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**Research on the influence of investors' confidence on Chinese stock price**

In Partial Fulfillment of the Requirements

for the Bachelor of Science in Finance

by

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## **Abstract**

In China, there are more individuals started to invest in the stock market. However, individuals are more likely to be affected by their invest confidence. As a result, it is important to pay more attention to investors' confidence. This research tries to examine the relationship between investors' confidence and the stock price in China's A-share in the Shanghai Stock Exchange. To analyze the topic, I will investigate investors' confidence and stock prices in two periods, which are 2014 to 2015 and 2018 to 2019. Meanwhile, I will analyze the main events happened in these two periods that may cause the changes in investors' confidence and stock prices. By comparing two different periods – one is the bull market and the other is bear market, I will find some factors that may influence investors' confidence. For data of investors' confidence index, I will collect secondary data from reliable sources. Also, according to the huge amount of Chinese stocks are available in the market, I choose to use the Shanghai securities composite index as the stock price. Finally, I will arrange and analyze the data I collected to test my hypothesis.

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## **Introduction**

### Background of the Study

China has become the second-largest stock market in the world in 2014 (Carpenter, Lu, & Whitelaw, 2015). However, the market is unstable and the bear market is longer than the bull market. This paper chooses 2014-2015 as the representative of the bull market and 2018-2019 as the representative of the bear market. From March 2014 to June 2015, with the high profile launch of One Belt One Road and the smooth progress of state-owned enterprise reform, the securities composite index increased by 162% and the rise in share prices inspired enthusiasm among investors. However, from 2018 to 2019, China's stock market was in the bear period mainly due to the Sino-US trade dispute. Investors' confidence had been hit and started fleeing the stock market, causing a new plunge in share prices. According to different events happening in the periods, investors have a different level of confidence in the market. Therefore, it is important to identify the influence of investors' confidence in the changes in stock prices. Meanwhile, this research will explore the factors that affect investors' confidence.

### Thesis Statement

The Chinese stock market has already opened for 28 years. Nowadays, more investors choose to invest in the stock market. However, investment in the stock market is risky. Some investors may earn lots of money through investments while others may lose

money. Also, investors are irrational when they deal with the information. As a result, in the risky stock market, investors have to know how their sentiment will affect stock prices.

In this project, researchers will compare investors' confidence when One Belt One Road (OBOR) is announced and when Sino-US trade dispute is happened, in order to better understand how investors' confidence influences stock price.

### Hypothesis

If Chinese investors have high investment confident, the stock price in China's stock market will increase.

### Significance of Research

The psychological characteristics and behavioral patterns of investors in the investment will have an important impact on the stock price. China's stock market is just beginning, various systems still need to be improved and investors are irrational during investment. For investors, by identifying the relationship between investors' confidence and stock price, they can understand when the appropriate time is to invest so that they can avoid the period that has high potential to lose money. In this way, they are more possible to become successful investors. For regulators, they can announce some policies according to investors' sentiment to avoid the turbulence of the financial market.

So, studying how investors' confidence influences market performance is of great significance to understanding investor behavior, providing policy suggestions, and the operation trend of the capital market. Therefore, from the perspective of both individual investors and regulators, it has positive significance to avoid financial market turbulence caused by irrational behaviors of individual investors and to help investors avoid mistakes.

## Literature Review

### A. Behavioral finance and investor confidence.

There are lots of anomalies in the stock market, such as the small firm effect and January effect. However, the traditional financial theory, which examines how people behave in terms of wealth maximization, cannot help to explain these anomalies (FAKHRY, 2016). Therefore, researchers came up with behavioral finance, which studies people's "actual" behavior in a financial environment (FAKHRY, 2016).

Behavioral finance is a study that combines psychology and economic theory. In real life, investors are irrational. As a result, stock prices are not only affected by demand and supply but also influenced by investors' confidence. To be more specific, if investors are confident and are more likely to take risks, they would trade more in the market; if they are not confident and are not optimistic about the future market, they would trade less. So, investor confidence can be defined as the psychological state of investors' expectations for the future market. In addition, researchers stated that compared with institutional investors, individual investors are more likely to be affected by investor confidence (Zhang, Xian, & Fang, 2019).

In some researches, investor confidence is also called investor sentiment. When investors make the investment, there will always be psychological biases, which will lead to the generation of investor sentiment and thus affect investment behavior.

Here are some examples of psychological biases. The most common one is overconfidence. As mentioned before, investor confidence may affect the stock price. However, overconfidence is a different term. Many investors put too much faith in their own judgment when investing. As a result, they make irrational investment decisions. Some researches show that investors who are overconfident are more likely to trade and over believe they will achieve above-average returns. However, more trading tends to have less return.

In conclusion, more researchers started to study behavioral finance due to irrational investors. Investor confidence may affect investors' behavior and then cause a change in stock prices. There also are lots of psychological biases in investing, which are worth researching.

#### B. The Chinese stock market – events in two periods.

The Chinese stock market only has 28 years of history. It has two stock exchanges, which are the Shanghai Stock Exchange and the Shenzhen Stock Exchange (Chen, Chong, & She, 2014). Also, China's stock market has A share as well as B share. A shares can only be invested by Chinese investors while B shares can only be invested by foreign investors. The Chinese stock market was opened in 1991 in Shanghai and Shenzhen (Carpenter, Lu, & Whitelaw, 2015). After more than 20 years' development, China's stock market has made great progress. In 2014, China has become the second-largest stock market in the world, especially in its trading volume and market



capitalization(Carpenter, Lu, & Whitelaw, 2015). However, the main characteristic of China's stock market is that the bull is short and the bear is long. There are one bull period and one bear period and their causes in China below.

- i. The main event that causes China's bull market from 2014 to 2015 – One Belt One Road (OBOR).

From March 2014 to June 2015, the Chinese stock market was in a bull market. The Chinese government had implemented some policies that can boost the stock market. For instance, the reformation of the IPO registration system and the cut of interest rate (Wang, Tsai, & Li, 2019). And one of the most important policies is the implementation of One Belt One Road in 2015.

One Belt One Road was proposed by Chinese President Xi Jinping in 2013. He was aiming to establish a modern silk road linking China to other parts of the world. This initiative is called One Belt One Road. The purpose of OBOR is to build the largest economic cooperation platform in the world, including policy, trade, and cultural cooperation (Jinchen, 2016). OBOR started the implementation in 2015. During this period, it was the focus of China's diplomacy and played an important role in China's economic development (Swaine, 2015). Also, many observers expected that OBOR will be prominent in China's 13th Five Year Plan from 2016 to 2020 (Swaine, 2015).

- ii. The main event that causes China's bear market from 2018 to 2019 – Sino-US

trade dispute.

In 2018, China's stock market was in the bear market and it has not ended till now. During the period, the Sino-US trade dispute is one of the most high-profile events that caused Chinese stock prices to fall.

The Sino-US trade dispute was started in March 2018. The US imposed a 25% tariff on steel and a 10% tariff on aluminum on China (Tan & Chen, 2019). That was the first round of the Sino-US trade dispute. China's rapid growth has worried the United States, prompting it to start a trade war (Freund, Ferrantino, Maliszewska, & Ruta, 2018). However, although the trade war does harm China's development, it has no benefit to the US neither. To mitigate the impact of increasing U.S. tariffs, China has taken a series of measures, such as easing up credit growth (Liu & Woo, 2018). To sum up, the trade war will certainly be difficult, and there may be no winner in the end. Even if one side wins, it must win bitterly.

In conclusion, the Chinese stock market is still volatile, and the bear market has lasted longer than the bull market. It is obvious that the stock price is influenced a lot by government policies in China.

## Research Design

### Type of Research

The researcher uses mixed methods research, which includes both quantitative and qualitative research approaches. Also, because China's stock market has 28 years' history, which is a long period for research, comparative research is used as the major method of the research in order to obtain a common conclusion of the hypothesis. And the researcher will collect data from two typical periods and events.

This study chooses the period of the announcement and high profile launch of One Belt One Road which is 2014 to 2015 as well as the period of the Sino-US trade dispute which is 2018 to 2019. The researcher will compare these two periods by using secondary data of stock price and investors' confidence. Besides, the study will make a quantitative analysis and combine the quantitative data with information and facts of these two events to explain the reasons for the results.

### Respondents

The researcher collects the secondary data of investors' confidence from a Chinese investor protection institution. They have a sample database that includes individual investors and institutional investors. The institution releases more than 2000 questionnaires every month. The institution does not limit the age, gender, and

hometown of respondents, in order to obtain data that better represents the overall Chinese investors.

### Tools

Microsoft Office: For the research, Word is used to present the paper, and Excel is used to analyze collected data and create corresponding graphs.

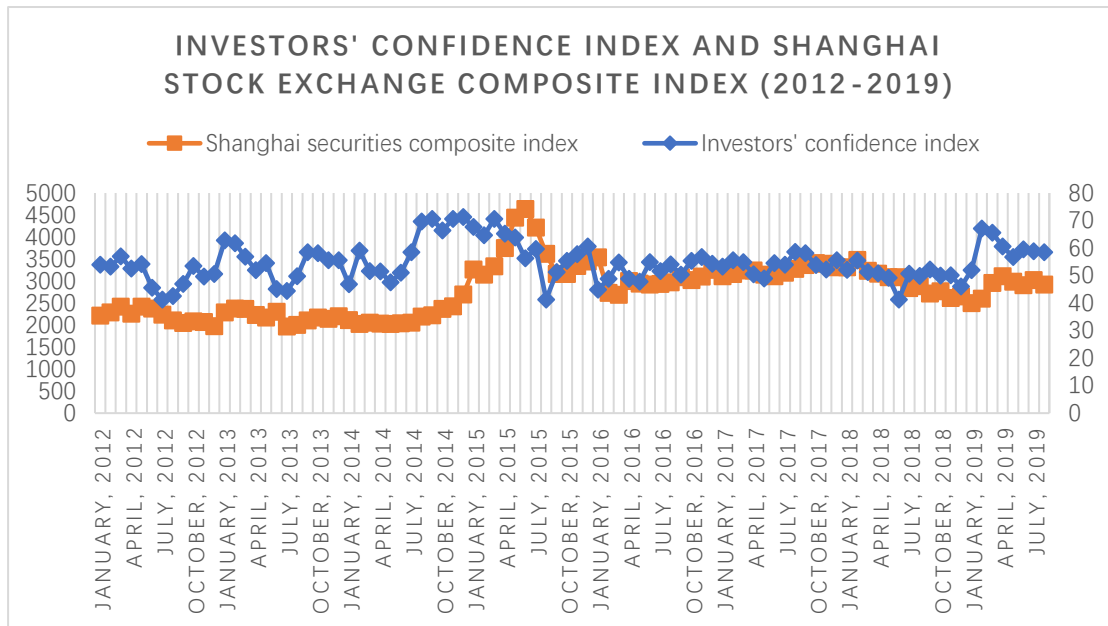
Review of documents: The secondary data used in the research is the historical data that has already reported by related institutions. The researcher reviews these reporters and collects data that can be used in the research.

## Analysis and Results

For stock prices, the researcher uses the historical Shanghai securities composite index. About investors' confidence index, it is reported monthly and describes eight indicators including domestic economic fundamentals, domestic economic policies, international economic and financial environment, and stock valuation index. The investors' confidence index of the Chinese securities market is between 0 and 100, with 50 being neutral. When the index is greater than 50, the proportion of investors with positive views is greater than that with negative views, and the overall investors' confidence is optimistic. The higher the index, the stronger the investors' confidence. When the index is less than 50, the proportion of investors with positive views is less than that with negative views, and the overall investors' confidence is pessimistic.

Chart 1.0 shows how investors' confidence index (ICI) and Shanghai stock exchange (SSE) composite index changes between January 2012 to August 2019. These two indexes almost move in the same direction, or when the investors' confidence index is high the stock price will then go up and when the investors' confidence index is low the stock price will then go down.

Chart 1.0 Investors' confidence index and Shanghai stock exchange composite index  
(2012-2019)



In order to better understand how investors' confidence influences stock price, the research compares investors' confidence when One Belt One Road (OBOR) was high-profile launched and when Sino-US trade dispute happened. So, the researcher extracted the data from these two periods, which are from March 2014 to August 2015 and from March 2018 to August 2019. The data and line charts are showing below:

Chart 2.0 Investors' confidence index and Shanghai stock exchange composite index  
(2014-2015)

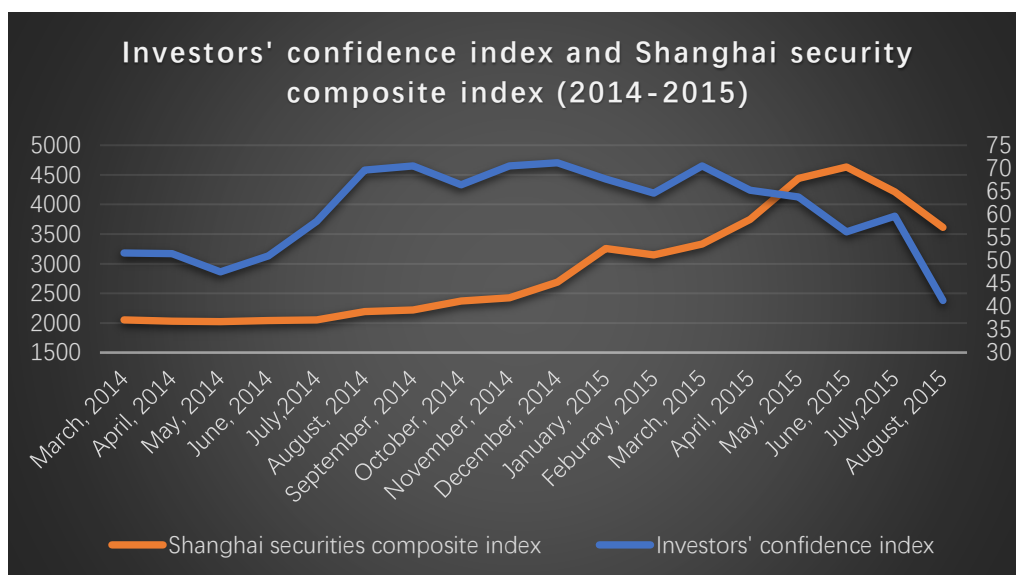
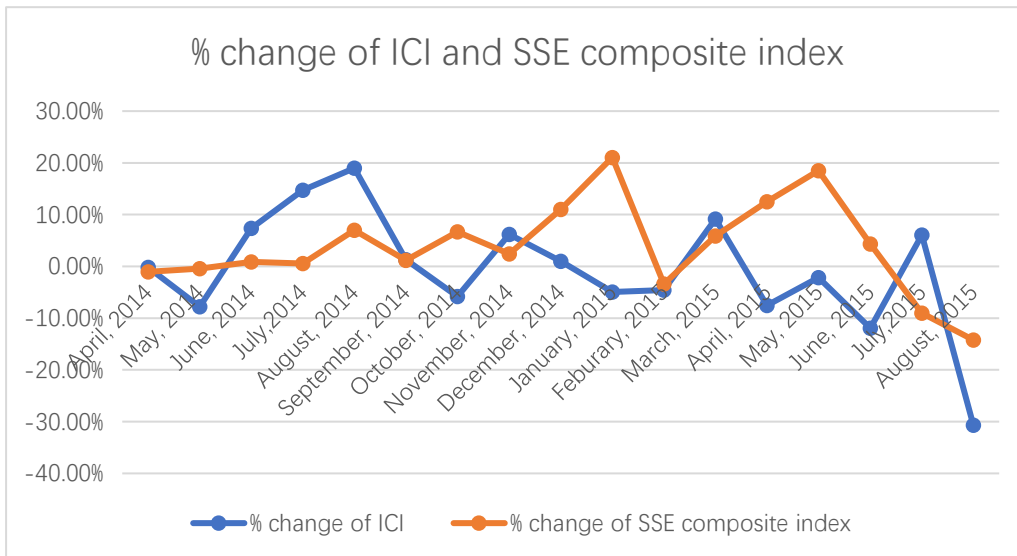


Chart 2.0 is a part of chart 1.0. In this period, the ICI is high compared to other periods. From June 2014, the ICI started to increase. It remains at a high level till May 2015 and then decreases. For SSE composite index, it increases steadily from July 2014 to June 2015 and then declines. The change in ICI is confirmed by the change of the SSE composite index in the following month.

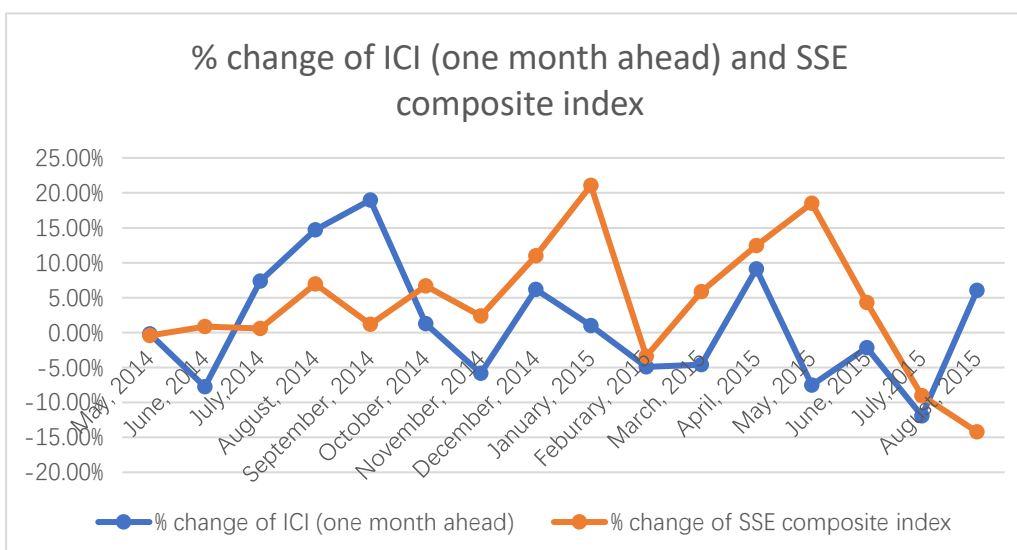
To get a clearer picture of the relationship between investors' confidence and stock prices, the researchers put the percentage change of ICI and SSE composite index into a chart.

Chart 3.0 Percentage change of ICI and SSE composite index (2014-2015)



However, the relationship is not clear in the chart 3.0. As mentioned before, the change of the SSE composite index will change about one month after the change of ICI. So, here is the chart that shifts the ICI curve one month to the right. In other words, the SSE composite index for that month matches ICI for the previous month.

Chart 3.1 Percentage change of ICI (one month ahead) and SSE composite index (2014-2015)





Besides several months, the percentage change of one month ahead ICI and the percentage change of SSE composite index move in the same direction. The ICI remains at a high level in this period. Even it decreases, it does not change a lot. With high ICI, the stock price keeps going up. As a result, these two indexes do not move together in some months.

Chart 4.0 Subindex of investors' confidence I (2014-2015)

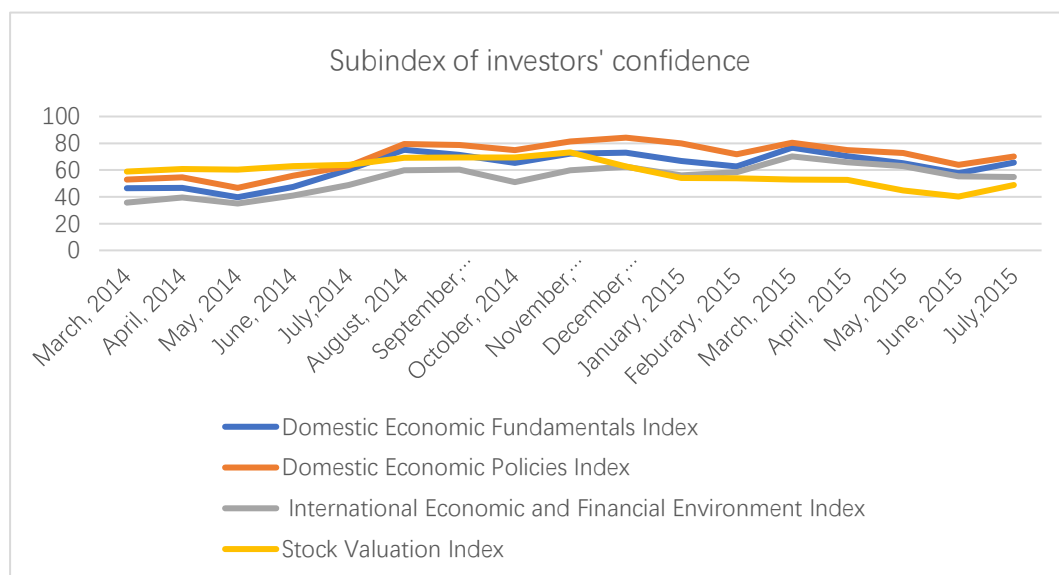
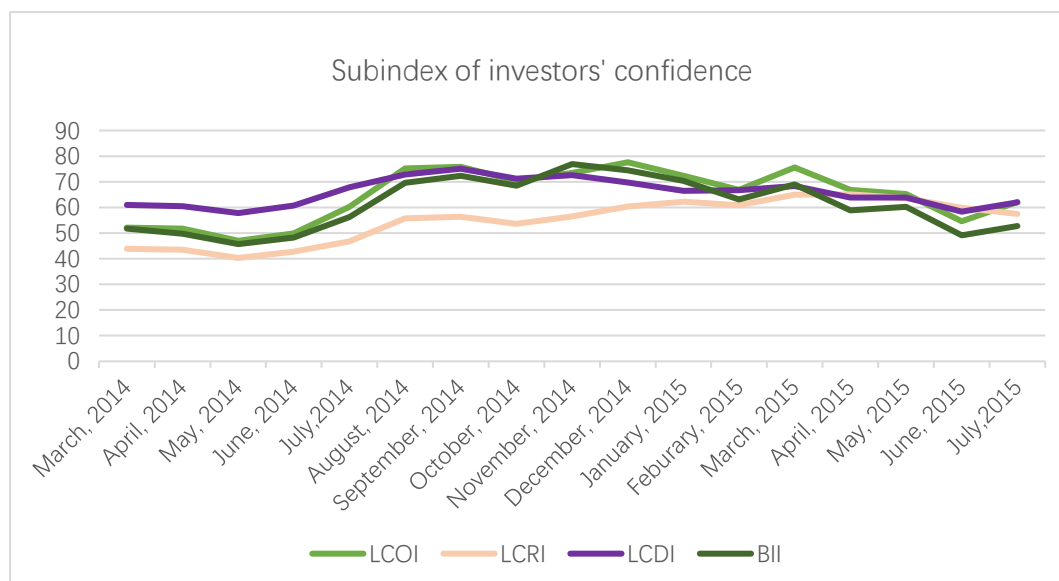


Chart 4.1 Subindex of investors' confidence II (2014-2015)



For most subindexes, especially the domestic economic policies index, they are in the highest level in August 2014 and March 2015 between this period. Related the data to OBOR, In August 2014, President Xi visited Mongolia and expressed his desire to cooperate with neighboring countries through OBOR. In March 2015, OBOR was officially implemented. The event was one main reason that made investors have high confidence in the market in the period.

Chart 5.0 Investors' confidence index and Shanghai stock exchange composite index (2018-2019)

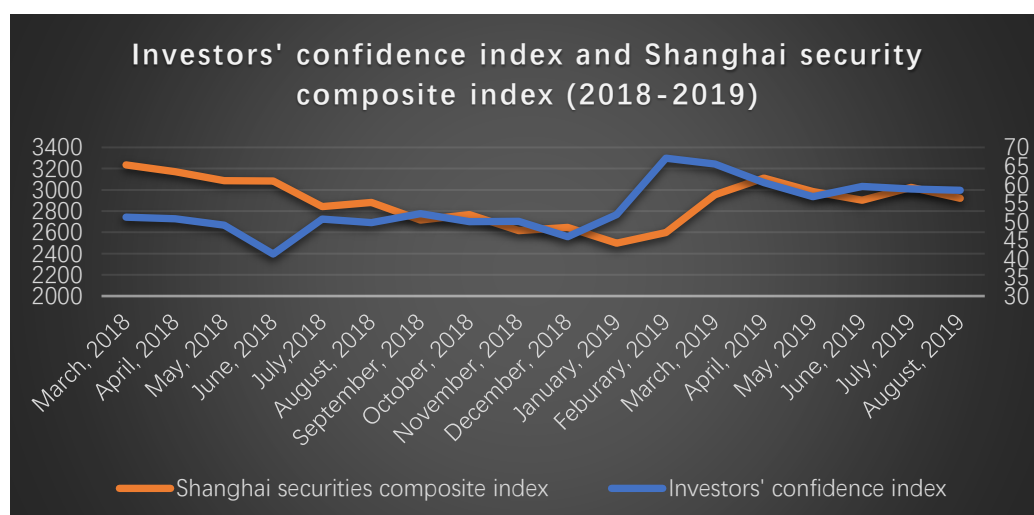
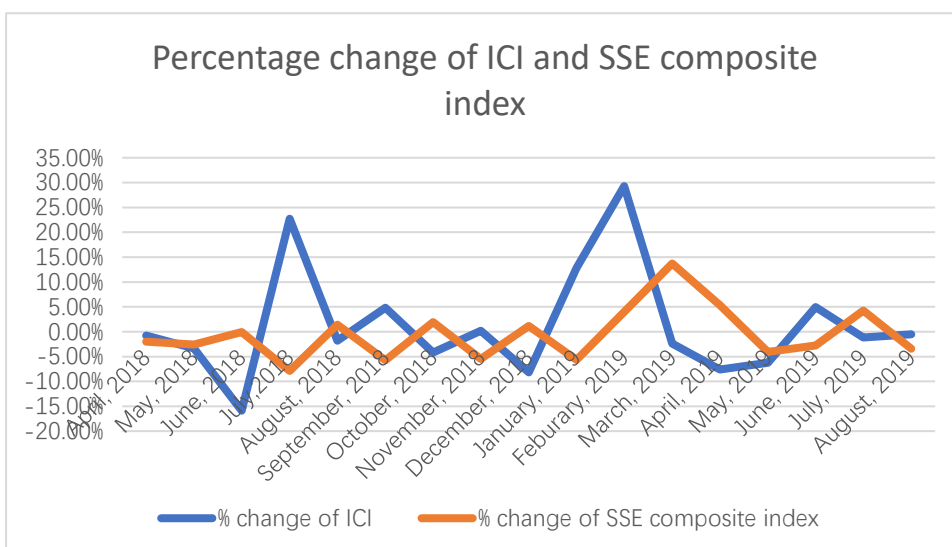


Chart 5.0 shows the ICI and SSE composite index from March 2018 to August 2019. This is also a part of chart 1.0. the ICI is relatively at a low level compared to it in chart 2.0. Since March 2018, the ICI is at a low level and SSE composite index is in a declined trend. In December 2018, ICI started to increase and SSE composite index increase since January 2019. It is the same as what shows in chart2.0, SSE composite index changes about one month after ICI changes and the changes are in the same direction.

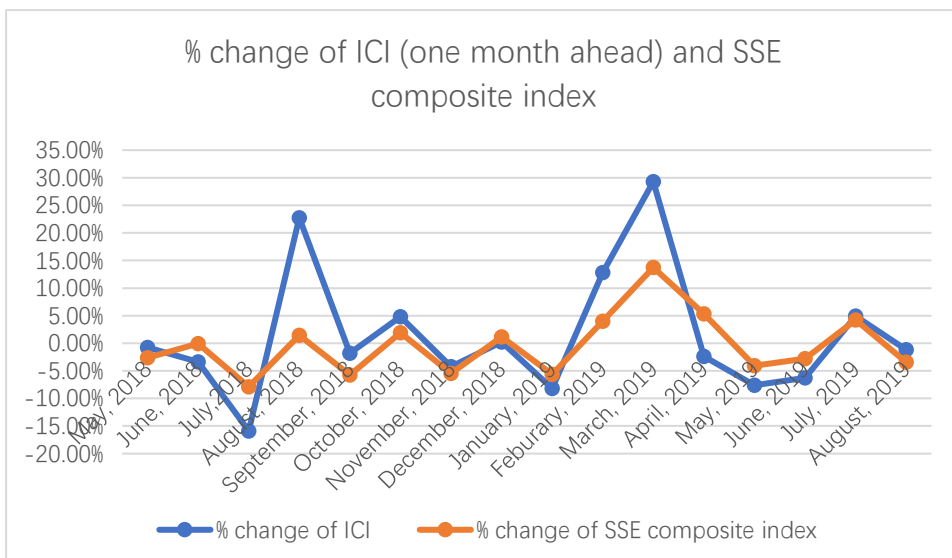
Again, put the percentage change of ICI and SSE composite index from 2018 to 2019 into a chart (chart 6.0), the relationship is not obvious.

Chart 6.0 Percentage change of ICI and SSE composite index (2018-2019)



Then, shift the ICI curve one month to the right to get chart 6.1.

Chart 6.1 Percentage change of ICI (one month ahead) and SSE composite index (2018-2019)



It is clear that the percentage change of one month ahead ICI and SSE composite index move in the same direction. This further supports the hypothesis: if Chinese investors have high investment confidence, the stock price will increase.

Chart 7.0 Subindex of investors' confidence I (2018-2019)

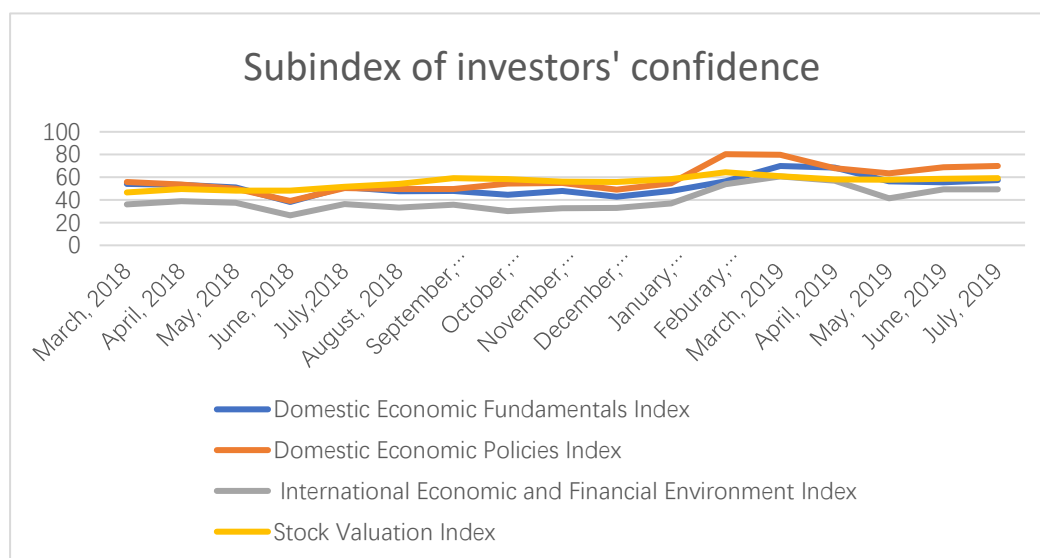
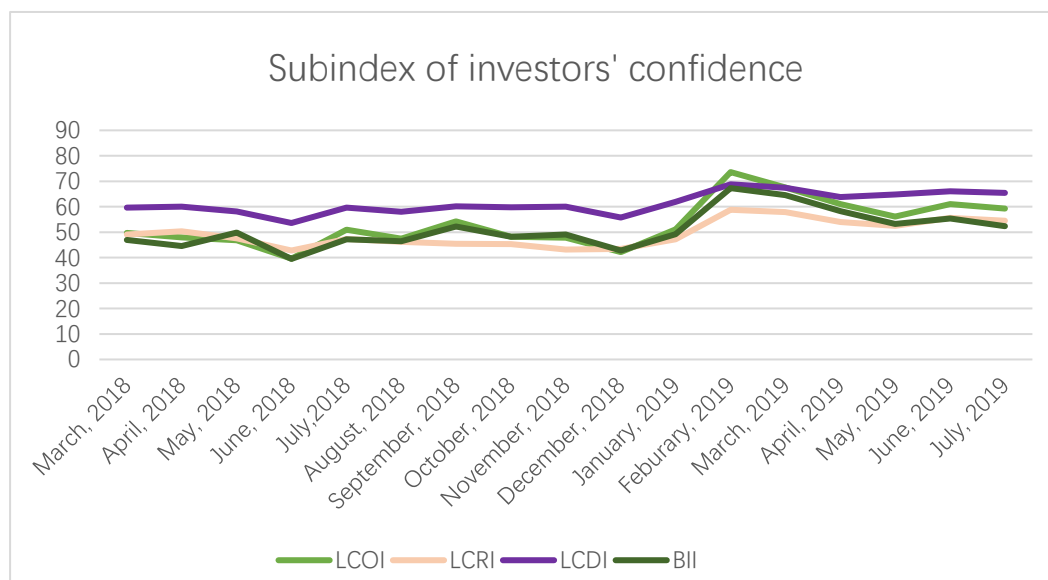


Chart 7.1 Subindex of investors' confidence II (2018-2019)



In this period, the international economic and financial environment index is always

the lowest subindex. It is one of the main factors that lead to low ICI. This means that the Sino-US trade dispute influences the investors' confidence. To be more specific, the Sino-US trade dispute was started in March 2018. The ICI remains at a low level from March 2018 to December 2018. In January 2019, China and the US discussed how to achieve a fair, mutually beneficial and peaceful trade relationship. This gave investors confidence in the market and the ICI increases since January 2019.

## Conclusion

### Analytical summary

This research focuses specifically on the Chinese stock market and investors and analyzes how investors' confidence influences stock prices. The researcher finds that the stock prices will go up when the investors are confident. However, it does not mean that stock prices and investors' confidence are always moving in the same direction. When the investors' confidence index is at a high level, even though it decreases a little, the stock price may also go up. In addition, there are eight indicators that influence the ICI. The researcher compared two events to analyze the factors that influence the ICI. In the period of high-profile launch of OBOR, domestic economic policy is the main factor that influences the ICI, in the period of Sino-US dispute, the international economic and financial environment is the main factor.

Although there are some small differences, the results of these two periods are almost the same. As a result, the researchers conclude that these findings are also suitable for other periods and events.

### Limitations

Due to the limited knowledge of the researcher and the restriction of various factors in the research process, the following limitations exist in this study: Firstly, in this study, the researcher only uses Shanghai securities composite index, which may have

insufficient coverage. There is still room for researching investors' confidence index and other stock data. Secondly, for each period, the researcher only chooses one main event. However, some other events that can affect investors' confidence. Moreover, it is hard to identify the exact time when One Belt One Road is high-profile launched.

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