
ALL CHANGE FOR CHINA A-SHARES AND MSCI?

Wisdomtree EU
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China A-shares, with respect to global equity benchmark indices, have been problematic for some investors in terms of market accessibility and index inclusion.

The evolution of the relatively restrictive Qualified Foreign Institutional Investor schemes—QFII and RQFII—combined with the relatively new Stock Connect schemes for both Shanghai and Shenzhen stocks has created a material change to investors' ability to trade A-shares. These moves have created an environment of more flexible market access which has increased the likelihood that, on a revised and limited basis, MSCI may include A-shares in their benchmark indices. It is important to note that the current proposal is substantially different from the previous attempts and only creates a modest inclusion of A-shares as opposed to a comprehensive approach.

The likely inclusion by MSCI of A-shares highlights the benefits of existing index strategies such as the S&P China 500 that feature a much broader coverage of Chinese equities and share classes. Currently most investors, hampered by adequate access to on-share China equities hold mainly Hong Kong listed H-shares and US-listed N shares. These types of index exposures whilst are operationally easy to manage, fail to capture the full opportunity set of the rapidly changing and dynamic Chinese economy.

In contrast to previous MSCI proposals, which envisaged adding 448 A-shares and which would've led to more substantial changes, the current proposal only entails adding 169 A-shares with a 5% inclusion factor. The key change is that only large cap companies that are accessible through the Shanghai and Shenzhen Stock Connect programmes would be eligible. Crucially, companies that already have H-shares in the MSCI China index would not have their A-shares included. Whilst an interesting compromise, the resultant index, almost by design, is less inclusive than the approach taken by S&P in constructing the S&P China 500 and results in only minimal change. The weight of the new A-shares to be included in the index is only 1.8%.

Table 01. MSCI China Index breakdown of number of constituents and index weight (current versus new)

MSCI China	Number of constituents		Index weight	
	Current	New	Current	New
A-Shares	0	169	0.0%	1.8%
B-Shares	2	4	0.2%	0.4%
H-Shares	70	86	38.6%	37.6%
Red Chip	30	38	16.9%	16.6%
P Chip	34	50	21.5%	21.8%
Overseas	14	18	22.8%	21.8%
Total	150	365		

Source: MSCI China, WisdomTree. Data as at 3 March 2017.

S&P's solution is to consider the entire investable universe of Chinese equities, ranging from A-shares and B-shares, H-shares, overseas listings (typically NYSE or Nasdaq), and P Chip and Red Chips. At its heart, this index is designed to match the sector breakdown of the S&P Total China Broad Market Index (BMI) which combines the constituents of the S&P China A BMI and the S&P China BMI. This unique approach to Chinese equities sector weighting means the S&P China 500 has been designed from the outset to combine liquidity and sector representation. In terms of index construction, all share classes that qualify are included and companies are ranked by market capitalisation within each sector with the aim to approximate the broad market's sector weights.

One aspect of the sector weights within the S&P China 500 index is that it more closely measures the Chinese economy—especially as it encompasses the structural shift with a greater focus on consumer spending and technology as opposed to older state-owned enterprises and financials. In terms of consumer-oriented sectors the S&P China 500 has an exposure of 23.4%; this compares to the 14.7% in the current MSCI China index which would potentially rise to 15% with the inclusion of a broader range of constituents including A-shares. With respect to Financials and Real Estate sectors, the S&P China 500 index at 26.3% is underweight relative to the current MSCI China index and the potentially expanded index where the weight is approximately 29.6%.

Table 02. S&P China 500 Index sector breakdown versus MSCI China

	S&P China 500	MSCI China Index	
		Proposed	Current
Consumer Discretionary	12.57%	10.08%	10.03%
Consumer Staples	5.52%	2.54%	2.40%
Energy	3.75%	5.93%	6.00%
Financials	21.83%	25.47%	25.52%
Health Care	5.30%	2.36%	2.31%
Industrials	13.81%	6.23%	6.05%
Information Technology	18.15%	31.57%	32.01%
Materials	8.91%	1.95%	1.84%
Real Estate	4.44%	4.14%	4.08%
Telecommunication Services	2.59%	6.80%	6.89%
Utilities	3.13%	2.93%	2.88%
Grand Total	100.00%	100.00%	100.00%

Source: MSCI China, WisdomTree. Data as at 3 March 2017.

Overall investors looking to access broad China equities, without waiting for a gradual and piecemeal approach by MSCI, may look consider the S&P China 500 index that already offers a complete solution and one that can be accessed through a physical UCITS ETF.

Our offering

+ [ICBCCS WisdomTree S&P China 500 UCITS ETF Class B - USD \(CHIC/CHIN/CHIP\)](#)

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