It's Time To Look For China Stocks

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The JP Morgan China Region Fund (NYSE:JFC) tracks the broad Chinese economy including Hong Kong, Taiwan and Macau including the top small, medium and large caps.

The Best Way To Invest In China

Investing in China is a complex nut to crack. The business and investment marketplace is subject to strict regulation dictated by an authoritarian government that likes to keep foreign investors at bay. Along with that is hazy financial information, a market driven on margin, massive amounts of QE and a recent 30% market correction. Despite these issues the region remains one of the largest economies on the planet, one of the largest consumers of energy and has one of the highest rates of growth with positive, if slowing, forward expectations.

I'm not here to blow smoke and tell you that the recent weakness in China is the buying opportunity of a lifetime. The market in that country has been falling like a knife and like they say, never try to catch a falling knife. However, the sell-off will soon abate and when that happens it will be time to go shopping in China. What I am here to tell you is that China is an attractive place for investors seeking to diversify, add a little risk to their accounts and capture the movement of one of the largest and most active markets in the world.

The problem faced is how to do so? Foreign investors have very limited access, are restricted to owning only certain kinds of shares, and can only access them through approved channels. This makes it hard to own individual companies but it has led to a proliferation of stock funds based on the region and more specifically, the MSCI China Indices. These indices target specific areas of investment within China by market cap and as allowed by the Chinese government. They focus on mainland A and B shares, Hong Kong/Taiwan shares, Red Chips and P Chips in differing blends. The problem is that no one MSCI index, and very few funds based on them, capture the entire market. There are multiple types of listing in the region, all with their own regulations which means as an investor you have to buy more than one fund to gain full market exposure.

What Is The China Region Fund?

The JP Morgan China Region fund (JFC) is a unique offering in the realm of foreign investment in Chinese stocks. Unlike other funds that tend to target certain industries or specific types of Chinese issues the Chine Region

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Fund is focused on the entire Chinese market. This includes mainland China and those areas which are part of the overall Chinese economy. In a nutshell it includes A, B and H shares as well as red and P chips. Because the focus of the fund is so broad it is the only one that truly captures the value of the broad Chinese economy.

The funds objective is “long term capital appreciation through investment … in equity securities of companies with substantial assets in, or revenues derived from, the People Republic Of China, Hong Kong, Taiwan and Macau... the China region.” Operated as a closed end fund, it is benchmarked against the two primary China tracking indices, the MSCI Golden Dragon Index and the CSI 300 Index. The Golden Dragon is comprised of 280 mid to large cap stocks and is representative of companies operating from locations outside of the mainland. The CSI 300 is an index provided by the China Securities Index Co, LTD which is a joint venture between the Shang Hai and Shenzen exchanges. It tracks the top 300 A share companies listed on the two mainland exchanges and is the benchmark for global indexing in small cap Chinese stocks.

The China Region fund goes a step further, it is not just a blend of the two indices. The fund is actively manged to filter out the best of each and combines them into one master fund. There are currently 197 holdings well diversified across sectors. The financials carry the most wieght, just over 43%, followed by an 18% staked in information technology. The next two top holding by sector, industrials and consumer discretionary, make up 8.3% of portfolio with smaller holdings in health care, consumer staples, utilities, materials and energy. According the most recent report managers have this to say

“While valuations have inflated to worrying levels in parts of the mainland market, financials stocks remain inexpensively valued, signaling continued worries about system integrity which we do not share (and which are incongruent with heady multiples in industrials). Policy support for the capital markets remains strong given China’s extensive financing needs. We continue to believe that the rally only ends when equity supply finally overwhelms the substantial excess demand implied by conservative household balance sheetsWe remain overweight

financials and secular growth areas such as healthcare environmental protection and technology, where equities remain favorably-valued versus strong multi-year growth prospects"

China Region Fund Compared To The Competition

There are numerous China funds, all based on underlying MSCI indexing. The problem with them is that in order to gain the exposure you get with the JPMorgan China Region fund you have to buy shares in more than one. Take for example the iShares China ETF's, you have to buy at least 3 including the (MCHI) "China Region" fund, the (ECNS) small cap China fund and the (EWH) Hong Kong fund to match the exposure of the JFC. When purchased together these three create an investment over $110 on a per share basis compared to current share prices for JFC near $17. Another popular choice for US investors is the Kraneshares Bosera China A ETF (KBA), a fund targeting mainland A shares but excludes everything else.

Aside from the exposure there are other reasons to look at JFC, namely it's discount to NAV. This discount, more than 12% based on recent share prices and information found on the fund website, offers a significant value opportunity for investors. It is undervalued compared to the other major China based funds. The MCHI, ECNS and KBA are all trading at a premium to their net asset values ranging from +5% to +16%, reason enough to make the JFC stand out from the crowd without the P/E comparison. JFC is trading near 7 times earnings, the sector average among US listed funds is near 12 times and mainland China A shares are trading at near 50 time earnings.

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Is China A Buy?

There is no doubt that volatility will continue in Chinese markets. The market is correcting and will take time to stabilize. At this time government officials and individual companies are throwing in support wherever they can, pledging to buy billions of yuan of small to mid cap stocks, which, along with the brokers, could put a floor in the market. This is evident in the charts where significant buying activity can be seen at long term support levels.

Now that we've got signs of a bottom forming it's time to start looking for places to invest and entry points for those investments. You could try to trade individual segments such as the small caps, the A shares or the Hong Kong market but you will be faced with higher prices, higher valuations and increased volatility. In my opinion, the JP Morgan China Region Fund offers a better value for investors and provides the most complete exposure making it my top choice for investing in this region.

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