday's announcement, however, represents a potential relaxation of the 2015 restrictions. The newly proposed rules allow non-hedging accounts to open 100 new positions a day on a single contract. Currently, anything over 10 is flagged as "abnormal trading." Meanwhile margin requirement for non-hedging trades may be lowered from 40% to 30%, and 20% to 10% for hedging trades. Fees are also likely to be lowered for day trading.



Source: Wind, as of 8.1.2016

The views expressed represent an assessment of market conditions at a specific point in time, are opinions only and should not be relied upon as investment advice regarding a particular investment or markets in general. Such information does not constitute a recommendation to buy or sell specific securities or investment vehicles.

People's Daily praises State Owned Enterprise reform initiatives

The People's Daily, the official newspaper of the Communist Party, published a front page article praising Shanghai's pioneering SOE reform initiatives. [3] Although a national SOE reform campaign remains ongoing, regional and municipal officials have begun to develop localized initiatives to expedite the reform process. Widely heralded, Shanghai's plan categorizes SOEs into types and employs a different strategy for reform of each. For example, those enterprises classified as "competitive" will be subject to market pressures, encourage private investment, and relinquish longstanding subsidies. On the contrary, "public service" enterprises will remain protected from market forces.

Beijing reportedly intends to adopt Shanghai's methodology to guide national standards. The article's prominent front page placement sends a strong message in support of liberalization, a sentiment evidenced further by the comment that Shanghai's reforms will take place by the end of the year. Markets rallied in response to the report, with Shanghai Composite shares adding .61% at day's end.

Glass prices skyrocket, suggesting rebounding of wider economy

Mimicking the trajectory of coal and cement figures, glass prices shot up 33% in July, adding evidence that China's economy may have already hit bottom in 1H2016. Bolstering the findings, the Caixin China Manufacturing PMI reported MoM expansion for the first time in 17 months.[4] Although slight, the index inched up to 50.6 in July from 48.6 in June. A PMI over 50 represents expansion.

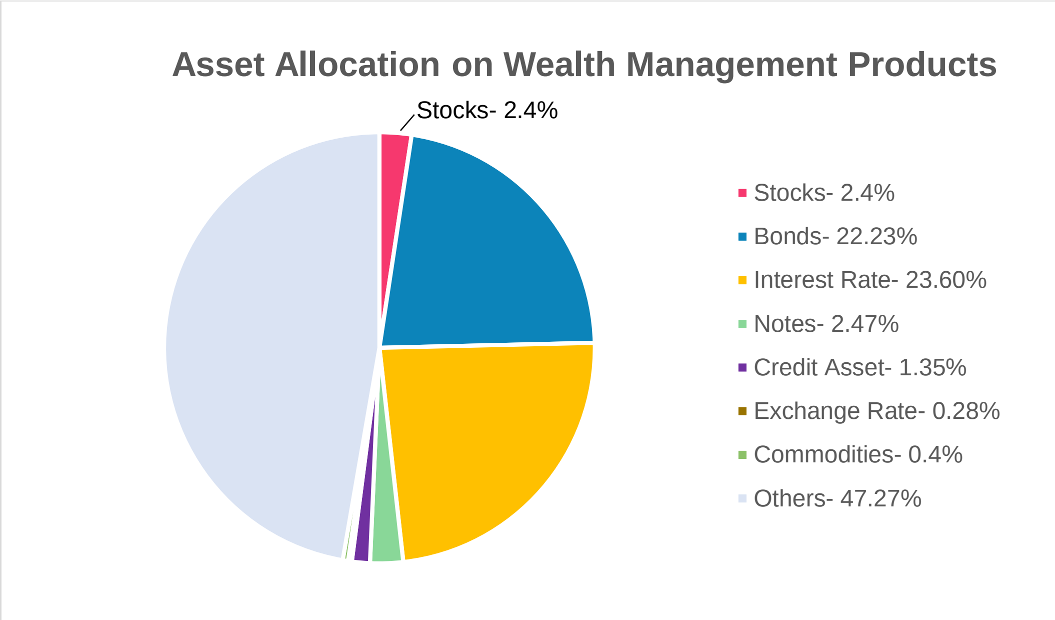
Tempering those encouraging figures, spending on fixed assets slowed to 2.8% in 1H2016, falling from 10% YoY.[5] Analysts and C-Suite executives point to ongoing concerns over the uncertain regulatory environment as an explanation. Evidencing this mood, Wanda Cinema Line (002739) announced that it was delaying its planned integration of US film studio Legendary Entertainment just months after it purchased the business for $3.5 billion USD.

Caixin reports additional restrictions on mass market WMPs

Adding clarification to last week's Wealth Management Product (WMP) reports, a leading local news outlet (Caixin) reported that wealth management product restrictions will apply to mass market rather than qualified investors. The latest draft indicates that cash from "mass market" WMPs can only be invested in bond and money markets, not domestic equities. In contrast, banks with more than 5 billion yuan of net capital or more than three years of experience with WMPS can invest in equities and other alternative assets.

The nuanced rule change is attributable to plummeting market sentiment following release of last week's proposed changes. The reversal also demonstrates the tightrope regulators navigate as they attempt to balance risk reduction and leverage tightening with growth and stability. Although the government seeks to avoid repeating last year's WMP-induced bubble and subsequent crash, the Shanghai composite is already down 15% on the year.

On balance, it appears that consequences of this WMP reform policy will be limited. At present, stocks represent only 2.4% of WMP asset allocation. So, even in the most dramatic scenario in which all WMP investment in equities is banned, the effect is slight. However, the proposed rule changes are significantly milder, impacting the comparatively small proportion of "mass market" players, thus rendering the potential regulation largely inconsequential to equity investors as a whole.



As of August 1, 2016

Notes:

1. The FTSE China A50 Index is the benchmark for investors to access the China domestic market through A Shares – securities of companies incorporated in mainland China and traded by Chinese and institutional investors under the Qualified Foreign Institutional Investor and Renminbi Qualified Foreign Institutional Investor (QFII & RQFII) regulation. **Note that one cannot invest directly in an index**
2. The CHINEXT index is China's Nasdaq-like barometer of high-tech stocks. Note that one cannot invest directly in an index
3. SOE: State-owned enterprise
4. MoM: month over month
5. YoY: Year over year