Market Mania In China
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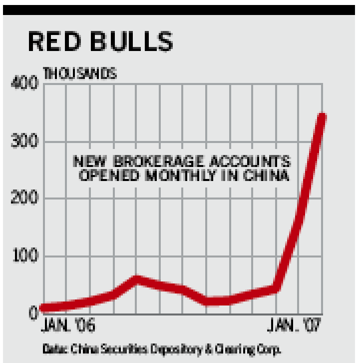
Stocks remain a wild gamble, but millions of unsophisticated investors are rushing in

It's a frigid Tuesday morning, and China's capitalists are just getting warmed up. The Baijiazhuang branch of the Citic Securities brokerage in eastern Beijing is packed with more than 100 investors milling around the unheated room. They sip green tea while perusing pages of the China Securities Journal plastered on the wall or gaze up at ticker screens overhead. Some punch orders into grimy PC terminals, while others sit under No Smoking signs puffing on cigarettes and playing Chinese chess.

Charles Schwab (SCHW) it's not. Most of China's "trading halls" feel more like betting parlors than prosperous brokerages. But they're front-and-center in the mainland's love affair with stocks. China today has some 81 million trading accounts, up from 61 million six years ago. In January alone, 341,000 investors—retirees, housewives, government officials, professionals, students—opened new accounts, vs. just 11,000 accounts added in January, 2006. Although less than 5% of the population owns equities, compared with more than 50% in the U.S., the trading halls are full, online chat rooms and financial Web sites are hopping, and just about everyone you meet has a hot tip. "A lot of elderly women play the market," says Ms. Li, a regular at Baijiazhuang who, like many other traders, declined to give her full name. "They should be careful because they are not strong and the high risks of the market could harm them," counsels the retired accountant. Li, 59, apparently feels she's made of sturdier stuff: She has plowed 20% of her savings into stocks.

The stampede into equities has set China's markets on fire for the past 12 months. The Shanghai A-share index (which tracks stocks largely restricted to Chinese investors) is up 120% in the past 12 months, even after the Feb. 27 rout that saw the exchange shed nearly 9% of its $1.1 trillion market capitalization in a single day. And although the Shanghai exchange is now trading at around 35 times next year's projected earnings (compared with 15 for the Standard & Poor's 500-stock index), Chinese continue to rush in. By some estimates, individual investors make up two-thirds of the market. That's partly because they have few other options: Local banks pay around 2.5% interest on deposits, and property prices in many cities have soared so high that real estate is beyond the means of many. These greenhorn investors "are momentum players who tend to jump on the bandwagon when the market is going up," says Jing Ulrich, Chairman of China Equities at JPMorgan Chase & Co. (JPM)

Quick buy and sell
For many in china's new shareholder class, stockpicking is more art than science. Li, for instance, can't resist a bargain: "I like stocks that cost no more than 8 renminbi [$1]." And you can forget about the concept of buy and hold. "I generally keep a stock for about a month" or until it has seen gains of about 10%, says Ms. Wang, a 52-year-old former department store clerk. Her hair-trigger tactics have not stood her in good stead: "I see that other people have earned a lot from the stock market, but I never have," she admits.



Even those who've been burned before are coming back. Zhai Maohui is a regular at Baijiazhuang when he's not piloting flights to San Francisco or Los Angeles for Air China.

An investor for more than a decade, he lost nearly all his money during a market bust in 2005. But his luck has improved, with his stocks tripling in value in the past 18 months. "I put all the money I am able into the stock market," says Zhai, 59, who expects prices to keep rising as the 2008 Beijing Olympics nears. "There are no risks for me in investing in the market right now."

Not all Chinese investors are quite that sanguine. Many try to educate themselves, poring over analyst reports available free of charge at Web sites such as Hexun and China- stock and visiting chat rooms. Unfortunately, what passes for information online is sometimes little more than rumor.

Shanghai-listed Winsan Industrial Corp., a property developer with meager earnings, shot up 30% in one week last October on chatter that it was to get an asset infusion from its parent company, only to fall back again a week later when the transfer failed to materialize. Indeed, talk that Beijing was considering a capital-gains tax, along with other measures to rein in exuberant investors, precipitated the Feb. 27 market dive.

Those without computer skills rely on the business pages of newspapers and magazines and TV shows such as Securities Live or the poetically named Finance Under Heaven. Still, many fledgling Chinese investors will readily admit they have a lot to learn. "I buy and sell too quickly, I should be more patient," says Mr. Zhou, a 63-year-old retired engineer in Shanghai. "I'm a speculator, not an investor."

It's not just mom-and-pop investors who believe the stock market is a one-way ticket to riches. The high-flying returns of the past 12 months have enticed many Chinese companies to invest as well. "In a country with so few checks and balances, it's naive to think that corporates who are cash-rich would sit by and watch the market," says Fraser Howie, who manages the China portfolio for CLSA Asia-Pacific Markets. "They are saying: Let's raid the corporate piggy bank and play, too.'"

A surge in initial public offerings has helped keep interest in the markets high. Witness the 38% jump in the stock of insurer Ping An on its first day of trading on Mar. 1. It's the kind of pop a day trader's dreams are made of. Just ask Boris Peng, a 28-year-old investment manager at the Shanghai branch of Standard Chartered Bank. He has been lucky enough in the past year to buy into two IPOs, which are typically oversubscribed, with shares allocated by lottery. Peng doubled his money by selling stock in China Life, the country's biggest insurer, on the first day of trading in Shanghai—a practice the Chinese call chao gu, which translates roughly as "stir-frying" shares. "Picking a company with an IPO is easy," says Feng, who has about $14,000 invested in the market. "You can't lose."

Getting Clearer

Despite the casino-like atmosphere, part of the surge of interest in stocks reflects a steady improvement in the environment for retail investors. Since the Shanghai and Shenzhen exchanges opened in 1991, transparency has grown, better companies are coming to market, and the brokerage industry has cleaned up its act under pressure from Beijing. Today, China boasts a thriving mutual fund industry, with some $110 billion in assets under management, equal to some 8% of the $1.4 trillion combined market capitalization of China's two bourses. "Listed companies are more serious about corporate governance issues, being transparent, and creating shareholder value," says Tian Rencan, chief executive of Fortis Haitong Investment Management Co. in Shanghai, which manages $3.3 billion worth of mutual funds and has doubled its client roster, to some 600,000, in the past year. Others, however, stress that China's capital markets still have a long way to go. The quality of financial data published by companies is wanting, while the macroeconomic statistics from the government are often suspect. Without these tools, it's difficult for even the most sophisticated of investors to make the right calls. Says Michael Pettis, a professor of finance at Beijing University: "Even Warren Buffett would be a speculator if he moved to China."

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