We have seen a significant sell-off in the “China A” market in recent weeks following very strong returns over the first half of 2015.

- **Of more concern for the China A market is its seeming dysfunction.** There has been a dramatic increase in securities suspended from trading, made worse by other securities hitting the 10 percent “limit down” during a day and more or less ceasing to trade.

- **Most of this is of limited concern to global investors.** Most global investors with positions in Chinese securities hold securities listed in Hong Kong rather than mainland China.

- **In Hong Kong, the problem has been a spike in volatility rather than market dysfunction.**

What exactly is the “China A” market?

**A Shares:** Most (but not all) of the press has been around “China A Shares”. These are shares in companies incorporated in mainland China that trade on the two primary mainland exchanges (Shanghai and Shenzhen). They trade and settle in Renminbi (RMB).

Most of the buyers, sellers and owners of A Shares are mainland Chinese institutions or individuals. Roughly 90 percent of trading in China A shares is done by retail investors. The government strictly rations foreign investor access via a program known as Qualified Foreign Institutional Investor (“QFII”).

**B Shares:** These are shares in companies incorporated in mainland China that trade on the mainland exchanges, but trade and settle in USD or HKD and are accessible by foreign investors.

**H Shares:** These are shares in companies incorporated in mainland China, but they trade in Hong Kong in HKD and are also available to foreign investors.

**Others:** Other types of securities (including “Red Chips” and “P Chips”) have exposure to mainland China but are incorporated and trade outside the mainland.

The turmoil in the China A market has minimal *direct* impact on foreign investors. However, turmoil in the China A market has had an *indirect* impact on the other securities listed above, through price falls and an increase in volatility.

While China represented nearly 25 percent of the MSCI Emerging Markets Index\(^1\) as of 30 June 2015, there are only two small “B Share” companies in the index representing less than 0.10 percent of its capitalization. Even the MSCI Emerging Markets Small Cap Index\(^2\) had less than 3 percent exposed to “B shares” at June 30, 2015, and none to “A shares”.

**Collectively, the Shanghai, Shenzhen and Hong Kong exchanges constitute the second-largest stock market in the world.** At the end of May 2015, the combined capitalization of the securities listed on these exchanges amounted to USD 14 trillion compared to USD 27 trillion for the NASDAQ and NYSE.\(^3\)

The Shanghai and Shenzhen exchanges are characterized by very high turnover.

---

\(^1\) The MSCI Emerging Markets Index captures large and mid cap representation across 23 Emerging Markets (EM) countries. Source: MSCI, as of June 30, 2015.

\(^2\) The MSCI Emerging Markets Small Cap Index includes small cap representation across 23 Emerging Market countries. Source: MSCI, as of June 30, 2015.

\(^3\) Source: World Federation of Exchanges.
What has been happening over recent weeks?

- **Prior to June of this year, the China A market had experienced exceptionally strong price returns, fueled by expanding margin accounts and leverage.** Market buoyancy led to an explosion in IPOs, with over 100 for the Shanghai exchange in 2015 alone.

- **The sell-off started in late June, and as of July 9, the Shanghai composite was 29% off its 2015 peak.** The Shenzhen exchange, with a higher proportion of smaller cap and tech names, was down 36 percent from its peak. Interestingly, the run-up during the early part of the year was so strong that both composites still showed positive YTD returns as of 9 July at +9.8 percent and +38.2 percent, respectively.

- **The Hong Kong market, where most global investors have their exposure, has also suffered.** The Hang Seng Index has retreated 15 percent from its peak in late April, leaving its YTD return at +3.3 percent.

**Volatility versus dysfunction**

Dramatic as the price falls have been, the most significant issue for the mainland exchanges has been the suspension of securities from trading, combined with “limit down” triggers.

Across the Shanghai and Shenzhen composite indices, 48 percent of securities have been suspended from trading, representing 35 percent of market capitalization. The situation is most acute among smaller cap names. The CSI 300 Index, which captures the largest 300 China A securities, has 30 percent of names suspended, representing 20 percent of its capitalization.

To make matters worse, trading more or less ceases once securities hit a 10 percent limit down. Over 800 securities hit the 10 percent limit down on 8 July due to aggressive selling. While volatility control mechanisms like limit down mechanisms can give market participants time to pause for breath, the scale of limit down combined with multiple suspensions has given market observers ample cause for concern.

In Hong Kong, there are no equivalent limit down rules, and there has not been a spike in trading suspensions. In that respect at least, Hong Kong has continued to function as normal. The indirect impact for Hong Kong has been a spike in volatility as investors have dumped anything liquid to fund margin calls.

**What’s next?**

Clearly, we expect to see plenty of volatility in both Hong Kong and the mainland in the weeks to come. Daily movements in the Shanghai or Shenzhen composite indices of 5 percent have been common in recent weeks. The Chinese government has introduced a wide range of measures to try and stem the fall. These include restrictions on selling activity for large investors, injections of liquidity, the creation of a market stabilization fund and a suspension of IPOs.

In the meantime, it is too early to know what the broader ramifications for global investors will be. While the volatility is unnerving and market action in the A-share market is concerning due to its impact on Chinese investors, we believe that the potential for contagion in other markets and the broader

---

4 The Hang Seng Index ("HSI") is one of the earliest stock market indexes in Hong Kong. Publicly launched on November 24, 1969. Only securities with a primary listing on the Main Board of the Stock Exchange of Hong Kong ("SEHK") are eligible potential constituents. Mainland China enterprises that have H-share listing in Hong Kong will be eligible for inclusion in the HSI if they meet various conditions. Source: Hang Seng Indexes, as of July 9, 2015.

5 CSI300 consists of 300 stocks with the largest market capitalization and liquidity from the entire universe of listed A share companies in China. Launched on April 8, 2005, the index aims to measure the performance of all the A shares traded on the Shanghai and Shenzhen stock exchanges.

6 Limit down is the maximum decline permitted in individual stocks on certain exchanges before trading curbs occur.
The Chinese Stock Market

The global economy is small at this juncture – assuming the multiple policy measures enacted by the Chinese authorities are successful.

The alphabet of Chinese shares

<table>
<thead>
<tr>
<th>Type</th>
<th>Incorporated</th>
<th>Traded in</th>
<th>Traded on</th>
<th>Held by</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Shares</td>
<td>Mainland China</td>
<td>RMB</td>
<td>Shanghai and Shenzen</td>
<td>Mainland Chinese</td>
</tr>
<tr>
<td>B Shares</td>
<td>USD or HKD</td>
<td></td>
<td></td>
<td>Mainland and Global</td>
</tr>
<tr>
<td>H Shares</td>
<td>HKD</td>
<td></td>
<td>Hong Kong</td>
<td></td>
</tr>
<tr>
<td>Red Chips</td>
<td>HKD</td>
<td></td>
<td>Hong Kong</td>
<td>Wide range of global investors</td>
</tr>
<tr>
<td>P Chips</td>
<td>HKD</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Listed Overseas</td>
<td>Varies</td>
<td></td>
<td>Varies</td>
<td></td>
</tr>
</tbody>
</table>

This document represents the views and opinions of our investment team based on market conditions as of July 9, 2015, and is subject to change as the situation in China continues to evolve. This material is provided for informational and educational purposes only and is not intended as investment advice.

State Street Global Advisors makes available many investment products that may not have investments in Chinese securities or investment exposure to the Chinese market. Please consult your investment professional and/or investment documents to determine Chinese securities exposure. Investment in any security involves market risk. Investing involves risk including the risk of loss of principal.

State Street Global Advisors Worldwide Entities

Australia: State Street Global Advisors, Australia, Limited (ABN 42 003 914 225) is the holder of an Australian Financial Services Licence (AFSL Number 238276). Registered office: Level 17, 420 George Street, Sydney, NSW 2000, Australia; Telephone: +61 9240-7600; Facsimile: +61 9240-7611

Belgium: State Street Global Advisors Belgium, Chaussee de La Hulpe 120, 1000 Brussels, Belgium. Telephone: 32 2 663 2036; Facsimile: 32 2 672 2077. SSGA Belgium is a branch office of State Street Global Advisors Limited. State Street Global Advisors Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom.


Dubai: State Street Bank and Trust Company (Representative Office), Boulevard Plaza 1, 17th Floor, Office 1703 Near Dubai Mall & Burj Khalifa, P.O Box 26838, Dubai, United Arab Emirates. Telephone: +971 (0)4-4372800; Facsimile: +971 (0)4-4372818.

France: State Street Global Advisors France. Authorised and regulated by the Autorite des Marches Financiers. Registered with the Register of Commerce and Companies of Nanterre under the number 412 052 680. Registered office: Immeuble Defense Cedex, 92064 Paris La Defense Cedex, France. Telephone: (+33) 1 44 45 40 00; Facsimile: (+33) 1 44 45 41 92.

Germany: State Street Global Advisors GmbH, Briener Strasse 59, D-80333 Munich. Telephone +49 (0)89-55878-400; Facsimile +49 (0)89-55878-440.

Hong Kong: State Street Global Advisors Asia Limited, 68/F, Two International Finance Centre, 8 Finance Street, Central, Hong Kong; Telephone: +852 2103-0288; Facsimile: +852 2103-0200

Ireland: State Street Global Advisors Ireland Limited is regulated by the Central Bank of Ireland. Incorporated and registered in Ireland at Two Park Place, Upper Hatch Street, Dublin 2. Registered number 145221. Member of the Irish Association of Investment Managers.

Italy: State Street Global Advisors Limited, Milan Branch (Sede Secondaria di Milano) is a branch of State Street Global Advisors Limited, a company registered in the UK, authorised and regulated by the Financial Conduct Authority (FCA), with a capital of GBP 71'650'000.00, and whose registered office is at 20 Churchill Place, London E14 5HI. State Street Global Advisors Limited, Milan Branch (Sede Secondaria di Milano), is registered in Italy with company number 06353340968 - R.E.A. 1887090 and VAT number 06353340968 and whose office is at Via dei Bassi, 4 - 20121 Milano, Italy; Telephone: 39 02 32066 100; Facsimile: 39 02 32066 155.
Flash Report – The Chinese Stock Market

Japan: State Street Global Advisors (Japan) Co., Ltd., Toranomon Hills Mori Tower 25F 1-23-1 Toranomon, Minato-ku, Tokyo 105-6325 Japan, Telephone +81-3-4530-7380 Financial Instruments Business Operator, Kanto Local Financial Bureau (Kinsho #345), Membership: Japan Investment Advisers Association, The Investment Trust Association, Japan, Japan Securities Dealers’ Association

Netherlands: State Street Global Advisors Netherlands, Adam Smith Building, Thomas Malthusstraat 1-3, 1066 JR Amsterdam, Netherlands. Telephone: 31 20 7181701. SSGA Netherlands is a branch office of State Street Global Advisors Limited. State Street Global Advisors Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom.

Singapore: State Street Global Advisors Singapore Limited, 168, Robinson Road, #33-01 Capital Tower, Singapore 068912 (Company Reg. No: 200002719D); Telephone: +65 6826-7500; Facsimile: +65 6826-7501

Switzerland: State Street Global Advisors AG, Beethovenstr. 19, CH-8027 Zurich. Telephone +41 (0)44 245 70 00. Facsimile Fax: +41 (0)44 245 70 16.


United States: State Street Global Advisors is the investment management arm of State Street Corporation; State Street Global Markets, LLC is a wholly owned subsidiary of State Street Corporation.

Web: www.SSGA.com

© 2015 State Street Corporation - All Rights Reserved

IBG-15643