Fund Manager Perspective

1 June 2015

In a significant turn of events, the stock market strongly pulled back on May 28th after a long, nonstop rally. The Shanghai composite index fell by 6.5%, the second biggest decline this year, while the SME Board and ChiNext Board shed 6.3% and 5.4% respectively. The trading volume of the Shanghai and Shenzhen markets reached a total of RMB 2.36 trillion, a new record high.

The prevailing opinion towards this market pullback is that it was caused by the unloading of stocks by Central Huijin Investment and the increased scrutiny of inflowing funds by regulators. At the same time, the April economic figures reveal that Jan-April nominal fixed asset investment increased by 12%, 1.5% lower than the Jan-March data; exports fell by 6.2% and imports fell by 16.1% YoY. All kinds of data indicate that the real economy is now in accelerating decline.

After more than one year of rapid rallying and record-breaking capital inflows, characteristics of a market bubble are quite obvious. This rally is now entering its latter half. Main reasons are as follow:

1. Certain boards and stocks have racked up dramatically in a short time. Since hitting bottom in March 2014, the composite index has risen nearly 150% while the ChiNext Board has risen more than 500%. Stock picking will be a huge challenge in the next round.

2. The most notable feature during this rally is the increased amount of leveraged capital and the continually record-breaking high trading volumes. However, regulators are currently rigorously investigating inflow of illegal funds in the market and the marginal effect of capital is declining.

3. From a bottom-up perspective, most stocks have risen quite a bit. Despite our judgement that a few industries and stocks still have relatively large long-run growth potential, it is likely the market is running on steam.

Looking at June, we think that despite the slightly concerning market bubble, there are still market segments and individual stocks, such as e-commerce and healthcare services, that have room for long-term growth. Therefore, meticulous stock picking is imperative in the next stage.

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