## CHINA'S BEAR MARKET
**By Gregg Biro**

The recent severe volatility in China's mainland markets has raised questions among many investors about the causes of the market downturn in China and the wider implications for the global economy and markets. The Shanghai Composite Index more than doubled from mid-2014 to mid-2015, only to lose more than 30% of its value in a span of roughly four weeks starting in mid-June of this year. Cue the next crisis du jour.

The decline in Chinese stocks triggered repeated interventions by China's government, which has been seeking to transition their economy from an export-driven economy to an economy whose future growth is based more on domestic demand.

US investors are concerned about the volatility in the Chinese market, what it means for their own investments, and what it might signify for the global economy, particularly given the rapid growth of China in the past 20 years.

### PERSPECTIVE
Although China's economy is massive, it's important to note that China makes up just 2.6% of the MSCI All Country World Index, which takes into account the proportion of a company's shares that are available to be traded by the public.

Also, China's stock market is still relatively young and difficult to access. The two major national exchanges, Shanghai and the southern city of Shenzhen, were established in 1990 and have grown rapidly as China has industrialized. With foreign participation in these mainland Chinese markets still heavily restricted, many foreign investors seek exposure to China through Hong Kong or "China shares" listed on the New York Stock Exchange. Market volatility was much lower on the Hong Kong exchange versus the mainland exchanges during this recent bull and bear market. The Hong Kong exchange (Hang Seng Index) fell about 17% from April's seven-year high, though it had a more modest run-up in the prior year of about 25%.

As a consequence of these heavy restrictions, Chinese investors account for about 90% of the activity on the mainland markets. In addition, the participation is relatively narrow. According to a China household finance survey, only 37 million, or 8.8% of Chinese families, held shares as of June 2015. As a comparison, just over half of all Americans own stocks, according to Gallup. In Australia, the proportion is 36%.

China is also classified by some index providers as an emerging market. These markets fall short of the definition of a developed market on a number of measures such as economic development, size, liquidity, and property rights. Navigating these markets can be complex. There can be particular challenges around regulation and restrictions on foreign investment and there are risks that go with investing in this environment. Due to these risk factors, investment exposure to China in our clients' portfolios is modest.

While the mainland Chinese stock market is about 30% off its June highs, it was still about 70% higher than where it was 12 months before, as of late July 2015. As such, much of the pain of the recent market decline has been felt by people who entered the market in the past year.

One final point is that while the Chinese economy has been slowing, it is still expanding at around 7% per annum – more than twice the rate of most developed economies.

**SUMMARY**

The emergence of China as a major force in the global economy has been one of the significant drivers of markets in the past decade and a half. China's rapid industrialization, as the population urbanized, drove strong demand for commodities and other materials. Investment and property boomed as credit expanded and people took advantage of gradual liberalization.

Now, China is entering a new phase of modernization. The government and regulators are seeking to rebalance growth and bring to maturity the country's still relatively undeveloped capital markets. There are risks that go with this maturation phase.

We have seen those risks appearing recently, as about a third of the previous year's sharp rise in the Chinese mainland market was unwound in a matter of weeks. Markets globally are weighing the wider implications, if any, of this correction. We have seen concurrent weakness in other equity markets and falls in commodity prices and related currencies.

Yet it is important to understand that the stock market is not the economy. Also, China's stock market is only about 2.6% of global market capitalization and its volatile mainland exchanges are, for the most part, out of bounds for foreign investors.

For individual investors, the best course in this climate, as always, is to maintain diversification and discipline, and remember that markets accommodate new information constantly.



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