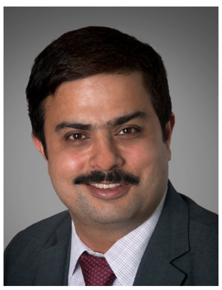
MSCI A-share inclusion – Third time's (*still not*) the charm

15 June 2016



MSCI announced that it will delay including China's A-shares into its Emerging Markets index, the 3rd rejection since 2011. Expectations were very mixed coming into the decision with a 50:50 probability of pass / fail according to strategists. Despite efforts by Chinese regulators to improve its standing in recent months, MSCI expressed concerns over quota allocation, trading suspension and the 20% monthly repatriation limit. It will reevaluate A-share inclusion as part of its 2017 Market Classification Review in June next year, and is open to a potential off-cycle announcement should further significant positive developments materialize before then.

Impact of the delay – limited

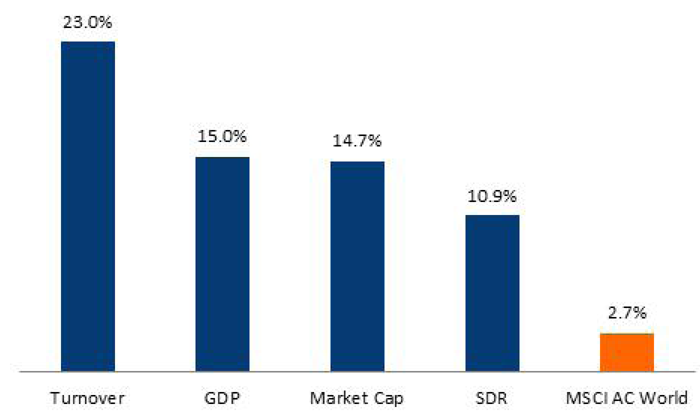
While the delay is negative on near-term sentiment, there is little fundamental impact. At the proposed 5% inclusion factor, A-share inclusion would have equated to inflow of roughly US$22bn from global investors – merely less than 1% of A-share market's US$2.8tn free float[1]. In addition, full inclusion will likely take years to materialize. Taking Korea and Taiwan as references, which are much smaller markets compared to A-shares, full MSCI inclusion took roughly 7 years and 9 years respectively[1]. Having said that, we expect near-term sentiment to be negatively affected by the event given relatively higher expectation from domestic investors.

The Shanghai Composite index opened lower by 1.5% on Wednesday but subsequently rallied, ending the morning session up 1.5%[2].

Long-term roadmap remains

We believe the long-term roadmap for A-shares inclusion remains unchanged. China's weight in global indices is significantly low relative to metrics such as market cap, GDP, SDR weight and market turnover. Given China A-shares make up about three-quarters of China's total market cap[3], with further market reforms, we believe A-shares inclusion is inevitable.

China's weight from global perspective



Source: Bloomberg, Factset, Haver, WFE and Citi Research; Note: Mkt Cap and MSCI AC World data as of Jun 13, 2016; Turnover data Jan-Apr, 2016; GDP data as of 2015,SDRs data will take effect on Oct 1st, 2016.

Maintain a bottom-up approach

The China exposure in our flagship Asia regional equity strategies is nearly entirely coming from Hong Kong-listed H-shares and US-listed ADRs. While we have significant A-shares research capabilities in the research team, we remain hesitant to have significant exposure in the on-shore market given concerns towards market dynamics and valuations. The Mirae Asset Asia Sector Leader Equity Fund and the Mirae Asset Asia Great Consumer Equity Fund have 0% and 2.5% exposure in A-shares as of the end of May 2016.

As China goes through a prolonged "L"-shaped recovery, our investment strategy remains focused on bottom-up opportunities in the new economy that benefit from the rise of the Chinese consumers. These areas include internet / e-commerce, tourism, insurance and healthcare.

Source:
[1] Bank of America Merrill Lynch [2] Bloomberg [3] Citibank

Global Offices

Mirae Asset Global Investments

East Tower 26F, Mirae Asset CENTER1 Bldg,
67, Suha-dong, Jung-gu,
Seoul, Korea (100-210)
Tel.+82-2-3774-8200

Mirae Asset Global Investments (HK)

Level 15, Three Pacific Place, 1 Queen's
Road East, Hong Kong, HK
Tel.+852-2295-1500

Mirae Asset Global Investments (UK)

4-6 Royal Exchange Buildings,
London, EC3V 3NL, United Kingdom
Tel. +44-20-7715-9900

Mirae Asset Global Investments (USA)

1350 Avenue of the Americas,
33rd Floor, New York, NY, 10019, USA
Tel. +1-212-205-8300

Mirae Asset Global Investments (Taiwan)

6F, NO. 42, Sec.2 Zhongshan N. Rd.,
Taipei City 10445, Taiwan (R.O.C)
Tel. +886-2-7725-7555

Mirae Asset Global Investments (India)

Unit No. 606, 6th Floor, Windsor Building
Off. C.S.T Road, Vidyanagari Marg.
Kalina, Sanatacruz (East), Mumbai
400 098, India
Tel. +91-22-6780-0300

Mirae Asset Global Investments (Brazil)

Rua Olimpíadas, 194/200,
12 Andar, CJ 121, Vila Olímpia
São Paulo, CEP 04551-000, Brazil
Tel: +55-11-2608-8500

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