

# CHINA'S TECH- AND CONSUMER-DRIVEN CONVERSION

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Most market participants are likely familiar with the growth of tech and consumer discretionary names in weight and importance in U.S. equities, but some may be overlooking a similarly dramatic change that has materialized in emerging markets. Over the past 10 years, due in large part to the slow and steady liberalizing of capital markets coupled with the exceptional growth of some of the country's biggest companies, China's star has risen not only as an economic power, but as an investing destination as well.

The country's largest companies, primarily in the information technology and consumer discretionary sectors, are joining the ranks of U.S. multinationals atop the charts of the largest, fastest-growing and most recognizable companies in the world. Since the start of 2017, the two largest companies in China have grown their combined [market capitalization](#) by more than \$500 billion and have ascended to within the top five by size of global information technology companies. Such fast-growing companies are emblematic of the "new China" that is fundamentally different from "old China." Even more interesting, the rise of China's national champions has largely been homegrown. As we show in the table below, nearly all of Tencent's and Alibaba's revenue was earned in China. This compares to a much more U.S.-centric model for most other large tech firms. This is an important distinction, particularly given heightened regulatory scrutiny in the U.S.

## Alibaba and Tencent: Hallmarks of a Sectoral Shift

MSCI ACWI Index: Top 10 Firms by Market Capitalization in Information Technology Sector			Country Revenues	
Company Name	Market Capitalization (USD Billions)	Country of Domicile	U.S.	China
Apple, Inc.	\$851.3	United States	36.83%	7.34%
Microsoft Corp.	\$702.8	United States	50.30%	9.54%
Alphabet, Inc.	\$670.5	United States	47.35%	2.84%
Tencent Holdings Ltd.	\$496.0	China	2.46%	95.02%
Alibaba Group Holding Ltd.	\$471.6	China	0.00%	100.00%
Facebook, Inc.	\$382.8	United States	45.37%	3.22%
Samsung Electronics Co., Ltd.	\$296.4	Korea	12.91%	15.50%
Intel Corp.	\$243.7	United States	20.03%	22.92%
Taiwan Semiconductor Manufacturing Co., Ltd.	\$218.8	Taiwan	63.58%	9.00%
Visa, Inc.	\$215.6	United States	47.45%	9.91%

Sources: WisdomTree, MSCI, 3/31/18. Past performance is not indicative of future results. You cannot invest directly in an index. Holdings subject to change.

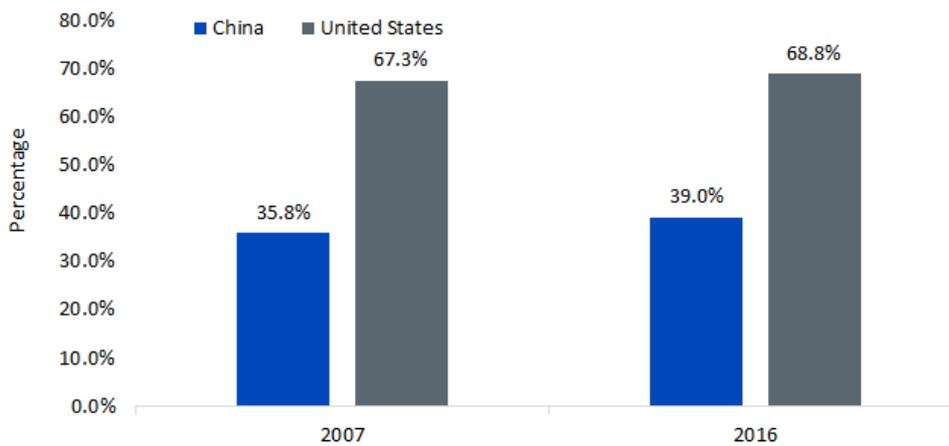
## Shifting Consumer Habits

In our view, the investment case around China 10 years ago, like other export-dependent economies, was critically tied to the value of the yuan and the prospects for global trade. As illustrated with the high percentage of revenue earned in China and the transition toward a more consumption-driven economy, China is less reliant on global

growth and trade. The miraculous growth of the first decade of the 21st century was driven by export- and investment-led growth. Chinese policy makers have sought to strike a pragmatist’s balance between maintaining economic growth and overseeing a transition. In every year since 2010, consumption has accounted for greater than half the growth of [gross domestic product \(GDP\)](#), and household consumption as a percentage of total GDP has been steadily increasing toward 40%.<sup>1</sup> However, this proportion is still well below developed markets like the United States, where consumption accounts for almost 70% of GDP.

**Consumption as Percentage of GDP well Below U.S.**

**Household Consumption as % of GDP**



Source: World Bank, data latest available as of 3/31/18. Past performance is not indicative of future results.

Today, the focus for investors is on the changing habits of the population’s increasing and pervasive use of technology and the decades-long trend of a growing middle class that will propel domestic consumption to supplant exports as the engine of growth. Based on 2017 data, of the nearly 753 million Chinese who access the Internet via mobile, more than 65% used their phones to purchase something online. Despite a comparatively low (by American standards) 55.8% Internet penetration rate, China is the most connected country in the world. As such, 40 million people gained access for the first time last year.<sup>2</sup> Based on these trends, we believe the rise of Chinese technology and the consumer class will undoubtedly have a profound impact on global markets and investment opportunities going forward.

**Largest Companies Driving Innovation and Growth**

To establish a baseline of the rapid growth occurring in the technology and consumer discretionary sectors, we highlight the 10 largest technology and consumer companies in the [S&P 500](#). Over the last five years, these businesses have boosted sales by a cumulative 57%. Because they make up nearly 19% of the index, this has led to total returns for each sector of 155.6% and 107.1%, respectively. Among these firms are the most-well-known technological innovators and brands in the world.

**Top 10 Weights: S&P 500 Index**

S&P 500 Index: Top 10 Firms Information Technology & Consumer Discretionary Sectors		
Company Name	Index Weight	Cumulative Sales Growth (5 Years)
<b>Full Index</b>		<b>50.3%</b>
Apple, Inc.	3.8%	45.3%
Microsoft Corp.	3.1%	35.2%
Amazon.com, Inc.	2.6%	191.1%
Facebook, Inc.	1.7%	698.8%
Alphabet, Inc.	2.8%	117.8%
Intel Corp.	1.1%	17.7%
Visa, Inc.	1.0%	75.0%
The Home Depot, Inc.	0.9%	35.0%
Cisco Systems, Inc.	0.9%	1.8%
Mastercard, Inc.	0.7%	68.9%
<b>Top 10 Total/Median Sales Growth</b>	<b>18.6%</b>	<b>57.1%</b>

Sources: WisdomTree, FactSet, as of 3/31/18. You cannot invest directly in an index. Holdings subject to change.

Next, we contrast these sales growth figures with the largest tech and consumer companies in China. While many names may appear familiar, many of them may not. This is despite the fact that median sales for these companies have grown in excess of 435% over the last five years. Among the less obvious names is TAL Education Group (TAL). While Alibaba has topped sales growth, TAL has experienced the second highest revenue growth in China over this period. TAL stands poised to benefit from the digitization of the Chinese consumer. It is the largest provider of online tutoring services for children in the world. As China grows richer and the middle class continues to expand, parents will increasingly focus on ways to invest in their children’s education. Companies like this are an example of the powerful combination of technological trends driving household consumption patterns that will power earnings going forward.

Top 10 Weights: [WisdomTree China ex-State-Owned Enterprises Index](#)

WT China ex-SOE Index: Top 10 Firms Information Technology & Consumer Discretionary Sectors		
Company Name	Index Weight	Cumulative Sales Growth (5 Years)
<b>Full Index</b>		<b>325.1%</b>
Tencent Holdings Ltd.	9.8%	403.7%
Alibaba Group Holding Ltd.	9.0%	586.2%
Baidu, Inc.	4.8%	255.2%
JD.com, Inc.	3.7%	720.2%
Ctrip.com International Ltd.	2.4%	466.7%
Midea Group Co. Ltd.	2.3%	233.9%
Geely Automobile Holdings Ltd.	1.7%	250.5%
NetEase, Inc.	1.6%	515.2%
New Oriental Education & Technology Group, Inc.	1.4%	133.1%
TAL Education Group	1.3%	591.7%
<b>Top 10 Total/Median Sales Growth</b>	<b>38.0%</b>	<b>435.2%</b>

Sources: WisdomTree, FactSet, as of 3/31/18. You cannot invest directly in an index. Holdings subject to change.

**Conclusion**

Two main themes have been guiding our view that investors should seriously consider

boosting exposure to Chinese equities over the medium term: capital market integration and domestically oriented earnings potential. We discussed the [impact of capital market reforms](#), including impending [A-shares](#) inclusion in MSCI Indexes, in a recent blog post. While active management or stock picking is often utilized when going abroad, we would advocate the merits of reviewing a broad index-based approach given the breadth of the opportunity set. One such index that has been effective in targeting the fast-growing companies we have highlighted, while mitigating the risks associated with unprofitable companies operating at the behest of the Chinese government, is the WisdomTree China ex-State-Owned Enterprises Index. For a deeper look, see our [full white paper on this topic](#).

<sup>1</sup>Sources: Bloomberg, National Bureau of Statistics, World Bank.

<sup>2</sup>Source: China Internet Network Information Center, 39th Survey Report, 1/17.

#### Important Risks Related to this Article

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For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

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DEFINITIONS

**Market Capitalization**: Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

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

**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.

**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.