

# LOWERING YOUR CHINA RISK

Jeremy Schwartz — Global Chief Investment Officer, Matt Wagner — Associate Director, Research  
05/19/2023

When the [MSCI Emerging Markets Index](#) launched in January 2001, the market-cap weight of the Chinese equity market was around 7%.

Fast-forward two decades and its weight has ballooned to roughly one-third of all [emerging markets](#) equities in most benchmarks. At its peak in October 2020, China made up 43% of the MSCI EM index.

## Percent China Weight in the MSCI Emerging Markets Index



Sources: WisdomTree, FactSet. Data 1/31/01-4/28/23. You cannot invest directly in an index. Past performance is not indicative of future results.

Chinese equities have recently been driven by idiosyncratic risks: China's self-inflicted tech regulations, U.S.-China trade tensions, overbuilding and problems with real estate developers, and COVID-19 lockdowns and questions over the pandemic's origins to name a few.

There is now increasing geopolitical tension with the U.S. over both China's long-run intentions for Taiwan and its support of Russia. Seemingly, the only issue to unite Washington politicians is posturing over who could be 'tougher on China.'

Given the significant weight of China in broad emerging markets allocations, increased but difficult-to-forecast risks have repeatedly frustrated some asset allocators.

The chorus is asking, "Is China investable?" Often an 'un-investable' narrative is what creates some of the best opportunities—think back to when oil prices went negative during the pandemic as a recent asset class that was also considered un-investable.

But actions of the U.S. regulators to penalize U.S. investors when Russia invaded Ukraine calls into question whether the same could happen to U.S. investments in China. This risk is certainly not zero and we believe increasingly investors will want to isolate and mitigate China-specific risks and opportunities that emanate from them.

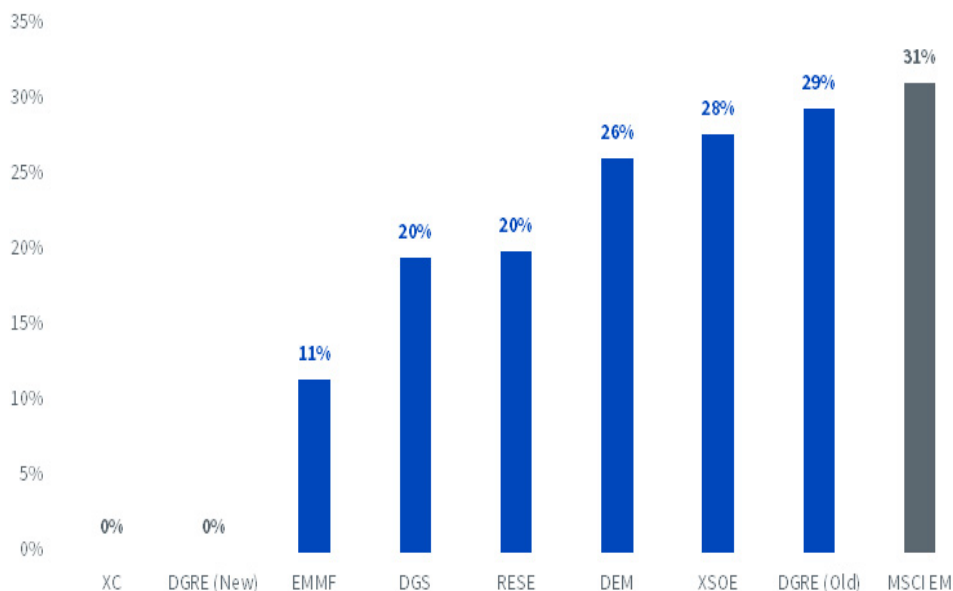
WisdomTree offers investors emerging markets exposure across seven different ETFs. In an attempt to give investors the optionality to unpack the percentage of China exposure in their EM portfolios and control how much China they really

want, we launched the broad-based [WisdomTree Emerging Markets ex-China Fund \(XC\)](#) last fall.

In two actively run portfolios, WisdomTree took further steps to lower our China risks and give more tools to investors who want diversified emerging markets exposure.

The [WisdomTree Emerging Markets Quality Dividend Growth Fund \(DGRE\)](#) rebalanced and re-allocated completely away from China, while our [Emerging Market Multifactor ETF \(EMMF\)](#) lowered the weight in China to less than half that of the broad MSCI EM Index. We will follow up with more information on [EMMF](#) in another blog post, while focusing discussion in this post on the refreshed portfolio characteristics for [DGRE](#).

### Percent China Exposure



Sources: WisdomTree, MSCI, FactSet. All China exposure weights as of 4/28/23 except for DGRE (New), which is as of 5/17/23.

### Methodology

[DGRE](#) is a rules-based active ETF. The model selects roughly 250–300 dividend-paying constituents, selected based on characteristics of higher operating profitability (quality) and trailing dividend growth.

Several Chinese companies among the top 10 Fund holdings were removed for risk considerations, including Tencent Holdings, ENN Energy and ANTA Sports. JSW Steel Limited—an Indian Materials company—was the only non-China holding removed from the top 10 holdings based on the quantitative dividend-growth model.

### Top 10 Holdings

DGRE (Old)		DGRE (New)		MSCI Emerging Markets Index	
Company Name	Wgt	Company Name	Wgt	Company Name	Wgt
Taiwan Semiconductor	6.0%	Taiwan Semiconductor	6.0%	Taiwan Semiconductor	6.2%
Tencent Holdings Ltd.	5.8%	Samsung Electronics Co., Ltd.	3.5%	Tencent Holdings Ltd.	4.2%
Samsung Electronics Co., Ltd.	3.5%	Reliance Industries Limited	1.7%	Samsung Electronics Co., Ltd.	3.6%
Grupo Bimbo SAB de CV Class A	1.1%	Grupo Bimbo SAB de CV Class A	1.1%	Alibaba Group Holding Limited	2.4%
Infosys Limited	1.0%	Infosys Limited	1.0%	Reliance Industries Limited	1.4%
Vale S.A.	1.0%	Vale S.A.	1.0%	Meituan Class B	1.3%
ANTA Sports Products Ltd.	1.0%	Tata Consultancy Services Limited	0.9%	China Construction Bank Corp. Class H	1.0%
JSW Steel Limited	0.9%	Samsung Electronics Co Ltd Pfd	0.8%	HDFC	0.9%
ENN Energy Holdings Limited	0.9%	America Movil SAB de CV Class B	0.8%	ICICI Bank Limited	0.9%
Tata Consultancy Services Limited	0.9%	ICICI Bank Limited	0.7%	Vale S.A.	0.9%

Sources: WisdomTree, MSCI, FactSet. Weights as of 4/28/23 except for DGRE (New), which are as of 5/17/23. You cannot invest directly in an Index.

The weighting process is modified market-cap to give greater weight to companies with higher scores on quality and dividend growth. After this week's reconstitution, [DGRE](#) maintained a trailing [P/E ratio discount](#) and 2X P/E points below the MSCI EM Index. Further, as the process favors high-quality companies earning a high return on equity and assets, those advantages over the broad MSCI EM Index were also well maintained.

In short, WisdomTree believes all the attractive portfolio characteristics of [DGRE](#) were maintained, but with the benefit of a significant decrease in China-specific risks.

### Fundamentals Comparison

Fund/Index	P/E Ratio	Forward P/E Ratio	P/B Ratio	Return on Equity	Return on Assets
DGRE (Old)	10.51x	12.40x	2.00x	17.38%	4.68%
DGRE (New)	9.69x	11.79x	1.89x	16.98%	4.51%
MSCI China Index	12.99x	11.15x	1.38x	11.43%	1.31%
MSCI Emerging Markets Index	12.07x	12.71x	1.59x	13.31%	1.85%

Sources: WisdomTree, MSCI, FactSet. Fundamentals as of 4/28/23, except for DGRE (New), which are as of 5/17/23. You cannot invest directly in an Index.

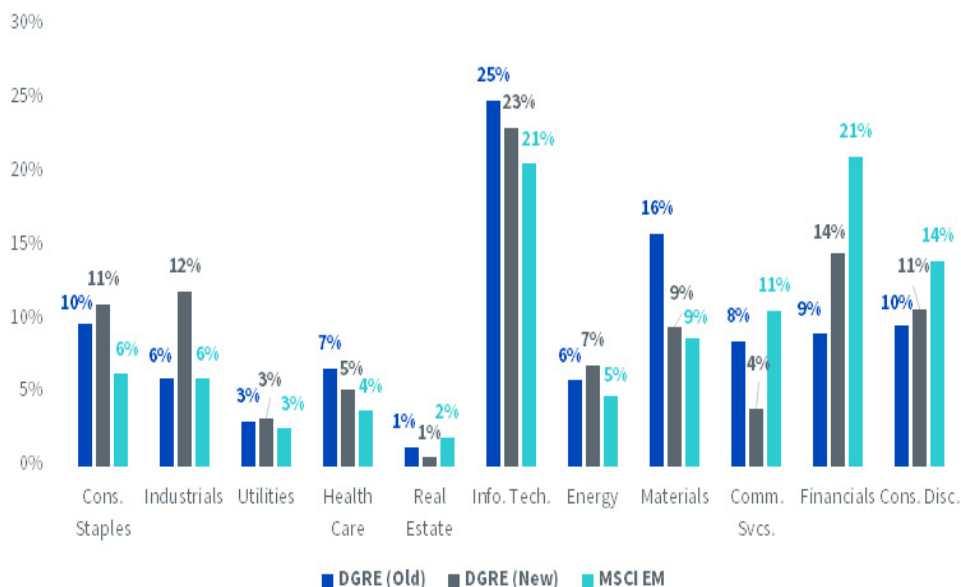
The performance data quoted represents past performance and is no guarantee of future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted.

For the most recent month-end and standardized performance as well as fund holdings, click [here](#).

For definitions of terms in the chart above, please visit the [glossary](#).

From a sector perspective, the rebalance increased weight to Financials and Industrials and reduced weight to Communication Services and Materials.

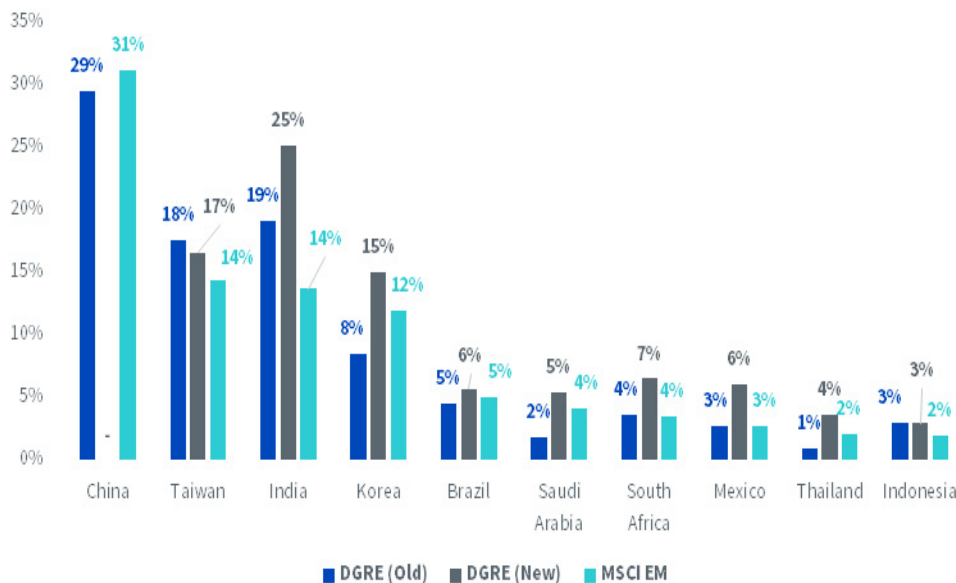
### Sector Exposures



Sources: WisdomTree, MSCI, FactSet. Sector weights as of 4/28/23 except for DGRE (New), which are as of 5/17/23. You cannot invest directly in an Index.

In terms of country exposures, removing the 31% weight to China results in notable increases to India (+6%) and Korea (+7%).

### Country Exposures



Sources: WisdomTree, MSCI, FactSet. Country weights as of 4/28/23 except for DGRE (New), which are as of 5/17/23. You cannot invest directly in an Index.

## Conclusion

After the rebalance, the ex-ante beta of [DGRE](#) to the MSCI EM Index was materially lowered from 0.97 to 0.87.

We believe the recent rebalance of [DGRE](#) allows investors to access quality dividend growth emerging markets companies while mitigating exposure to some of the idiosyncratic risks associated with Chinese equities in recent years.

## Important Risks Related to this Article

**DGRE:** There are risks associated with investing, including the possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Funds focusing on a single sector generally experience greater price volatility. Investments in emerging, offshore or frontier markets are generally less liquid and less efficient than developed markets and are subject to additional risks, such as of adverse governmental regulation, intervention and political developments. Due to the investment strategy of this Fund it may make higher capital gain distributions than other ETFs. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

**XC:** There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Investments in emerging markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks. The Fund's investment strategy limits the types and number of investment opportunities available and, as a result, the Fund may underperform other funds. The Fund's exposure to certain sectors, countries, or regions may increase its vulnerability to any single economic or regulatory development related to such sector, country, or region. The Fund is non-diversified, as a result, changes in the market value of a single security could cause greater fluctuations in the value of Fund shares than would occur in a diversified fund. Investments in currency involve additional special risks, such as credit risk and interest rate fluctuations. The Fund invests in the securities included in, or representative of, its Index regardless of their investment merit and the Fund does not attempt to outperform its Index or take defensive positions in declining markets. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

**EMMF:** Investing involves risk including possible loss of principal. Investments in non-U.S. securities involve political, regulatory, and economic risks that may not be present in U.S. securities. For example, foreign securities may be subject to risk of loss due to foreign currency fluctuations, political or economic instability, or geographic events that adversely impact issuers of foreign securities. Derivatives used by the Fund to offset exposure to foreign currencies may not perform as intended. There can be no assurance that the Fund's hedging transactions will be effective. The value of an investment in the Fund could be significantly and negatively impacted if foreign currencies appreciate at the same time that the value of the Fund's equity holdings falls. While the Fund is actively managed, the Fund's investment process is expected to be heavily dependent on quantitative models and the models may not perform as intended.

Additional risks specific to EMMF include but are not limited to Emerging Markets Risk. Investments in securities and instruments traded in developing or emerging markets, or that provide exposure to such securities or markets, can

involve additional risks relating to political, economic, or regulatory conditions not associated with investments in U.S. securities and instruments or investments in more developed international markets. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

For the top 10 holdings of DGRE please visit the Fund's fund detail page at <https://www.wisdomtree.com/investments/etfs/equity/dgre>

For the top 10 holdings of EMMF please visit the Fund's fund detail page at <https://www.wisdomtree.com/investments/etfs/equity/emmf>

For the top 10 holdings of XC please visit the Fund's fund detail page at <https://www.wisdomtree.com/investments/etfs/equity/xc>

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

#### **Related Funds**

- + [WisdomTree Emerging Markets Quality Dividend Growth Fund](#)
- + [WisdomTree Emerging Markets Multifactor Fund](#)
- + [WisdomTree Emerging Markets ex-China Fund](#)

View the online version of this article [here](#).

## **IMPORTANT INFORMATION**

**U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.**

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages ([www.msci.com](http://www.msci.com))

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

## **DEFINITIONS**

**MSCI Emerging Markets Index** : a broad market cap-weighted Index showing performance of equities across 23 emerging market countries defined as “emerging markets” by MSCI.

**Emerging market** : Characterized by greater market access and less potential for operational risks when compared to frontier markets, which leads to a larger base of potentially eligible investors.

**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.

**Discount** : When the price of an ETF is lower than its NAV.