

Biggest risks and potential upsides

China and the Chinese stock market

Chris Rynning
Staur Asset Management AS

“We are pro’s, not refugees”

PERCEPTION



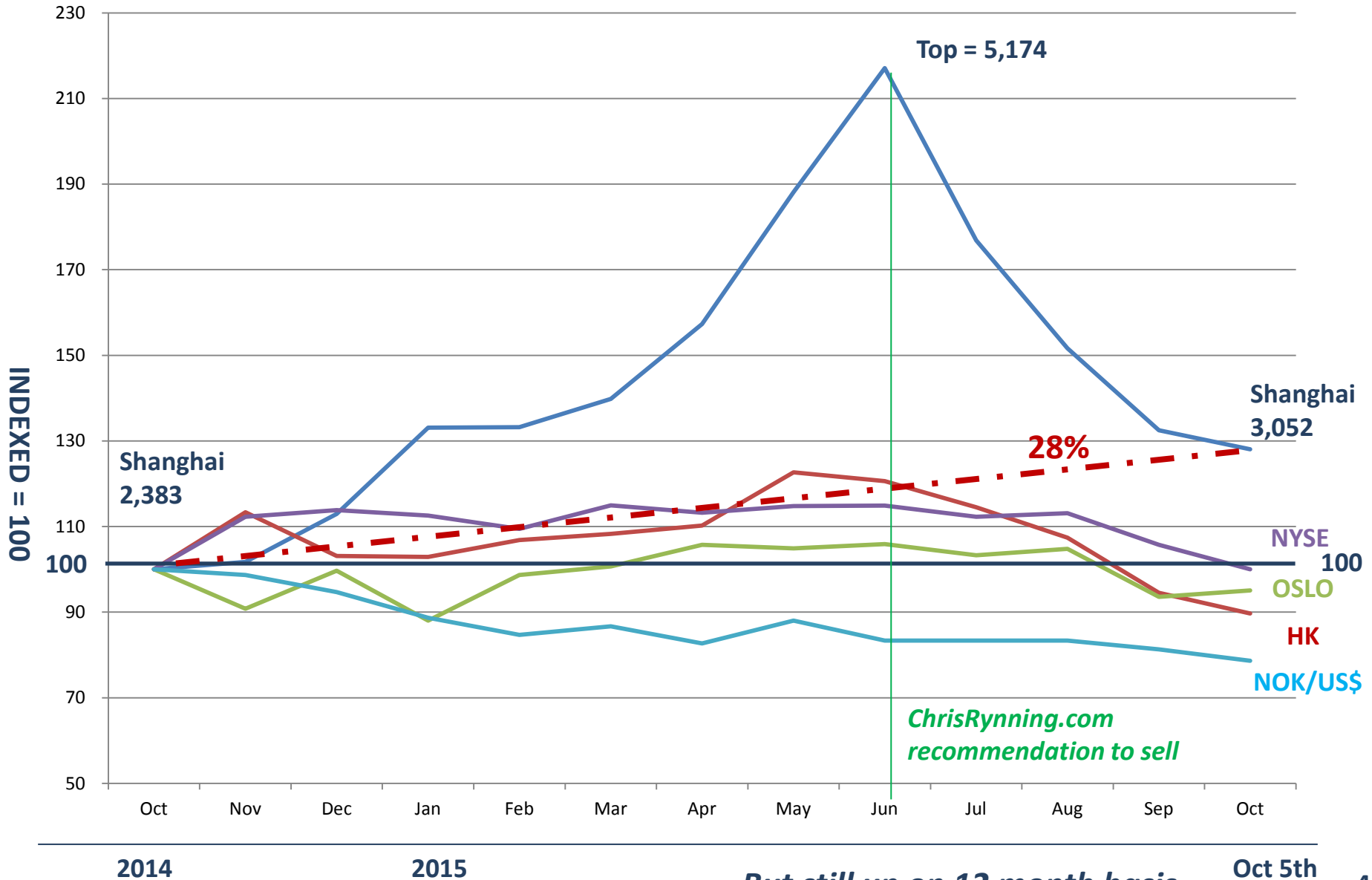
REALITY



“Give a Job” event in Oslo, December 2015
European Series

*“Det første vi brukte å sjekke om morgenen var forventet åpning i USA, vi bør nå først sjekke **“closing”** i Shanghai”*

Shanghai bubble and burst

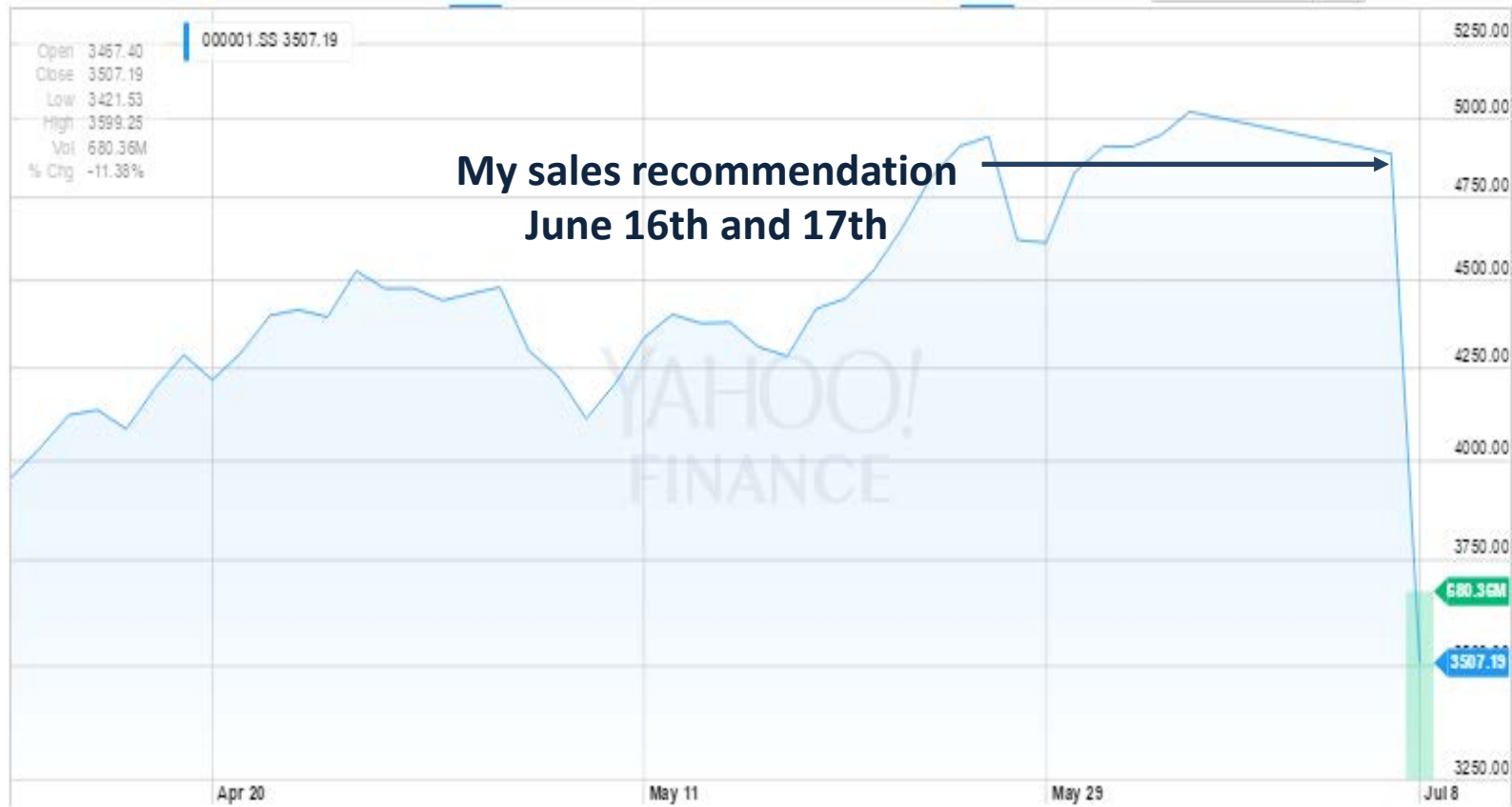


But still up on 12 month basis

Oct 5th

“Sell in June, Come back in October”

Why come to my quarterly outlook sessions



Official links to my recommendations to sell on CR.com:

1. <http://chrisrynning.com/sell-in-june-and-come-back-in-october-for-another-look/>
2. <http://chrisrynning.com/chinese-aquaculture-stocks-and-oil-thoughts-and-a-brave-9-year-old/>

Nordmannen Chris Rynning har ledet oppkjøpsfondet Origo i Beijing de senere årene, og investerer selv i aksjemarkedet. Han tror aksjemarkedet kan falle 30 prosent til. Foto: Per Ståle Bugjerde

Finans Børs

Tror Kina-aksjer faller 30 prosent til

Kinesere har lånt penger for å kjøpe aksjer i stort omfang, og fortsatt er gjeldsgraden høy. Forvalter Chris Rynning i Beijing tror aksje-markedet vil falle 30 prosent til.

Jacob Trumpy og Jakob Schultz
Publisert: 08.07.2015 – 21:50

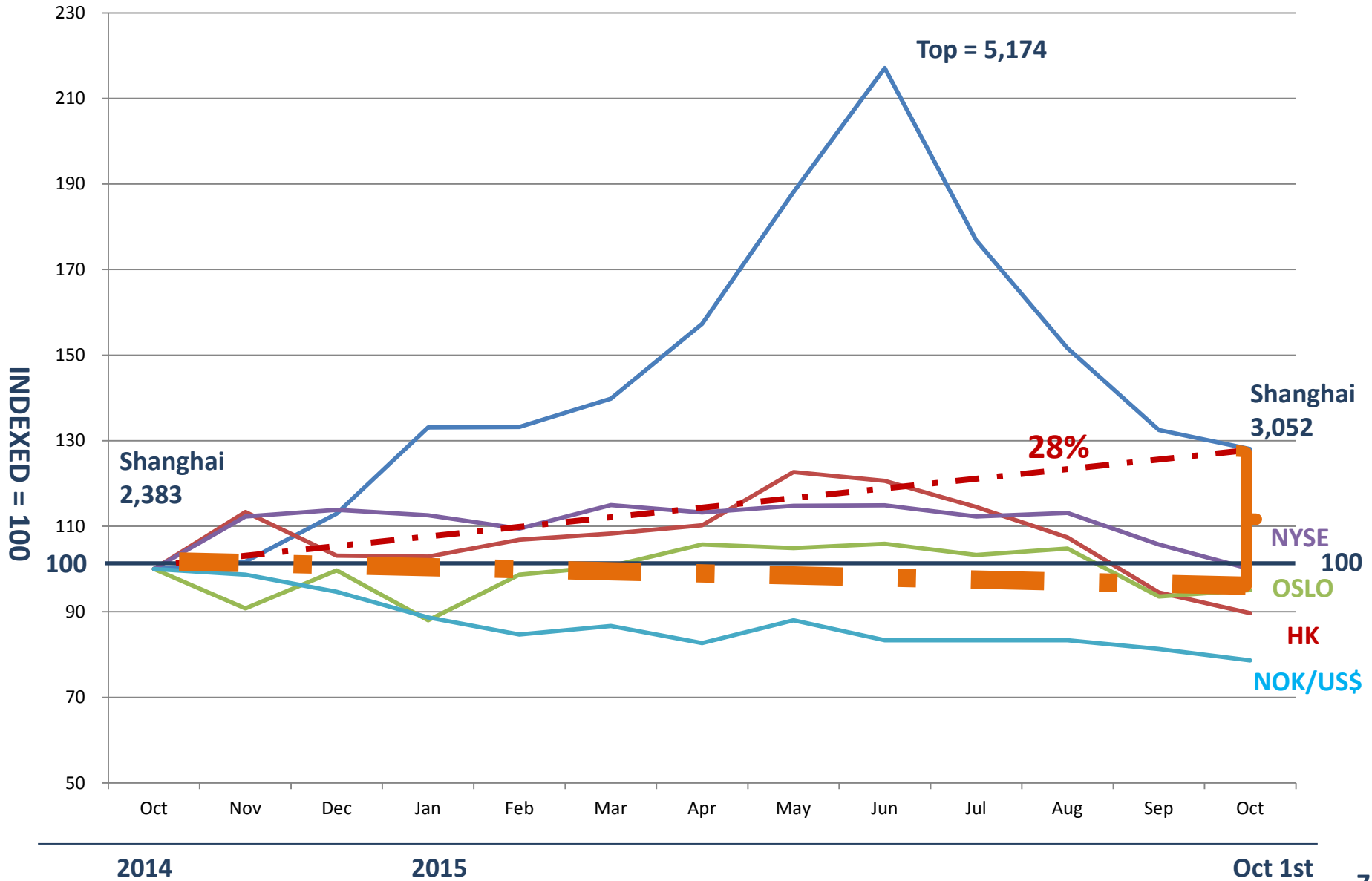


3,975
(8.July)

3,052
(1.Oct)

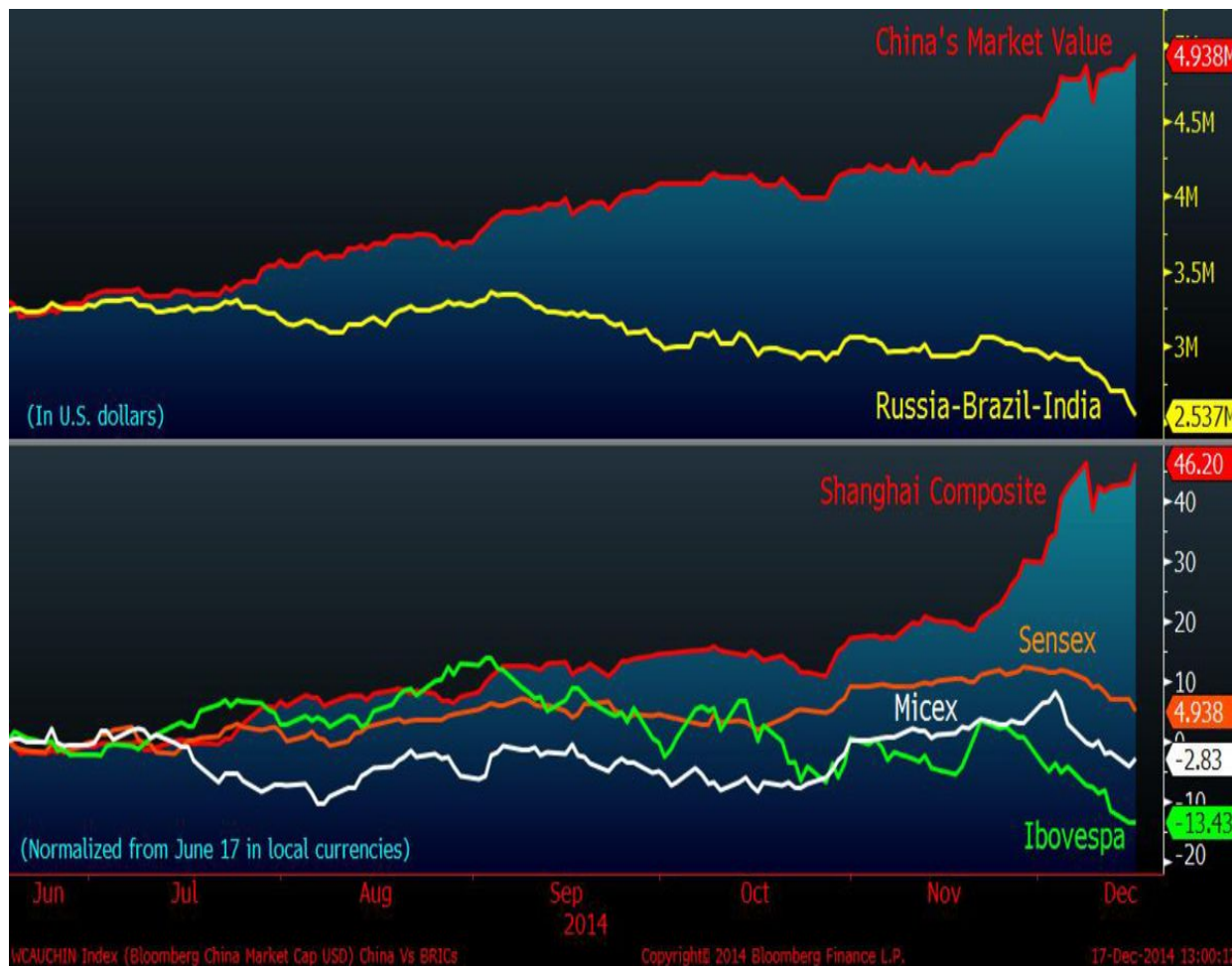
What now: Further downside of -30%

Into Q3 and 1H 2016



Remember BRICS?

China's stock market has outperformed BRICS....



**China market: US\$6.8bn
October 1, 2016**

BRIC: US\$ 2.4bn

In fact, it is nearly 3x India, Brazil and Russia combined

China dominates global GDP growth

World GDP

Contribution to growth from:
Percentage points

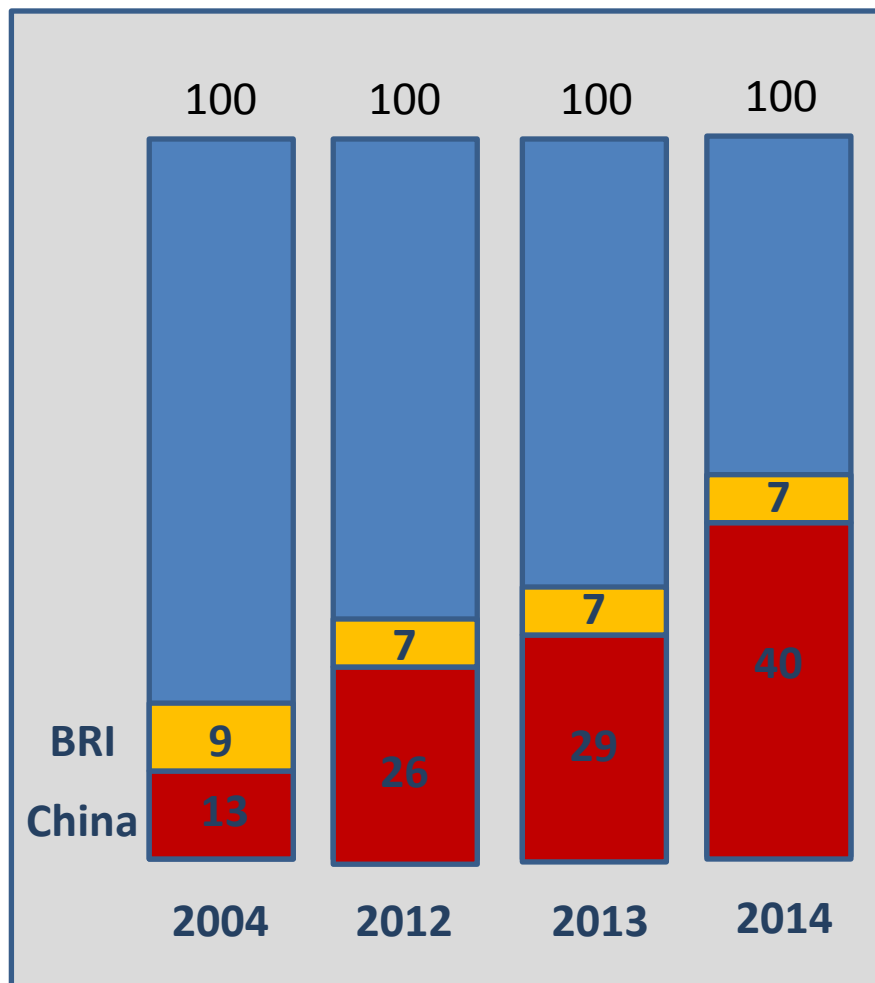


Sources: Haver Analytics;
IMF; *The Economist*

*Estimates based on 54 countries representing
90% of world GDP at purchasing-power parity

BRIC - Contribution to global growth

China dominates global GDP growth



Nominal Global GDP, 2014

1.	USA	17,419,000
2.	China	10,360,105
3.	Japan	4,601,461
4.	Germany	3,852,556
5.	UK	2,941,886
6.	France	2,829,19
7.	Brazil	2,346,11
8.	Italy	2,144,33
9.	India	2,066,902
10.	Russia	1,860,598
Total		US\$ 77.8 tr

GDP/Capita (E)

- Norway US\$100K
- **China US\$ 8K**

For now, we can forget BRIC, lets talk about China...

Chinese Financial System **must** grow

	<u>China</u>	<u>USA</u>
• Total Financing		
– GDP	US\$10tr	US\$18
– Total Financing multiple of GDP	2.7x	12x
– Total Financing	US\$27tr	US\$200tr
– Banking Sector size of TF	50%	10%

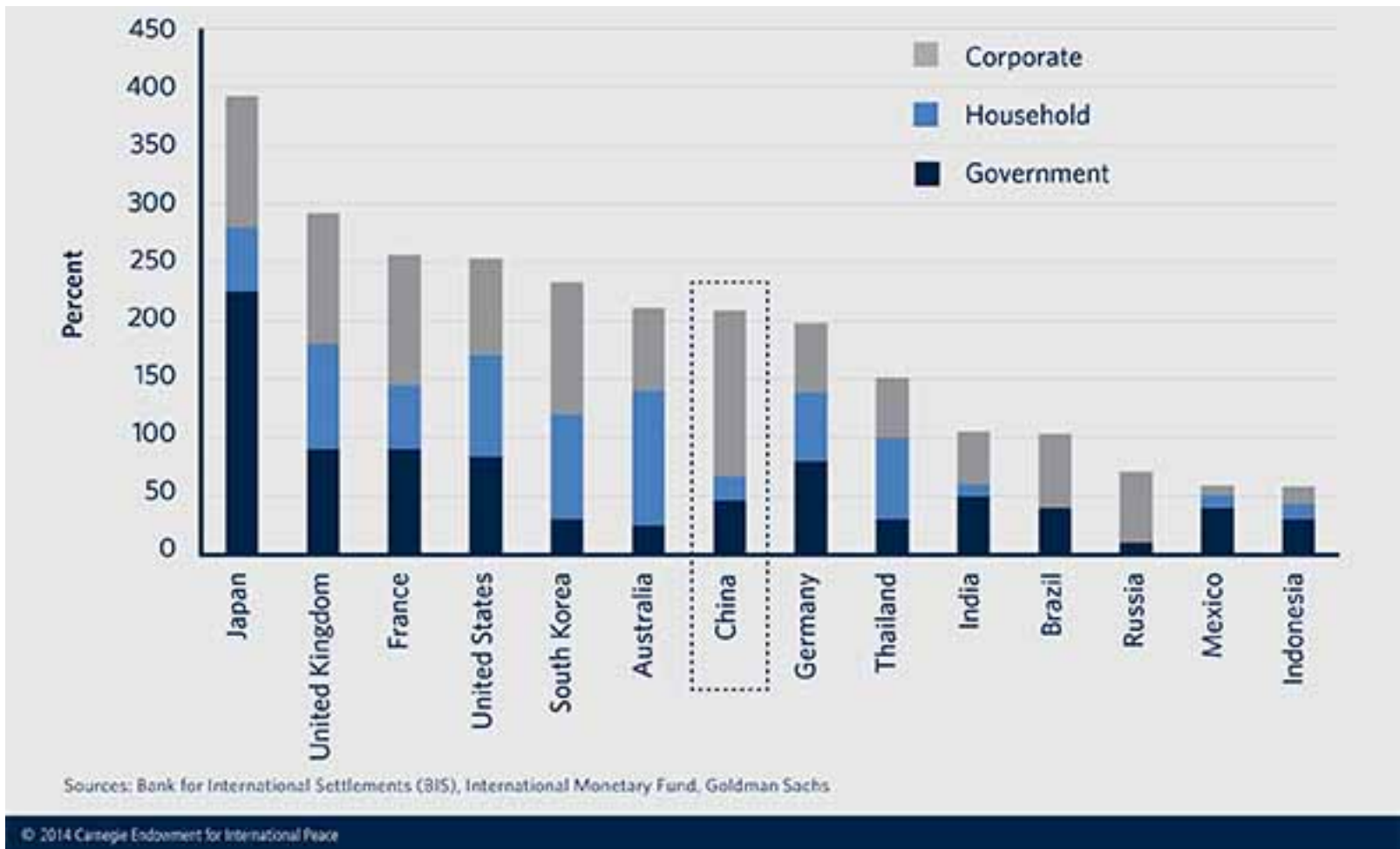
*Evidence suggest the Chinese Financial system must **GROW** dramatically*

	<u>GDP</u>	<u>US\$</u>
• Credit market breakdown		
– <i>Corporate debt, SOE</i>	<i>30%</i>	<i>11.5tr</i>
– <i>Local Governments</i>	<i>50%</i>	<i>4.5tr</i>
– <i>National Government</i>	<i>30%</i>	<i>3.0tr</i>
– <i>Housing, Mortgage</i>	<i>40%</i>	<i>4.0tr</i>
<u>Total size</u>	<u><i>250%</i></u>	<u><i>23.0tr</i></u>

Source: Fitch/S&P

Global Debt to GDP Rankings

Japan is an outlier, China is mainly SOE debt



But back to the stock market...



Two main markets
A, B, H shares

Global stock market overview

Exchange	Market Cap in US\$ (October 1, 2015)	% of Total
NYSE	18.0	29.5%
NASDAQ	7.0	11.5%
Americas	28.0	45.9%
Shanghai	4.1	7.0%
Shenzhen	2.7	4.4%
India	1.4	2.6%
Japan	4.7	7.7%
Asia	21	34.4%
London	3.9	6.3%
Frankfurt	1.6	2.6%
Norway	0.2	0.3%
Europe/Africa/ME	12.0	19.6%
Total market cap	61.0	100%

China accounts for about 11.5% of world market cap

Shanghai market top 10 list

Company	Market Cap US\$ bn	“Similar”	Market Cap US\$ bn
Petro China	275	Apple	640
ICBC	202	Citigroup	140
Ag Bank	158	DNB	21
Bank of China	128	Alibaba	145
China Life	111	Prudential	52
Sinopec	93	Statoil	46
Ping An	56	Storebrand	1.5
China Merchant	54	Danske Bank	25
Shenhua	53	Rio Tinto	45
<u>CITIC</u>	<u>52</u>	<u>Berkshire</u>	<u>157</u>
Total	1182		

All state owned.....top 10 accounts for nearly 1/3 of Shanghai market

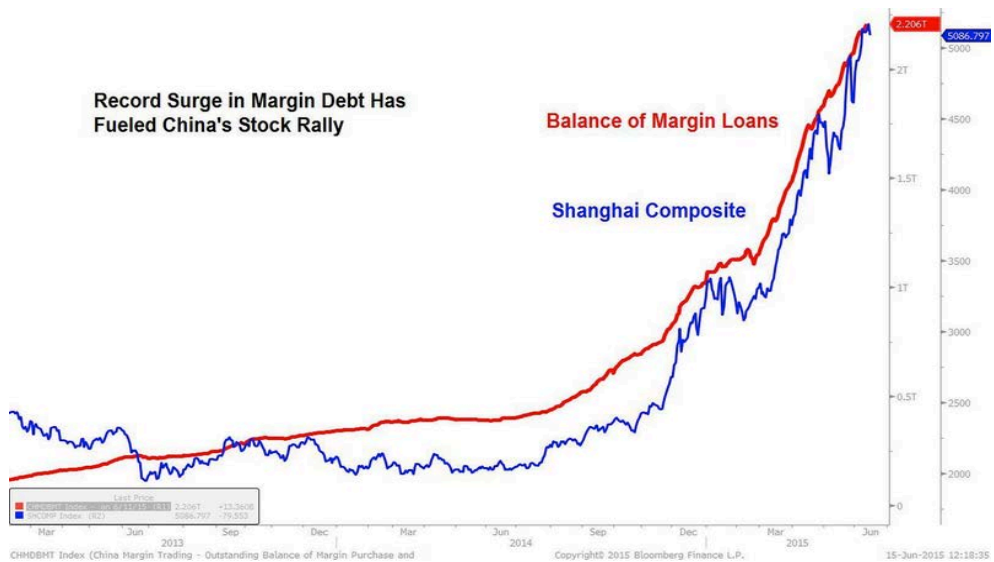
Bobler har sprukket før....



2005-2007: 6x

2008: Kollapset til 2x

- Boom var mer vekst relatert, spesielt da Kina...
- Krise var balanse relatert

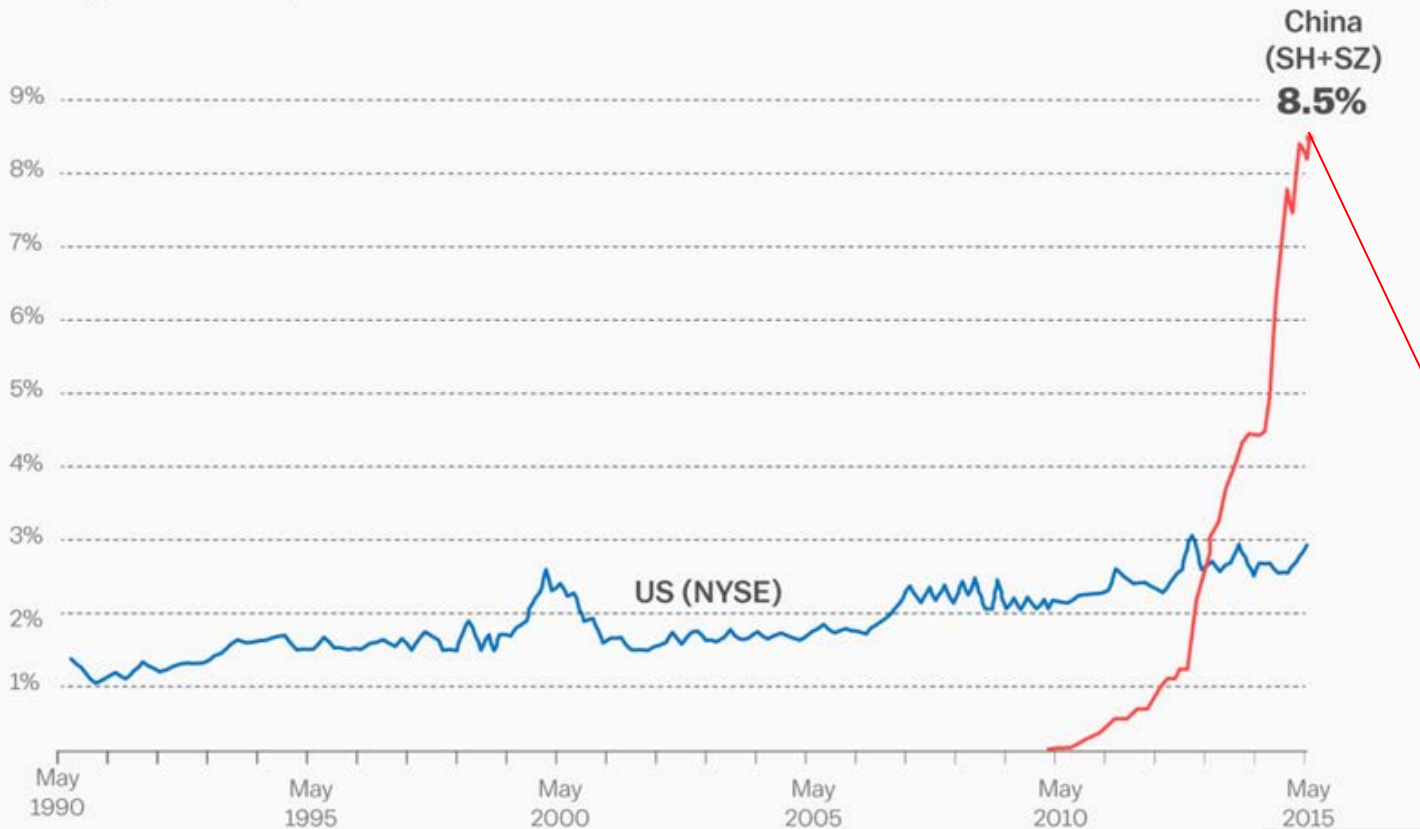


2015 var annerledes...

- Ikke vekst relatert
- Mer margin lånefinansiert

Margin lån en stor relativ andel

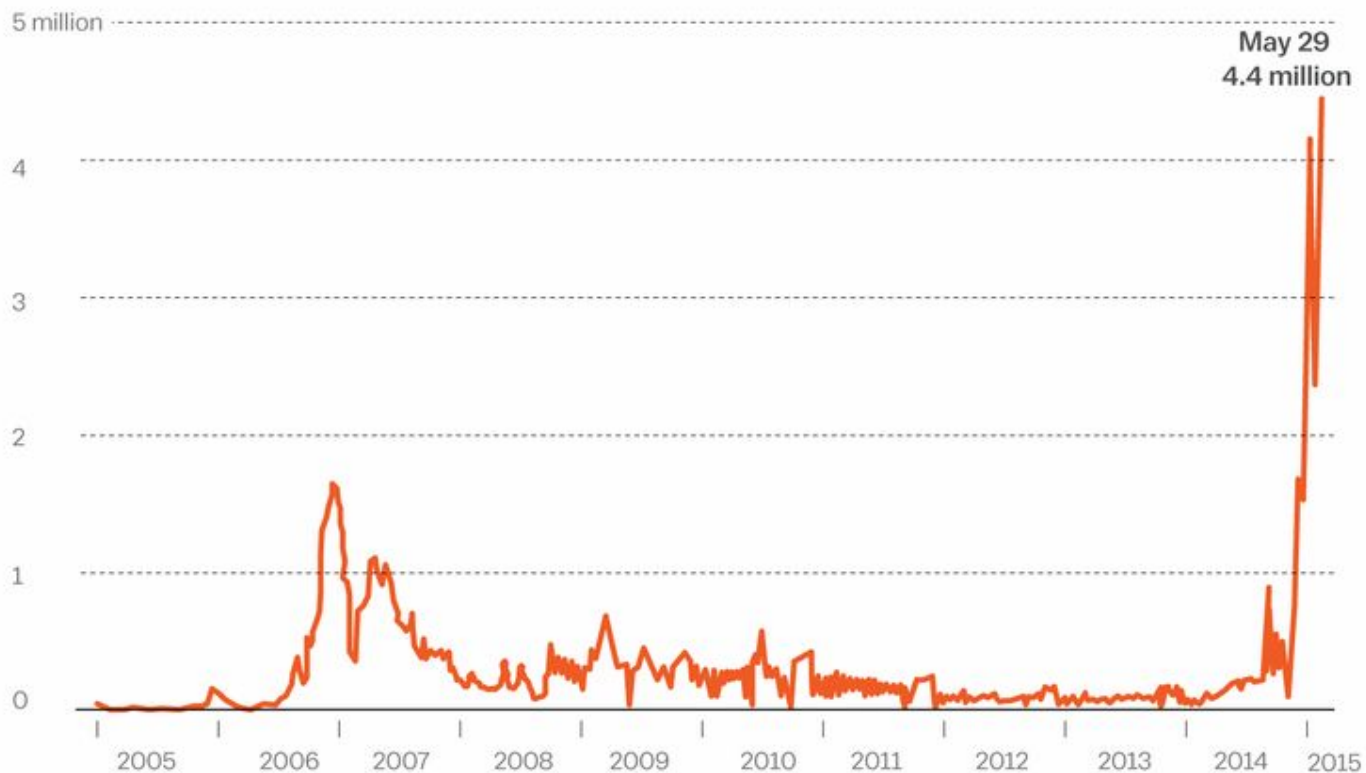
Margin debt as percent of estimated free float



China
Margin Debt:
US\$350-500bn

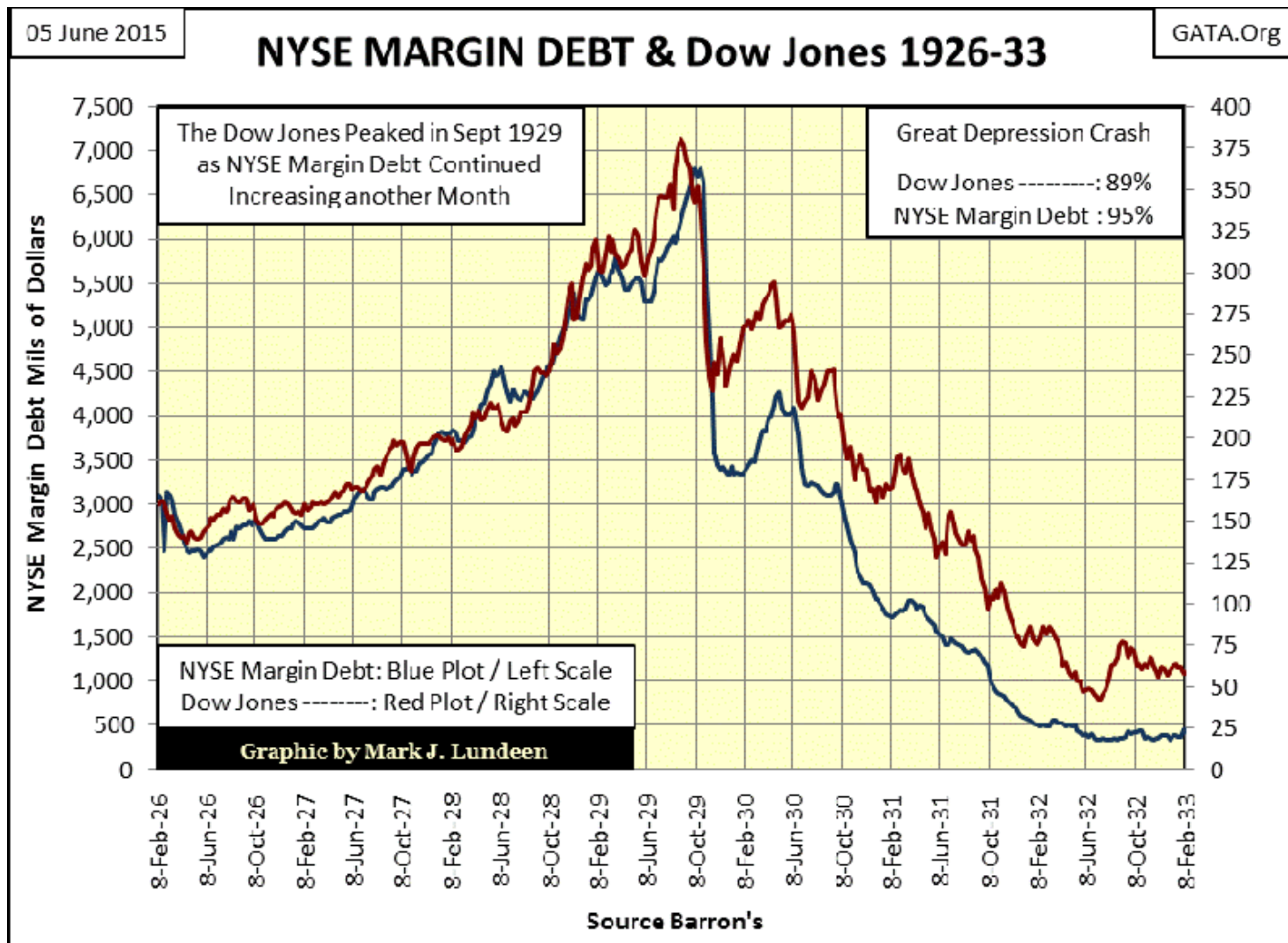
SOURCES: Wind, Bloomberg, Macquarie Research

China stock market: new A-share accounts per week

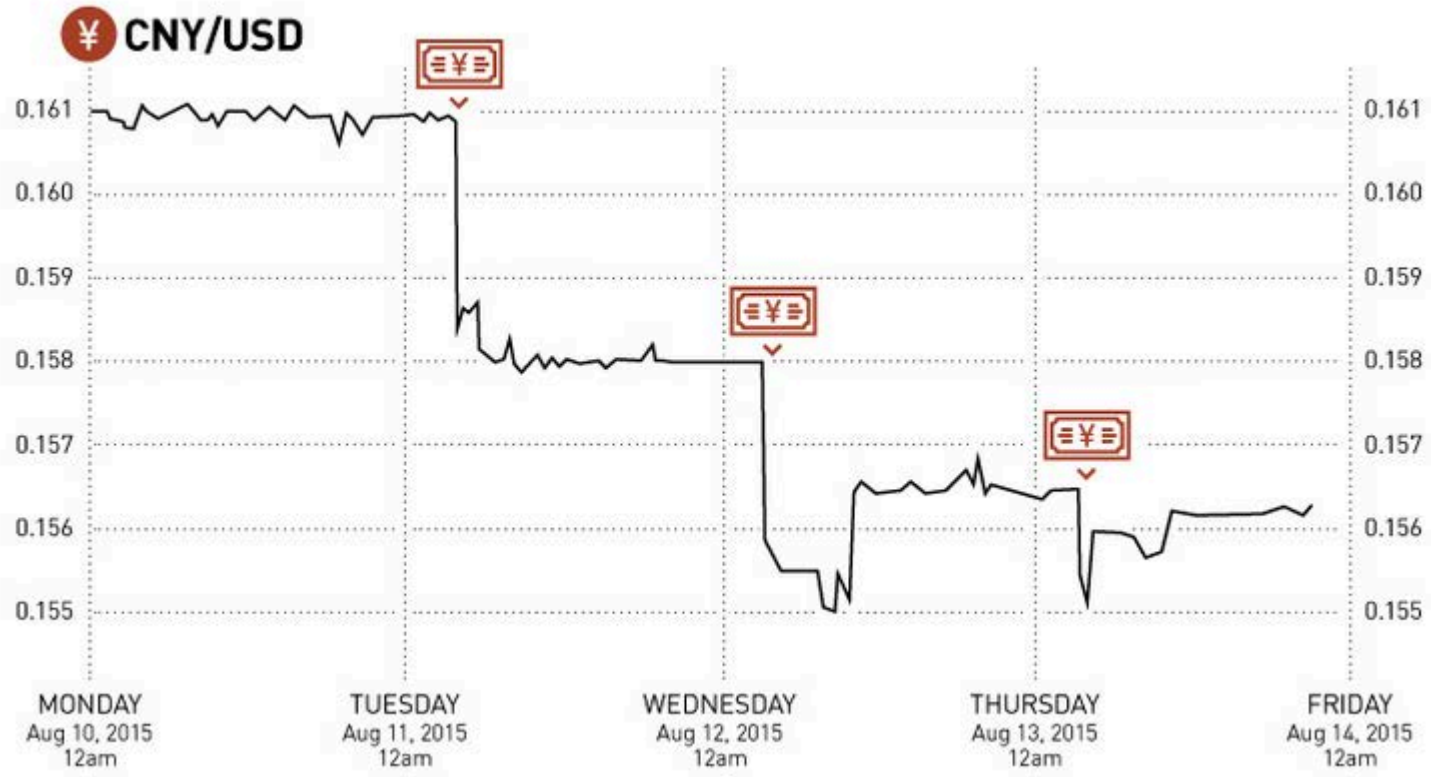


SOURCE: KKR.com

Dette har vi også sett før...



Renminbi har falt, og falt

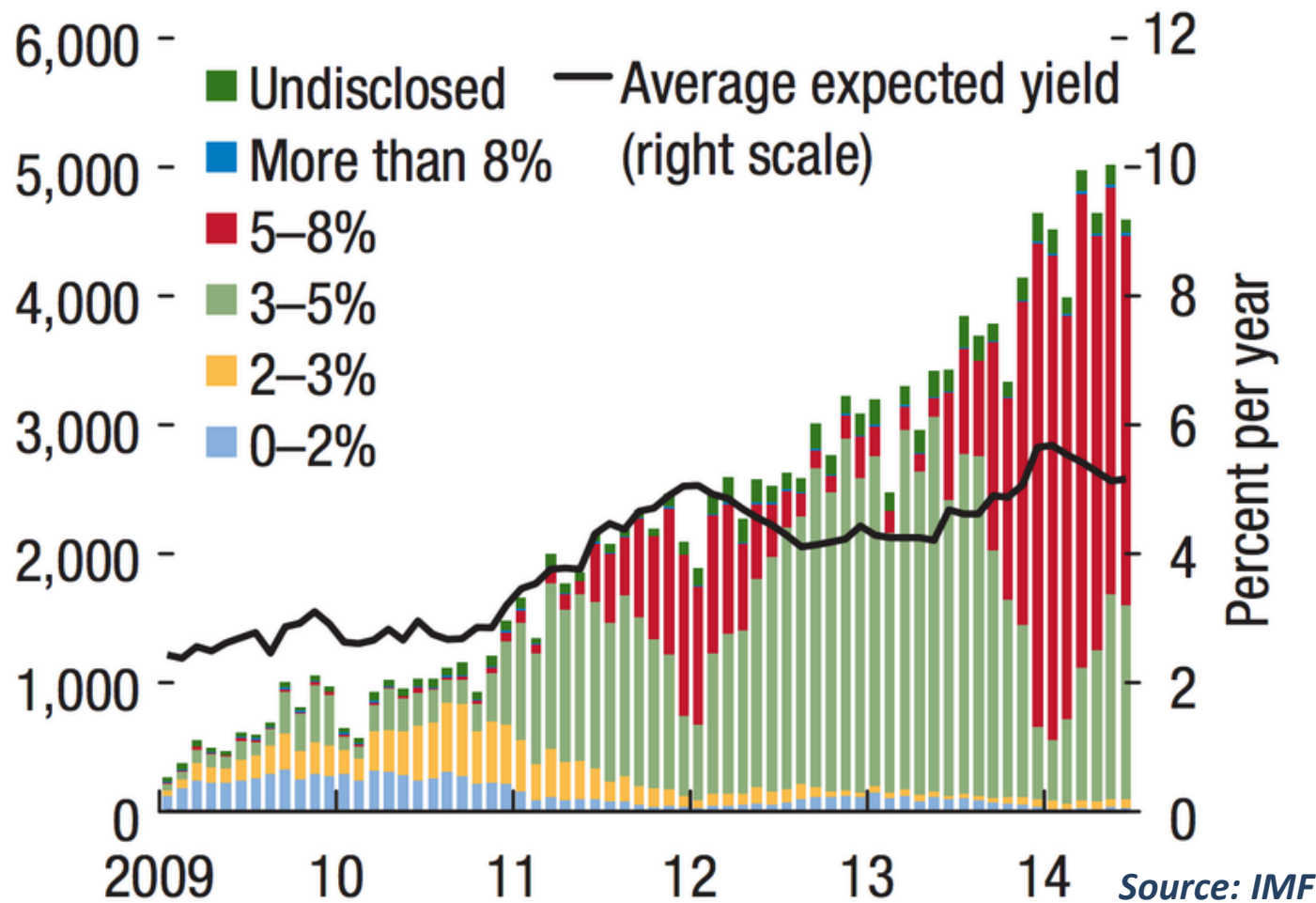


Largely explained by interest reduction

Wealth Management Products

Vokser (for) raskt

Gross Monthly WMP Issuance by Expected Return³

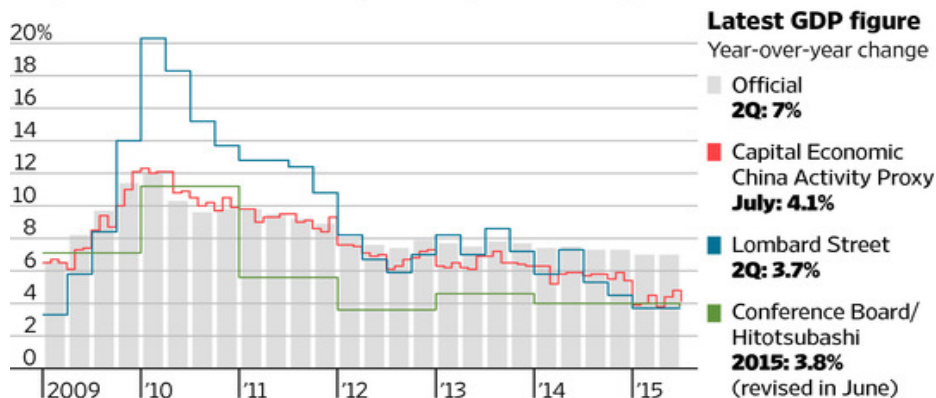


Og er blitt betydelig mer risikabelt

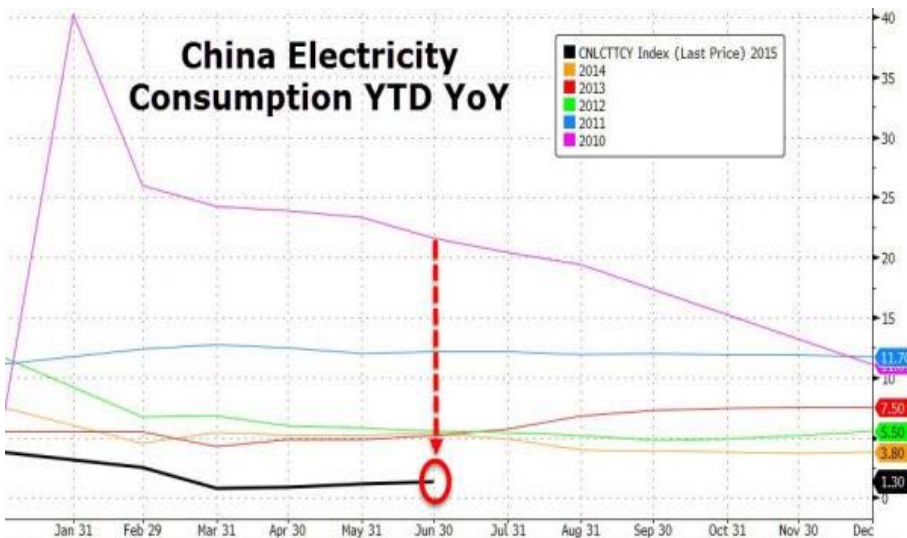
Vekst er på vei ned, men.....

China's Growth Mystery

Irregularities have economists pondering China's real growth rate



Sources: Capital Economics, Lombard Street Research, Hitotsubashi University/Conference Board China Center
THE WALL STREET JOURNAL.



Elektrisitetsvekst, 2015 YTD: 3%

- FAI Infrastruktur, 1H 18.6%
- Sentral Budsjett, 1H 46%
- Social Security, 1H 21.4%
- Helsekostnader, 1H 19.2%
- Energy conservation, 1H 19.3%
- Handelsoverskudd US\$ 400bn
- Fiscal surplus, 1H US\$ 60bn
- Non Tax revenue, 1H 25.6%
- VAT, Business Tax, 3M 10.1%
- Bank RRR: 18%
- 1 års utlånsrente: 4.6%
- Innskuddsrente: 1.75%

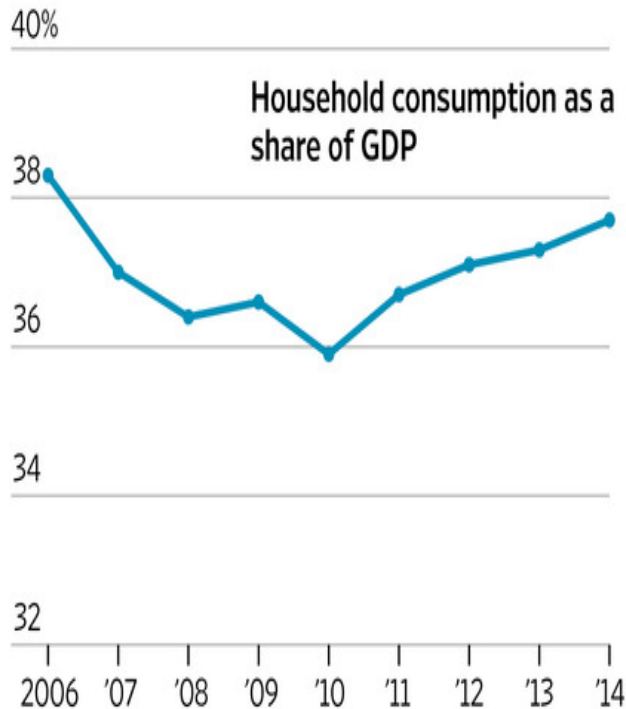
Realøkonomien ser relativt robust ut...

Kinesisk middelklasse

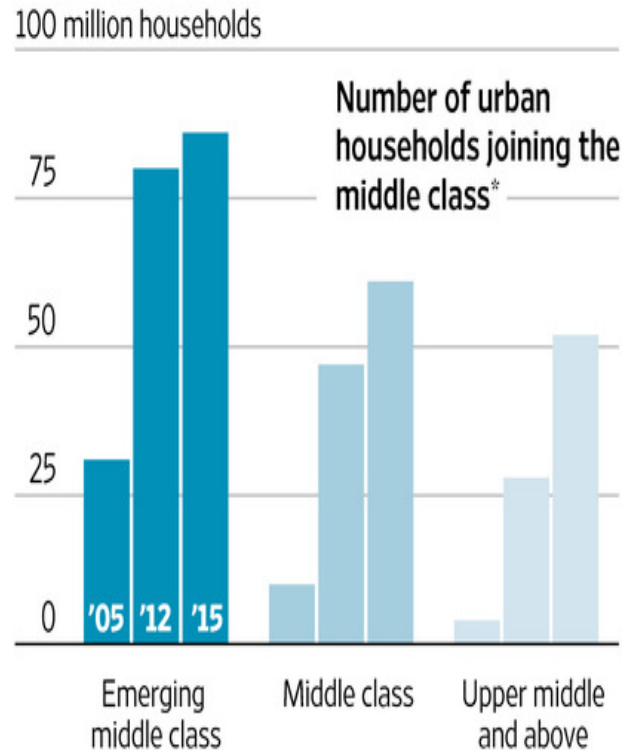
I sterk fremvekst

Spending Power

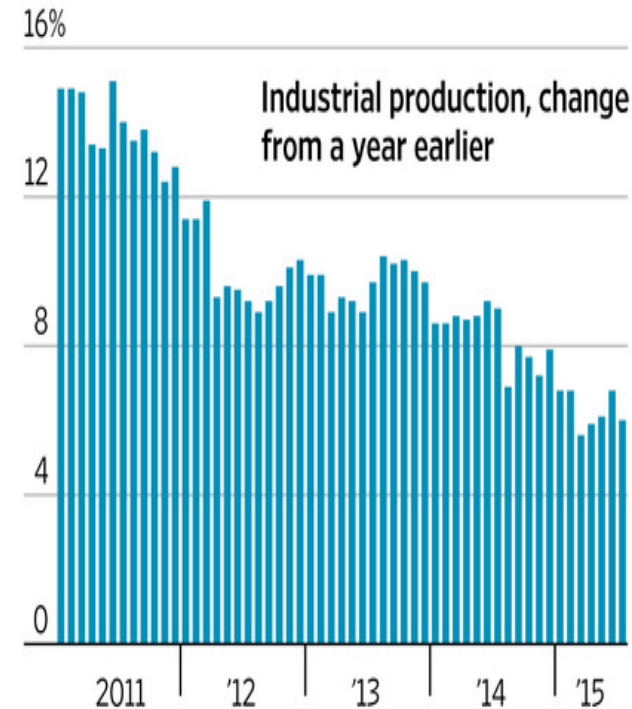
China's consumers are slowly becoming a greater economic force...



...as more join the middle- and upper-middle class...



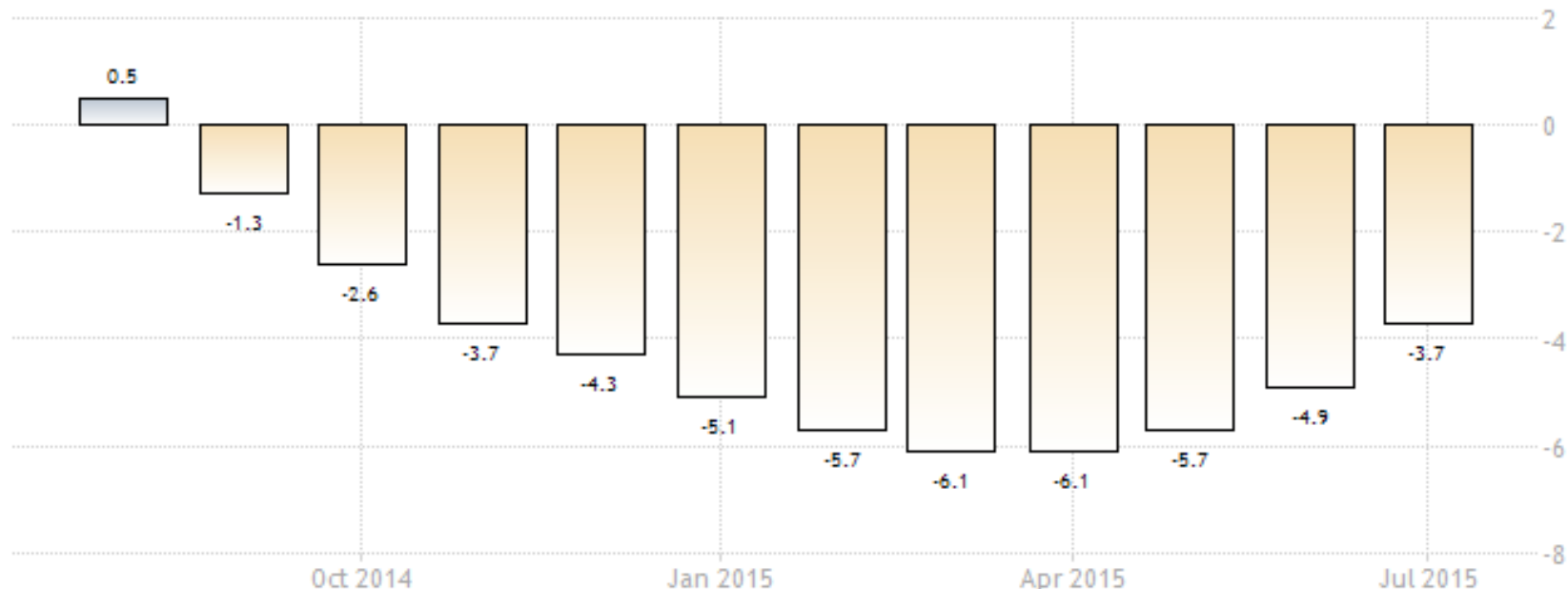
...bolstering the retail sector while China's industrial sector slows.



*Monthly household income for emerging middle class is 5,000 yuan, middle class is 8,000 yuan and upper middle class is 12,000 yuan. \$1 = 0.1559 Chinese yuan

Sources: CEIC (consumption, industrial production); The Boston Consulting Group (households)

CHINA NEWLY BUILT HOUSE PRICES YOY CHANGE



SOURCE: WWW.TRADINGECONOMICS.COM | NATIONAL BUREAU OF STATISTICS OF CHINA

- **Average new home prices in 70 cities in China decreased 3.7% yoy July of 2015.**
 - **In Beijing, prices rose 1%, while Shanghai went up 3.1%**
- **YOY volume is up 46% YTD**
- **A Share: 11x 2015e P/E; 1.6 x P/B; 4% NAV Discount**
- **H Share: 7.7x 2015e P/E; 0.8 x P/B; 46% NAV Discount**

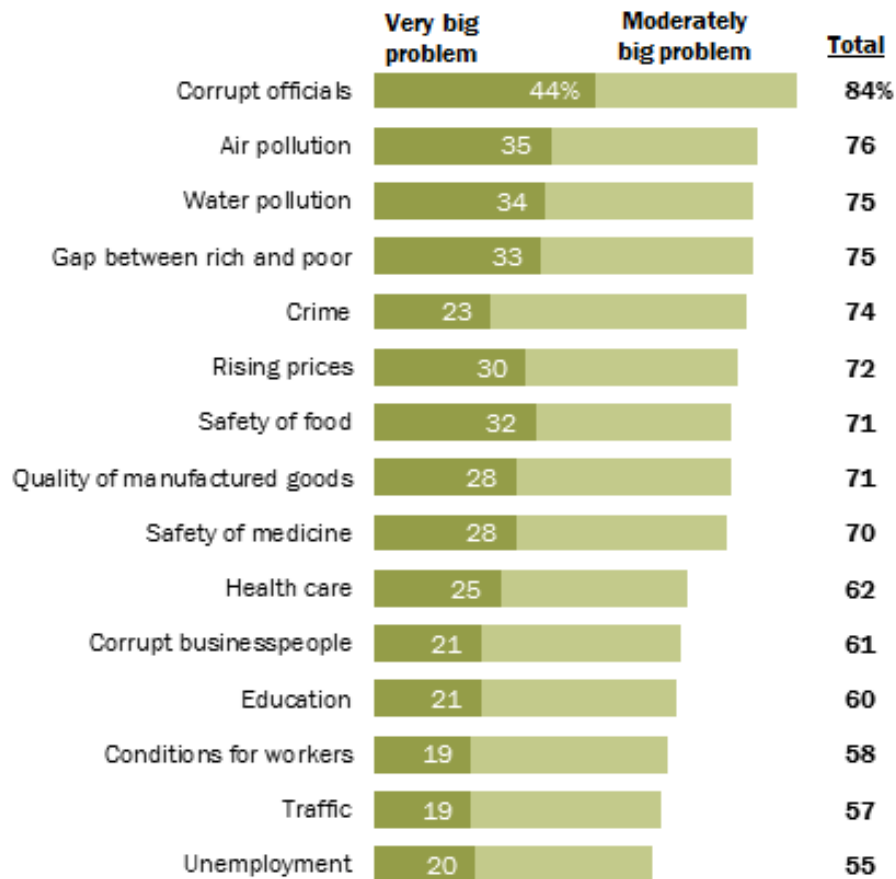
Where are the biggest risks?

What does **independent PEW** data suggest?



Corrupt Officials, Pollution Are Top Concerns

How big of a problem is/are ...

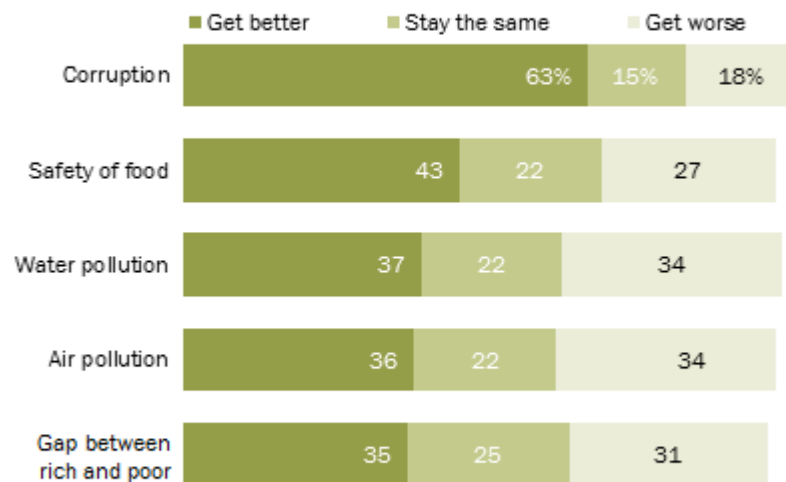


Source: Spring 2015 Global Attitudes survey. Q60a, bCHI, d-f, h-q.

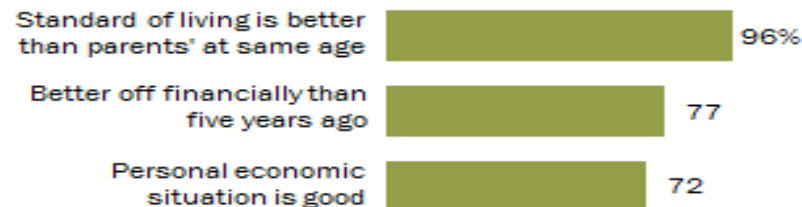
PEW RESEARCH CENTER

Chinese Expect Corruption to Improve in Next 5 Years

In the next five years, do you expect ___ to ...



Chinese Happy with Economic Situation



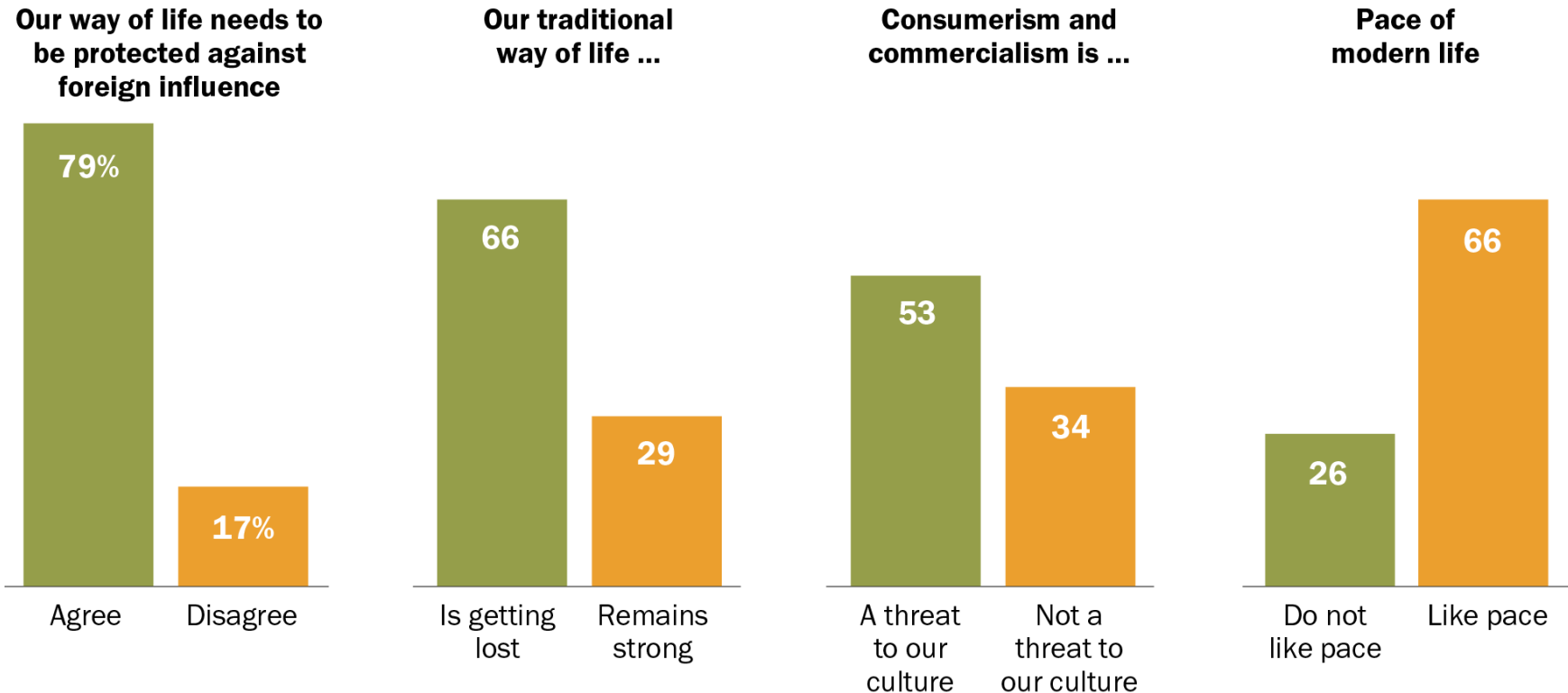
Source: Spring 2015 Global Attitudes survey. Q5, Q7 & Q8.

PEW RESEARCH CENTER

Protecting the “Chinese Way”

Why Xi is embracing Confucius

Chinese Concerned about Impact of Foreign Influence on Way of Life



Source: Spring 2015 Global Attitudes survey. Q141, Q142, Q143 & Q144a.

PEW RESEARCH CENTER

De positive elementene for Kina

1. Service sektoren er 47% av Kinesisk økonomi
 - Opp 8.4% i Q2, fra 7.9% i Q1 2015
 - Service PMI rundt 54; Inntjening god og utsiktene positive
2. Råvarekostnadene dramatisk ned
3. Handelsbalanse historisk høy
4. Budsjettene i balanse
5. Svakere valuta er positivt i forhold til eksportindustri
6. Inflasjon er lav
7. Sysselsetting høy
8. Valuta og capital account ikke konvertibel
9. Aktiva langt større enn gjeld
10. FDI større enn ODI
11. Boligmarkedet flatet ut, svak vekst i “tier one”
12. Household savings, cash balance of US\$15tr*
13. Gain in housing market since 2014 of US\$ 3tr**
14. Shadow Banking market/WMP, estimate less than UK at US\$ 6.5tr***
15. Black market economy, could be as big as US\$ 10tr

1. **President Xi er populær**
2. Forurensingen er bedre
3. Korrupsjon bekjempes
4. “Uhell” får konsekvenser (Tianjin)
5. **“One Belt” initiativet og AIIB vil skape SOE vekst**
6. HK og Japan har lite sympati
 - Vietnam, Filippinene enda mindre
7. Reformen fortsetter
8. Kina er en stor, relativt åpen og innovativ økonomi
9. Store investeringer vil fortsette i infrastruktur, romteknologi og forsvar
10. Stabiliserende ift Nord Korea og Pakistan

So in conclusion:

Kina har sett en (klassisk) reprising av en boble

-

Lite som tyder på en økonomisk eller politisk krise

Chris Rynning
Staur Asset Management
Email: chris@staurholding.no
www.chrisrynning.com