

EXECUTIVE SUMMARY

With China's rapid economic growth, many researchers try to research the China's new capital market by different methods, especially in the two main stock exchanges: SHSE and SZSE. In this paper, we try to use the spreads between earning yields and interest rates to evaluating the performance of A shares & B shares in Shanghai and Shenzhen. We select the monthly data from 1999 to 2004, and use the simple regression & Granger's causality test to assess the performance of A shares & B shares. At the same time, we also analyze the relationship between present return and present/past spread, and assess the forecast performance in three models by using three measures: Mean of Error (ME), Mean Absolute Error (MAE) and Root Mean Square Error (RMSE). Moreover, based on regression model and Granger's causality test, we have two portfolio switching trading strategies. Comparing with buy-and-hold strategy, we found that the spread-based trading strategies have better performance than buy-and-hold trading strategy.

In this study, we think the spread as new analysis tools should be important in China stock market. And spread should be received as a signal to enter or exit the stock market.