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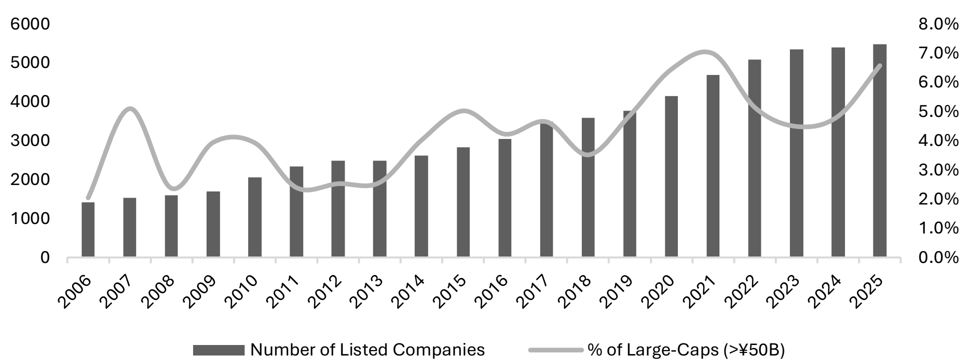
Unlocking Alpha in China A-shares

June 12, 2026

Many foreign investors remain hesitant to invest in China A-shares, largely because they associate the market with macro uncertainty, regulatory risks, and stereotypes. That hesitation is understandable, but it can also obscure the market's underlying structure and the opportunities it creates for active stock pickers. For experienced active stock pickers, these same features are not simply obstacles; they are part of what makes the opportunity set so compelling. With more than 5,000 listed companies, deep liquidity even in bearish markets, and unusually wide dispersion in both valuations and returns, China A-shares offer fertile ground for investors who can distinguish intrinsic value from crowd-driven pricing.

The Active Sandbox – Size, Liquidity and Retail Participation

Large Universe - With more than 5,000 listed companies, China's equity market offers unparalleled depth and breadth for active stock pickers. Within this vast universe, we count exactly 416 institutional-grade companies with market capitalizations exceeding RMB 50 billion as of the end of May. Comprising roughly 7.5% of all listed names, this tier represents a robust ecosystem of large-cap enterprises that rivals the structural depth of major developed Western markets.

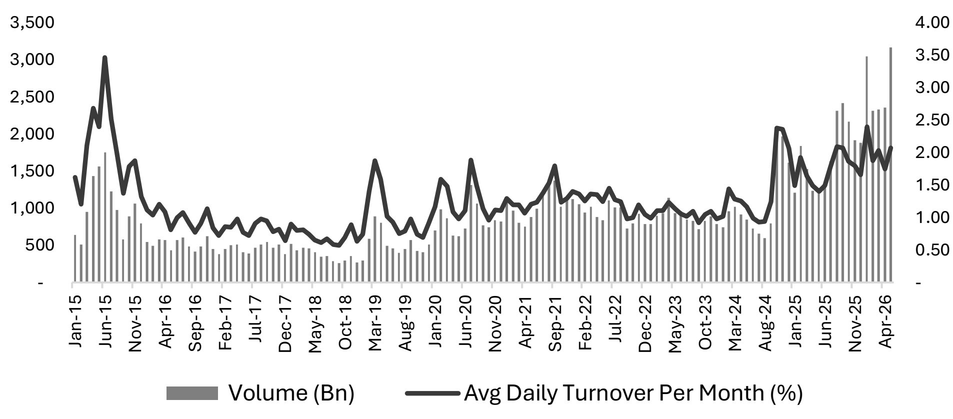


Source: iFinD, Bayan Partners.

As a major industrial economy with a broad domestic supply chain, China gives investors access to opportunities across mature sectors, industry leaders, and emerging businesses within a single market. In many other developed or emerging regions, with the notable exception of the United States, investor must navigate multiple countries, regulatory frameworks, and currencies to build comprehensive sector exposure. China's vast investable universe removes this structural friction; its sheer scale offers comprehensive, deep coverage across every major economic sector, allowing investors to find everything from high-quality compounders to overlooked, nimble businesses within a single market.

A universe of this scale may appear vulnerable to liquidity fragmentation, but in practice it remains highly dynamic, with persistent turnover continuously renewing the opportunity set.

Liquid Market - What defies common expectations is that China's equity market remains extraordinarily liquid even in bearish periods. In many markets, a prolonged downturn usually leads to shrinking turnover, fading participation, and a much thinner opportunity set, but that has not been the case in China. Even during the weak market conditions of 2022 and 2023, trading activity stayed remarkably high, with average daily turnover in 2023 still running at around RMB 700 to 800 billion. In 2024, that figure rose to roughly RMB 900 billion a day, with peak daily turnover reaching about RMB 1.3 trillion, showing that liquidity remained deep even when sentiment was fragile. This liquidity allows investors to enter and exit positions, build exposure across thousands of companies, and search for opportunities far beyond the narrow group of index heavyweights. More recently, average daily volume in May 2026 across both Shanghai Stock Exchange (SHSE) and Shenzhen Stock Exchange (SZSE) has reached RMB 3.2 trillion. A significant share of this volume is driven by retail investors, whose participation remains a defining feature of the market.



Source: iFinD, Bayan Partners.

As the graph indicates, daily turnover in the A-share market ranges from 0.5% to 3.5% in the last ten years, with the last 18 months hovering around a 2% daily average. At this velocity, the entire market capitalization of the China A-share market turns over roughly 5-6x per year. For perspective, US equities typically see an annual turnover of just over 1x, underscoring the extraordinary liquidity and vibrant trading dynamics unique to the onshore Chinese market.

Heavy Participation from Speculative Retail Investors - Another defining feature of China's A-share market is that it combines institutional scale with unusually strong behavioral noise. Chinese retail investors account for around 62% of total turnover, compared with about 38% in the US, and they tend to be far more speculative, sentiment-driven participants. As a result, prices often move more violently than fundamentals would justify, especially in smaller and newer listings. In that sense, China offers a rare mix of deep liquidity and recurring mispricing. High retail participation keeps the market highly emotional, while its scale and turnover still allow fundamental investors to build positions, exit efficiently, and repeatedly exploit entry points created by crowd behavior.

This behavioral noise creates unusually wide gaps between price and value across individual stocks. As sentiment surges and reverses, some parts of the market become excessively crowded while others are neglected, leading to sharp dispersion in both valuations and subsequent returns. For investors with genuine stock-picking skill, what matters is not the market average but the unusually wide spread between winners and losers.

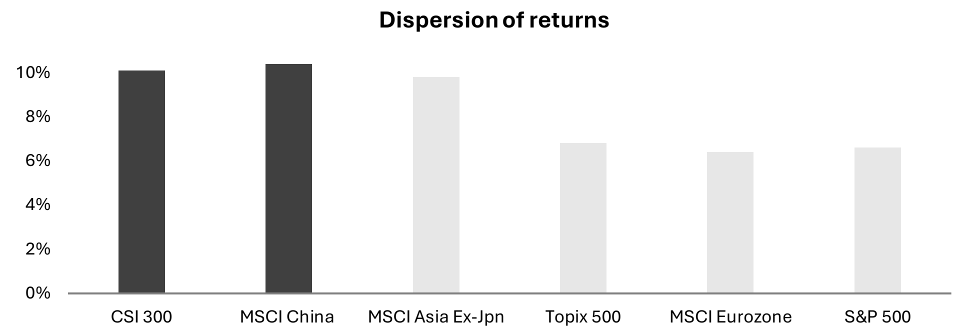
Visual Proof – Dispersion of Valuation & Return, Portfolio Diversification

Dispersion of Valuation & Return - The CSI index family provides a particularly clear window into valuation dispersion across China's equity market. As sequential market-cap buckets with no overlap, the CSI 300, CSI 500, CSI 1000, and CSI 2000 allow investors to observe how valuations vary across different parts of the size spectrum. The CSI 300 contains China's 300 largest listed companies, the CSI 500 contains the next 500 after that, the CSI 1000 contains the next 1,000, and the CSI 2000 extends further down the size spectrum into smaller-cap stocks.

Index	P/E	P/B	DIV Yield	ROE
CSI 300	14.3	1.4	2.9%	9.7%
CSI 500	35.1	2.4	1.4%	6.6%
CSI 1000	53.2	2.7	1.0%	5.0%
CSI 2000	147.3	3.0	0.7%	1.5%

Source: Wind, Banyan Partners. Based on financial reports as of Dec 2025, price as of June 2026.

As the chart shows, large caps are attractively valued, with the CSI 300 looking cheap even on an absolute basis, while many smaller companies trade at frothy levels driven by speculation in lower-quality names. In other words, one market can simultaneously contain deep value and obvious excess. That makes aggregate index multiples a poor guide to the actual opportunity set, because they compress very different pockets of the market into a single headline number. And this dispersion is not confined to valuations; it is equally visible in return outcomes.



Source: Thomson Datastream, UBS, as of 30 June 2020. Based on 5-year average standard deviation of constituents' monthly returns.

As shown by the graph, return dispersion in China is higher than in the US and Europe, meaning individual stocks deviate more sharply from the average which creates more scope for both long and short alpha. This is reinforced by the market's structure: retail investors still account for a large share of turnover, and yet liquidity remains strong even in smaller names. Clearly, market conditions in Chinese equities offer skilled active fund managers opportunities to deliver better risk-adjusted returns.

Portfolio Diversification - Broad international benchmarks tend to capture only a limited slice of China's full equity universe, with a bias toward larger and more externally familiar names, while much of the domestic listed market remains outside standard allocations. As a result, dedicated exposure to Chinese equities can widen both sector and company-level opportunity sets, giving investors access to a broader pool of businesses whose earnings and valuations are influenced by a different mix of local conditions. As the table illustrates, the CSI 300 has a correlation of only 0.39 with the S&P 500, while MSCI China exhibits a similarly low correlation of 0.53. China A-shares can serve as an important complement to a global portfolio because their investable universe is driven by economic forces that differ meaningfully from those shaping most developed markets. Much of the onshore market is tied more closely to domestic demand, local industrial activity, China-specific policy and local consumption trends than to the multinational revenue streams that define many benchmark-heavy global portfolios. That means an allocation to this market can

	S&P 500	MSCI ACWI	MSCI EM	MSCI EAFE	MSCI China	CSI 300
S&P 500	1.00					
MSCI ACWI	**0.98**	1.00				
MSCI EM	0.76	0.83	1.00			
MSCI EAFE	**0.89**	**0.94**	**0.87**	1.00		
MSCI China	0.53	0.61	**0.85**	0.66	1.00	
CSI 300	0.39	0.45	0.59	0.44	0.73	1.00

Source: Guide to China Q1 2024. J.P. Morgan Asset Management, 2024. Monthly Correlations from 2009-2024 introduce return drivers that are not fully captured by conventional emerging-market or global equity exposures.

Access - For overseas investors looking to leverage these market dynamics, the main direct channels into A-shares are the **Stock Connect** program and **QFII**. Stock Connect allows foreign investors to access eligible mainland-listed shares through brokers located in Hong Kong—currently covering around 2,700 stocks and 248 ETFs. Meanwhile, QFII provides a license-based route to invest more directly in all A-shares listed on the SHSE and SZSE, including companies that the Stock Connect program does not cover.

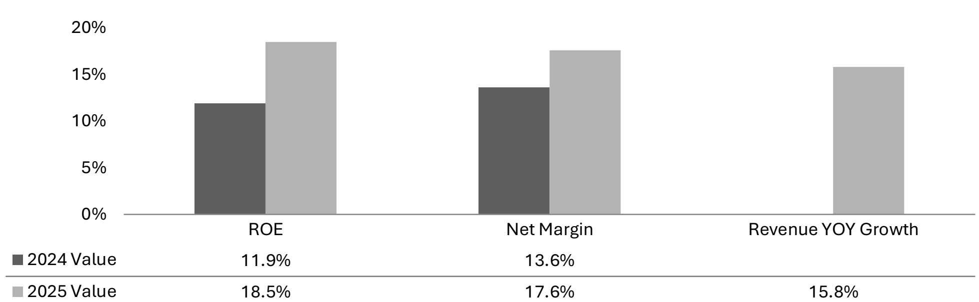
Overseas-listed ETFs are also an option, acting as a purely passive vehicle. However, choosing an ETF means blindly holding a rigid index block that blends the strong indiscriminately with the weak. For investors looking to capitalize on true market inefficiencies, moving past passive ETFs and utilizing direct channels via a skilled active stock-picker is essential.

The Improving Setup – Micro Resiliency & Buyback Catalyst

While macro uncertainty in China is real, many top-tier companies continue to deliver impressive earnings and execute shareholder-friendly corporate actions. To isolate these opportunities, we analyzed the entire onshore listed universe, ranking companies by Return on Equity (ROE) and selecting the top 800 performers for our proprietary research universe (distinct from the market-cap-weighted CSI 800 Index).

Recent earnings seasons demonstrate that these top 800 companies are expanding margins and compounding capital efficiently despite a challenging macro backdrop. Within this high-quality cohort, aggregate ROE rose sharply to 18.5% in 2025 from 11.9% in 2024, while net margins expanded to 17.6% from 13.6%, backed by a robust 15.8% top-line revenue growth. These companies are industry leaders or niche champions with real moats, built on competitive advantages that have been tested and reinforced over many years through brand strength, distribution reach, execution, and the ability to keep gaining share in their core categories.

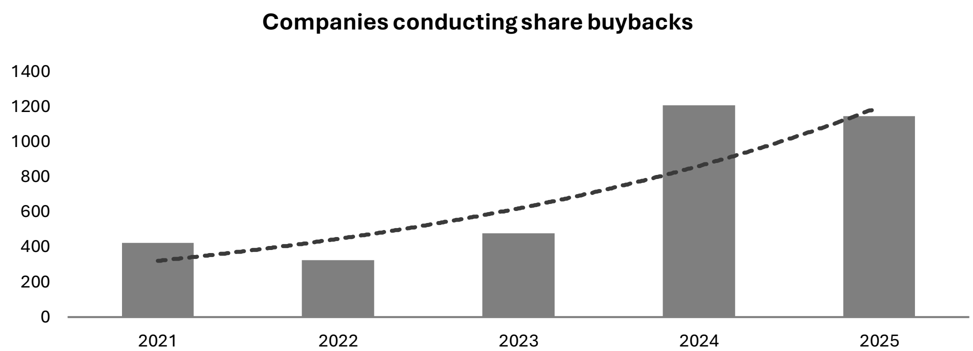
ROE TOP800 Average: Key Metrics 2024 vs 2025



Source: iFinD, Bayan Partners.

This structural resilience matters; it enables premier businesses to not only defend profitability but to aggressively widen the competitive gap. Just as importantly, a significant portion of these high-quality operators maintain robust balance sheets with ample cash reserves, granting them the capacity to aggressively repurchase shares. While many Chinese equities continue to trade at deep valuation discounts relative to history, robust market liquidity and vast sector breadth remain intact. In such an environment, companies pairing fortress balance sheets with disciplined capital allocation—specifically via share repurchases and sustainable dividends—provide a tangible valuation floor that relies on hard cash rather than narrative.

This shift is heavily reinforced by the current policy framework. The China Securities Regulatory Commission (CSRC) has systematically incentivized listed companies to enhance minority shareholder returns, driving corporate buybacks and dividend frequencies to historic highs. Yet, these shareholder-friendly dynamics remain largely overlooked by foreign capital. To unlock the true alpha potential of this market, it is essential to clear away three persistent misconceptions that continue to distort overseas perceptions of the A-share universe.



Source: iFinD, Bayan Partners.

Debunking Top 3 Foreign Investor Misconceptions

Poor Disclosure - One of the most persistent misconceptions is that Chinese companies are broadly prone to corporate governance failures and that their accounting data cannot be trusted. While fraudulent actors exist in China, this challenge is by no means unique to the onshore market; financial misconduct occurs across the US and Europe as well. In our view, high-profile corporate scandals in China are often amplified by the global media far more than positive fundamental developments, distorting overseas perceptions. Corporate fraud remains a structural reality globally, but our ground-level analysis suggests that local regulatory scrutiny and enforcement mechanisms are far more stringent than most foreign investors realize.

A primary example of this rigorous oversight is the **Inquiry Letter** scheme—a distinctive regulatory mechanism that blends international standards with unique local features to safeguard market transparency. Executed by specialized experts from both the Shanghai and Shenzhen exchanges under the direct supervision of the CSRC, this process is highly dynamic. When stock exchanges flag suspicious financial items, unusual trading activity, or potential irregularities, they require the listed company to publicly disclose the inquiry letter alongside their formal response within a matter of days.

Rather than waiting to punish misconduct after the fact, this scheme operates as a highly transparent, preventive regulatory tool. By 'drilling down' into accounting logic, auditor independence, complex M&A deal terms, and even media rumors, regulators can flag risks and deter capital market abuse before resorting to formal administrative penalties. To maintain systemic vigilance, the exchanges also randomly select target recipients as an additional layer of oversight. If an inquiry uncovers actual violations, the matter is swiftly escalated from a simple inquiry letter to an official warning or a regulatory supervision letter, forcing the company to implement corrective actions within a strict timeframe.

For foreign investors, systematically tracking these public inquiry cycles provides an incredibly granular, decision-useful look into a company's true corporate governance and operational risks. Far from being a market plagued by poor disclosure, the transparency and compliance practices among high-quality Chinese listed enterprises appear fully on par with Western peers, with no systemic evidence of structurally inferior disclosure onshore. Ground-level observation suggests a compelling institutional dynamic at play: by working harder and smarter, Chinese regulators seem to have effectively substituted the reactive, litigation-heavy legal frameworks of the West with their own relentless, preventative oversight. As the Inquiry Letter scheme demonstrates, this intense regulatory vigilance creates a deeply transparent ecosystem that, in many respects, goes above and beyond standard Western frameworks.

Abrupt Regulatory Shifts - Some foreign investors treat abrupt regulatory shifts in China as unpredictable 'black swans' capable of suddenly wiping out entire sectors, but this view heavily overstates the randomness of the process. While Chinese policymaking can appear cryptic from afar, it is far from unreadable. Before the landmark interventions in the after-school tutoring and online gaming industries, authorities had already deployed a multi-year 'warning matrix' of draft rules, public warnings, and incremental policy signals.

Most investors' recollection of China's education sector begins and ends with the 2021 collapse, but the writing was on the wall far earlier. In 2018, Beijing had already begun tightening its grip through a steady drumbeat of guideline notices aimed at curbing off-campus tutoring. They signaled a clear regulatory intent to contain the sector's scale and rein in its unchecked expansion. And yet the industry did precisely the opposite of what regulators wanted. Rather than retrenching, the tutoring sector continued to grow through 2019 and 2020, effectively betting that enforcement would remain toothless. The persistent gap between regulatory intent and market behavior culminated in the sweeping, comprehensive crackdown of 2021.

We saw the identical pattern play out in online gaming. In October 2019, Beijing imposed the first formal limits on minors' gaming playtime and spending. Yet the industry's overall scale was never truly contained, as related companies merely took token efforts in response to the regulatory guidance while market growth continued to climb. In 2020, China's gaming market generated approximately RMB 280 billion in sales revenue, representing more than 20% annual growth — a sharp acceleration from roughly 5% in 2018 and 8% in 2019. A market trend that ran counter to the regulator's stated intent ultimately left authorities with no choice but to intervene more forcefully. In August 2021, state media branded online games as 'spiritual opium,' and Beijing swiftly followed with a far stricter anti-addiction directive. This mirrors the tutoring sector's playbook almost exactly: an early, explicit regulatory signal is met with superficial compliance from the affected industry, regulators fail to see visible evidence that the industry is moving in the direction they intended, which in turn all but guarantees a harder crackdown down the road.

In China's policy framework, a distinct lag typically exists between the initial release of 'soft' guidance and its full economic enforcement. Often, these early warnings are designed to give target companies the opportunity to self-regulate and realign before punitive measures are taken. Rather than portraying these actions as capricious or blunt, sophisticated investors recognize them as a phased, logical evolution of policy. The challenge for global capital is not the randomness of the state's hand, but the lack of localized insight required to decode informal communication channels. Experienced on-the-ground managers can read these signals early, providing ample time to systematically de-risk exposure or reposition portfolios well ahead of formal announcements.

Research Coverage Myth - Many global investors approach China through a traditional Western lens, assuming that mispricings emerge in neglected small- and mid-cap stocks that lack research coverage. In mature developed markets, this framework works well. However, in the hyper-competitive domestic ecosystem of China A-shares, this dynamic is entirely reversed.

While formal sell-side coverage on smaller names appears limited on paper, it does not imply an informational vacuum. In China, the ratio of analysts to stocks is incredibly high; virtually every listed entity—down to micro-caps—is intensely scrutinized. The perceived gap in coverage exists only because 'Sell' or 'Underperform' ratings are culturally and commercially disfavored, leading to institutional silence rather than a lack of attention.

This institutional scrutiny operates alongside intense retail and speculative participation, a dynamic clearly illustrated by comparing the market-cap-weighted CSI 800 constituents against the bottom 1,000 A-share companies. Based on calendar 2025 averages, the CSI 800 companies are vastly larger, averaging a market capitalization of RMB 105,532 million compared to just RMB 2,887 million for the bottom tier, with average daily trading values of RMB 890 million versus RMB 108 million. Yet, these micro-caps are by no means dormant or neglected. The bottom 1,000 stocks boast an astonishing average daily turnover velocity of 4.4%, more than double the 1.9% posted by the CSI 800.

Crucially, as of the end of May, the average static shareholder count for these bottom-tier companies was just about 20,000, compared to over 140,000 for the CSI 800. This low shareholder count does not imply neglect; rather, it reflects a highly transient investor base. The 20,000 or so shareholders represent merely a snapshot of who happened to hold the equity at that specific moment. Beneath the surface, a vast pool of speculators constantly monitors these names—trading momentum rather than investing for the long term, and driving hyper-liquidity through a relentless cycle of rapid-fire entries and exits.

This combination of local professional surveillance and retail hyper-velocity fundamentally distinguishes China from the classic U.S. small-cap hunting ground. In the West, neglected small-caps can sit mispriced due to institutional apathy. In China, small-caps are under constant, speculative watch, driving up their valuations. This creates a highly unique market structure: while foreign investors broadly perceive China to be 'cheap,' that deep valuation discount actually exists almost exclusively within the high-quality, large-cap universe—such as the constituents of the CSI 300—leaving the highly active small-cap space structurally overvalued.

Final Thoughts

China's onshore equity market is vast, dynamic, and deeply nuanced. Our objective is not to provide an exhaustive summary, but to demonstrate that China A-shares should not be viewed merely through the lens of macro or systemic risk. Instead, they represent a unique market structure that heavily rewards disciplined, bottom-up stock selection.

Capturing true alpha in this environment requires far more than monitoring a Bloomberg terminal or parsing translated sell-side reports; foreign investors must look beyond headline volatility and generic passive indices. The real opportunity lies in exploiting the structural information gaps that favor long-term, fundamentally driven investors: accumulating high-quality market leaders trading at attractive valuations.

To accurately read the pulse of the real Chinese corporate landscape, an investor needs a deeply entrenched domestic network. Without being part of this ecosystem for many years, investors will find it impossible to gain real insights and make judgments on which companies truly have sustainable competitive advantages. For investors possessing the patience to conduct rigorous boots-on-the-ground fieldwork, the sophistication to decode policy signals, and the absolute discipline to act when price and intrinsic value diverge, the market's very inefficiencies become an ongoing source of opportunity, thereby unlocking the true alpha potential of China A-shares.