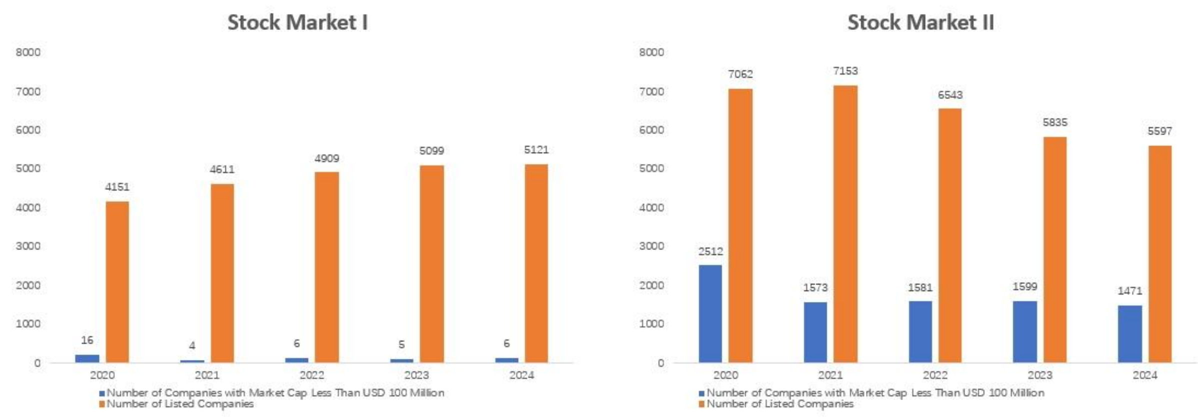
# A Tale of Two Markets

**Xin Wu, CIO | January 6, 2025**

The US and Chinese stock markets are two of the largest and most active equities markets, with a comparable number of listed companies: 5,597 in the US and 5,121 in China as of the end of 2024. We present two charts here, one each for the two markets showing the total number of stocks and the number of listed companies with a market capitalization below USD 100 million. Now, take a guess—which chart represents the Chinese A-shares and which represents the US market?

**Charts: Stocks with Market Cap Below USD 100 Million**




Data Source: Wind

If you selected Chart II for Chinese A-shares, assuming it reflects the much-discussed "cheap valuations" in A-shares, you're in for a big surprise. Although this assumption might seem logical—given that Chinese stocks, represented by the CSI 300 Index, fell 18.6% over the past three years, while US stocks, represented by the S&P 500, gained 28.8%—Chart I actually represents Chinese A-shares, while Chart II corresponds to the US market.

As of December 31, 2024, China had only six stocks with a market capitalization below USD 100 million (converted to RMB), out of 5,121 listed stocks. In contrast, the US had 1,471 such stocks out of a total of 5,597. Without additional context, one might conclude that China's stock market hosts many "small and beautiful" companies, giving them larger market capitalizations than their US counterparts. However, this is not the case. More often, these micro-cap companies are "small and ugly."

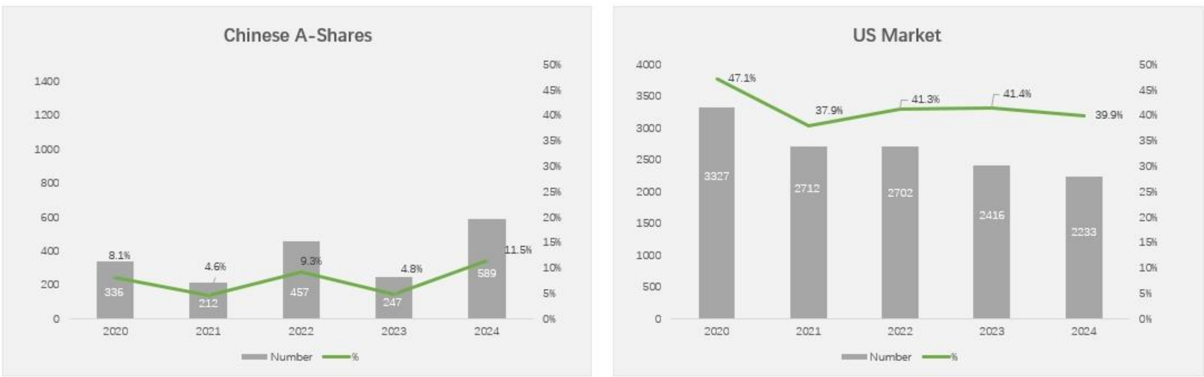
Why does China have so few micro-cap stocks? Many experts have shared their views, and we highlight one perspective from economist Li Xunlei (link: Economist Li Xunlei's Analysis), which offers valuable insights into this phenomenon. While there isn't a definitive answer, several factors stand out.

A significant number of poorly performing micro-cap companies in China are focused on hyping their stocks with the "next big story," often following trends like AI. Moreover, more than 70% of the trading volume in the Chinese stock market comes from individual investors, who are typically unskilled and highly temperamental. This speculative mindset, deeply ingrained in the culture, drives them to chase quick jackpots rather than consider valuations carefully.

As a result, the Chinese A-share market often resembles a casino, characterized by extreme volatility and frenzied trading activity. Some argue that the limited number of micro-cap stocks may also stem from distortions in the IPO pipeline due to stringent listing rules. These rules create demand for micro-cap companies as vehicles for backdoor listings.

Nonetheless, we observe the same conclusion when we raise the threshold to a market capitalization of USD 300 million for both markets: the number of micro-cap stocks in the US far exceeds that in China, with 2,233 in the US compared to 589 in China as of the end of 2024.

**Charts: Stocks with Market Cap Below USD 300 Million**




Data Source: Wind

The change in the total number of stocks over time also provides a clue. In the US, the market appears to embody the principle of "survival of the fittest," where the strong thrive, and the weak are eliminated, resulting in a reduction in the total number of stocks. In contrast, the trend in China moves in the opposite direction due to outsized new IPOs with scarcely few delistings.

The stark contrast between the US and Chinese stock markets—both in the change in the total number of stocks and the proportion of micro-cap companies—offers intriguing insights into the underlying dynamics of each market. The higher prevalence of micro-cap companies in the US suggests a more diverse and potentially more mature investment landscape, while China's scarcity of such companies points to a market that is either less developed or shaped by unique cultural and regulatory factors.

These disparities present not only challenges but also significant opportunities. For us, as value investors in China, we see ample opportunities on both the long side and the short side.