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# *AH Share Price Spread: Investors Sentiment Study*

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***Abstract:*** This paper develops a comprehensive index of sentiment differences that can accurately describe the differences in investor sentiment between mainland China and Hong Kong to explain the higher premium of A-shares more than H-shares in the long run from the perspective of market differences in individual investor behavior. The results show that the higher the level of optimism of the A-share market relative to the H-share market, the higher the level of A-H share premium; Research shows that investors are more susceptible to the hazards of emotional elements during the market downturn phase, that emotional differences have an amplifying effect on the explanatory power of AH share premiums, and the higher the institutional share of stocks differences emotional, the more substantial explanatory power on AH share premiums. We should take notice of the critical role of irrational factors in price fluctuations and have certain psychological expectations about the fluctuations of stock prices caused by irrational factors.

***Keywords:*** emotional differences, AH share premium, information asymmetry, behavioral finance

## 1. Introduction

China's securities trading market has made significant progress; market efficiency, market infrastructure, and policy guidance have matured. At the same time, making outstanding achievements, it is also necessary to find out the shortcomings of today's securities market, and the reform of China's securities market still has a long way to go. Meanwhile, because the operation mechanism of China's securities market is different from that of developed countries in the West, it is not easy to get practical conclusions from traditional investment hypotheses used in the study of China's securities market

Due to the earlier development of foreign markets, China's new market is more developed compared to the Chinese securities market, has more experience, and is more mature. The research on the securities market is more in-depth and extensive, and there are still many things that could be improved in China's related research. The research of this paper is based on the Shanghai-Hong Kong Stock Connect, and the positive three aspects:

(1) According to the new collaborative system helps to improve the overall strength of the asset market in China, the Shanghai securities market expansion of investors' project investment scope promotes the communication and collaboration between Shanghai and Hong Kong to improve competitiveness.

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(2) The Shanghai-Hong Kong Stock Connection helps to promote the influence of the financial markets of Shanghai and the two countries concerned and improves the investor structure of the Shanghai market. Relying on Hong Kong's market attractiveness to international investors, it further strengthens Shanghai's financial infrastructure, helps advance Hong Kong's international investment influence, and consolidates Hong Kong's position as a critical overseas asset investment market for domestic investors.

(3) Promoting the globalization of the RMB, Hong Kong underpins the RMB business process. The Shanghai-Hong Kong Stock Connect enables domestic investors to invest in the Hong Kong market using RMB projects while at the same time broadening the investment channels for foreign RMB assets, giving convenience to both domestic and foreign circulation of RMB.

Traditional investment laws are challenging to explain. Therefore, this article aims to analyze the underlying reasons through behavioral finance, which refers to investor sentiment.

The article integrates the current Hong Kong Stock Connect policy environment, uses the discount rate of closed-end funds to consider investor sentiment, adds investor sentiment indicators to the traditional market segmentation assumption, and analyzes the influencing factors of the premium level of AH shares. Comprehensively analyze the influencing factors of AH stock premium from five levels: policy, regulations, market, industry, and investor sentiment, and attempt to demonstrate the issue of AH stock premium based on various aspects of argumentation and analysis.

The critical approach in the article is to use a close combination of fundamental theoretical research and empirical analysis to discuss the reasons for the price differences in AH stocks. The article selected 4,000 sets of panel data from 100 AH-listed companies from December 31, 2016, to December 31, 2021, to construct a random effects model. The generalized least squares method was used for estimation, and the significant impact of various factors on the premium level of AH shares was empirically analyzed.

The innovation of this article is reflected in the fact that current research on "investor sentiment" primarily focuses on the relationship between investor sentiment and returns, volatility, liquidity, etc.

## 2. Literature Review

### 2.1. Investor Behavior's Impact on Asset Prices.

The initial correlation entity model was the well-known DSSW noise trader risk entity model, explicitly proposed by Delong [1]. In the DSSW approach, there are two types of investors. One is objective investors, who have sufficient information content and will invest in projects based on economic development logic or business thinking rather than being manipulated by emotions or lured by external factors. They have an objective expectation and analysis of the return on capital and a specific grasp of stocks.

Another type is noise traders who need clarification about the stock fundamentals. Their estimation of asset returns is dominated by short-term speculation, which in turn, is dominated by emotions. That is, compared to rational expectations, they sometimes overestimate expected returns and sometimes underestimate them. These two major market categories of investors buy and sell based on their ideas. Objective investors can push stocks over positions that exceed their functional value, buy short stocks, and hedge arbitrage when they decline in the face of overly optimistic and unbelievable noise traders. However, due to the impact of the project investment period, when objective investors are forced to close their positions and prepare to exit in advance, the stock may not necessarily decline but rather be pushed up by noise traders. This is because objective investors are likely to lose money when they cannot predict and analyze the situation of noise traders. Delong calls the type of risk generated by noise traders noise trader risk. Due to the risk of noise traders, stocks can be harmed by investor sentiment factors.

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The DHS entity model created by Hirsh Lifer and Sabra Anya describes investors with higher payment intentions due to overconfidence and optimism in the corporate market outlook [2]. This type of trader is called a crazy investor. The key to the personal behavior error of fanatical investors is based on overconfidence and personal information, as investors may lose special trust in personal information due to overconfidence. In addition, due to 'relatively limited concern,' investors overlook the harmful information content in the published data, resulting in too much optimistic discrimination and promoting stock prices to deviate from the fundamental use value of the stock. The primary natural environment for this type of operation is the significant information asymmetry among investors.

Chinese experts and scholars have also done some scientific research in this area. Liu and Chen applied the "good and bad index value" as an index value to consider the sentiment, which is customized in the "Dynamic Analysis of Stock Market," to study the interrelationship between investor sentiment and stock profitability scientifically. The results of the argumentation show that both the value of the excellent index and the value of the lousy index are very much increased, and the future market profitability will decline significantly. Small and medium-sized investors socialize emotionally in China, while investor relativity is objective. He used the discount rate of closed funds as the value of sentiment indicators. He obtained the result that the investor structure under the special conditions of China has a very critical and direct impact on the ups and downs of stocks and the level of bubble generation.

### 2.2. A Study on Investor Sentiment and AH Share Price Spread

Since the listing of listed companies in mainland China and simultaneously on the Hong Kong Stock Exchange, the overall price of A-share listing has been higher than that of H-share for the same enterprise Wang et al. found that the launch of the plan had a positive but different impact on volatility and returns in Shanghai, as well as in the Shen Zhen and Hong Kong stock markets [3]. Chan found that the price parity (and cointegration) between April 2014 and July 2014 was higher, and the A-H share premium increased along with the price changes after the implementation of the substantive plan Fan and Wang conducted regression tests on the impact of the implementation of the plan on the A-H premium index They checked the changes in A-H premiums Their main evidence is contrary to ours, and the sample size can partially explain this difference [4]. In addition, Wang Chaoyang and Wang Zhenxia studied the discount and premium phenomenon of AH shares from the perspective of trading systems in the two markets, and found that the limit up and down system and margin trading system did not reduce the market volatility of A-shares, which is also an important factor leading to the discount and premium of AH shares [5].

## 3. Theoretical Basis and Model Design

### 3.1. Emotional Differences and AH Stock Premia

Shiller mentioned in his book 'Unreasonable Prosperity' that countless investors' judgments and decisions are independent of each other and not influenced by others [6]. Based on the hedging of most people's thoughts, any irrational ideas in the market will offset each other In this case, the price will not deviate excessively from its value. However, if most systemic emotions influence, most investors in the market will experience systematic deviations in stock prices. The overall price in the market will also change with their expectations. With the increasing development of economic information, people who communicate and exchange ideas may converge, and stock prices are influenced by their thoughts and emotions.

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H1: The emotional differences between markets are positively correlated with the premium of AH shares; that is, the greater the emotional differences, the higher the premium level of AH shares.

### 3.2. Investor Sentiment Variations in Different Environments

(1) Affected by investors' preferences, investors' optimism, that is, their sentiment, will change with changes in the stock market. According to the prospect theory of Tversky and Kahneman, people are generally risk averse, and investors react more strongly to losses than to equal returns, meaning that the utility of investors receiving a share of the return is lower [7]. The essence of the impact of emotional differences on AH stock prices is the degree of optimism that mainland and external investors have towards the same company. In different market conditions, the premium level of AH shares will also be affected by the difference in investor optimism between the two regions. When extending the Conclusion of prospect theory to markets, the emotional differences between the two regions during the downturn should better explain the phenomenon of price deviation between A-shares and H-shares, according to the above theory, this article proposes the second hypothesis.

H2: The difference in investor sentiment between the two regions during a downturn in the stock market can better explain the premium level of AH shares.

(2) The impact of institutional investors on investor sentiment

As an essential part of market participants, institutional investors undoubtedly significantly impact stock prices and further affect investor sentiment. Therefore, the weaker their ability to explain the premium through investor sentiment. Based on the above theory, this article proposes the following corresponding assumptions.

H3a: The more significant the proportion of institutional shareholding, the lower the explanatory power of emotional differences on the premium of AH shares

H3b: The more significant the proportion of institutional shareholding, the higher the explanatory power of emotional differences on the premium of AH shares

### 3.3. Model Design

This article selects a panel model to learn the influence of investor sentiment differences on the stock price spread of AH cross-listed companies. Firstly, after testing the panel F value to reject the original hypothesis, the panel model is subjected to a Houseman test. The test results rejected the original hypothesis that no significant difference exists in the estimation of fixed and random effects. Therefore, this article uses a fixed effects panel model to test the relationship between emotional differences indicators and other control variables and AH stock premiums. The specific model is as follows:

$$PREM_{i,t} = \alpha + \beta_1 SENT_t + \beta_2 RP_{t-1} + \beta_3 IP_t + \beta_4 Y_t + \beta_5 EER_t + \beta_6 DD_t + \beta_7 SIZE_{i,t} + \varepsilon_{i,t} \quad (1)$$

Monthly data is used for all indicators in the regression equation, $\varepsilon_{i,t}$ represents the individual time mixed random error component, which satisfies the independent identically distributed mean of 0. All explanatory and control variables were standardized to facilitate the comparison of the effects of different variables on the premium of AH shares. The economic significance of the regression results is the change in the premium of AH shares caused by the percentage change of explanatory or control variables. The meanings of the variables are shown in Table 1.

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Table 1: Variable Meaning.

| English letters | meaning |
|---|---|
| PREM | AH share premium indicator |
| SENT | Emotional difference indicators |
| RP | Risk premium difference |
| IP | Non-liquidity premium difference |
| Y | Yield difference |
| EER | Expected exchange rate changes |
| DD | Demand Differences |
| SIZE | Difference in company market value |

## 4. Index Construction and Data Explanation

### 4.1. Sample Data

The data in the article is selected from the Wande database. The period from December 31, 2016, to December 31, 2021, after the opening of the Shanghai-Hong Kong Stock Connect, will be used as the research period To explore the reasons why the premium of AH shares has remained at a high level for a long time under the premise of more convenient market financing under the conditions of relaxed capital flow restrictions Construction of a comprehensive index for emotional differences

#### 4.1.1. Selection of Constituent Indicators

Referring to Yi Zhigao and Mao Ning's construction of sentiment indicators for Chinese investors, this paper will use composite index to describe the difference of investor sentiment between Chinese Mainland and Hong Kong market to the greatest extent [8]. When constructing a comprehensive indicator of investor sentiment in this article, common non subjective indicators include the discount and premium ratio of closed end funds, the number of new stock issuances and their first day returns, stock turnover rates in mainland and Hong Kong markets, trading volume, and the number of new account openings. At the same time, subjective indicators such as questionnaire surveys will also be used to construct investor confidence indices. This article selects objective indicators to describe the comprehensive index of investor sentiment. And to represent the emotional differences between the two markets, this article uses the price difference of the same indicator between the markets as the independent variable.

(1) Closed-end fund discount difference (CEF). Many scholars have proved that the discount rate of closed-end funds reflects investors' optimism about the market. The discount rate of closed-end funds is selected as a proxy indicator for emotional differences.

(2) Differences in the number of IPOs (IPOs). Most companies' IPOs often choose times when the market is good or when market sentiment is high.

(3) Market turnover rate difference (TR). The turnover rate can reflect the degree of investor participation in the market.

(4) Price-to-earnings ratio difference (PE). The P/E ratio is an important indicator of whether the valuation of a reference stock is reasonable. The high or low P/E ratio can also reflect investors' optimism towards the market. If the overall P/E ratio is high, it reflects investors' better future expectations. This article uses the difference between the monthly average P/E ratio of the A-share market and the monthly average P/E ratio of the H-share market as the proxy variable.

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### 4.1.2. Comprehensive Emotional Differences Index

This article standardizes each indicator and constructs a comprehensive indicator of emotional differences using principal component analysis to analyze the contribution of different indicator differences to emotional differences. The composition of indicators first needs to determine whether the variables use lagged terms. It retains the first four principal components to construct an initial emotional difference index (send) containing eight variables, with a cumulative variance interpretation rate of 87.53% (see Table 2).

Table 2: Correlation between SENT and various variables.

| Variable | $CEF_t$ | $CEF_{t-1}$ | $TR_t$ | $TR_{t-1}$ | $IPO_T$ | $IPO_{t-1}$ | $PE_t$ | PEt-1 |
|---|---|---|---|---|---|---|---|---|
| correlation coefficient | 0.3831*** | 0.2677*** | 0.7135*** | 0.7258*** | 0.5797*** | 0.5565*** | 0.8519*** | 0.8925*** |
| Observations | 4000 | 4000 | 4000 | 4000 | 4000 | 4000 | 4000 | 4000 |

Note: *, * *, * * There are significant differences respectively at the 10%, 5%, and 1% levels, the same below

The construction process of the Emotional Differences Comprehensive Index SENT is the same as above. The first three principal components were retained while ensuring an 85% explanation ratio, resulting in a final explanation ratio of 95.45%. The correlation between the final indicator obtained and the original difference indicator reached 94.59%, indicating that excluding lagging and non-lagging terms has little impact.

## 4.2. Descriptive Analysis of Emotional Differences Index

The data used in indicator construction has been standardized to reflect the impact of different factors on investor sentiment differences.

### 4.2.1. The Dependent Variable

AH Stock Premium Index (PREM) AH share premium index, using the Hang Seng Index AH share premium index composition method The A-share price of individual stocks is based on the RMB bid price. In contrast, the H-share price of the unified company is converted into RMB price.

Table 3: Descriptive statistics and correlation analysis of the comprehensive index and constituent indicators of emotional differences.

| Variables | General value | standard deviation | least value | max | Observations |
|---|---|---|---|---|---|
| $CEF_t$ | 0.0177 | 0.1359 | -0.1087 | 0.9738 | 4000 |
| $TR_{t-1}$ | 248.8089 | 140.1244 | 80.6610 | 690.5010 | 4000 |
| $IPO_t$ | 7.2285 | 15.3379 | -27 | 39 | 4000 |
| $PE_{t-1}$ | 4.1846 | 2.0235 | 1.0810 | 9.9510 | 4000 |
| | $SENT_t$ | $CEF_t$ | $TR_{t-1}$ | $IPO_t$ | $PE_{t-1}$ |
| $SENT_t$ | 1 | - | - | - | - |
| $CEF_t$ | 0.5570*** | 1 | - | - | - |
| $TR_{t-1}$ | 0.6587*** | 0.2068 | 1 | - | - |
| $IPO_t$ | 0.6520*** | 0.1030 | 0.0730 | 1 | - |
| $PE_{t-1}$ | 0.8377*** | 0.3373*** | 0.7826*** | 0.2846** | 1 |

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### 4.2.2. Control Variables

(1) Yield difference (Y). The difference in return rate is calculated by subtracting the monthly average return rate of H-share stocks from the monthly average return rate of the subsequent period. Referring to the research of Rompotis, an increase in ETF yield will increase the level of ETF premium [9]. This article speculates that an increase in return spread will also make investors prefer high-yield assets, thereby driving up the premium of AH shares.

(2) Risk premium difference (RP). Because AH shares are different markets, an increase in the risk premium of A-shares will inevitably require an increase in the risk premium of H-shares, and conversely, H-shares will also affect A-shares Thus, thus changing the premium level of AH shares.

(3) Non-liquidity premium difference (IP). The factor of overseas listing of firms is to enhance the liquidity of individual stocks and reduce transaction costs. Since investors highly value liquidity. Other things being equal, the higher the liquidity, the lower the cost of funds; liquidity can be improved with the overseas listing, especially the entry of a large number of investors will increase the trading volume.

(4) Expected Exchange Rate Change (EER). Arquette et al. found that expected exchange rates have a significant impact on the different prices of cross-listed stocks [10].

(5) Demand Differences (DD). Li Shuangfei believe that the difference in demand between AH stocks can explain the long-term existence of AH stock price differences [1s that the difference in demand between AH stocks can explain the long-term existence of AH stock price differences [11].

(6) Difference in company market value (SIZE). Previous studies have shown that information asymmetry is the explanatory factor for the premium of AH shares. The total market value of the company's AH is used as a proxy variable to control the impact of information asymmetry on the premium of AH shares. The larger the SIZE indicator, the larger the company, and the corresponding degree of information asymmetry, resulting in a smaller premium for the company's AH shares.

## 4.3. Descriptive Statistics

The unit root test was conducted on all variables in the regression analysis. Table 4 shows that all variables rejected the original assumption at the 1% level, confirming that each variable is stable. Each variable's descriptive statistical data information is shown in the table below. The table lists descriptive data statistics for each variable. The overall average premium of AH shares is close to 1.35, indicating a long-term premium between A-shares and H-shares. The following graph further illustrates the average price increase rate of 100 listed companies at different times. The graph shows that the average level of 100 companies remains above 1.34 after the Hong Kong Stock Connect. The estimated average value of the US dollar trend is positive, indicating the overall decline of RMB during the sample period.

Figure 1: AH Stock Premium Index.

Source: Snowball Securities

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Table 4: Descriptive Statistics of Variables.

| Variables | General value | standard deviation | least value | crest value | Observations |
|---|---|---|---|---|---|
| PREM | 1.7989 | 0.8337 | 0.7749 | 8.7165 | 4000 |
| SENT | 0.3657 | 0.1588 | 0.0760 | 0.8618 | 4000 |
| R | 0.0062 | 0.0954 | -0.7513 | 1.0664 | 4000 |
| RP | 1.0858 | 0.5481 | 0 | 6.39032 | 4000 |
| IL | 0.4689 | 0.8368 | 0 | 27.3866 | 4000 |
| EER | 0.2051 | 1.5359 | -3.5419 | 4.8473 | 4000 |
| DD | 3.2940 | 2.0121 | 0.0389 | 15.5777 | 4000 |
| SIZE | 25.7576 | 1.5124 | 21.5530 | 29.2983 | 4000 |

## 5. Empirical Results

### 5.1. Regression Result Analysis

The specific regression results are shown in Table 5 below.

Table 5: Fixed Effect Analysis Results.

| alternating quantity | Fixed-effects regression model | | | | | | |
|---|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
| $SENT_1$ | 0.4885*** (4.26) | 0.4370*** (3.74) | 0.4237*** (3.77) | 0.4495*** (3.84) | 0.4559*** (4.12) | 0.4516*** (3.72) | 0.3265*** (2.76) |
| EER | - | 0.1075*** (3.26) | 0.1065*** (3.39) | 0.1373*** (4.10) | 0.1182*** (3.69) | 0.1340*** (4.00) | 0.1359*** (3.64) |
| $Y_{i,t-1}$ | - | 0.2682*** (6.78) | - | - | - | - | 0.2364*** (6.60) |
| $RP_{i,t}$ | - | - | 0.2555*** (4.29) | - | - | - | 0.2315*** (3.55) |
| $IL_{i,t}$ | - | - | - | -0.1628** (-2.55) | - | - | -0.0639*** (-2.89) |
| $DD_{i,t}$ | - | - | - | - | -0.0563*** (-2.34) | - | -0.0649*** (-2.89) |
| $SIZE_{i,t}$ | - | - | - | - | - | 0.0889 (0.96) | 0.0792 (0.86) |
| absolute term | 1.6212*** (38.39) | 1.4865*** (33.24) | 1.5122*** (31.93) | 1.6174*** (32.30) | 1.7532*** (22.48) | 1.5359*** (28.39) | 1.6658*** (19.25) |
| Aduj_ R2 | 0.0413 | 0.0573 | 0.0622 | 0.0512 | 0.0510 | 0.0469 | 0.0885 |
| Obs. | 4000 | 4000 | 4000 | 4000 | 4000 | 4000 | 4000 |

Table 4 shows that regardless of how many control variables are added, the regression coefficient of the investor sentiment difference composite index remains significantly non-zero at the 1% level, indicating that the sentiment differences between the two markets can effectively explain the changes in AH stock premiums. The index of sentiment index value is positive, indicating that the higher the sentiment of A-share relative to H-share, the higher the premium level of AH share. This confirms the hypothesis H1 proposed in this article that sentiment differences are positively correlated with AH share premium; that is, the more optimistic A-share market investors are compared to H-share

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market investors, the greater the irrational driving effect on stock prices, which leads to a higher premium level of AH share. The coefficient of return difference with a lag of one period is significantly regularized in each regression.

### 5.2. Institutional Shareholding and Investor Sentiment Impact

The index of sentiment index value is positive, indicating that the higher the sentiment of A-share relative to H-share, the higher the premium level of AH share. This confirms the hypothesis H1 proposed in this article that sentiment differences positively correlate with AH share premium. That is, the more optimistic A-share market investors are compared to H-share market investors, the greater the irrational driving effect on stock prices, which leads to a higher premium level of AH share.

The Conclusion that the premium of AH shares during the downturn in the stock market can better reflect the emotional differences between the two regions is in line with the explanation of loss aversion in prospect theory, confirming H2.

When testing hypotheses H3a and H3b, the article further introduces the value of the shareholding ratio index to investigate its impact on the emotional difference of AH stock premium. The institutional shareholding ratio is the average of two markets, with only one-quarter of the data information available in the A-share market. The article assumes that the shareholding ratio remains unchanged for the first quarter and uses the generalized least squares method for estimation. After adding interaction terms, to ensure the significance of the original explanatory variable, the interaction terms were centralized.

The Conclusion drawn from the regression results is that the proportion of institutional holdings is inversely proportional to the premium of AH shares, meaning that the heavier the proportion of institutions, the smaller the degree of price anomalies. When further examining the impact of institutions on the ability of sentiment to explain premium, the coefficients of the interaction terms in both regressions were significantly positive, indicating that institutional investors amplified the impact of emotional differences on AH stock premium, and H3b was validated. The empirical results of this article support the Conclusion that institutional investors have an amplifying effect on market sentiment: institutional investors have convergent investment behavior due to their existence. Stocks with a higher proportion of institutional ownership are more susceptible to market sentiment, so their prices are more likely to be explained by market sentiment. When examining the price difference between the two regions, the higher the proportion of institutional holdings, the more the prices of A-shares and H-shares reflect the local investor sentiment. The sentiment difference can explain the premium level of AH shares. This result is also consistent with relevant literature in China.

## 6. Conclusion

This paper analyzes the reasons for the differences in the prices of A-shares and H-shares of the same enterprise and conducts an empirical analysis based on investor sentiment, and the following results were obtained:

(1) After controlling for factors such as profit margin and illiquidity, the difference in investor sentiment is directly proportional to the premium of AH shares. The higher the relative level of A-share market investors compared to H-share investors, the greater the premium of AH shares.

(2) From the perspective of sample analysis, investors are more susceptible to emotional factors during market downturns, and emotional differences have a more significant explanatory effect on AH stock premiums.

(3) When examining the role of institutional investors, they exhibit convergent investment behavior and have a magnifying effect on the explanatory power of emotional differences. The higher

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the proportion of institutions, the stronger the explanatory power of stock emotional differences on AH stock premiums

The empirical study in this paper verifies that the traditional rational analysis explains the discount-premium phenomenon of AH stocks and also verifies that irrational sentiment can be used to explain the discount-premium phenomenon of AH stocks, which gives us the following insights:

Firstly, in the process of investing in physical assets, especially in the arbitrage trading of AH stocks, We should not only pay attention to the impact of rational factors on stock prices but also pay attention to the critical role of irrational factors in price fluctuations, and have a confident psychological expectation of the impact of irrational factors on stock price fluctuations.

Secondly, it has essential policy significance. If most small mainland investors could trade H-shares from the beginning,

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