US-CHINA TRADE: WHEN VS. WHAT

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If we break down investing into two principal components, most questions centre upon when to buy or sell and what to buy or sell.

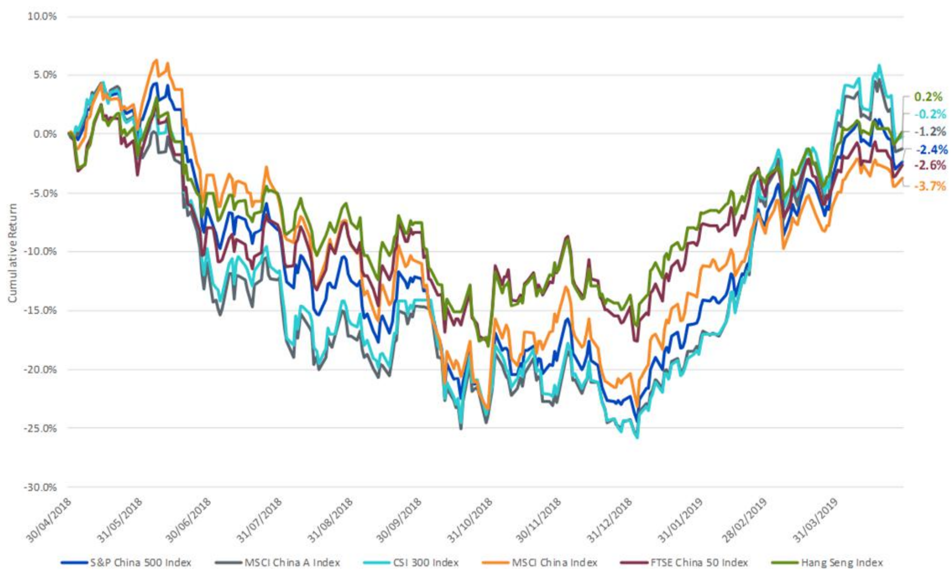
The trade war between the US and China over the last 15 months has forced investors without a dedicated position in China to consider focusing on this first question of when to buy.

In our view, a formal trade agreement is likely to be signed before the G20 meeting in June. In response, investors should have a plan as China is potentially too large an opportunity to ignore in global portfolios.

As the market has grown more confident of an impending deal, global equity markets have rebounded sharply after a painful fourth quarter in 2018. But there's a wide degree of dispersion between different measures of Chinese markets, where the question of what to buy or sell starts to take top priority.

In Figure 1 below, we show six Chinese equity benchmarks. What's immediately apparent is that, even with China's equity market rally thus far in 2019, over the past period of one-year these markets are basically flat. This could give at least some comfort to those wondering, if they are only looking at 2019 year-to-date, if they missed the rally.

Figure 1: Cumulative performance of major Chinese indices indicates nearly flat performance over past year (30 April 2018 to 29 April 2019)



Source: Bloomberg, as of 29 April 2019.

Historical performance is not an indication of future performance and any investments may go down in value.

How to consider a benchmark exposure to China's Equity markets

What's also very clear in Figure 1 is that the various equity benchmarks for China's stock market might deliver a very different performance experience, depending on the period under consideration. Here, we offer a few metrics that might help one to better compare the pros and cons of each approach. While we wouldn't know which might provide the strongest performance in the future at any time, we might be able to show metrics for consideration to better align one's China equity exposure with their broader investment goals.

1. Number of Holdings

One of the broadest measures of European equity market performance is the MSCI Europe IMI Index which had 1431 constituents as of 29 March 2019. Chinese equity benchmarks can be more concentrated. If we look at the benchmarks that we showed in Figure 1[1].

- MSCI China Index: 469 companies
- S&P China 500 Index: 563 companies
- MSCI China A Index: 387 companies
- CSI 300 Index: 300 companies
- FTSE China 50 Index: 50 companies
- Hang Seng Index: 50 companies

The wide variation in the number of constituent companies in each of these indices will definitely contribute to expectations of differentiated performance. In our experience, if investors have a specific view on a market or a specific thesis, then a specific exposure to, for example, A-share[2] equities of China could make sense. However, if there is a greater degree of uncertainty and the desire is to have exposure to an array of China's market, then a more diversified approach that includes A-shares as well as other share classes and a great number of companies could make more sense.

In our view, the degree of conviction should have a relationship to how specific (or broad) the exposure should be.

2. Sector Concentration

With the vast divergence in the number of constituents that we explored earlier, it stands to reason that looking at sector exposures would also showcase some disparities across these different indices for China's equity market performance. Within Figure 2:

- We used colours to highlight sector concentration. As you look across the page horizontally, a very dark shade of green indicates the index with the highest exposure to that respective sector. A very dark red colour, conversely, indicates a very low exposure. The lack of a dark green or a dark red shading indicates a less extreme exposure to the respective sector.
- Financials is a great sector to look at as an example. The FTSE China 50 Index and the Hang Seng Index had more than 45% exposure to this single sector—that's nearly half of the Index! On the other hand, the S&P China 500 Index and the MSCI China Index had less than 25% exposure to this sector.
- As investors think about their exposure to China, in our view it again comes back to conviction. Is the goal a big exposure to Financials with some exposure to other sectors? Or is the goal to be more evenly distributed? These are important questions to ask when choosing an index.

Figure 2: Sector weight comparisons across China's index benchmarks

Sector Name	S&P China 500 Index	MSCI China A Index	CSI 300 Index	MSCI China Index	FTSE China 50 Index	Hang Seng Index
Communication Services	11.89%	1.96%	1.33%	26.00%	19.47%	15.69%
Consumer Discretionary	16.17%	7.95%	9.37%	22.54%	5.07%	4.64%
Consumer Staples	5.99%	12.65%	9.76%	2.60%	0.00%	2.48%
Energy	3.25%	2.58%	2.29%	4.88%	11.20%	6.09%
Financials	24.32%	29.59%	35.02%	22.09%	45.62%	47.81%
Health Care	5.15%	6.75%	6.81%	2.96%	0.00%	1.22%
Industrials	11.41%	13.40%	13.63%	5.35%	4.69%	3.94%
Information Technology	6.21%	8.87%	7.84%	2.99%	2.23%	1.04%
Materials	7.26%	7.82%	6.67%	2.00%	1.22%	0.00%
Real Estate	5.64%	5.49%	4.79%	5.92%	9.55%	12.28%
Utilities	2.71%	2.93%	2.48%	2.67%	0.96%	4.81%

Source: WisdomTree, as of 29 March 2019.

3. Share Classes

Another headline that caught attention was MSCI's January announcement that it would accelerate the pace of inclusion of Chinese A-shares in its indices. While this announcement may have flown under the radar due to macro headwinds from trade, this marks yet another step in the process of financial market liberalisation in China.

The MSCI China A Index and the CSI 300 Index offer two ways to track the performance of China's A-share equity markets, and we do know that some investors want to concentrate within China's equities in this specific way. But, do China's A-Shares always outperform all of China's other share classes—like H-Shares , which are traded on the Hong Kong Stock Exchange, for example? No—similar to trying to predict which sector or which factor will be the strongest performer, China's share classes are also difficult to forecast. The S&P China 500 Index is designed to build exposure across China's different share classes. The MSCI China Index is making greater and greater progress toward this end, but, as of 29 March 2019, it still had less than 5% total exposure to A shares. As a point of comparison, the S&P China 500 Index had approximately 50%[4].

Final Thoughts

As the two largest economies in the world, relations between the US and China dictate the tone for global markets. While the US has been a leader in global capital markets for nearly a decade, China's rise is still in its infancy. Investors must consider the degree of conviction they have on different measures to best assess which Index of China's equity performance could be of greatest interest to them.

Source

1 Bloomberg, with data as of 29 March 2019.

2 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.

3 H shares: Refers to the shares of companies incorporated in mainland China that are traded on the Hong Kong Stock Exchange.

4 Factset, Bloomberg, with data as of 29 March 2019.

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