

TAKING STOCK: A IS FOR ACCESS, MSCI UPS LOCAL CHINA SHARES IN INDEXES



Jennifer Appel, CFA, Senior Research Analyst, Asset Allocation, and
Tim O'Connell, Senior Research Consultant, Traditional Research

BLOG POST

March 7, 2019

Benchmark provider [MSCI Inc.](#) recently announced two [changes](#) to its process of increasing [China A shares](#) in its indexes.

The changes are expected to pave the way for an orderly and gradual transition as the MSCI Emerging Markets Index, a primary benchmark for investors in developing economies, ratchets up its exposure to China A shares to around 3.3% from 0.7% currently. The move is estimated to lead to over \$60 billion in capital inflows into China's domestic stock market.

At NEPC, we are closely following MSCI's measured approach to increasing the allocation to China A shares in its indexes. We believe that ongoing efforts to liberalize markets in China may speed up this process over the coming years. We will continue to monitor these changes and the potential implications for investors.

The first of two changes announced by MSCI was to increase the weight of China A shares in the MSCI indexes by increasing the inclusion factor to 20% from 5% in three steps, beginning in May 2019. Given that the MSCI Emerging Markets Index is currently tracked by about \$1.9 trillion in funds, the three-step process was suggested by international investors to help alleviate potential pressures related to execution on the implementation dates.

The second announcement was the initial inclusion of mid-cap securities at a 20% inclusion factor, starting in November. The move follows a successful two-step

implementation of the 5% inclusion factor by MSCI in 2018.

Inclusion Time Line

Date	Ending Inclusion Factor	Estimated Ending Weight*
Current	5%	0.7%
May 2019	10%	~1.4%
August 2019	15%	~2.1%
November 2019	20%	~3.3%

*based on February 28, 2019 weights

Step 1: In May 2019, MSCI will increase the inclusion factor of all China A large-cap shares in MSCI Indexes from 5% to 10% and add ChiNext large-cap shares with a 10% inclusion factor.

Step 2: In August 2019, MSCI will increase the inclusion factor of all China A large-cap shares in MSCI Indexes from 10% to 15%.

Step 3: In November 2019, MSCI will increase the inclusion factor of China A large-cap shares in MSCI Indexes from 15% to 20% and add China A mid-cap shares, including eligible ChiNext shares, with a 20% inclusion factor.

Upon completion, there will be 253 large- and 168 mid-cap China A shares in the index, including 27 ChiNext stocks, representing approximately 3.3% of the MSCI Emerging Markets Index – more than quadrupling the current exposure of 0.7%.

Until recently, international investors were limited to owning offshore Chinese companies, or those listed in Hong Kong and New York, with minimal exposure to mainland China. As a result, the [Stock Connect](#) program—a partnership between the stock exchanges of Hong Kong, Shanghai and Shenzhen that allows international and mainland Chinese investors to trade securities in each other’s markets—has been the catalyst for more significant foreign inflows.

MSCI has acknowledged further increases to the inclusion factor would require Chinese authorities to address outstanding issues of accessibility, including restrictions on futures contracts and other hedging instruments, and alleviating concerns surrounding same-day settlements and closure of Stock Connect for public holidays.

Stay tuned for more information as this transition unfolds.

DISCLAIMERS AND DISCLOSURES

Past performance is no guarantee of future results.

All investments carry some level of risk. Diversification and other asset allocation techniques do not ensure profit or protect against losses.

The information in this report has been obtained from sources NEPC believes to be reliable. While NEPC has exercised reasonable professional care in preparing this report, we cannot guarantee the accuracy of all source information contained within.

The opinions presented herein represent the good faith views of NEPC as of the date of this report and are subject to change at any time.