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What to expect from China's Stock Market in 2016

There were many reasons behind the much-discussed ups and downs in China's stock market in 2015. However the main cause of the volatility was that there were too many people buying stocks with margin loans they couldn't really afford to repay – they were over leveraged. In fact China's stock market is, on average, far more leveraged than any other in the world. The proportion of total market capitalisation that is financed can be as high as 7-8% in China, while in the US the proportion is usually below 2%.

The Chinese government's anti-corruption efforts began focusing on the financial sector in 2015 and have, to a certain extent, dampened insider trading and created a more level playing field in the market. However there is still the need for a better top-down design to ensure that capital markets develop in a more healthy and orderly fashion.

I expect China's financial markets to gradually stabilise in 2016. The government has introduced a number of measures to limit stock index futures trading. It is also trying to steer the Chinese financing system away from indirect shadow-banking and towards the direct financing that is typical in more developed markets. This will help lower financing costs across all areas of the Chinese economy. Making financing more accessible will also help encourage the development of small and medium-sized private enterprises and inspire more entrepreneurs to start their own business.

We also need to remember that it has only been 25 years since the launch of China's stock market; so the market is not yet fully mature and volatility is unavoidable. The US stock market also experienced severe insider trading problems in the 1920s, which ultimately resulted in the creation of the US Securities and Exchange Commission to better regulate its markets.

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China's markets may see some

more volatility again in March when regulators are expected to begin gradual implementation of a new IPO registration system. The new system is expected to make it easier for companies to list, without first needing to meet regulators' profitability indicators. This should mean that their listing price will more accurately reflect the real valuation of the company. Under this new system, companies should only seek a listing if, after careful consideration, they find the benefits will far outweigh the costs. This will serve as a natural selection mechanism. The present system has tended to result in over-inflated valuations for newly listed companies, in part because it severely limited the number of new IPOs and supply and demand became imbalanced. The new registration system will likely lower the valuation of all new listings, however the valuations should be more accurate, and bad companies will not list.

Retail investors also need to take a hard look at their investment strategy. They need to decide whether they are really investors or just speculators. Speculators cannot blame the market when they lose money, it is just bad luck. However if a long-term investor has failed, then the market is to blame. A good market should provide long term investors who invest in good companies with a reasonable rate of return within three to five years.

Investors should also better understand their risk tolerance before making any investment, and must be diversified in order to reduce risk. It would be better for small investors purchase a basket of stocks through institutions rather than buying individual stocks themselves. Finally, investors should pay more attention to national policy, and retail investors should stay away from speculation. Investors should capture the long-term trend instead of identifying short-term volatility. Thus timing is certainly more important than stock picking.