INTRODUCING WISDOMTREE CHINA EX STATE OWNED ENTERPRISES INDEX

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07/02/2015

In a previous blog post, we discussed the characteristics of Chinese state-owned enterprises and the growing interest that some investors have expressed in avoiding or limiting their exposures. State-owned enterprises are typically defined as companies that are either wholly or partially owned or operated by a government. Some investors believe that government ownership can negatively impact the operational aspects of a company because government-owned companies might be influenced by a broader set of interests, beyond generating profits for shareholders. *The Wall Street Journal* recently reported that the Chinese government is seeking reforms within its state-owned enterprises in order to make them more profitable. This reform is speculated to be accomplished through consolidation and not through a relaxing of the state's control, which many argue is needed. The newspaper reported:

> Though the government has taken some tentative steps to allow more private and foreign capital to flow into infrastructure, resources, banking and other areas that were long the preserve of state firms, Mr. Xi has said they remain an "important pillar of the national economy." The government "must ensure they thrive," Mr. Xi said in remarks in August. Bigger and stronger state companies, according to officials and scholars familiar with the leadership's thinking, are viewed by Mr. Xi as key to China's asserting its prominence in the world.[1]

To be fair, there are certainly price levels at which these state-owned companies can become very inexpensive, and all the bad news can become reflected in the prices such that they perform very well going forward. But given the dominance of many state-run companies (more than 70% in popular Chinese benchmarks), WisdomTree thought it prudent to offer an alternative view of China—without state-run companies. Therefore, we introduce our new Index, the WisdomTree China ex-State-Owned Enterprises Index, which is designed to measure the performance of broad-based Chinese stocks that exclude state-owned companies. To WisdomTree, state-owned enterprises are defined as those having government ownership of more than 20% of outstanding shares. **Index Methodology** The Index employs a modified float-adjusted market capitalization-weighting process to target the performance of Chinese stocks that are not state-owned enterprises. • **Eligible Universes:** Must be a member of the WisdomTree Emerging Markets ex-State-Owned Enterprises Index and be incorporated or domiciled in China. • **State-Owned Enterprises:** Companies with more than 20% ownership by government body are excluded. • **Minimum Market Capitalization:** $1.0 billion. • **Weighting:** Modified float-adjusted market capitalization. • **Holding and Sector Caps**

- **Holding Caps:** The top holdings will be capped at 10%.
- **Sector Caps:** Each sector will be capped at 30%.

WisdomTree China ex-State-Owned Enterprises Index Characteristics

	WisdomTree China ex-State-Owned Enterprises	MSCI China	FTSE China 50
SOE Weight	0.00%	70.80%	77.30%
Dividend Yield	1.24%	2.38%	2.53%
Price-to-Earnings Ratio	16.7x	11.6x	10.7x
Return on Equity	18.43%	13.49%	15.81%
Return on Assets	8.07%	3.83%	3.15%
Sectors			
Information Technology	30.34%	13.36%	11.51%
Financials	23.66%	41.84%	50.33%
Consumer Discretionary	22.42%	4.59%	2.69%
Consumer Staples	12.16%	3.82%	1.39%
Health Care	7.41%	2.29%	0.00%
Industrials	2.01%	7.85%	7.16%
Materials	2.00%	2.65%	0.83%
Energy	0.00%	9.48%	13.03%
Telecommunication Services	0.00%	10.28%	10.80%
Utilities	0.00%	3.83%	2.26%

Sources: WisdomTree, Bloomberg, as of 5/31/15. Subject to change. 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.

For definitions of terms and indexes in the chart, please visit our glossary. • **Valuations Tell a Mixed Story:** Looking at dividend yield and price-to-earnings (P/E) ratios of the various Chinese indexes above would lead an investor to believe that the non-state-owned part of the market is priced higher. But if considering profitability metrics like return on equity and return on assets, an investor could conclude that non-SOEs are more reasonably priced. WisdomTree believes that SOEs generally trade at lower valuations due to the perceived risk of government involvement; the most difficult part is determining the right level of discount warranted. • **Information Technology and Consumer Sectors Rise to the Top:** Given the Chinese government's low amount of involvement in the Information Technology sector and Consumer sectors (Discretionary and Staples), we are not surprised that these sectors become some of the largest weight after the state-owned enterprises have been removed. WisdomTree believes these sectors will continue to be important to focus on in the future as China's standard of living increases and its large population base transforms into consumers. • **Under-Weight Financial Sector:** Given the Chinese government's high amount of involvement within the Financials sector, specifically within the country's large banks, it is reasonable to expect this sector to make up a lower percentage after state-owned enterprises have been removed. WisdomTree believes that although state-owned Chinese banks are among the lowest-priced areas of the global markets, they remain the largest risk in owning China based solely on market cap. As China continues to grow and transform, investors will demand more ways to gain access to this unique country. Recently, some investors have expressed concern over state-owned enterprises, and they have sought tools to limit their exposure, even after understanding the valuation differences. These investors are interested in concentrating their exposure on the private sector and accessing higher profitability potential. Although it is impossible to know which area will be more beneficial to focus on going forward, we think it is important to have different tools available, and the case for either exposure could be made, depending on an investor's goals and objectives. [1]Lingling Wei and Brian Spegele, "China Considering Mergers among Its Biggest State Oil Companies," The Wall Street Journal, 2/17/15.

Important Risks Related to this Article

Investments in emerging, offshore or frontier markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention or political developments. Investments focused in China increase the impact of events and developments associated with the region, which can adversely affect performance.

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You cannot invest directly in an index.

DEFINITIONS

Float-adjusted market capitalization : Share price x number of shares outstanding, adjusted for the fact that in many emerging markets, not all of the shares outstanding regularly trade, which leads to a reduction in the number of shares outstanding used in the calculation.

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Dividend yield : A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

Price-to-earnings (P/E) ratio : Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

Return on Equity (ROE) : Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

Return on assets (ROA) : Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.