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WHO, REALLY, RULES THE WORLD'S STOCK-MARKET WAVES ?

This year, one has seen the 2 equity markets of the People's Republic of China (PRC) seemingly dictating to the rest of the world: If our key indices fall, so, also, do yours!

One is told by quite a number of Wall Street gurus, these days: Beware of the Chinese!

In the Hongkong Special Administrative Region (HKSAR) of the PRC, many stockbrokers and would-be gurus of The Stock Exchange of Hongkong Ltd point to the gyrations of the key index of The Shanghai Stock Exchange – The Shanghai Composite Index – as one of the most-important factors, influencing the *'thermometer'* of the Hang Seng Index, the latter-named, being the key index of the Main Board of The Stock Exchange of Hongkong Ltd.

It is as though one is led to believe that the PRC's 2 equity markets – located in Shanghai and Shenzhen – now rule the stock-market waves of the world.

Considering the age of the equity markets of the Middle Kingdom, this is quite amazing.

And, considering the lack of sophistication of most of the investors/speculators/gamblers of the Middle Kingdom, it makes little sense to believe that Shanghai and Shenzhen can eclipse the importance of Wall Street – ever.

Wall Street appears to have adopted the stance of paying a great deal of attention to any very material gains or falls in The Shanghai Composite Index; and, the reaction of the world's largest equity markets to violent gyrations in this key index of the PRC's premier equity market is met with immediate response.

Having said that, **TARGET** () is fully cognisant of the fact that:

1. The PRC is set to challenge the second-largest economy of the world, that of Japan;

2. The US economy is contributing less and less to global economic growth (latest statistics suggest about 30 percent, at most, down from 40 percent); and,

3. Asian equity markets are outperforming those of North America by a very wide margin.

Since January this year, as most observers are well aware, the key indices of the equity markets of the PRC have risen by about 61 percent (to the end of May).

While there is some justification for the key indices of these 2 equity markets to have risen, moderately, it boggles the imagination that Price-Earnings Ratios of many of the companies, listed on these 2 equity markets, should be commanding as much as 60 times.

By and large, the equity markets of the PRC are being fueled by cash, legally, but not necessarily, beneficially, belonging to completely unsophisticated investors of the country, most of whom, having read reports (or having been told of fabricated, or embellished, stock-market success stories) of the fortunes, having been made by their fellows on stock-market speculations – and they want their slice of the sweet, and, seemingly, ever-expanding, stock-market pie.

Because many of these people are first-time speculators, there is a real concern by the Government of the PRC that, should the key indices of the country's equity markets turn down, violently, it could trigger widespread domestic discontent.

This is due to the fact that stock-market investments/speculations are, almost, completely new to these first-timers of the PRC's equity markets and they, most likely, would not be able to understand, fully, that the market prices of stocks and shares can rise as well as fall, sometimes very rapidly, within the period of less than one working week.

This must be a very valid (and very worrying) concern to the powers-that-be in Beijing, as history has proved, because nothing is more important to a man than his prized possessions and the accumulation of the current medium of exchange, permitting a man to add to his collection of possessions.

Last Friday, The Shanghai Composite Index lost about 1.50 percent of its value, ending the trading session at 4,115.21 points, while The Shenzhen Composite Index, which tracks the prices of stocks and shares, listed on the smaller of the country's 2 equity markets, fell about one percent to 1,221.17 points.

The falls in these 2 key indices followed a statement, made last Thursday from Beijing, the Capital City of the PRC, that The State Council, the PRC Government's highest administrative body, is intent upon reducing excess liquidity in the country.

This statement must mean that the PRC Government is about to get very tough on its runaway equity markets and it will employ means to cool them, post-haste.

The Government of the PRC is intent, inter alia, on trying to prevent large-scale financial losses for the innocent and the ignorant of the country and, to that end, it has implemented, since March this year, schemes to try to cool down the country's red-hot stock markets, gradually and orderly, before the inevitable comes to pass.

To this day, these measures appear to have been of little avail, however.

The Government of the PRC has raised the stamp duty on share trading in the country, from 0.10 percent to 0.30 percent, and has loosened its grip, to some extent, by permitting investments outside the country by what is known as the **Q**ualified **D**omestic **I**nstitutional **I**nvestor (QDII).

In May, the PRC Government increased the size and scope of the QDII Scheme so that, today, domestic banks may invest a part of their funds abroad, provided that the funds are invested in fixed-income *'instruments'*.

This is a bit of a mistake, in **TARGET**'s opinion, because it is well expected that the translation value of the renminbi vis-à-vis the hard currencies of the world will appreciate; and, as this transpires, it will erase a great deal, if not all, of any gains that would be forthcoming to PRC domestic banks which have invested up to $US14.20 billion of their money, overseas.

If there is any medium of exchange that is bound to appreciate against the *'hard'* currencies of the world before the end of the year, it is the currency of the PRC: The renminbi.

The US Government is pushing hard for this to happen, too, claiming that the PRC Government is *'subsidising'* its exports by keeping the lid on allowing the renminbi to appreciate against the US dollar.

It is quite likely that there is a great deal of truth to this allegation because the PRC Government does control the exchange rate of the renminbi against other currencies.

The US Congress has been pressing, for some time, to have Beijing revalue, upwards, the renminbi, claiming that that is only fair and proper.

Looking at all of the above facts and extrapolations of the facts, it seems quite unlikely that any rapid gains or falls in the key indices of the PRC's equity markets could have any appreciable effect on any other equity market in the world.

The psychological effect of a rapid and/or prolonged decline in the key indices of the PRC's equity markets is, probably, the nut of consideration for many people, rather than any supposed, detrimental effect that such a decline could have on any other equity market.

For certain, the wealth effect to PRC investors of rapidly rising key indices of The Shanghai Stock Exchange and/or The Shenzhen Stock Exchange is bound to be substantial, but such gains can – and, probably will – be fleeting.

Further, there is little to no correlation between the rise in the key indices of the PRC's equity markets and the very substantial gains in the economy of the PRC.

This is contrary to much of the nonsensical discourses, being spouted by stockbrokers of the HKSAR, as well as their counterparts in Shanghai and Shenzhen.

Also, thus far, the wealth effect from equity trading in the PRC has had little effect on consumer consumption although, clearly, there must be some effect.

The PRC investor, by and large, because his funds are still very limited, is unlikely to spend lavishly on luxury goods due to the fact that he is looking at *'paper'* gains, only, that gains, earned in share trading.

That situation, of course, could change in time.

But, for now, there is no correlation between PRC stock-market gains and substantially increased purchases at shopping centres in the main cities of the country.

The reason for this is that things have happened too quickly for gains from stock-market investments to filter through to the shopping centres, at least, not to any appreciable extent.

Conversely, therefore, it follows that, should there be a violent sell-off on PRC equity markets, with hundred of millions of renminbi, being wiped off market capitalisations of the corporate *'darlings'* of these 2 equity markets, it will make little difference to consumer spending in the country, generally.

Also, one must bear in mind that, in the scope of things, internationally, The Shanghai Stock Exchange and The Shenzhen Stock Exchange, combined, are, still, very tiny.

The real threat, in **TARGET**'s opinion, from a violent and/or prolonged fall in the value of the key indices of the PRC's equity markets, is civil unrest – because such things as equity trading is very new for the majority of investors of the country.

At this time, it appears that any and all violent corrections in the key indices of the PRC's equity markets should not have any appreciable effect on other equity markets, internationally.

As long as there is no connection between international capital flows into the economy of the PRC and PRC stock-market operations and the knock-on effect, therefrom, it seems unlikely that there could be any knee-jerk reaction to a material stock-market correction in the world's tailor shop.

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