HOW TO POSITION FOR A REBOUND IN CHINA

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Chinese equities have ripped higher this year, and we see catalysts to support further gains.

MSCI recently announced plans to add more Chinese A-share stocks to its traditional China-focused indexes and to its broader emerging market and regional indexes. We think this will add further buying momentum to Chinese equities throughout the year.

Chinese A-shares currently have only a 5% inclusion factor in their indexes—but MSCI is upping the A-shares' weight in three equal tranches to 20% by the end of November.

This adds to a few other catalysts for potential outperformance of Chinese equities:

1. **U.S.-China Trade Deal:** Pessimism about a long-lasting trade war has abated. While there are fundamental differences in the worldviews of the U.S. and China, we believe President Trump is likely to follow a similar approach with China to the one he used in negotiating trade deals with Canada and Mexico—particularly after his "no deal" discussion with North Korea.

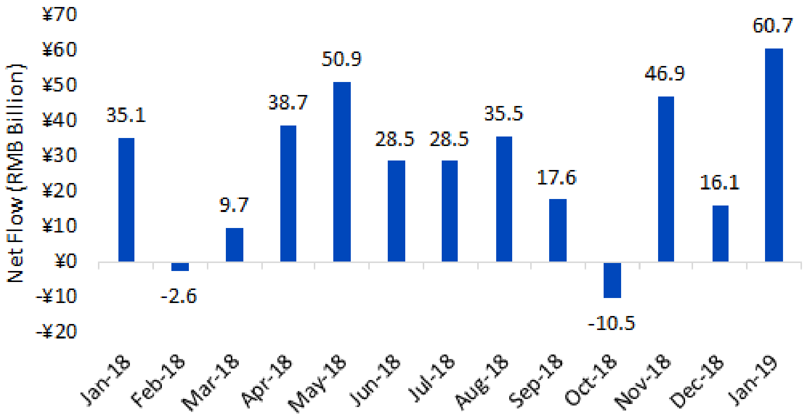
2. **Chinese Stimulus:** Concerned about the slowdown of GDP, the Chinese government has taken several measures to stimulate growth by increasing liquidity and borrowing. In Q4, China launched the targeted medium-term lending facility (TMLF), which offers a lower interest rate than the existing medium-term lending facility (MLF) to specifically support small and private firms' growth. In January 2019, the People's Bank of China took further steps to release $116 billion into the market by cutting required reserve ratios by 100 basis points (bps).[1]

3. **Federal Reserve (Fed) Pause:** The Fed has lowered its expectations for the pace of rate increases this year. Similar to the 2016 pause, we believe risk assets can continue to rally as fears of a recession are pushed into the future.

Tracking Money Flows into China

While 2018 was a disappointing year for returns, China's Stock Connect program was a huge success. In the chart below, we track net flows from foreign investors into Chinese stocks on mainland exchanges.

Net Flow of Foreign Investments through Stock Connect Program



Source: HKEX, as of 2/25/2019. Net flow of foreign funds is calculated by summing the net flow of Northbound Shanghai Stock Exchange and that of Northbound Shenzhen Stock Exchange.

With many investors needing to continue to buy mainland shares due to MSCI China benchmark changes, we believe flows into A-shares will continue to accelerate. And we believe investors should be over-weight A-shares as demand continues to increase.

Chinese Beta

While many investors spend a great deal of time deciding when and if to go over-weight China, we believe they often make a mistake about how to access this market.

We think China remains in the early innings of its path to financial market liberalization. Many index providers have a different definition of which types of Chinese stocks should be eligible for inclusion. So Chinese beta could be composed of seven share classes trading on four different exchanges.

Due to companies' decisions about where to incorporate and list their stock for trading, each share class has its own distinct characteristics. As we show below, this can lead to a wide dispersion of returns.

2008		2009		2010		2011	
-46.4%	Red Chips	137.8%	B-Shares	59.9%	N/S-Shares	0.6%	N/S-Shares
-50.8%	H-Shares	134.2%	P Chips	33.0%	B-Shares	-9.1%	Red Chips
-50.8%	MSCI China	96.7%	A-Shares	11.2%	Red Chips	-18.4%	MSCI China
-61.8%	A-Shares	95.9%	N/S-Shares	4.6%	MSCI China	-20.8%	H-Shares
-63.9%	P Chips	67.5%	H-Shares	3.1%	H-Shares	-22.8%	P Chips
-66.0%	B-Shares	62.3%	MSCI China	-2.2%	P Chips	-22.9%	A-Shares
-	N/S-Shares	31.0%	Red Chips	-4.4%	A-Shares	-34.4%	B-Shares

2012		2013		2014		2015	
27.8%	B-Shares	76.0%	N/S-Shares	46.5%	A-Shares	9.6%	P Chips
26.4%	Red Chips	29.8%	P Chips	15.2%	H-Shares	7.1%	A-Shares
26.4%	P Chips	24.3%	Red Chips	11.9%	N/S-Shares	2.6%	N/S-Shares
22.8%	MSCI China	3.6%	MSCI China	9.5%	B-Shares	-2.0%	Red Chips
20.5%	H-Shares	0.8%	A-Shares	8.0%	MSCI China	-7.8%	MSCI China
9.5%	A-Shares	-1.3%	H-Shares	1.7%	P Chips	-15.5%	H-Shares
-9.8%	N/S-Shares	-25.5%	B-Shares	-1.1%	Red Chips	-23.1%	B-Shares

2016		2017		2018		YTD	
10.7%	P Chips	107.1%	P Chips	-3.6%	Red Chips	18.8%	N/S-Shares
2.7%	H-Shares	71.9%	N/S-Shares	-12.3%	H-Shares	11.1%	MSCI China
0.9%	MSCI China	54.1%	MSCI China	-16.7%	B-Shares	10.0%	P Chips
-2.2%	N/S-Shares	30.3%	H-Shares	-18.9%	MSCI China	9.1%	H-Shares
-5.3%	Red Chips	20.8%	Red Chips	-24.8%	P Chips	8.7%	A Shares
-19.1%	A-Shares	20.3%	A-Shares	-33.0%	A Shares	6.1%	Red Chips
-32.5%	B-Shares	-13.8%	B-Shares	-35.8%	N/S-Shares	2.2%	B-Shares

Sources: WisdomTree, Zephyr, as of 1/31/2019.Subject to change. You cannot invest directly in an index.

For definitions of terms in the chart, please visit our glossary.

In our view, investors seeking broad-based exposure to China should consider a total market access product across all listings—something like the S&P China 500 Index.

By including all available share classes, investors are able to allocate to China in the same way they benchmark to U.S. markets via the S&P 500 Index strategies.

S&P China 500 Index vs. MSCI China Index

When it comes to Chinese beta, many investors have defaulted to the MSCI China Index. However, our view is the S&P China 500 Index gives a more accurate measure of the Chinese market not only by offering comprehensive coverage of all Chinese share classes but by taking a large stake in A-shares.

Comparing to MSCI China’s current 2.25% weight in A-shares, the S&P China 500 Index’s 50.76% weight indicates its focus on the Chinese domestic market. While MSCI just recognized A-shares’ value with the announcement to increase their weight to 20% in November, the S&P China 500 Index has already incorporated A-shares as an essential component.

Share Class	S&P China 500 Index	MSCI China Index	WisdomTree China Ex-State-Owned Enterprises Index
A-shares	50.76%	2.52%	26.37%
B-shares	0.08%	0.16%	0.00%
H-shares	16.24%	32.36%	5.98%
N-shares	13.09%	24.90%	33.40%
P chips	13.07%	25.30%	33.22%
Red chips	6.67%	14.77%	1.04%
S-shares	0.08%	0.00%	0.00%
TOTAL	**100.00%**	**100.00%**	**100.00%**

Source: Wisdomtree, as of 2/28/2019. Weights subject to change. You cannot invest directly in an index.

The fundamentals between the S&P China 500 Index and the MSCI China Index are similar. However, across the board, the S&P China 500 Index has had higher value, better quality and a lower price.

Index	Dividend Yield	P/E Ratio	Forward P/E Ratio	Return on Equity	Return on Assets	P/B Ratio	P/S Ratio	P/CF Ratio
S&P China 500	2.41%	12.36x	11.70x	12.83%	1.48%	1.71x	1.23x	6.50x
MSCI China	2.27%	12.81x	15.91x	12.39%	1.42%	1.70x	1.42x	6.70x
WisdomTree China Ex-SOE	1.36%	16.93x	17.05x	16.68%	2.22%	2.91x	1.87x	10.96x

Source: WisdomTree, as of 1/31/2019. Past performance is not indicative of future results. You cannot invest directly in an index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns.

For investors looking for a broad access vehicle to Chinese equity beta, WisdomTree launched a Fund to track the S&P China 500 Index—WCHN, the WisdomTree ICBCCS S&P China 500 Fund. MSCI is adding more A-shares this year and will have to continue to creep higher in their exposure, but our fund is already positioned across all the Chinese stocks.

[1]Source: Kevin Yao, Lusha Zhang, “China Slashes Banks’ Reserve Requirements Again as Growth Slows,” Reuters, 1/4/19.

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You cannot invest directly in an index.

DEFINITIONS

A-share : shares traded on the Shanghai and Shenzhen stock exchanges. This is contrast to Renminbi B shares which are owned by foreigners who cannot purchase A-shares due to Chinese government restrictions.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Liquidity : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.

Targeted medium-term lending facility (TMLF) : A new type of People's Bank of China lending to Chinese banks that can be used up to three year.

Interest rates : The rate at which interest is paid by a borrower for the use of money.

Medium-term lending facility (MLF) : A type of People's Bank of China lending to Chinese banks typically with maturity from three months to one yea.

Reserve Ratio Requirement (RRR) : portion of depositors' balances that banks must have reserved in the form of cash.

Basis point : 1/100th of 1 percent.

Stock Connect : A program connecting Hong Kong, Shanghai, and Shenzhen stock exchanges to allow international and mainland Chinese investors to trade Chinese stocks.

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

Beta : A measure of the volatility of a security or a portfolio in comparison to a benchmark. In general, a beta less than 1 indicates that the investment is less volatile than the benchmark, while a beta more than 1 indicates that the investment is more volatile than the benchmark.

S&P China 500 Index : Comprises 500 of the largest, most liquid Chinese companies while approximating the sector composition of the broader Chinese equity market. All Chinese share classes including A-shares and offshore listings are eligible for inclusion.

Value : Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over tim.

Quality : Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over tim.