

Profitable INVESTING Tips

Stock Market Investing Tips, Techniques, and Resources



How Far Will Chinese Stocks Fall?

According to *CNBC* stocks in **Shanghai** fell six percent. The miracle of year after year stellar economic growth is coming to an end in China and the real estate bubble may be set to deflate.

China was the main focus for investors as the country's Shanghai Composite benchmark tumbled in the final hour of trade. It finished the session down 5.3 percent after rallying to a three-and-half-year high of 3,091 points earlier in the day. It marked its biggest one-day fall in percentage terms since August 2009.

*"It's not a stock market, it's a casino," Peter Elston, a global investment strategist at Seneca Investment Managers, told *CNBC* about the Chinese benchmark.*

The Chinese central bank has lowered interest rates in an attempt to stimulate internal growth now that exports are slowing. As the forty year economic miracle comes to an end it remains to be seen how well the economy will adjust and how far Chinese stocks will fall.

Real Estate in China

The November 21 interest rate cut by the People's Bank of China was meant to stimulate internal growth but so far it has not done much. According to an article in *Forbes* **China's housing market** is not responding all that well to interest rate cuts.

Our tracking of the Chinese housing market suggests that the rate cut has had a much tamer impact than previous policy changes.

Last week, the week following an interest rate cut, primary home transaction volume increased by 6% week-over-week for both units and square meters sold nationwide. That compares to 100% and 105% week-on-week increases, respectively, during the week immediately after September 30, when Chinese authorities announced that they were relaxing requirements for mortgage lending. Secondary home transactions changed by -1.4% and 2.2% in units and square meters sold nationwide, compared to 238% and 244% respective increases during the week following the September mortgage policy change.

It may well be that the housing bubble is worse than everyone thought and that simply dropping rates will not be enough to avoid a collapse of prices. If that happens it will likely cause waves throughout the economy including the stock market. The question, again, is how far will Chinese stocks fall?

Where Are Chinese Stocks Heading?

The recent fall in Chinese stocks came after a weeks-long rally. The question investors are asking is if this is just a market correction or if it foretells a continuing fall in stock prices due to weakening underlying fundamentals. An article in the online *Financial Times* notes that **Chinese stocks are volatile** after the recent downturn and that a further correction is likely.

"We see a further sell-off likely in coming days," wrote Ken Peng, Asia strategist at Citigroup. He estimates that at least half of the A-share rally since July is "fundamentally driven and sound." The rest is euphoric.

Since July the Shanghai Composite is still up about 40 per cent.

Trading on the Shanghai market hit a record high of \$128bn on Tuesday. Morning trading volumes today are 27 per cent below yesterday's level, but still 46 per cent above the 30-day average.

Today's biggest loser is the financial sector, down 1.7 per cent, whereas consumer discretionary stocks are up more than 3 per cent.

As key commodity prices continue to drop, China's producer price index tumbled to a year-over-year pace of -2.7 per cent pace last month, a 33rd month of deflation.

"The PPI deflation clearly suggests Chinese corporates are struggling amid economic slowdown, and real cost of funds is close to 10%, which will further squeeze profit margin and increase debt burden," said Li-Gang Liu, chief economist at ANZ.

The long term complaint about investing in China is the lack of transparency. If the economic fall off turns out to be worse than previously believed the Chinese market could give back the forty percent gains of the last months and more. How fall will Chinese stocks fall? When anticipating percentage losses, comparisons to the most recent market crash in US markets or the crash leading to the Great Depression are not out of line. It could well be that the Chinese markets are as much as fifty percent overvalued and will painfully correct.

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