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# BUCKING THE PUBLIC'S CONFIRMATION BIAS ON CHINESE STOCKS

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**10/26/2018**

Does the “global trade war,” quotation marks intentional, spell doom? It depends on your silo.

The 2009 American Recovery and Reinvestment Act poured some \$787 billion of stimulus into the system, while China's coincident crisis-era package dumped a \$586 billion package on top.<sup>1</sup> Central banks added trillions in bond purchases for the trifecta.

But some people may have missed the boat. Who? Those who couldn't get past their ideological differences with the last U.S. president, who made some of them think the global financial crisis would lead to a perpetual depression. Distorted reality costs money, and what happened with Obama's detractors is now happening in the Trump administration. Some proportion of the public, including many on Wall Street, are letting their political views with respect to President Trump get in the way of arithmetic.

That can create opportunity for the sober observer.

What is one mistake investors are making? Prognosticating “global trade war” doom.

## ***Global Trade War?***

2018 has witnessed nothing but improvement in relations between China and Japan, nothing but improvement in relations between Japan and Europe and, arguably, nothing but improvement in relations between the U.S. and both Mexico and Canada, at least compared to this past summer.

Some global trade war this is, with major foreign leaders jumping over each other to prove their free market bona fides.

*“We must promote trade and investment, liberalization and facilitation through opening up—and say no to protectionism.”* — Chinese President Xi Jinping, 2017

*“It is also quite vital that we keep on raising high the flag of free trade.”* — Japanese Prime Minister Shinzo Abe, 2017

*“We believe multilateral cooperation can add value for everyone, and that's why we're advocating global trade that is as free as possible and which is based on common rules.”* — German Chancellor Angela Merkel, 2018

The truth is that Trump is calculating that Americans have finally hit a wall on the status quo with respect to China. Regular people on the street may not know the specific trade numbers, but they know where the knock-off purses come

from, they know now about wanton intellectual property theft and, most disconcertingly, cyberwarfare.

In reframing the argument about global trade, does anyone care that Japan, China and South Korea are sitting at the table with one another for trilateral trade talks?<sup>2</sup> How about the big August trade deal between Japan and the EU? Talk about large economies.

While market angst is focused on the Trump administration's "global trade war," most of the planet is actively making deals, in direct contrast to the meme of global internecine tariff warfare.

## And China's Scythe on Taxes

While markets react to headlines, China's fiscal stimulus continues apace. Some investors appear to be missing the good in hoping for Trump to prove an economic failure. One such "good" is the total revolution happening in China's personal income tax code, shockingly ignored by so many. Figure 1 shows the \$435 tax cut that the average white-collar Chinese worker, earning \$13,608 a year, is set to witness. There's more too if we count mortgage, student loan and child deductions (figure 1).<sup>3</sup>

**Figure 1: Proposed China Personal Income Tax Example, Average White-Collar Worker**

	Old Tax Code		New Tax Code		
Monthly Gross Income (CNY)		7,789		7,789	
Exemption (CNY)		3,500		5,000	
<b>Taxable Income (CNY)</b>		<b>4,289</b>		<b>2,789</b>	
	Amt. of Income in Each Bracket	Tax Due	Amt. of Income in Each Bracket	Tax Due	
Marginal Rate					
3%	1,500	45	2,500	75	
10%	2,500	250	289	29	
20%	289	58	0	0	
25%		0	0	0	
<b>Monthly Tax (CNY)</b>		<b>353</b>		<b>104</b>	<b>Savings 249</b>
<b>Yearly Tax (CNY)</b>		<b>4,234</b>		<b>1,247</b>	<b>2,987</b>
<b>Monthly Tax (USD)</b>		<b>51</b>		<b>15</b>	<b>36</b>
<b>Yearly Tax (USD)</b>		<b>616</b>		<b>182</b>	<b>435</b>

Sources: WisdomTree, by China International Capital Corp. "China, Japan and South Korea Aim to Speed Up Talks on Free-Trade Agreement to Counter U.S. Tariffs," South China Morning Post, 9/22/18.

That comes on the heels of this spring's 1% cut in [value-added tax \(VAT\)](#) rates. Combined with income tax relief, we count \$103.8 billion in cuts this fiscal year alone (figure 2).<sup>4</sup>

**Figure 2: VAT + Personal Income Tax Cuts, 2018 Amount**

	1% VAT Cut	Personal Income Tax	Total
<b>CNY (bil.)</b>	240.0	427.0	712.0
<b>USD (bil.)</b>	35.0	68.8	103.8

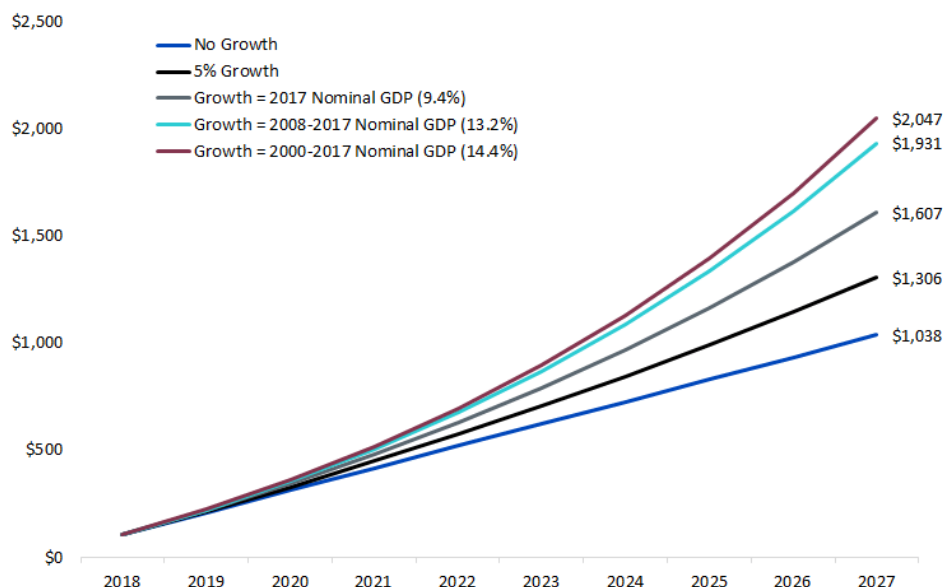
Sources: WisdomTree. VAT cuts from China's State Council, reported by Reuters, "China to Cut VAT Tax Rates for Manufacturing and Other Sectors: State Media," 3/28/18. Personal income tax estimate from Barclays, reported by Asia Times, "China Tax Cuts Will Help Offset Tariff Pain: Barclays," 9/13/18.

Granted, there are offsets. For example, Beijing is also vaguely promising reductions in social insurance premiums, but that may be more than offset by the tax authority's ratcheting up of collections efforts this year. The result could be a net

tax hike on this front.

Nevertheless, figure 3 shows the decade-long effect of Chinese President Xi Jinping's tax cuts on the VAT and personal income fronts. At slow-to-fast growth rates, the cumulative 10-year estimate is \$1.04 trillion to \$2.05 trillion, straddling both sides of Trump's \$1.5 trillion package that sent stocks higher in 2017.

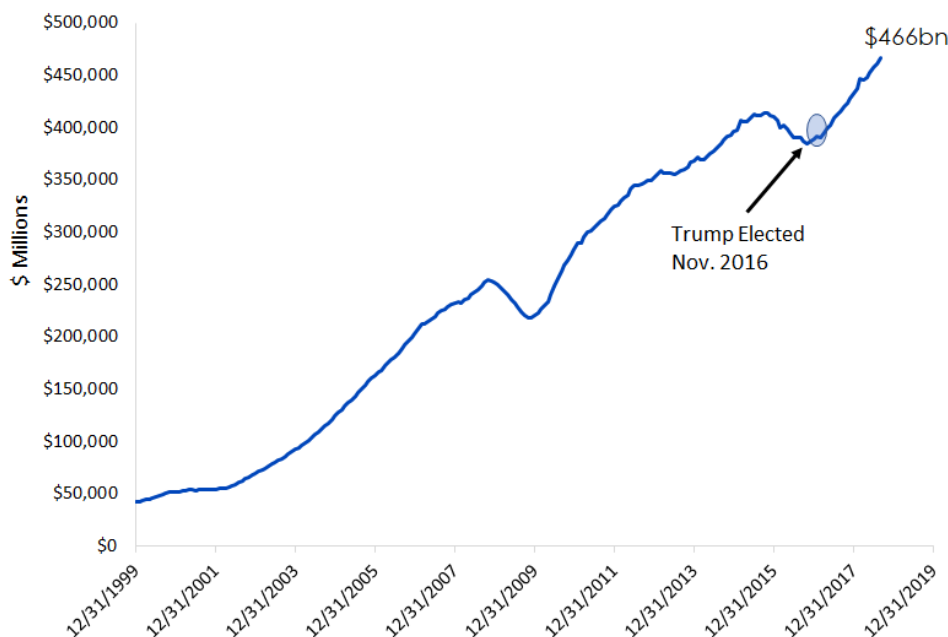
**Figure 3: Cumulative 10-Year Total, Xi Tax Cuts (Using WisdomTree's \$103.8bn Calculation for 2018)**



Source: WisdomTree, extrapolating our estimate of \$103.8 billion in tax cuts for fiscal 2018 for 10 years at various economic growth rates and summing them.

Meanwhile, we present figure 4; China's exports to the U.S. have been shooting higher in a largely uninterrupted fashion for most of this century.

**Figure 4: Annual Chinese Exports to the U.S.**



Source: Customs General Administration PRC, through 8/31/18.

## The Play

Our dedicated China ETFs are the [WisdomTree ICBCCS S&P China 500 Fund \(WCHN\)](#) and the [WisdomTree China ex-State-Owned Enterprises Fund \(CXSE\)](#). The former hits broad China with a 9+% earnings yield and tracks [China's S&P 500](#).<sup>5</sup> The other one, CXSE, tosses out companies that have more than 20% of their equity owned by Beijing.

While the mass of investors focus on “global trade wars,” few observers are noting Chinese fiscal expansion or, for that matter, big trade deals being signed right now. There’s your edge, contrarian reader.

<sup>1</sup>Sources: Congressional Budget Office, Publication 49958, Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output in 2014. Chinese stimulus data by The Economist, China Seeks Stimulation, 11/10/08.

<sup>2</sup>Source: Laura Zhou, “China, Japan and South Korea Aim to Speed Up Talks on Free-Trade Agreement to Counter U.S. Tariffs,” South China Morning Post, 9/22/18.

<sup>3</sup>Average white-collar worker income calculated by Zhaopin Ltd., a career platform similar to Monster.com, as of end-2017. Tax cut calculations by WisdomTree, using the PBoC’s tax proposal that is likely to become law in October.

<sup>4</sup>See source data beneath Figure 1.

<sup>5</sup>Sources: Bloomberg, WisdomTree, as of 10/24/18.

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## **DEFINITIONS**

**Value-added tax (VAT)** : is a type of consumption tax that is placed on a product whenever value is added at a stage of production and at final sale.

**S&P China 500 Index** : Comprises 500 of the largest, most liquid Chinese companies while approximating the sector composition of the broader Chinese equity market. All Chinese share classes including A-shares and offshore listings are eligible for inclusion.