HOW MANY CHINA A-SHARES ARE IN YOUR CHINA PORTFOLIO?

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Unlike the U.S., where the S&P 500 Index is the main gauge for broad equity exposure, China lacks consensus on a benchmark most widely accepted index.

Broad China indexes differ according to how many state-owned companies and A-shares they include. As a result, the sector exposures of the indexes are widely different and their short-term performances can diverge significantly.
For example, the financial sector is dominated by state-owned banks, so the indexes that exclude state-owned enterprises are under-weight in financials but over-weight in other sectors like health care, communication services and consumer discretionary.

To illustrate further, consider the state-owned exposure (SOE), A-shares exposure and various sector exposures of four leading China equity indexes: the WisdomTree China ex-State-Owned Enterprises Index (CHXSOE), the S&P China 500 Index–which takes the largest 500 Chinese companies regardless of listing place, the MSCI China Index and the MSCI China A Index.

Table 1: SOE, A-share and Sector Exposures of Broad China Indexes

	% SOE	% A-shares	Sectors										
			Communication Services	Consumer Discretionary	Consumer Staples	Energy	Financials	Health Care	Industrials	Information Technology	Materials	Real Estate	Utilities
WisdomTree ex-State-Owned China Index	0%	24%	20%	32%	5%	0%	8%	14%	8%	8%	1%	3%	1%
S&P China 500 Index	36%	58%	9%	18%	8%	1%	15%	9%	12%	12%	10%	3%	2%
MSCI China Index	24%	13%	18%	33%	5%	1%	13%	8%	5%	7%	3%	3%	2%
MSCI China A Index	49%	100%	1%	8%	16%	2%	18%	11%	15%	15%	11%	2%	2%

Sources: S&P, MSCI, WisdomTree as of July 30, 2021.

Table 2: Performance as of July 30, 2021

Return	WisdomTree China ex-State-Owned Enterprises	MSCI China	MSCI China A	S&P China 500
MTD	-14.9%	-13.8%	-6.6%	-8.9%
YTD	-13.0%	-12.3%	-2.3%	-5.7%
1-Yr	8.5%	0.3%	15.8%	9.5%
3-Yr	14.0%	5.9%	17.4%	11.7%
5-Yr	20.7%	12.4%	11.2%	12.7%
Common Period (3/31/15 – 07/31/21)	14.4%	6.7%	4.3%	6.4%
12/31/08 – 07/31/2021	N.A.	9.4%	9.6%	N.A.
Volatility (03/31/15 – 07-31-21)	24.7%	21.5%	23.9%	21.7%
Volatility (12/31/08 – 07/31/21)	N.A.	21.2%	25.6%	N.A.

Investments cannot be made in an index. Unmanaged index returns do not reflect any fees, expenses or sales charges. Past performance is no guarantee of future results.

Table 3: Different Portfolio Characteristics, as of July 30, 2021: China A-shares more value, less quality, slightly less growth

Characteristic	MSCI China A shares	WisdomTree ex-SOE China
Dividend Yield	1.60%	1.01%
Estimated Price/Earnings (P/E)	16.01	20.79
Estimated Price/Earnings (P/E) Excl. Neg.	15.89	17.11
Return on Equity (ROE%)	12.17%	14.93%
# of Stocks	480	173
Median Mkt Cap in Billions	7.47	10.81
Leverage	8.3	6.77
Median Earnings Growth (1 year)	33%	22%
Median Earnings Growth (3- year)	20%	21%
Median Earnings Growth (5- year)	22%	25%
Overlapping Holdings	25%	
Return Correlations	86%	

Here are a few pointers for A-share exposure in a broad China equity portfolio:

1. **We believe somewhere between 20% and 60% is a good reference point for A-share exposure in a broad Chinese portfolio.** The MSCI China Index has finally increased its weight in A-shares, currently targeting 20%. It has been around 13% with more gradually being added.

   When taking the S&P China 500 approach, A-shares are about 58% of the largest 500 Chinese companies regardless of listing location. Among SOEs, 76% are listed as A-shares. Among non-SOEs, 48% are A-shares.

   With the political consequences of new U.S. delisting laws, we will likely see a trend of Chinese SOEs moving further toward A-shares, as shown by China Mobil's recent listing approval. Non-SOEs generally prefer moving to the Hong Kong exchange from the U.S. if they can meet the stringent listing requirements, as listing offshore is still a positive signal for Chinese private businesses. Others may move to Shanghai's NASDAQ-like STAR (Science and Technology Innovation) board or go private.

2. **Mainland China A-shares and STAR board tend to offer diversification and**

exposure to more domestic industrial and consumer staples companies, and may have higher alpha potential for active strategies, but both come with their own nuances. That's why we view it as an important part of broad China equity exposure for overseas investors. We recently discussed quantitative signals with Vivek Viswanathan, head of research for active alpha China strategy at Rayliant. Chinese A-shares are typical of emerging markets equities, and could provide good potential for alpha from non-traditional factors, like A-H share spread, or flow data of large clients versus small clients. Academic research found these kinds of friction-induced signals have worked better than traditional factors like value, momentum or size. Historically alpha is also higher when the strategy was run within China where one could have full access to A-share stocks. For clients based outside of China, there is a 30% hard cap on secondary market foreign ownership of any Chinese A-share stocks. The accounting standards are generally perceived to be better for offshore-listed Chinese equities than A-share stocks. However, if a company has dual A-H listings, it has less stigma for unreliable accounting data.

3. **We believe A hybrid China A and H share could become the norm soon for many high-performing private Chinese companies.** The case of health care company Wuxi Apptec would be an interesting case study for what's to come. Its founder was educated both in China and the U.S. Its main operation is in China, but it also has U.S. operations. It was listed in the U.S., but the founder felt there was not enough U.S. investor interest and brand name recognition, and the company was undervalued as U.S. investors seemed to significantly favor Chinese tech companies. Wuxi Apptec then voluntarily delisted from the U.S., did a spin-off of Wuxi Biologics and listed in Hong Kong. The main Wuxi Apptec got dual-listed in Hong Kong and China A-shares. The WisdomTree China ex-State-Owned Enterprises Index owns all three listings. Through this A+H structure, the company can tap into mainland China investors through its high brand recognition in China and offshore capital.

In summary, A-shares and Shanghai STAR board stocks will likely become an even more important part of a portfolio's China equity portfolio. We annually assess A-shares investment case and exposure in our own WisdomTree China ex-SOE Index, together with other risks such as delisting and VIE (variable interest entity) structure risks.

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DEFINITIONS

S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

S&P China 500 Index : Designed to track the 500 largest and most-liquid Chinese companies while approximating the sector composition of the broader equity market.

MSCI China Index : A free float-adjusted, market capitalization-weighted equity index designed to measure the performance of the Chinese equity market.

MSCI China A International Index : Captures large and mid-cap representation and includes the China A-share constituents of the MSCI China All Shares Index. It is based on the concept of the integrated MSCI China equity universe with China A-shares included.

Alpha : Can be discussed as both risk-adjusted excess return relative to a specific benchmark, or absolute excess return relative to a benchmark. It is sometimes more generally referred to as excess returns in general.