

Analysis and investment suggestion on the current situation of AH share premium

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Abstract. Recently, the phenomenon of AH share premium has once again aroused widespread concern in the market, which refers to the difference in the prices of AH shares of companies listed in Hong Kong and the Mainland at the same time, usually due to differences in market liquidity, investor structure and regulatory environment. In recent years, with changes in the global economic environment and fluctuations in investor sentiment, the AH share premium phenomenon has become more and more obvious. This article provides an in-depth analysis of the current situation of AH share premium and its causes, and discusses the impact of AH share premium on Hong Kong stock investment. At present, the AH share premium phenomenon is still prevalent, and the main reasons for this premium include differences in market liquidity, different investor structures and differences in regulatory policies between the two markets. In terms of the international economic environment, global economic uncertainties and geopolitical risks have had a significant impact on the Hong Kong stock market. By analyzing the valuation data of Hong Kong stock indices, under the current market environment, investors should focus on companies with sound financial position and good growth prospects, and consider diversification to reduce risk. Based on the above analysis, it is recommended that investors should cautiously assess the potential risks arising from the AH share premium and formulate a reasonable investment strategy taking into account the international economic situation and the characteristics of the Hong Kong stock market when making investments in Hong Kong stocks. This will help realize sound investment returns in a complex and volatile market environment.

Keywords: AH share premium, international economic environment, investment advice.

1. Introduction

In recent years, AH share premium has attracted much attention in the financial market. With the evolution of the global economic pattern and the fluctuation of investor sentiment, the premium of AH shares has become increasingly obvious.

The significance of studying AH premium lies in its impact on investors and market dynamics. Understanding the causes and effects of the AH premium can provide valuable insights for investors navigating the complex Hong Kong and mainland stock markets. This analysis helps investors make informed investment decisions in a context where global economic uncertainty and geopolitical risks are having a profound impact on market behavior.

The purpose of this paper is to analyze the current situation of AH share premium, explore its deep reasons, and discuss its impact on Hong Kong stock investment. By examining the valuation data of the Hong Kong stock index and taking into account the international economic environment, we provide strategic advice to investors. The purpose is to help investors assess the impact of AH premium on Hong Kong stock investment.

2. Literature Review

The AH premium has been one of the most talked about topics in finance and economics for many years. Previous studies have explored various aspects of this phenomenon to gain a comprehensive understanding of its causes, impacts and long-term trends.

One of the main reasons for the premium on AH shares is the difference in market liquidity between the Hong Kong and mainland stock exchanges. Higher liquidity in the Hong Kong market

leads to more efficient price discovery, resulting in H shares trading at A premium to A shares. Instead, A-shares tend to trade at A discount due to low liquidity and high volatility.

The difference in the investor structure of the two markets is also an important reason for the premium of AH shares. The Hong Kong market is dominated by international institutional investors, who are generally more risk-averse and have better access to information. In contrast, the mainland market is largely made up of retail investors, who may be more prone to speculative trading. This difference in investor behavior has contributed to the price difference between A shares and H shares.

The differences in the regulatory environment further aggravate the premium of AH shares. Mainland markets are subject to stricter capital controls and regulatory oversight, which can restrict the flow of money and information. This regulatory environment leads to inefficient pricing of A-shares and A premium for H-shares, which are subject to Hong Kong's looser regulatory framework.

Global economic factors and political policies can also have a significant impact on the AH share premium. International economic uncertainties, such as trade tensions and currency fluctuations, will affect investor sentiment and capital flows, leading to increased volatility in the Hong Kong market, which will further affect the AH share premium.

The existing studies provide valuable resources for understanding the phenomenon of AH share premium and its reasons. However, there are still some areas that need further research in order to better understand more information about the AH share premium, so that investors can better understand the difference between the A-share market and the H-share market and make more effective investment strategies.

3. Premium status and reason analysis of AH shares

3.1. AH share premium

AH share premium is defined as the ratio of A-share price to H-share price, all minus 1, where HKD denominated H-share prices are converted into CYN equivalent prices based on the spot exchange rate. (Zhao, 2020). Typically, this difference is expressed in the form of A premium index, which is the ratio of the A-share price to the H-share price. If the index is greater than 1, it indicates that A shares are at a premium to H shares. If it is less than 1, it indicates that the H shares are at A premium to the A shares.

3.2. AH share premium status

Since the introduction of the AH share premium index in 2007, A shares have been in a premium state. At present, a serious AH share premium is a common phenomenon, and the Hang Seng AH Share Premium Index (HSAHP) has continued to rise since 2023 and broke the key threshold of 156 in January 2024. This data shows that A shares are priced on average 56 percent higher than H shares, a significant premium.

3.3. The reasons of AH share premium

3.3.1. Macroeconomic factors

The difference in monetary policy between China and the United States has had an important impact. The divergence in monetary cycles between the two countries, especially with the Fed tightening and China's relatively accommodative policy, has supported the rise in the AH premium.

3.3.2. Market microstructure differences

Changes in market liquidity between A-shares and H-shares, investor risk appetite and trading volume differences all play A role. Higher liquidity and trading volumes in A-shares are usually associated with higher AH premiums.

a) Market access restrictions: The A-share market has limited access for foreign investors, while the H-share market is more open to international investors. This difference in access can lead to different investor structures in the two markets, which can affect share prices.

b) Liquidity differential: A-shares generally have higher trading activity and liquidity, which may result in their price being higher than H-shares.

c) Currency exchange rate fluctuations: A-shares are denominated in RMB, while H-shares are denominated in Hong Kong dollars. Exchange rate fluctuations between RMB and HKD may lead to price differences in AH shares.

d) Differences in investor expectations/Risk appetite and investment styles: Mainland and Hong Kong investors may have different expectations and reactions to the market, policy environment and company fundamentals, affecting share prices. International investors do not have a deep understanding of China's economy, so their risk tolerance is not high, so they are more inclined to choose industries and individual stocks with low risk and clear growth, such as banking, insurance and other industries are sought after, and naturally they will give a higher premium. However, Chinese investors have A strong risk appetite and are more in pursuit of short-term investment returns. Therefore, industries with long-term stable growth are often difficult to be favored by the A-share market, but industries and individual stocks with flexible performance and explosive growth are more likely to be sought after by investors.

e) Policy and regulatory environment: Different regulatory policies and market rules may also have an impact on stock prices in both places.

f) Information asymmetry: Due to differences in market information transmission and access, investors may have different valuations of the same company.

g) Differences in investor structure: individual investors dominate A-share market, and the proportion of individual investors in A-share market is much higher than that in Hong Kong stock market; The proportion of foreign investment in the A-share market is much lower than that in the Hong Kong stock market. The difference in investor structure makes the volatility and turnover rate of the A-share market much higher than that of the Hong Kong stock market. Individual A-share investors value many sectors at A premium to Hong Kong stocks.

h) Regulatory factors: The strict IPO regulation of the A-share market and the related "shell value" of listed companies are also reasons. In general, large companies with larger market capitalization tend to have A lower AH premium because the relative "shell value" of their A-share components is lower.

As of the close of trading on January 30, 2024, the shares of Hongye Futures, Zhejiang Shibao and Capital Electromechanical were the three lowest AH premium rates (H/A), with premium rates of -87.82%, -84.67% and -78.07%, respectively. Byd (002594) shares, Wuxi Apptec (603259), Haier Zhijia (600690) were the top three AH premium rates, with premium rates of -5.89%, -9.91%, and -10.85%, respectively.

*AH shares refer to companies listed in both A shares and Hong Kong shares, the smaller the premium (H/A), indicating that H shares are cheaper than A shares, and the investment is more cost-effective.

Table 1. Lowest 10 AH Premium Rates (H/A)

Stock name	H shares (HK \$)	A shares (RMB)	Premium rate
HOLLY FUTURES	1.37	10.23	-87.82%
Zhejiang Shibao	2.11	12.52	-84.67%
Jingcheng Electromechanical Co., Ltd	2.5	10.37	-78.07%
Longyuan Power	4.69	19.08	-77.64%
Sinopec oilfield service	0.46	1.78	-76.49%
Nanjing Panda electronic shares	2.64	10.04	-76.08%
China Securities	6.01	22.3	-75.48%
CICC	9.34	32.95	-74.21%
Zhongzhou Securities	1.03	3.63	-74.19%
Fudan Zhang Jiang	2.22	7.77	-74.01%

(Data source: Tonghuashun)

Table 2. Highest 10 AH Premium Rates (H/A)

Stock name	H shares (HK \$)	A shares (RMB)	Premium rate
BYD Company Limited	177.9	171.97	-5.89%
WuXi AppTec	56.3	56.85	-9.91%
Haier Smart Home Co., Ltd.	22.05	22.5	-10.85%
Zijin Mining Group Company Limited	11.72	12.18	-12.46%
Byd Stock -R	163.4	171.97	-13.56%
China Merchants Bank	28.5	31	-16.36%
Fuyao Glass	35.3	38.4	-16.37%
Weichai Power	13.72	14.93	-16.40%
Yihuatong Corporation	31.1	35.51	-20.32%
China Tourism Group Duty Free Corporation Limited	70	82.25	-22.58%

(Data source: Tonghuashun)

3.4. Case study: Take Bank of China and BYD as examples

A. Bank of China

We examine both its A shares listed in Shanghai (601988.SH) and its H shares listed in Hong Kong (3988.HK)

Table 3. Bank of China AH Premium Rates (H/A)

Date of transaction	A shares(601988.SH)			H shares(3988.HK)			AH share price ratio	Exchange rate
	Closing price (CNY)	Trading volume (shares)	Change (%)	Closing price (HKD)	Trading volume (shares)	Change (%)		
2024-01-30	4.27	208,305,689	-0.70	2.95	235,323,820	-1.34	1.59	0.9095
2024-01-29	4.30	274,380,378	0.47	2.99	269,397,021	0.67	1.58	0.9097
2024-01-26	4.28	338,161,640	3.13	2.97	242,734,357	-0.67	1.59	0.9091
2024-01-25	4.15	240,280,996	1.22	2.99	395,298,043	1.70	1.53	0.9087
2024-01-24	4.10	270,184,731	3.02	2.94	352,870,368	3.52	1.54	0.9084

(Data source: Tonghuashun)

The latest data as of January 30, 2024: Bank of China's A-shares (601988.SH) closed at 4.27 yuan, with A market value of 1257 billion yuan and a price-earnings ratio (P/E) of 5.39; H shares (3988.HK) closed at HK \$2.95, giving them a market value of HK \$8,684 trillion and a price-to-earnings ratio of 3.47.

The reason why the premium of AH shares of Bank of China is large can be analyzed from the following aspects:

1. Capital price: RMB is not freely convertible compared with Hong Kong dollar, and the financing cost of RMB is usually higher than Hong Kong dollar. The premium between AH shares will further increase when RMB funding costs rise or the price of funds in Hong Kong is tight. Moreover, if liquidity is easy, such as a decline in interest rates, the premium may also increase accordingly.

2. Liquidity: The trading volume of A-share market is much higher than that of H-share market, which means that A-share trading liquidity is better. This liquidity advantage may cause the A-share price to be higher than the H-share price.

3. Dividend tax: in the A-share market, the dividend tax of listed company stocks held by individuals for a long time is low, while in the H-share market, the dividend tax rate is 20%, and there are specific tax exemption provisions. These tax differences can affect investor decisions across markets.

B. BYD (002594.SZ) vs BYD Stock (1211.HK)

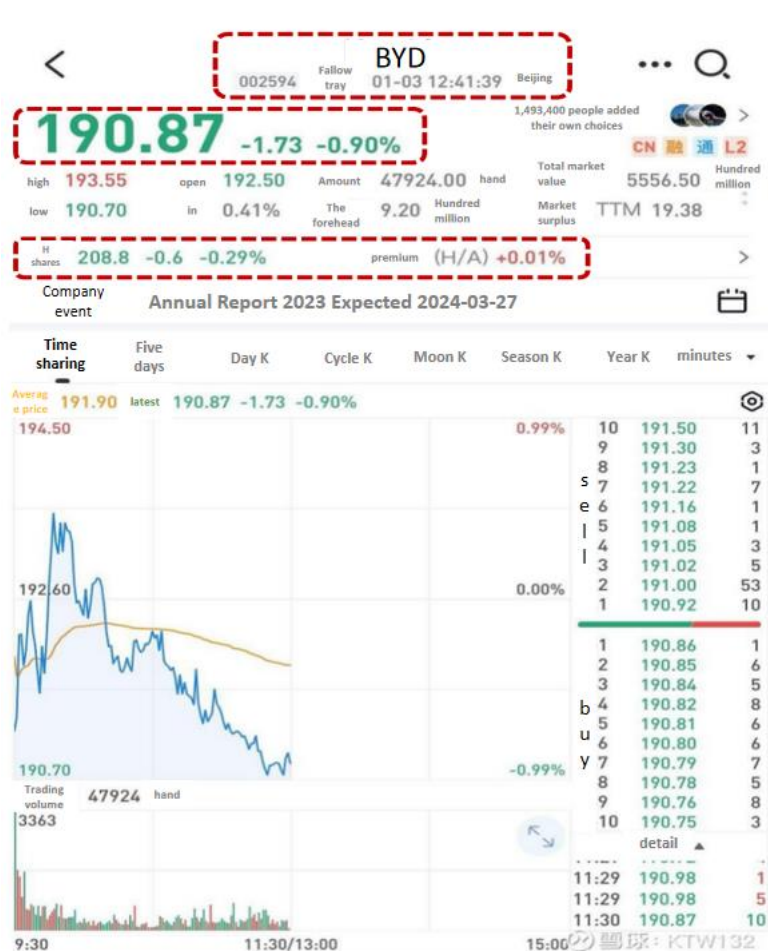


Figure 1. Byd Company Limited AH Premium Rates (H/A)

At midday on January 3, 2024, BYD experienced a unique situation when its AH share premium turned negative, meaning that the Hong Kong share price was still higher than the A share price after exchange rate conversion. This is a special case among dual-listed companies, and it is the only company with a negative premium at that time. The shift comes against the backdrop of major events, such as Warren Buffett's reported reduction of his stake in BYD, and the decline of the Hang Seng Index over the years, among others.

4. Investment suggestions based on AH share premium and international economic factors

In terms of the trend of AH share premium, the valuation difference between A shares and Hong Kong shares is expected to continue to fluctuate within a reasonable range in the future, and the AH share premium phenomenon will not disappear in the short term. Historically, when the AH share premium reaches a high level, it tends to reverse over time, suggesting some investment opportunities in H shares.

On the macroeconomic level, global economic growth has slowed down, and although inflation has fallen, it has fallen at a slower pace and has not been as optimistic as expected. In its latest October World Economic Outlook Report (WEO), the International Monetary Fund (IMF) expects global economic growth to slow from 3.5% in 2022 to 3.0% in 2023 and 2.9% in 2024, lower than the historical (2000-2019) average of 3.8%. The 2024 forecast was revised down 0.1 percentage point from its July estimate. (IMF, 2023) Energy and food prices remain high, factors that could have an impact on Hong Kong stocks.

On the other hand, the Hong Kong stock market will show a trend of "low first and then high" in 2024, which may be related to the US Federal Reserve's interest rate reduction policy. If the interest rate cut is implemented, it may improve the investment climate and have a positive impact on the stock market. At the same time, China's economic recovery is seen as a major potential upside that, if realized, could significantly lift earnings forecasts for stocks.

Hong Kong's stock market has performed poorly over the past year. According to the most recent data and analysis, as of the closing price of Hang Seng Index on January 29, 2024, the P/E ratio was 7.89, the P/E ratio was 3.22, the P/E ratio was 0.84, and the P/S ratio was 0.97. These figures suggest that the overall valuation level of the Hong Kong market is relatively low, especially compared with historical data. In addition, the long-term average of the Hang Seng index is also well below its historical level, and the current market is undervalued relative to its historical level.

Comparing the Hang Seng Index with other international markets, the Hang Seng Index fell below 15,000 on January 22, 2024, hitting a 15-month low. At the same time, stocks in the U.S., Japan and other major markets have performed relatively well, and valuations in Hong Kong can be found at low levels. This may indicate that there are investment opportunities in the Hong Kong stock market in the current international economic environment, especially for investors seeking relatively low valuation markets.

The Hong Kong stock market is affected by the international market sentiment, especially the uncertain global environment, such as high interest rates, geopolitical complexities, uncertainties in supply chains and freight transportation, as well as the changing election prospects in the United States, which makes the market very sensitive.

China's economy has faced serious challenges since COVID-19, which has had a notable impact on the Hong Kong stock market. China's economy has been struggling to recover from strict COVID-19 pandemic lockdowns and restrictions that wreaked havoc on trade, woes also exacerbated by a property market collapse and a shrinking population. In addition, the Chinese government's tighter control over Hong Kong, such as the implementation of a national security law and regulations on large enterprises, has also affected investor confidence and market performance. Foreign investors' confidence in China and Hong Kong has waned amid economic challenges and changes in the country's political environment. For example, foreign direct investment in China fell in 2023 for the first time in 12 years.

Investment suggestions:

A. Diversification: Given the uncertainty and volatility of the current market, A diversification strategy is recommended. The allocation of funds across industries and companies could be considered to reduce the risk of volatility in a particular industry or market.

B. Focus on value stocks: Given the current low valuation state of the Hang Seng Index, investors may find value stocks attractive. Value investing, looking for companies with solid financials, stable earnings and good governance, can be smart.

C. Long-term perspective: Given the market's current low valuations and potential political risks, a long-term investment perspective is recommended. The market may continue to experience volatility in the short term, but quality assets are likely to offer good returns over the long term.

D. Follow policy trends: closely follow political and economic policy changes related to the Hong Kong market.

E. Risk management: Risk management is key in any investment decision. Given the volatility and uncertainty of the Hong Kong stock market, investors should do their risk management well, and it is recommended to set stop-loss points and risk limits to protect the portfolio from significant market fluctuations.

F. Continuous monitoring and evaluation: Market conditions change frequently, so it is important to regularly evaluate and adjust the portfolio. Follow relevant economic indicators, company performance and market news in order to adjust strategies in a timely manner.

Sector investment suggestions:

* Technology sector: Often a hot spot for capital markets, especially in the context of increasing market demand driven by innovation and technological advancement, this sector is likely to see more inflows, especially among companies with strong R&D capabilities and market potential.

* Biotech and healthcare: The healthcare sector is likely to attract significant investment, benefiting from an aging population, increased health awareness, and advances in medical technology. Moreover, the long-term impact of the pandemic is also likely to further drive investments in the healthcare sector.

* Consumer discretionary: This sector includes leisure, entertainment, high-end consumer goods, etc. As the economy recovers and consumer confidence increases, the consumer discretionary sector is likely to experience growth and attract investor attention.

* Financials and real estate: The financial sector may face some near-term challenges, but there may be localized short-term investment opportunities in the sector as the global economy recovers and financial markets stabilize. The property and construction sector is usually closely linked to the economic cycle, and although it may face cyclical challenges, it may also provide some short-term investment opportunities, especially when the market picks up.

* Energy and raw materials: These two sectors are generally affected by fluctuations in international commodity prices. As the global economy recovers and demand increases, these sectors are likely to experience volatility in prices and demand, offering potential opportunities for investors.

5. Conclusion

Overall, Hong Kong's stock market in 2024 May face certain challenges, but there are also investment opportunities. Changes in the international economic situation are expected to continue to affect the market. Hong Kong local economic factors, such as GDP growth, employment rate and government policies, also directly affect stock market performance. AH share premium reflects market sentiment and investment opportunities. Investors should deeply analyze the reasons behind the premium and make diversified investments to reduce risks. In addition, investors should implement effective risk management strategies to cope with market volatility. By considering these factors together, investors can be more comfortable with market complexity and uncertainty in 2024, and thus make more informed and forward-looking investment decisions. This will not only help achieve stable investment returns, but also effectively manage and reduce risks and ensure the sustainability and robustness of investments.

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