

China Strategy – Sustainable bull or bubble risk?

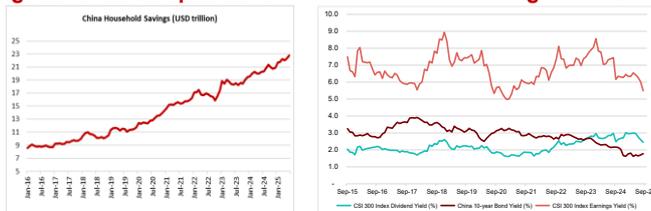
Playing catch-up

The **Hang Seng Index** has been a key outperformer, up **+26% YTD** driven by Southbound flows, a surge in IPOs and structural AI tailwinds. While **China's A-share market initially lagged**, it has gained **significant momentum from early August**, with the **CSI 300 index up +13% YTD**. *Is China's bull market sustainable or is a bubble forming?*

What is driving the A-share rally?

1. **Retail deposit flows.** Total Chinese household savings are at a record 160trn yuan (USD22trn), 60% above the combined market cap of Shanghai and Shenzhen indices at 100trn yuan (USD14trn). With significant term deposits maturing this year and falling interest rates, households are shifting funds into the stock market seeking higher returns. In July 2025, bank deposits fell by RMB1.1trn, while deposits in non-bank financial institutions (*funds, insurers, investment firms etc.*) rose RMB2.1trn.

Figure 1: Retail deposits flow to stock markets for higher returns



Source: LSEG DataStream, Bloomberg, CIMB CIO Office

2. **Institutional investors support.** In January 2025, Chinese regulators introduced the 'Implementation Plan for Promoting the Entry of Medium and Long-Term Funds into the Market', to stabilize the A-share market. Key measures include requiring state-owned insurers to allocate 30% of annual premiums to A-shares and mutual funds to increase A-share holdings by 10% annually over the next 3 years.

3. **Easing trade tensions and improved sentiments.** On 12 August, US and China extended their trade truce by another 90 days to 10 November, boosting sentiment and prompting a rotation from bonds to equities.

Is the A-share rally sustainable?

The recent surge has drawn comparisons to 2015, when the Shanghai Composite index surged 150% between mid-2014 to mid-2015, fueled by easing policies, credit expansion, margin financing and a retail investor frenzy, before a sharp crash.

1. **Not yet a frenzy.** In August, the Shanghai Stock Exchange saw 2.65mil new A-share trading accounts opened (+165% yoy) compared to 6.8mil in October 2024 during the post-stimulus surge, and around 7mil in 2015's rally peak. Outstanding amount of margin trade climbed to RMB2.28trn on 1 September, surpassing the high of RMB2.27trn in 2015, but accounts for 2.2% of A-shares' total market cap, still below the 2015 peak of 4.6%.

Figure 2: A-share margin financing at 2.2% of total market cap



Source: LSEG DataStream, CIMB CIO Office

2. **More long-term capital.** As compared to the 2015 rally, which was largely driven by retail speculation and excessive leverage, the current A-share market rally appears more stable, underpinned by growing participation from institutional investors such as insurers, mutual funds, and pension funds, supported by targeted policy initiatives.

3. **Divergence from weak macro.** However, a key risk and similarity to 2015, in our view, is that both rallies occurred against a backdrop of weak economic fundamentals, suggesting that recent market gains are being driven more by liquidity, policy support, and investor sentiment than by underlying earnings or growth.

Should investors switch to A-shares?

While **A-shares** are experiencing a **liquidity-driven rally**, we prefer **H-shares** for their structural advantages and remain **Overweight HK/China**. **H-shares** should form the **core holding**, with a **tactical allocation to A-shares for higher-risk investors** seeking to capitalize on the rally. Media reports suggest Chinese regulators **may introduce cooling measures to curb speculation**, which could result in a sell down. We view this as a **healthy correction for a more sustainable bull market** and an **opportunity to buy the dip**.

- **H-shares:** We like its higher weighting in 'new economy' sectors, strong IPO pipeline driving liquidity, better corporate governance and accessibility to global investors. Our HSI target is **26,430** (implies 11.2x PER). Key to watch is if the involution-style competition is brought under control. Add quality growth stocks and yielders on pullback.
- **A-shares:** Best proxy to ride on domestic liquidity and policy support due to heavier weighting in 'old economy' sectors. We believe there is still room for A-shares to run. Investors can gain exposure via ETFs and funds.

What could derail the rally?

1. **Regulatory intervention.** Cooling measures e.g. removal of short-selling curbs, tightening margin financing etc.
2. **Policy disappointment.** Anticipated stimulus measures to stem the weakening macro fall short of expectations.

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