THREE REASONS WHY CHINA CAN ROAR IN 2020

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We're only a few weeks into 2020, but the Chinese equity market has already continued the surge that began late last year. With the thawing of trade tensions between the U.S. and China, culminating in the long-awaited Phase One trade deal being signed earlier this month, investors have become increasingly optimistic amid the global risk-on sentiment.

Chinese equities[1] finished 2019 up over 20%, which solidified them as one of the best performing risk assets globally. While that's certainly an impressive return, what if there was a way that investors could allocate to China more strategically, and potentially eclipse the gains of the broader market?

In 2012, WisdomTree introduced its China ex-State-Owned Enterprises Fund (CXSE), which avoids companies with a significant government influence in favor of those with the liberty to make decisions on behalf of their business and shareholders. Our unique strategy has delivered unique results, returning over 36% (on a NAV basis) last year and beating the broader Chinese market by about 13%. For standardized performance of CXSE, please click here.

We believe that China may continue to surge even higher this year for a few different reasons.

Reason #1: Addition via Subtraction

CXSE avoids companies where the government is a significant shareholder, whose interests may not align with that of the business or other common shareholders. Classified as companies where the government owns at least 20% of shares outstanding, state-owned enterprises (SOEs) make up about 40% of the Chinese market (represented by the MSCI China Index) but have little to show for their prominence.

If we compare the performance of the WisdomTree China ex-State-Owned Enterprises Index (the index that CXSE seeks to track[2]) versus the MSCI China Index, we see that WisdomTree's rejection of SOEs is responsible for half of the 13% excess return generated in 2019. The other half came from reallocating into non-SOEs, or companies that are able to make decisions aligned with shareholder interests and business objectives.

Figure 1: State-Ownership Performance Attribution

State-Ownership Attribution									
Category	Attribution Components				Average Category Weight			Category Performance	
	Allocation	Stock Selection	Interaction	Total Attribution	Index Weight	Benchmark Weight	+/- Wgt	WT Index Return	Benchmark Return
State-Owned Enterprises	6.72%	-	-	6.72%	-	40.17%	-40.17%	-	9.16%
Non-State-Owned Enterprises	4.81%	1.07%	0.85%	6.74%	100.00%	59.83%	40.17%	36.92%	34.36%
Total	**11.53%**	**1.07%**	**0.85%**	**13.46%**	-	-	-	**36.92%**	**23.46%**

Sources: WisdomTree, FactSet, as of 12/31/19. Past performance is not indicative of future results. You cannot invest directly in an index. Index used: WisdomTree China ex-State-Owned Enterprises Index (CHXSOE). Benchmark used: MSCI China Index (MXCN). Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns. Analysis period: 12/31/18–12/31/19.

Reason #2: Targeting the Right Sectors

The second reason is a byproduct of the first. By avoiding SOEs, our exposures are titled away from the government-influenced fixtures of the economy, such as banks, energy and utility companies, in favor of consumer-driven and growth-oriented businesses, like information technology.

During 2019, we had an average underweight of about 15% to banks, energy companies and utilities, which, along with the non-SOEs within them, contributed about half of the year's excess return. By contrast, our average 15% *overweight* to information technology, health care and consumer discretionary contributed about 5%, driven by the larger allocation in these non-SOE-heavy sectors.

Figure 2: Sector Performance Attribution

Sector Attribution									
Category	Attribution Components				Average Category Weight			Category Performance	
	Allocation	Stock Selection	Interaction	Total Attribution	Index Weight	Benchmark Weight	+/- Wgt	WT Index Return	Benchmark Return
Financials	0.77%	5.81%	-2.12%	4.47%	13.82%	22.32%	-8.50%	42.37%	17.02%
Information Technology	0.81%	0.59%	0.77%	2.17%	6.77%	3.12%	3.65%	72.50%	46.36%
Health Care	0.69%	0.51%	0.71%	1.91%	7.86%	3.26%	4.60%	55.89%	37.52%
Industrials	0.15%	1.84%	-0.23%	1.75%	4.60%	5.36%	-0.76%	39.23%	6.16%
Energy	0.97%	1.91%	-1.86%	1.03%	0.15%	4.37%	-4.22%	40.27%	2.52%
Consumer Discretionary	2.21%	-0.93%	-0.34%	0.93%	30.43%	23.44%	6.99%	48.28%	52.14%
Communication Services	0.43%	0.47%	-0.07%	0.83%	22.13%	24.44%	-2.32%	10.17%	8.88%
Utilities	0.49%	0.60%	-0.44%	0.65%	0.84%	2.99%	-2.15%	21.08%	5.79%
Real Estate	0.00%	0.28%	0.04%	0.32%	6.53%	5.56%	0.96%	38.55%	33.76%
Materials	-0.14%	-0.15%	0.12%	-0.17%	1.29%	2.06%	-0.77%	15.82%	24.68%
Consumer Staples	0.32%	-0.40%	-0.35%	-0.42%	5.59%	3.07%	2.52%	24.60%	38.15%
Total	**6.71%**	**10.52%**	**-3.77%**	**13.46%**	-	-	-	**36.92%**	**23.46%**

Sources: WisdomTree, FactSet, as of 12/31/19. Past performance is not indicative of future results. You cannot invest directly in an index. Analysis period: 12/31/18–12/31/19. Index used: WisdomTree China ex-State-Owned Enterprises Index (CHXSOE). Benchmark used: MSCI China Index (MXCN).

Reason #3: Avoiding SOEs Targets Efficient Companies

Our third reason is attributable to our non-SOE mandate once again. We only allocate to companies that are free from the government's interests as a shareholder, which means leaders and directors are able to pursue business objectives, such as cutting costs, increasing revenues and other endeavors. That results in a collection of companies with robust operations and financial health.

If we compare last year's returns by return-on-equity (ROE) quintiles, we see that performance was driven by companies with the highest ROE quintile (which had an 18% overweight), while underweighting those with the lowest ROE. In many cases, the underlying methodology invested in the companies that performed the best within the lower ROE quintiles as well, which aided performance further.

Figure 3: ROE Quintile Performance Attribution

Return on Equity Attribution									
Category	Attribution Components				Average Category Weight			Category Performance	
	Allocation	Stock Selection	Interaction	Total Attribution	Index Weight	Benchmark Weight	+/- Wgt	WT Index Return	Benchmark Return
1st Quintile (Highest ROE)	0.89%	2.57%	1.94%	5.40%	44.49%	26.99%	17.50%	38.69%	26.54%
2nd Quintile	0.01%	-0.74%	0.06%	-0.67%	27.20%	24.51%	2.69%	28.04%	31.66%
3rd Quintile	0.44%	12.30%	-6.29%	6.44%	12.74%	28.66%	-15.92%	65.22%	20.32%
4th Quintile	0.41%	1.62%	-0.51%	1.52%	5.80%	8.71%	-2.92%	30.41%	13.63%
5th Quintile (Lowest ROE)	0.48%	2.15%	-0.80%	1.83%	4.52%	8.08%	-3.55%	31.86%	9.08%
Negative Return	-0.27%	-0.62%	0.16%	-0.73%	3.38%	2.45%	0.93%	6.92%	36.49%
N/A	0.05%	-0.03%	-0.35%	-0.33%	1.87%	0.60%	1.27%	20.14%	163.10%
Total	**2.00%**	**17.24%**	**-5.78%**	**13.46%**	-	-	-	**36.92%**	**23.46%**

Sources: WisdomTree, FactSet, as of 12/31/19. Past performance is not indicative of future results. You cannot invest directly in an index. Analysis period: 12/31/18–12/31/19. Index used: WisdomTree China ex-State-Owned Enterprises Index (CHXSOE). Benchmark used: MSCI China Index (MXCN).

Will China Climb Higher in 2020?

While past performance is not indicative of future results, we do think that unique performance is indicative of a unique strategy. For investors considering where China fits into their asset allocation, we think the WisdomTree China ex-State-Owned Enterprises Fund (CXSE) is a compelling offering with a track record of success.

Unless otherwise stated, data sources are WisdomTree and FactSet, as of 12/31/2019.

[1]Universe used: MSCI China Index (MXCN)

[2]CXSE seeks to track the price and yield of the WisdomTree China ex-State-Owned Enterprises Index before fees and expenses

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You cannot invest directly in an index.

DEFINITIONS

Risk-on/risk-off : refers to changes in investment activity in response to perceived risk. During periods when risk is perceived as low, investors tend to engage in higher-risk investments. When risk is perceived as high, investors tend to gravitate toward lower-risk investments.

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

MSCI China Index : A free float-adjusted, market capitalization-weighted equity index designed to measure the performance of the Chinese equity market.

Excess Returns : refers to investment returns on a securities above that of a benchmark or index exhibiting similar risk characteristics.