

Individual investors control over 60% of the Shanghai and Shenzhen stock exchanges. Experts believe this to be a primitive and transitory phase for China's stock market. However, the Chinese enthusiasm for numerology and betting, which goes back a long way, should not be brushed off as mere superstition and folklore. Some elements of general culture may be useful to help Westerners understand the euphoria of the average Chinese investor

## Confucius, the stock exchange and numerology

CHINA 3

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The timing and form of China's opening to a market economy is an extremely particular historical event. Many Western observers still have trouble understanding the nature of what remains a planned economy with strategic and binding five-year plans but is accompanied by the flowering of countless and apparently uncoordinated private initiatives. Going by the facts, or at any rate by the country's aggregate growth figures and the more realistic living standards of growing numbers of people, the contradiction inherent in the oxymoron "market

socialism" appears to be working. The Land of the Great Wall has no lack of such contrasts and these peculiar aspects are precisely why the casual observer finds it fascinating and incomprehensible in equal parts. This article examines one example, the stock market, with a focus on the particular characteristics of its structure – a very new market that has inserted itself into the context described above – and an aspect that has already been written about, i.e. individual behaviour, or the psychological elements that nudge the

stock market and individual investment choices in one direction rather than another.

2006 was a golden year for the Shanghai stock exchange, and 2007 also seems to have met the expectations of Chinese investors. The stock exchange index increased 130% from January to September 2007, making all previous records, such as those established by NASDAQ, the American index of technological stocks, during the heyday of the Internet economy boom pale in comparison.

Each time the Shanghai index leaped, there was a host of dire prophecies about an imminent bursting of the investment bubble and warnings about everything from risk to recession to a crisis worse than the 1929 Wall Street crash. When the index went past the 4000-point milestone, a chorus of Cassandras predicted possible stock market speculative bubbles. But the average Chinese investor kept buying, undeterred, in the hope of doubling his fortune in the short term like other people he had heard of or seen.

As the Shanghai composite index (SCI) climbed from 4000 to 5000 points, the government used all the media to continually emphasise the dangerousness of the market and the possibility of serious losses for all investors. Leading businessmen such as Li Kashing, the Hong Kong magnate, made their concerns heard alongside the government's.

Nevertheless, about 100,000 new trading accounts on average are opened each day by all classes of the population, from white-collar employees to university students and pensioners. The latest response by investors to government warnings about the high level of speculative investment and the resulting increase in risk has been to take out mortgages on their homes and high-interest loans so as to have more cash to play the stock exchange.

In sum, the scenario appears to be a complex one. The Shanghai stock market has a highly respectable history: one can trace its origins to 1860 and the period of foreign concessions following the signature of the Treaty of Nanking, when shares of companies



exploiting mines and other natural resources such as rubber were traded. There was a major development in 1920 with the creation of the Shanghai Stock Exchange and a change from the preferential issue of shares of insurance and shipping companies to the sale of shares of emerging industries with foreign capital. By 1930 Shanghai had become a Far Eastern financial centre of primary importance, competing directly with Hong Kong. Mirroring Chinese history, it remained inactive for over four decades and officially re-opened on 26 November 1990 after being closed in 1949.

The Shanghai index has now become a kind of barometer of the Far Eastern economy as well as a catalyst for the European and American stock exchanges, with daily oscillations of even 5% in the local market affecting both the Asian and the European stock markets. Stock market experts estimate that Chinese share movement has become an index of risk tolerance for investments in the region.

A further element to consider is that the lack of a trade press free of government controls on the one hand and limited communication opportunities for analysts on the other results in the lack of reliable sources of precise and updated information for investors. While financial blogs rule the roost, they are limited by efficient and timely censorship, as well as by unreliable



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sources and an excess of information of little value.

To complete an objective view of the situation, it is worth recalling that shares traded on the Shanghai stock exchange are exclusively Class A shares, with limited access for international investors. They are essentially reserved for Chinese capital. In this relatively young set-up with limited product categories and lack of information, the behaviour of individuals and their risk propensity are markedly different from the West.

To start with, there are no structured "trends"; these are the result of the sum of individual behaviour, which is based on very particular and differentiated considerations that Western logic would in some cases classify as decidedly irrational. Some elements of general culture may be useful to understand the euphoria with which the average Chinese invests. The "luck" factor in the life of an individual has been culturally overestimated from ancient times. Waiting for an event that can change the course of one's existence is strongly connected to tradition, and

translates into a very widespread propensity for risk-taking and gambling that has little room to flourish in today's society because of strict limits imposed by the central government. The stock exchange was immediately interpreted as a place where the impossible can happen. Another aspect to keep in mind is the meaning of wealth as an element of social differentiation and individual liberation. It is not for nothing that the people greet each other at the New Year by saying: "May you become rich!"

This subjective determination to get rich, combined with a lack of places in which to try one's luck, lead to events that cannot be explained by the usual financial observations. For example, immediately after "Black Wednesday", 27 February 2007, when there was an 8.9% decline in the A share index, the Shanghai stock exchange crossed the psychological threshold of 4000 points in one month. The fact of this milestone being reached in such a short lapse of time generated irrational euphoria at all levels of the urban population, which opened 300,000 new trading accounts on 8 May alone for a total 1.2 million nationwide since the beginning of the year. Meanwhile, the watchdogs together with the central authorities began examining financial mechanisms aimed at containing the speculative bubble. The immaturity of Shanghai's share market is also a glaring local example of how, at the national level, the country's economy is tied to wide-ranging risks inherent to excessive investments in real estate and dependence on exports.

In the first week of August 2007, the Shanghai Composite Index climbed 153 points in a single day, taking the growth record of the index to 4560.77 points, with trading volumes of 175.9 bn yuan for daily growth of 3.47 percent. The Shenzhen stock exchange's composite index rose by 617.5 points for a daily increase of 3.97% and a turnover of 95 bn yuan.

The daily increase peaks of the A share index, valid only for the domestic market, had astonished experts all through 2006. Its current growth is all the more astounding considering that stock exchanges everywhere else in the world

have experienced strong decline because of Wall Street's lack of confidence in GDP growth indexes and the unemployment rate in the U.S. The irrevocability of subprime loans (a euphemism to indicate the high risk typology below the level of acceptability) has also pulled European stock exchanges into a downward spiral, while only slightly influencing the Chinese stock exchanges for the moment. This raises the question of whether the relationship between the Chinese and Western stock markets is univocal, and whether the restrictions in place for Class A shares heavily influence foreign markets without undergoing the same fate in their turn.

Coming back to the behavioural specificities of Chinese investors, there is no doubt that most of them attempt short-term speculation, taking advantage of the favourable moment and the lack of other investment tools. With inflation growing but still in check, the meagre returns from the fixed bank interest rate, just over 2%, provide no incentive at all compared to the stock market. In the urban area of Shanghai, the market craze has spread from experts to all levels of the population, involving even pensioners and students. Confirming this phenomenon, the main problem that banks are facing in these months is not just the withdrawal of fixed deposits but also people taking out mortgages on their first house so as to have more liquid capital available to invest. The overall result is that banks are seeing a drop in deposits by savers for the first time in a decade.

Excess available liquidity related to an irrational approach to investment portfolio choices has started creating market surges that institutional investors find hard to interpret and adding decision-making variables more closely linked to social anthropology and behavioural analysis than to purely financial criteria.

A recent survey has shown that the average Chinese investor's declared intention is to achieve an effective return on capital in less than three months. The survey, conducted by the Chinese Academy of Social Sciences, shows that an investor holds a share for 116 days on average. Over a fourth of respondents said they had

invested at least half of the family savings, and over 10% had taken out a mortgage on their homes or a loan to be able to invest in shares. 8.3% had invested all their family savings. The hope of a return on investment in 2007 varies from a minimum of 10% to 50 percent. 60% of the survey sample was composed of people with a high school certificate and an average monthly salary of 500 euros. It is commonly believed that the stock market will keep soaring until the forthcoming Beijing Olympics. Potential investors also view the 2010 Universal Exhibition in Shanghai as a guarantee of robust, continued growth for the stock market.

Besides the widespread risk-taking propensity, China's 5,000-year culture plays an important role in share portfolio management. It is not so much Confucius' sayings as the even more antique geomantic and numerological tradition of feng shui that influences the actions of Chinese investors in 2007. The terms *feng* (wind) and *shui* (water) are said to have appeared for the first time in Chinese literature in the Book of Burial Rites, which describes a sort of positive energy and its influence on the surrounding territory, an energy that moves with the wind and is circumscribed by the flow of water. In short, *feng shui*, sometimes translated in Western texts as geomancy, studies the influence on and the interaction of the environment with people. In the thousands of years since it originated, *feng shui* has been used both as a geomantic instrument to build and position buildings and as a tool to interpret individual horoscopes. Examples of its geomantic use are the old Forbidden City in Beijing and the Bank of China skyscraper in Hong Kong, as well as the octagonal mirrors that decorate buildings in the Chinese countryside. The second use of feng shui is demonstrated by the habit, still widespread even in the cities, of consulting the annual Tung Sing almanachs for indications regarding auspicious or inauspicious days or for weather forecasts.

Numerology is part of the most complex feng shui and permeates everyday life in Chinese society even today. Because of



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homophony, i.e. two Chinese characters being pronounced the same way, the number eight is auspicious, while four is unlucky. The homophone of the word “eight” means “wealth” and “good luck”, while the word for “four” is a homophone for “death”. Coupling these two numbers with others can create linguistic combinations with different meanings: from the number 164, literally “it leads you to death” to the number 158, i.e. “I desire wealth”. This attention to numbers can also be seen in the fact that many of the 3,000 skyscrapers dotting Shanghai do not have a 14th floor, which is replaced by a 15th floor or 15b. Where the 14th floor exists, the building’s market value drops considerably and it is almost always inhabited by *laowai* (foreigners). Numerology influences the stock market in that Chinese shares, for practical reasons, do not use mnemonics made up of Roman letters but are indicated using numbers. A stock symbol is composed of six numbers: symbols starting with 6 are

linked to the Shanghai index and those starting with 0 to the Shenzhen index. It is a short step from this operating requirement to a subjective numerological reading.

Non-experts, for instance, consider shares such as 600158, 600881 and 60028 to be strong positions because these are lucky numbers. It is normal for even people of a high cultural level to opt for strong numbers such as a share marked 600881 as soon they enter the dizzy world of investing, with no knowledge of the company issuing the shares, its history or its market. This is not an entirely haphazard choice. Since attention to numbers is extremely widespread, if a company has managed to be attributed the lucky numbers using its influence, it means it is reliable and has good connections (*guanxi*).

Partly superstition and partly self-fulfilling prophecy, the use of numerology is a variable of great importance in the negotiating and trading phases in China. From registering domain names on the Internet to car licence plates, the fixation with the number eight and the aversion for the number four permeates all of Chinese society at every cultural and economic level.

Another interesting factor that astounds Western economists is the percentage of interest rate hikes by China's central bank. The incremental value of rates appears arbitrary and non-standard to any economist, but is perfectly normal for anyone familiar with the use of an abacus, an instrument that is still used at bank counters and even by accountants when going over accounts done on a computer or using a calculator. In general, increases in interest rates are calculated at the international level on the basis of an annual calendar of 360 days, with incremental values that can be divided by nine. As regards China, we have to remember that the dates for the main festival, the Chinese New Year, are determined afresh each year using a combined solar/lunar calendar. The date varies each year by a few days between January and February. In the West, numbers are divided into blocks of three digits, i.e. 1,000, 1,000,000 etc, whereas in China they are divided into four digits: 1,0000 etc. The use of the abacus, a mathematical instrument that dates back nearly 3,000 years, means that increments used in the West cannot be used efficiently here and therefore require a "Chinese way".

Finally, the use of numbers and their intrinsic value in non-institutional investors' choice of shares is an indicator not only of the propensity for risk and gambling typical of the Chinese, but also of the fact that many behaviour patterns that international financial analysts consider to be irrational are seen as totally justified by local analysts. This aspect, together with the overestimation of informal information, rumours and urban myths leads to decision-making psychology on the part of most Chinese that is not very easy to identify or foresee, because it does not fit in with traditional decision-making patterns in the financial world. According to the Asian Wall Street Journal, individual investors control over 60% of the Shanghai and Shenzhen stock markets as compared to share markets such as America's, where banks like Goldman Sachs and Merrill Lynch firmly hold the reins of decision-making power

**Numbers have specific meanings in Chinese because they have non-numeral homonyms, i.e. words written differently but pronounced in the same way as the numbers, which give a good or bad connotation to the number itself, e.g.:**

1	yi also pronounced yao, the homophone of	WANT
2	er	LOVE
3	san	LIVE
4	si	DEATH
5	wu	i or NO
6	liu	FLOWING
7	qi	TOGETHER, ANGRY
8	ba	LUCK. WEALTH
9	jiu	LONG LASTING

over market trends.

According to non-Asian stock market experts, this trend is a momentary one related to an immature market that is still in the development phase. This and other contributory factors make normal statistical and financial share analysis tools only partly usable and on condition that they are reconfigured to take the many local variables into account. The marked propensity for gambling typical of the Chinese investor may seem to contrast with the elevated tendency towards savings and the subsequent liquidity of banks that have characterised the Chinese economy in the past decade. The fact is that the stock market is the only investment possibility apart from the property market, which is already experiencing a boom because of the ban on exports and investment abroad. For many Westerners, China's number-related superstitions are laughable, an element of folklore. Most Westerners, stock market experts included, relegate codes and numbers to travel anecdotes to add to their descriptions of China and funny, unusual things about life in Shanghai.

But there is strong empirical evidence to support such folklore. The keys that most often need replacing on keypads of cash dispensers all over the People's Republic of China are six, eight and nine. And it is no coincidence that the date the central government chose for the opening ceremony of the Beijing Olympics was 8-8-2008: at eight in the morning, obviously.