

# THE WEST IS TAKING A HARD LOOK AT CHINA'S STATE-OWNED ENTERPRISES

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05/25/2021

It is no secret that so-called “impact” investors are gunning for the oil majors, or that Uncle Sam is salivating at the prospect of taxing the Silicon Valley giants, or that Big Tobacco is racing to get people vaping to reduce the stigma of its business model.

But when it comes to Chinese equity targets, whether by activists or regulators, the picture is murky.

Sure, a couple firms are notable for divestment headlines in recent years. One is Xiaomi, the smartphone maker, who the Western powers view as a security risk. Another is Huawei, the critical cog in telecom’s 5G rollout, which has been on the front page for a few years now. The picture is especially cloudy when you consider that the Chinese Communist Party (CCP) is still holding Canada’s “Two Michaels,” the businessmen held on trumped-up espionage charges in retaliation for the 2018 arrest of Huawei’s CFO at the Vancouver airport. Michael Kovrig and Michael Spavor could be executed if found guilty.

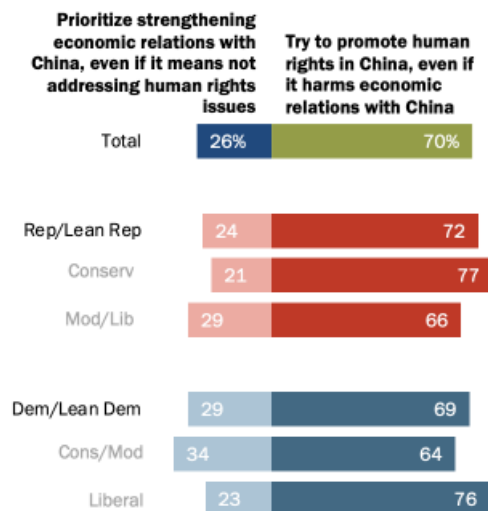
Beyond those two firms, there are many more companies with close ties to the state that have gotten the attention of Western politicians. In the waning days of the Trump administration, 44 Chinese companies with close ties to the People’s Liberation Army (PLA) were blacklisted. Notable among them are CNOOC, the energy giant, and China Mobile.

Can you think of *any* issue as universally bipartisan as China’s authoritarianism (figure 1)?

**Figure 1: Pew Research Center Poll, American Views of Chinese Human Rights**

**Americans across both parties support promoting human rights in China**

*% who say the U.S. should ...*



Source: Pew Research Center. Note: Survey of U.S. adults conducted 2/1/21–2/7/21.

Because a chunk of our emerging markets equity business excludes all companies with more than 20% state ownership,

we had none of the 44 PLA-affiliated companies in the [WisdomTree Emerging Markets ex-State-Owned Enterprises Index](#) or the [WisdomTree China ex-State-Owned Enterprises Index](#).

Another focal point are allegations of human rights abuses toward minority Muslims in the hinterland province of Xinjiang. In December, the European Parliament issued a statement saying “Parliament strongly condemns the Chinese government-led system of forced labour – in particular the exploitation of Uyghur, ethnic Kazakh and Kyrgyz, and other Muslim minority groups – in factories within and outside internment camps in the Xinjiang Uyghur Autonomous Region.”<sup>1</sup>

**Figure 2: China’s Provinces**



Source: Wikipedia Commons.

We believe the situation goes well beyond shoppers telling Sweden’s casual clothing brand H&M to stop sourcing cotton from that region, which grows 20% of the global supply. It could be viewed as a full-on societal pressure campaign on the CCP to abide by the global rules-based order. It is no stretch to forecast that the day is coming—or is already here —“when Western capital rejects China’s massive [state-owned enterprises \(SOEs\)](#) , as it did the apartheid-era South African stock market.

When the market takes fright at these ugly headlines, our research indicates it is often the SOEs that bear the brunt of the selling, as they are closest to CCP leadership.

Interestingly, when the market rages higher, the SOEs have also struggled. To wit, the SOE-heavy [FTSE China 50 Index](#) returned just 11.5% last year, a very different ballpark from the 61.1% run in the [WisdomTree China ex-State-Owned Enterprises Index](#).

We hold no false illusions: Kicking out SOEs does not get the Party out of your portfolio. Just ask Alibaba founder Jack Ma, who has been largely “disappeared” since he gave a CCP-critical speech in October.

Nevertheless, a venture into our kick-out-the-SOEs strategies will help keep you away from many of the PLA-linked firms. It will also separate your capital from China’s megabanks, an investment decision that may prove fortuitous if the US, EU and allies such as Japan, South Korea and India open the sanctions playbook.

WisdomTree ideas for this concept are:

[The WisdomTree Emerging Markets ex-State-Owned Enterprises Fund \(XSOE\)](#)

[The WisdomTree China ex-State-Owned Enterprises Fund \(CXSE\)](#)

[The WisdomTree India ex-State-Owned Enterprises Fund \(IXSE\)](#)

Please see *standardized performance and portfolio holdings* for [XSOE](#), [CXSE](#) and [IXSE](#)

<sup>1</sup>“EU Parliament Condemns China Over Uyghur ‘Exploitation,’” CNN, 2/17/20.

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## DEFINITIONS

**State-owned enterprise** : Companies in which governments have a significant ownership stake and the potential to influence the firms' actions over time.

**FTSE China 50 Index** : a market capitalization weighted index tracking the top 50 Chinese companies. Stocks are weighted by H or Red Chip share cap as appropriate.