The Chinese Equity Market correction isn't over. It's only half over.
However unpredictable the timing of the massive correction of the past 3 weeks might have been, the potential for losses on precisely that scale has been visible for weeks.

Stoxx® China A 900 Index

The Chinese equity market rose dramatically between July 2014 and June 2015. In that period the Stoxx® China A 900 Index of the 900 largest A-shares companies gained 160%.

Since the beginning of October 2014, Omega Metrics Risk Cycle analysis has been warning that this was an 'Unstable Expansion'–a period of market growth identified by a statistical fingerprint common to all unsustainable equity market booms in the past 120 years. The more explosive the boom, the more dramatic the correction.

The past year has been a nearly identical replay of the unsustainable boom which our Risk Cycle analysis identified in late 2006. The China A 900 Index peaked in the fourth quarter of 2007 and then collapsed. It reached our predicted Correction Level in November 2008.

By mid June 2015, the correction we were predicting to the current boom had reached 59%. In the period since then, against a backdrop of increasing interventions by the Chinese authorities, losses have accumulated to almost 33%. The Index closed today at 133.25. We expect it to fall to 80.5 at least. The correction isn't over, it's only half over.

Risk Predictions and Daily Returns

The daily Omega Metrics Value at Risk (VaR) and Expected Shortfall (ES) measured from short samples of historic data have a high degree of predictive power out of sample. Over extended time periods, VaR breaches are in excellent agreement with the target frequency and ES breaches are consistent with the (time varying) tail model's predicted frequency. Because it is breached relatively rarely, ES can be used to size market exposures with confidence.

The 1 in 100 day VaR for the China A 900 Index *doubled* between January and mid May of this year–as did the Expected Shortfall. Of the largest losses since then, only two have been VaR breaches. Neither has come close to exceeding the daily ES level, which has been above 7% since the beginning of May.

Multi-Day Risk Measurement

Single day losses do not tell the whole story of course. It has been the accumulation of many daily losses, combined with weak gains, that produced the headline collapse over the past three weeks.

Naive rules for extending daily VaR and ES to multiple day periods are inadequate for predicting such declines.

Our fundamental advances in probability and statistics have allowed Omega Analysis to extend to 5, 10 and 15 day periods the same out of sample predictive power which Omega Metrics VaR and ES provide for daily returns.

The 1 in 100 day VaR and ES levels for each of these periods also rose dramatically *in advance of* the recent large losses.

By the end of May the ES level for 10 day returns on the China A 900 Index had reached 17%. It had risen to 22% by the end of June.

By the end of May the ES level for 15 day returns had grown to 24%. It had risen to 26% by the end of June.

So however unpredictable the timing of the massive correction of the past 3 weeks might have been, the potential for losses on precisely the scale observed has been visible to our statistical analysis for many weeks. So too has the fact that a major correction was coming. These are 'interesting times' indeed for investors in the Chinese equity markets.

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