China A-Shares – international capital's route to sharing the country's domestic growth potential

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The investment case for China has long been on the minds of the international investment community.

Through myriad reports and articles surrounding the nation's latent potential (or burgeoning, depending on your view), China has often been cited as the 'next big thing' in investment markets. And while many investors have taken notice and aptly upped their exposures, most likely via an Asia-Pacific fund or similar, few have been allowed to feel the nation's true investment capability.

In some ways, the situation international investors have historically faced when investing in China has mirrored that of the nation's cuisine, or rather, the international interpretation of it. Chinese restaurants are a popular component of the global diet, however, while many of the tones and flavours may be indicative of true Chinese fare, the international version has been irrevocably skewed toward the Western palette, meaning those that have sampled may have enjoyed a different experience to having eaten within mainland China.

This sentiment carries true to the Chinese investment story, where much of the exposures available have been broad brush or simplified to accommodate the restrictions of an international investment portfolio, while the nation's more attractive domestic stories have laid tantalisingly out of reach.

This is beginning to change.

China A Shares have been in circulation since 2002, albeit in limited supply due to the nation's more protectionist approach to foreign investment. China A Shares afford investors direct access to the Chinese economy, with equity in Chinese companies via the Shanghai and Shenzhen stock exchanges, and are denominated in the local currency, the Renminbi.

There are several benefits of this approach. Rather than the sweeping exposures of other vehicles, China A Shares allow investors to directly access the country's two premier stock exchanges, crucially in their domestic currency, thereby cutting much of the noise from international markets and allowing investors to analyse companies based on their true fundamentals. Additionally, China A Shares have shown a significant decorrelation to broader investment markets, providing additional diversification to a balanced investment portfolio. This may be of particular interest to investors following the events of 2022 in which stock and bond markets alike endured an indiscriminate sell-off and, as a result, tumbled in lockstep for much of the year.

So, why is this important?

Following a prolonged period of city-wide lockdowns due to the Covid-19 pandemic, the Chinese economy finds itself in a unique position, having re-opened at a significantly slower rate than much of the global economy. While the US, UK and Europe have each felt the wrath of pent-up inflation following the pandemic (which was exacerbated by Russia's invasion of Ukraine in February of last year) in the interim, China's then-closed borders left it relatively well insulated from the fallout. Central banks across the developed economies have spent much of the last year tightening their respective monetary policies, while China now finds itself at an entirely different point in its economic cycle.

In fact, in stark contrast to many other economies, China is now entering a phase of looser monetary policy, underpinned by a revised economic strategy from its government, targeting domestic growth and a softer stance toward international investment.

The Communist Party of China outlined its objectives at its Central Economic Work Conference in December 2022, where the key pillars centred around expanding domestic demand, accelerating construction and modernising of manufacturing, equal treatment for private and state-owned businesses, attracting foreign capital and improved management of economic and financial risks.

Having released the valve in what was an overtly defensive approach to managing the Covid-19 infection rate, the Chinese government has enacted a pro-growth strategy aimed, in part, at harnessing the pent-up demand for goods and services, both domestically and internationally. In addition, there is a desire to support domestic innovation and entrepreneurialism while the economic picture remains in a more supportive position than elsewhere in the world.

At a time of slowing global economic growth, by using China A Shares, international investors now have an opportunity to directly access this unique domestic growth story and find exposure to the companies poised to benefit from the unleashed potential of the Chinese consumer.

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