A BETTER WAY TO ACCESS CHINESE EQUITIES

June 2019

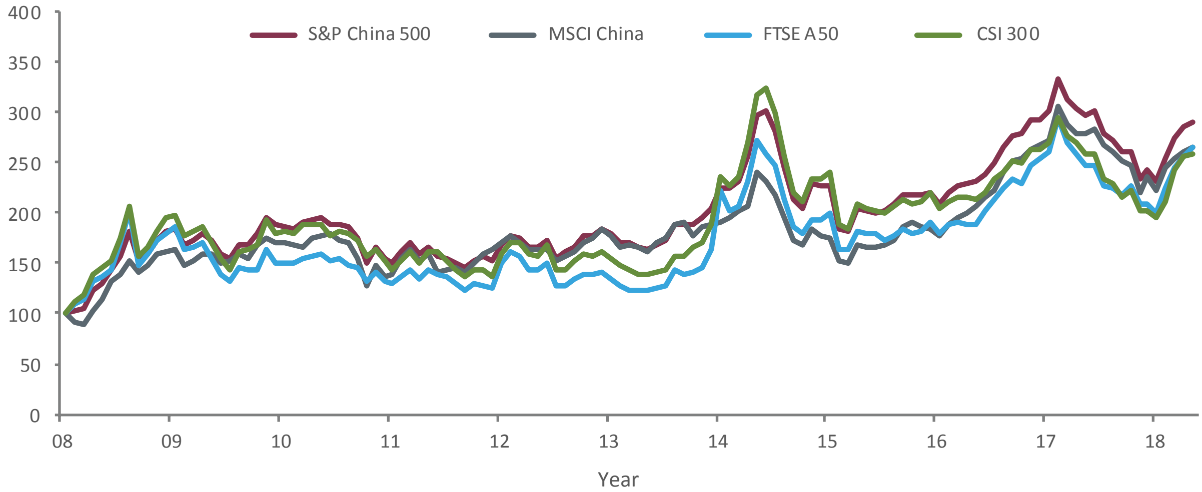
China has been on the path of liberalising its capital markets, making it more accessible and attractive to foreign investors. MSCI recently announced that it will increase the inclusion factor of large-cap China A-shares from 5% to 20% over the course of this year. This will result in meaningful flows of capital into the Chinese stock market. Given the large discrepancy between China's share of global Gross Domestic Product (GDP) (around 19% based on Purchasing Power Parity) and China's share in global indices (around 4% in MSCI ACWI), investors are keen to diversify their global equity portfolios by increasing the exposure to China.

Investing in Chinese equities however is not entirely straightforward, given the wide array of share classes on offer. This raises a very crucial question of how to best access the Chinese equity beta. We believe the S&P China 500 is the best way to gain exposure to Chinese equity, given its superior risk adjusted returns driven by a more balanced share class exposure and a more diversified split among sectors compared to other indices.

Superior risk adjusted returns

We observe the return and risk characteristics of some of the key Chinese equity indices following the global financial crisis. It is evident that S&P China 500 has the most efficient risk profile among peers.

FIGURE 1: THE S&P CHINA 500 HAS HAD BETTER PERFORMANCE COMPARED TO PEERS SINCE THE GLOBAL FINANCIAL CRISIS



Source: WisdomTree, Bloomberg. Includes backtested data. The S&P China 500 began its live calculation on 28 August 2015. Monthly data from 31 December 2008 to 30 April 2019. All returns are in USD. Net total return indices have been used. **You cannot invest in an index. Historical performance is not an indication of future results and any investments may go down in value.**

FIGURE 2: THE S&P CHINA 500 HAS A FAVOURABLE SHARPE RATIO AMONG PEERS SINCE THE GLOBAL FINANCIAL CRISIS

	S&P China 500	MSCI China	CSI 300	FTSE A50
Rendite	10,8 %	9,9 %	9,6 %	9,9 %
Risiko	22,1 %	21,3 %	27,0 %	28,0 %
Sharpe-Ratio	0,44	0,41	0,31	0,31

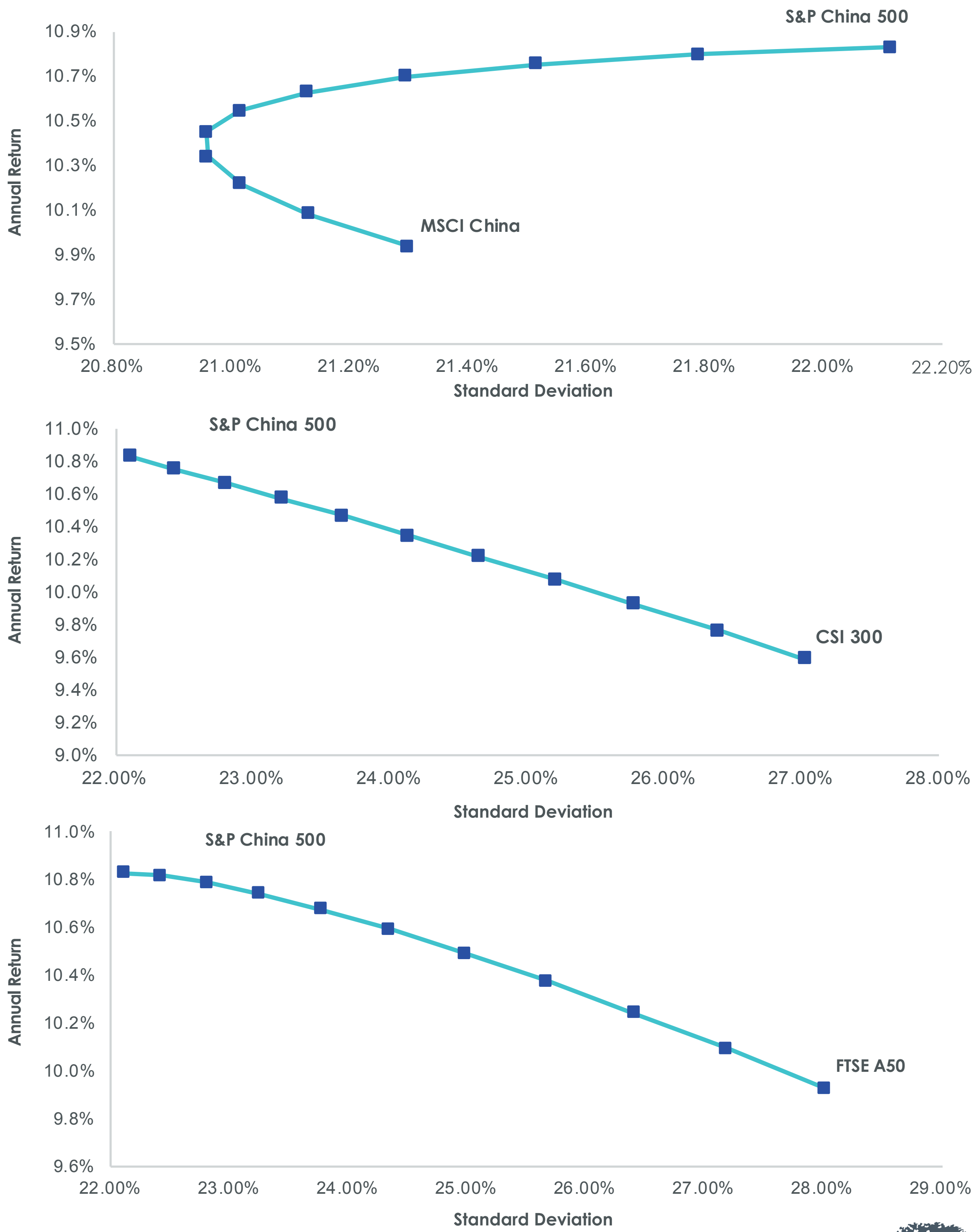
Source: WisdomTree, Bloomberg. Includes backtested data. The S&P China 500 began its live calculation on 28 August 2015. Monthly data from 31 December 2008 to 30 April 2019. All returns are in USD. Net total return indices have been used. Return and risk numbers have been annualised. Standard deviation is the measure of risk. 3-year US Treasury yield has been used as the risk-free rate to calculate Sharpe Ratios. **You cannot invest in an index. Historical performance is not an indication of future results and any investments may go down in value.**

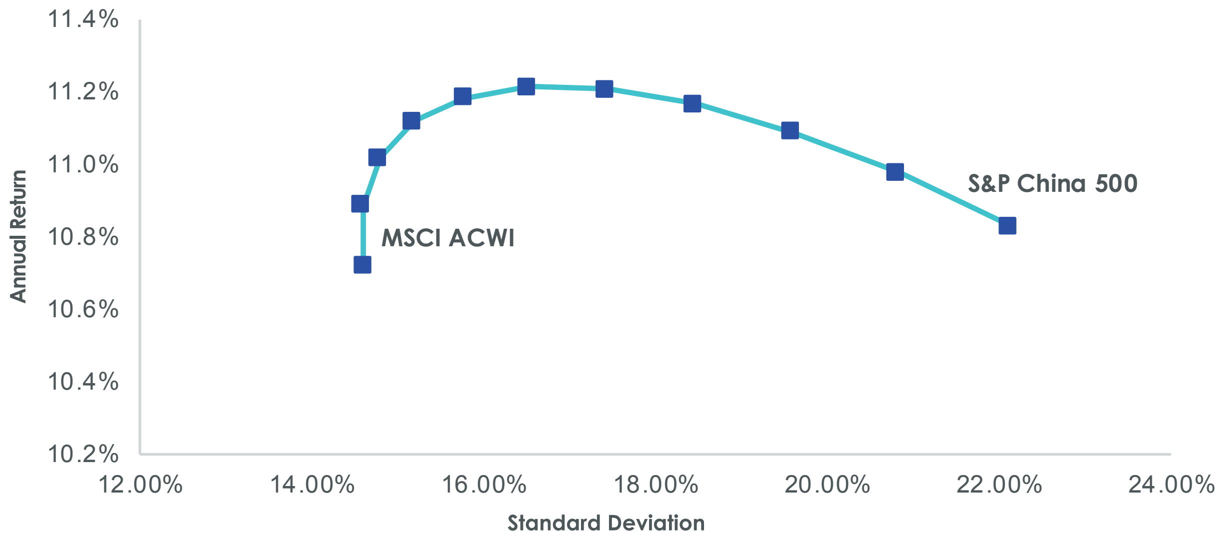
Given the historically superior risk adjusted returns profile for S&P China 500 compared to other key indices, adding an exposure to S&P China 500 within an existing allocation to any of the other indices would naturally result in an improved risk profile for the total portfolio. We illustrate this by showing the risk and return profile for portfolios which blend different weights of S&P China 500 with the given index.

In figure 3 below, we show the annualised return and standard deviation of hypothetical portfolios invested fully in a given index (named respectively, e.g. MSCI China represents 100% allocation in MSCI China). Each marker on the line represents a new blend portfolio with a 10% reduction from one index in favour of the other index in the given chart. This gives us 9 intermediary blend portfolios going from one index to another. If the resulting line curves, the blend portfolio with the higher level of return for the same amount of risk is more 'efficient'.

We also illustrate the benefit of adding S&P China 500 to MSCI ACWI as the risk profile below shows that swapping a small amount of MSCI ACWI into S&P China 500 meaningfully improves the return without adding a large amount of risk.

FIGURE 3: RISK RETURN PROFILE OF BLEND PORTFOLIOS





Source: WisdomTree, Bloomberg. The S&P China 500 began its live calculation on 28 August 2015. Monthly data from 31 December 2008 to 30 April 2019. All returns are in USD. Net total return indices have been used. **You cannot invest in an index. Historical performance is not an indication of future results and any investments may go down in value.**

More balanced share class exposure

Depending on where they are listed and who they are available to, there are several different Chinese share classes. Critically, given their distinct characteristics, their returns vary considerably in different time periods.

FIGURE 4: VARIATION IN RETURNS FOR CHINESE SHARE CLASSES

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

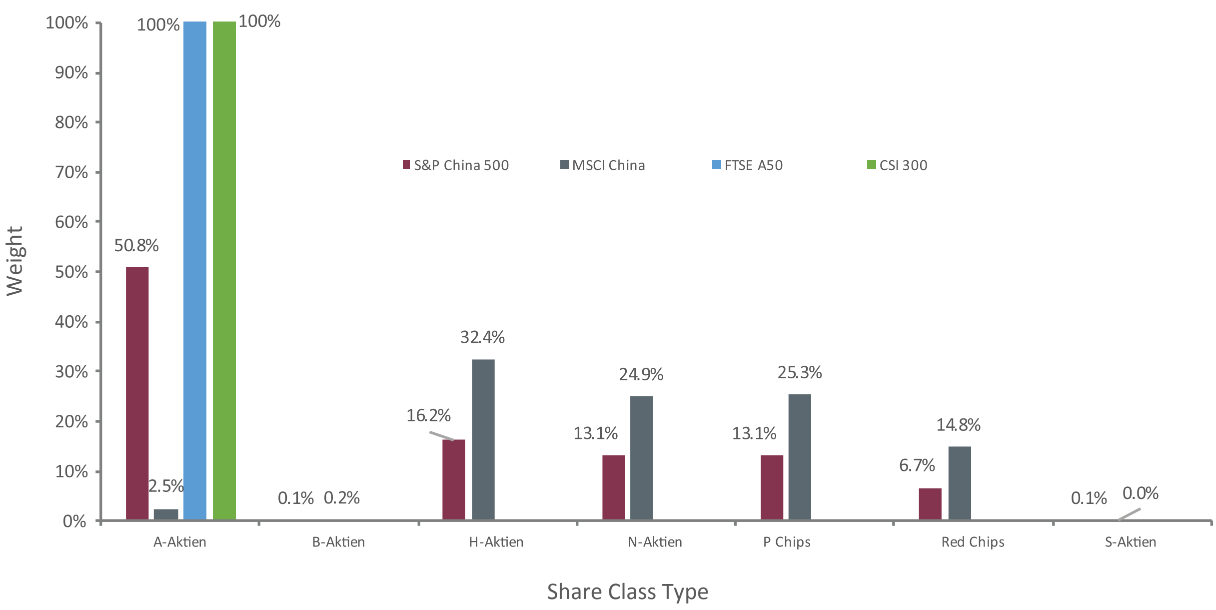
2011	2012	2013
0.6% N/S-Shares	27.8% B-Shares	76.0% N/S-Shares
-9.1% Red Chips	26.4% Red Chips	29.8% P Chips
-18.4% MSCI China	26.4% P Chips	24.3% Red Chips
-20.8% H-Shares	22.8% MSCI China	3.6% MSCI China
-22.8% P Chips	20.5% H-Shares	0.8% A-Shares
-22.9% A-Shares	9.5% A-Shares	-1.3% H-Shares
-34.4% B-Shares	-9.8% N/S-Shares	-25.5% B-Shares

2014	2015	2016
46.5% A-Shares	9.6% P Chips	10.7% P Chips
15.2% H-Shares	7.1% A-Shares	2.7% H-Shares
11.9% N/S-Shares	2.6% N/S-Shares	0.9% MSCI China
9.5% B-Shares	-2.0% Red Chips	-2.2% N/S-Shares
8.0% MSCI China	-7.8% MSCI China	-5.3% Red Chips
1.7% P Chips	-15.5% H-Shares	-19.1% A-Shares
-1.1% Red Chips	-23.1% B-Shares	-32.5% B-Shares
2017	**2018**	**2019**
107.1% P Chips	-3.6% Red Chips	140.1% N/S-Shares
71.9% N/S-Shares	-12.3% H-Shares	136.9% A-Shares
54.1% MSCI China	-16.7% B-Shares	87.0% P Chips
30.3% H-Shares	-18.9% MSCI China	74.2% MSCI China
20.8% Red Chips	-24.8% P Chips	47.5% H-Shares
20.3% A-Shares	-33.0% A-Shares	32.0% B-Shares
-13.8% B-Shares	-35.8% N/S-Shares	27.2% Red Chips

Source: WisdomTree, Bloomberg, FTSE Russell (for descriptions). Data to 30/04/2019. All returns are in USD. Net total return indices have been used. **A-shares** *are securities of Chinese incorporated companies that trade on either the Shanghai or Shenzhen stock exchanges. They are traded in Renminbi (Chinese Yuan). They can only be traded by residents of the People's Republic of China or under the Qualified Foreign Investor (QFII), the Renminbi Qualified Foreign Institutional Investor (RQFII) rules, or via the Stock Connect programs.* **B-shares** *are securities of Chinese incorporated companies that trade on either the Shanghai or Shenzhen stock exchanges. They are traded in US dollars on the Shanghai Stock Exchange and Hong Kong dollars on the Shenzhen Stock Exchange. They can be traded by non-residents of the People's Republic of China and also residents of the People's Republic of China with appropriate foreign currency dealing accounts.* **H-shares** *are securities of companies incorporated in the People's Republic of China that trade on the Hong Kong Stock Exchange. They are traded in Hong Kong dollars. Like other securities trading on the Hong Kong Stock Exchange, there are no restrictions on who can trade H shares. A* **Red Chip** *is a company incorporated outside the People's Republic of China (PRC) that trades on the Hong Kong Stock Exchange and is substantially owned, directly or indirectly, by Mainland China state entities with the majority of its revenue or assets derived from Mainland China. A* **P Chip** *is a company controlled by Mainland Chinese companies or individuals, with the establishment and origin of the company in Mainland China. It must be incorporated outside the People's Republic of China (PRC) and traded on the Hong Kong Stock Exchange with a majority of its revenue or assets derived from Mainland China. An S* **Chip** *is a company controlled by Mainland Chinese companies or individuals, with the establishment and origin of the company in mainland China. It must be incorporated outside the People's Republic of China (PRC) and traded on the Singapore Stock Exchange with a majority of its revenue or assets derived from Mainland China.* **N-shares** *are companies controlled by Mainland Chinese companies or individuals, with the establishment and origin of the company in Mainland China. It must be incorporated outside the People's Republic of China (PRC) and traded on the New York Stock Exchange, the NASDAQ exchange, or the NYSE American with a majority of its revenue or assets derived from Mainland.* **You cannot invest in an index. Historical performance is not an indication of future results and any investments may go down in value.**

As an investor, the key is therefore to achieve a balanced exposure across the different share classes to diversify the risk as well as to achieve a more 'complete' exposure to Chinese beta. We believe the S&P China 500 best provides this balance compared to other indices. Moreover, the S&P China 500 places a rightful emphasis on China's domestic market by tilting towards A-shares - something the MSCI indices are now looking to address.

FIGURE 5: SHARE CLASS EXPOSURE FOR VARIOUS INDICES



Source: WisdomTree, FactSet. Data as of 28 February 2019. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

Better diversity across sectors

Most indices tend to have a strong concentration in financials (FTSE A50 54.68%, CSI 300 35.63%) whereas the S&P China 500 has a more balanced split across the sectors. This, as well as the diversity among share classes, contributes to the lower level of risk for the index compared to others.

FIGURE 6: A MORE BALANCED SECTOR SPLIT FOR S&P CHINA 500

Source: WisdomTree, Bloomberg. Data as at 30 April 2019. **You cannot invest in an index. Historical performance is not an indication of future results and any investments may go down in value.**

As China liberalises its markets, capital will continue to flow into Chinese assets. The key question for investors in Chinese equity is to determine the best way to access Chinese equity beta. We believe that the S&P China 500 Index has the best approach for achieving this goal. This is due to the following reasons:

1. Superior risk adjusted returns compared to other competing indices
2. More balanced share class split providing a more ‘complete’ exposure to Chinese equity
3. Better weight distribution among sector providing improved diversity.

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