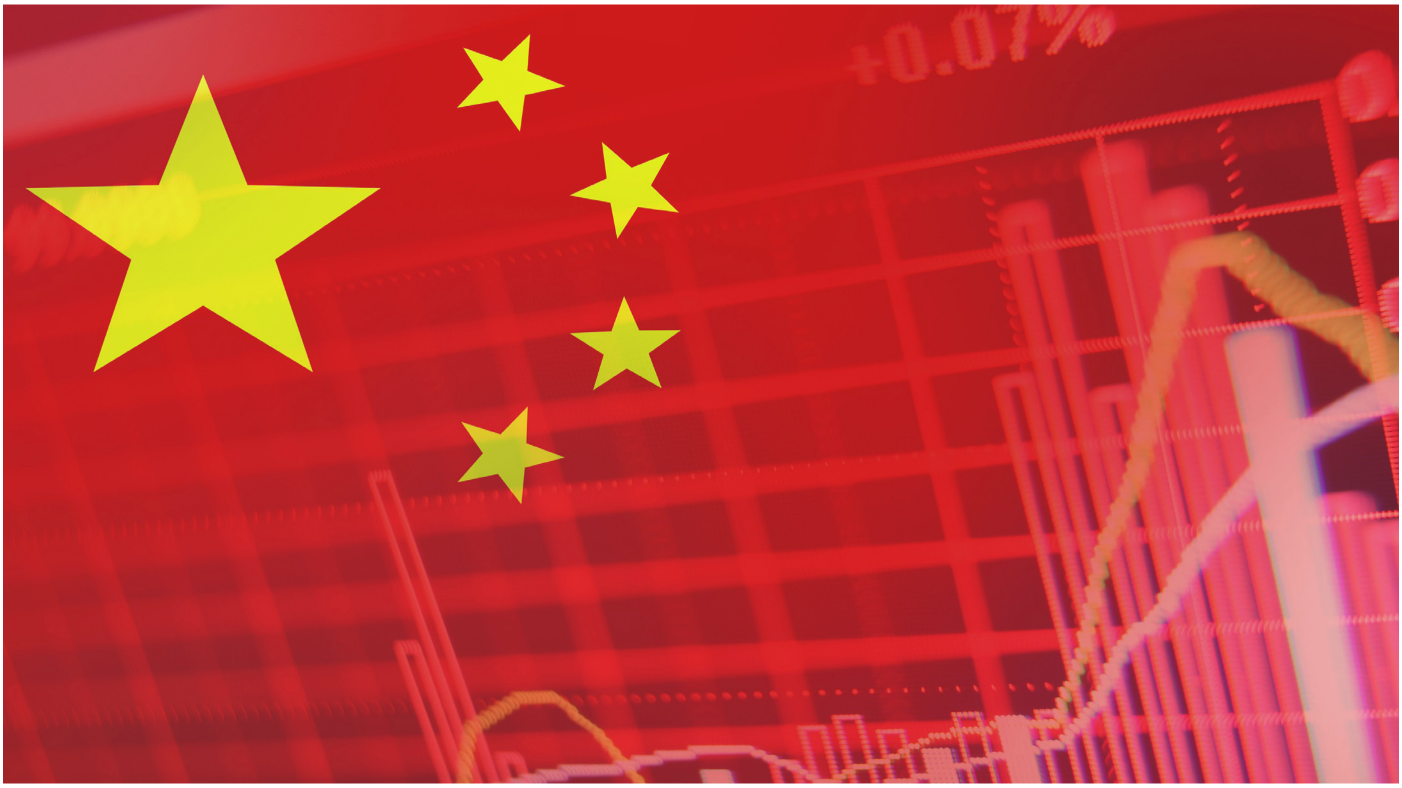
Should we be afraid of China‘s stock market?



The beginning of last week was a rude awakening for securities traders. On Monday, China‘s Shenzen300 Index was down as much as five percent (it even fell eight percent during the week) and Hong Kong‘s Hang Seng Index did the same (losing as much as nearly 9.5 percent during the week). This did not leave the other international stock exchanges unscathed, but the „push south“ was contained.

What had happened? The Chinese government had decided - quite surprisingly - that educational institutions would no longer be allowed to operate on a profit-oriented basis in the future. For us Europeans, this does not immediately sound like a worrying announcement and certainly not for the capital markets, but in order to understand the reaction of the stock markets, one has to look a little deeper into the Chinese system and also the recent past.

The rationale behind the Chinese central government‘s instruction was, according to its explanation, that education in the People‘s Republic must remain an affordable sector for everyone, and thus every child should have the same chance of education. In recent years, this segment has developed in such a way that tutoring institutes have been given an increasingly heavy weight in education, as many

Chinese have aimed to use tutoring to help their children achieve model student status and thus better opportunities. After all, access to universities and other tertiary educational institutions in China - and even more so than in Europe - is dependent on school performance. Whether the government was also concerned about the „sole sovereignty“ of scholars and education, as it is often accused of in the non-Chinese media, can be left open to interpretation. However, the move is also motivated by the fact that China is currently seeing the age pyramid shift sharply and the state, after the failed one-child policy, is urgently trying to increase the number of children per household through appeals and subsidies. The expectation of a very expensive education is probably also an obstacle, which could thus be at least partially removed. Furthermore, the goal of making education independent of the family‘s financial situation can also be seen as part of the efforts to spread prosperity more widely.

For investors, however, this step toward the education sector - and here we come to the more recent past - was also another step that made investments in Chinese companies seem increasingly uncertain. It began last fall with the furor over Jack Ma, the founder of Alibaba, who announced at very short notice that he was withdrawing the IPO of „his“ Ant Group. The simultaneous initiation of antitrust proceedings against Alibaba caused disquiet among investors. Confidence was at least not strengthened as a result of far-reaching regulations in the real estate and tech sectors as well as short-term ambiguities surrounding the bond redemption of a state-owned „bad bank.“ Thus, this surprising regulation of another sector has led to a sell order for many investors, and it is to be feared that other sectors will be taken by the scruff of the neck. Due to the impact and ambiguity, China felt compelled to reassure and allay fears of irrational further moves in a conference call with major international investors/institutions last Wednesday. The next few weeks will show whether this was successful in the long term. At any rate, as of the end of July, China‘s CSI300 and Hong Kong‘s Hang Seng Index are far and away this year‘s losers among the major leading stock markets, down -7.7% and -4.7%, respectively, since the beginning of the year.

The lesson to be drawn from this episode is that when investing in equities, which should ideally always be broadly diversified and with a close look at one‘s own risk-bearing capacity, even greater caution should be exercised in emerging markets - and this still includes China - as influencing factors play a role here that can largely be ruled out in developed markets. Despite this episode, emerging markets should be considered when building a diversified portfolio.

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