Addition of China 'A' Shares to MSCI Index Is Awkward Timing

BY TANZEEL AKHTAR

FUND INVESTORS looking into Chinese stocks are living in interesting times.

As the threat of a U.S.-China trade war continues, index firm **MSCI** Inc. is preparing to add some mainland Chinese-listed shares, known as A shares, to its widely watched and benchmarked emerging-markets index.

The move, with a first round on June 1, has been years in the making and is expected to draw billions of dollars to mainland-China stocks as funds seek to replicate the MSCI Emerging Markets Index. (Foreigners can already buy and sell shares in Chinese companies listed in Hong Kong, but access to shares traded in Shanghai and Shenzhen has been limited.)

But as big as the MSCI development is, at least symbolically, Chinese stocks are among the worst performers in the world so far this year, with the Shanghai Composite Index down 6.8%. The trade dispute is adding to economic uncertainty in the country, and even the MSCI boost hasn't been enough to offset it.

In addition, the China-stock infusion will be limited at first. Jackie Choy, the director of ETF research, Asia, at Morningstar Investment Management Asia Ltd., says the amount of China A shares expected to be included in the MSCI indexes on June 1 is relatively small, at around 0.73% of the MSCI Emerging Market Index. (More stocks will be added later.) He says it's too early to tell how a trade war could affect markets.

Two index-tracking funds that will have to act immediately to replicate the inclusion of A shares are **iShares MSCI Emerging Markets ETF** (EEM) and **iShares Core MSCI Emerging Markets ETF** (IEMG), says Todd Rosenbluth, head of ETF research for CFRA, a New York research firm. Mr. Rosenbluth says the inclusion of China A shares into MSCI indexes will create a tailwind for continued demand of such funds regardless of trade war risks.

For investors who want to get ahead of the index addition, Mr. Rosenbluth recommends some ETFs that already include A shares, such as **Xtrackers Harvest CSI 300 China A-Shares ETF** (ASHR) and **KraneShares Bosera MSCI China A Share ETF** (KBA). These funds, he says, invest in companies that generate significant revenue domestically in mainland China and so would see limited impact from a potential trade war.

China ETFs' headwinds

Since the trade-war rhetoric has ratcheted up, China-focused ETFs have faced performance headwinds, says Michael Cohick, senior ETF product manager at VanEck.

"It's possible that in some part this may be due to the threat of punitive tariffs from the U.S. as well as retaliatory threats from China, but is likely only part of a broader cyclical narrative," says Mr. Cohick.

He adds that VanEck's outlook for emerging-markets stocks and currencies generally is for continued strength driven by fundamentals and deepening U.S. deficit spending. Any short-term weakness in underlying markets may end up being a potential trading opportunity for intrepid investors, Mr. Cohick says.

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