The Wall Street Journal
Foreigners Set to Get Greater Access to Chinese Shares
September 3, 2014
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The wall separating Western fund managers from Chinese stocks is starting to come down, confronting investors with new risks and rewards.

Starting in October, overseas money managers will be able to buy Chinese companies listed in Shanghai via Hong Kong's stock exchange. Investors have poured money into funds that track these so-called A-shares in anticipation of the rule change, while some brokerage firms that operate in the region say they are hiring new staff to handle added trading. The Shanghai Composite Index, which tracks A-shares, is up 12% since early June.

China's decision to open its stock market to outsiders goes hand in hand with recent initiatives to liberalize the currency, the yuan, which is also known as the renminbi, and to boost the nation's influence on the global financial stage. The move will allow mainland Chinese firms to raise money from a wider pool of investors.

A new surge of cash could breathe new life into a market that has lost more than 60% of its value since 2007, even as the S&P 500, Dow Jones Industrial Average and other global stock indexes have hit record highs.

At the same time, the shift comes at a time of uncertainty over the Chinese economy, whose growth has slowed in recent years amid a sharp rise in debt. The decision highlights investors' concerns about the nation's disclosure and corporate-governance standards, which are broadly viewed as falling below Western levels.

"It's sort of an unknown market because there's no access, and you don't quite know what you're buying," said Simon Male, director of Asian equity sales at brokerage Auerbach Grayson & Co. "This is not going to be an overnight change. It's going to be a gradual evolution of the market."

Under current rules, the only way to invest in China is by buying a limited pool of Chinese stocks listed in Hong Kong, or applying for a special license to make purchases on the mainland, a laborious process that takes months to complete. Buying is capped by a quota.

François Perrin, head of greater China equities at BNP Paribas Investment Partners in Hong Kong, is using such a license to buy up companies in China that he expects to benefit from international investors flooding in.

"It's going to be a game changer in term of international investors getting access to mainland China," Mr. Perrin said. "Having investors willing to put money back to work in China, you need a strong catalyst, and this is potentially the catalyst that China has been waiting for."

China is granting new licenses at a record pace this year, expanding the outstanding quota by 100.1 billion yuan ($16.3 billion). But the new way of trading via Hong Kong will allow a further $48.8 billion of foreign investment.

Many big mainland companies have dual listings in Shanghai and Hong Kong, with shares trading at an average 7.4% discount in Shanghai. Some investors are betting that gap will close as the two markets connect. Yuan-denominated shares in the mainland are known as A-shares, while their Hong Kong counterparts are called H-shares.

"It is a big step forward," said Miguel Canizares, a vice president of equity operations at Fidelity Investments. Mr. Canizares says Fidelity is in discussions with brokers in Hong Kong to potentially add China A-shares directly to its mutual funds for the first time. He said he is still waiting for clear information about what regulations and taxes will apply to foreigners once the rules change in October.

Deutsche Wealth & Asset Management started the first China A-shares exchange-traded fund in November, and at least four more have been launched since, according toMorningstar Inc. MORN -0.82% These ETFs allow individual investors in the U.S. to invest directly in domestic Chinese stocks for the first time. Deutsche's ETF received record net inflows in August of $85.3 million.

Only 1.5% of China's mainland stock market is owned by foreigners, according to Deutsche Bank, compared with 30% in developing economies such as Brazil and South Korea.

Worries about opening up China's stock market are especially centered on the mainland's outdated trading technology, the opaque finances of some of China's companies and a history of scandals, where brokers sometimes trade ahead of big client orders in order to benefit from changes in prices.

Developing countries are often cautious about liberalizing their financial markets too quickly because doing so can lead to sudden inflows of cash and volatile price fluctuations.

China is also strengthening financial ties with Hong Kong at a time when both sides are fighting for political control. On Monday, China's government said candidates for Hong Kong's top leadership post must now be approved by a pro-Beijing committee, sparking protests by democracy advocates across the territory. Analysts say control by China could dim Hong Kong's appeal as a global financial center.

Still, Chinese brokerages such as Everbright Securities 601788.SH +1.09% are planning to add staff to start covering Hong Kong stocks.

Matthews Asia, a mutual-fund manager in San Francisco with $27.3 billion in assets, received in July its license to invest in $100 million worth of A-shares, after a four-month application process. The asset manager wanted to get access to A-shares so that it could invest in some of the more than 2,500 companies listed in mainland China.

"It's a big market, and there's lots of potential targets that you can buy," said Robert Horrocks, chief investment officer of Matthews Asia. "If you have confidence that the Chinese economy is growing…then it's a good place for a long-term investor."