

Adding China to Your Portfolio: Strategic and Tactical Considerations

Published June 13, 2024

Liqian Ren

Director of Modern Alpha

Key Takeaways

- China's equity market has experienced a surge in price momentum due to shareholder-focused policies and government support.
- China's ex-state-owned businesses tend to perform better over the long run, making them attractive for investment in the technology and consumer-oriented sectors.
- Investors should pay attention to policy announcements and evaluate the performance of different funds focused on China.

Since the Chinese New Year (February 9, 2024), when China fired the head of its securities regulator, the Chinese Securities Regulatory Commission (CSRC), China's equity market has experienced a surge in price momentum.

The recently appointed head of the CSRC has introduced shareholder-focused policies emphasizing higher dividend payouts and share buybacks. These policies have gained popularity among local investors. Notably, the CSRC now expects profitable companies to distribute dividends regularly, a practice that was not common in China.

Additionally, the CSRC treats share buybacks as equivalent to dividends when rewarding investors. Furthermore, the CSRC aims to encourage retail participation in the capital market by implementing policies that benefit shareholders, subtly hoping to attract retail capital that is concentrated in real estate investments.

China's momentum is fueled by better-than-expected economic data, government support for the capital market and policy announcements. Notably, the government has focused on aiding real estate developers and will hold an important economic policy meeting in July, at which significant policies are typically unveiled or leaked in advance. We provide our analysis on these developments every two weeks on our [China of Tomorrow podcast](#).

Figure 1: MSCI China Index (MXCN)



Data: FactSet, WisdomTree, for the period 12/31/22 to 6/4/24. You cannot invest directly in an index. MSCI China Index = a free float-adjusted, market capitalization-weighted equity index designed to measure the performance of the Chinese equity market.

Here is how we are thinking about China for various strategies.

Strategic Positioning

Over the long term, China's returns align with those of other emerging market economies. However, its volatility remains notably higher. Frequent shifts in domestic policies significantly influence the capital market, while foreign investors struggle with how to assess political risk with China's unique political system.

Performance as of 6/3/24						
Ticker	Name	Average Annual Total Returns				
		1-Year	3-Year	5-Year	10-Year	Common Period (9/19/12-6/3/24)
CXSE	WisdomTree China ex-State-Owned Enterprises Fund	-7.3%	-23.9%	-2.5%	2.6%	2.6%
MXCN	MSCI China Index	1.5%	-16.9%	-2.1%	2.1%	2.8%
MXEF	MSCI EM Index	11.5%	-5.9%	3.9%	2.8%	2.9%

Performance as of 5/28/24						
Ticker	Name	Average Annual Volatility				
		1-Year	3-Year	5-Year	10-Year	Common Period (9/30/12-4/30/24)
CXSE	WisdomTree China ex-State-Owned Enterprises Fund	27.3%	30.8%	28.5%	25.7%	24.4%
MXCN	MSCI China Index	23.4%	30.0%	26.7%	23.8%	22.7%
MXEF	MSCI EM Index	15.4%	17.4%	18.9%	17.1%	16.5%

Sources: FactSet, WisdomTree, as of 6/3/24. You cannot invest directly in an index. **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 CXSE's full standardized and most recent month-end performance, please click [here](#).

Considering China's still weak recovery from a housing bubble burst and broad U.S. sanctions on Chinese technology and trade, our most active [Emerging Market Multifactor Fund \(EMMF\)](#) maintains approximately 10% exposure to China. This allocation is non-trivial but falls below the typical weight in the MSCI Emerging Market Index (26.7%). The goal is to do better Chinese [stock selection to compensate for the lower China weight](#).

Tactical Positioning

For investors seeking a tactical play, China currently rides a price momentum trend. Policies will be leaked to entice investors leading up to the crucial economic policy meeting in July. The effectiveness of these policies will determine the trend's continuation.

Notably, some current policies—such as local governments purchasing excess housing units—often have less impact than hoped. Investors often overestimate the effectiveness of such policy announcements.

We offer a range of strategies that allow investors to adjust their exposure to China based on risk tolerance. Additionally, there's an ongoing debate about whether ex-state-owned Chinese companies remain a better bet. While state-owned monopolies can boost short-term profitability, China's ex-state-owned businesses tend to perform better over the long run. If China aims to compete successfully with the U.S. in technology and trade, it knows it must leverage these ex-state-owned entities.

Conclusion

In summary, with weak consumer and local government balance sheets, China also faces broad and relentless U.S. sanctions. Our strategic baseline view acknowledges these challenges. However, China's cyclical and tactical trends could persist, depending on the effectiveness of announced policies, as the central government appears slightly more willing to stimulate the economy using its balance sheet now than in 2023.

Performance as of 5/28/24							
Ticker	Name	Average Annual Total Returns					China Weight
		1-Year	3-Year	5-Year	10-Year	Common Period (8/10/18-6/3/24)	
CXSE	WisdomTree China ex-State-Owned Enterprises Fund	-7.32%	-23.93%	-2.51%	2.59%	-3.88%	100.00%
DGRE	WisdomTree Emerging Markets Quality Dividend Growth Fund	17.68%	-2.86%	4.90%	2.68%	3.53%	0.00%
DEM	WisdomTree Emerging Markets High Dividend Fund	21.75%	4.10%	6.70%	3.64%	5.94%	22.40%
EMMF	WisdomTree Emerging Markets Multifactor Fund	22.95%	2.32%	6.15%		3.96%	9.80%
XSOE	WisdomTree Emerging Markets ex-State-Owned Enterprises Fund	10.94%	-9.01%	4.10%		2.43%	24.60%
MXEF	MSCI EM Index	11.47%	-5.90%	3.94%	2.84%	2.54%	26.70%

Performance as of 5/28/24							
Ticker	Name	Average Annual Volatility					Common Period (8/10/18-4/30/24)
		1-Year	3-Year	5-Year	10-Year		
CXSE	WisdomTree China ex-State-Owned Enterprises Fund	27.27%	30.84%	28.54%	25.68%	28.37%	
DGRE	WisdomTree Emerging Markets Quality Dividend Growth Fund	13.58%	17.10%	18.82%	16.55%	18.59%	
DEM	WisdomTree Emerging Markets High Dividend Fund	12.94%	15.72%	18.18%	17.23%	17.87%	
EMMF	WisdomTree Emerging Markets Multifactor Fund	11.05%	12.40%	14.13%		13.88%	
XSOE	WisdomTree Emerging Markets ex-State-Owned Enterprises Fund	16.14%	17.96%	19.46%		19.45%	
MXEF	MSCI EM Index	15.37%	17.44%	18.87%	17.11%	18.60%	

Sources: FactSet, WisdomTree, as of 6/3/24. You cannot invest directly in an index. **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 full standardized and most recent month-end performance, please click the respective ticker: [CXSE](#), [DGRE](#), [DEM](#), [EMMF](#), [XSOE](#).

Important Risks Related to this Article

CXSE: 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. The Fund focuses its investments in China, including A-shares, which include the risk of the Stock Connect program, thereby increasing the impact of events and developments associated with the region which can adversely affect performance. Investments in emerging or offshore 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. The Fund's exposure to

certain sectors may increase its vulnerability to any single economic or regulatory development related to such sector. As this Fund can have a high concentration in some issuers, the Fund can be adversely impacted by changes affecting those issuers. 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.

DGRE: 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. Fund's 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.

DEM: 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. 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 investments in developed markets and are subject to additional risks, such as risks 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. Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

XSOE: 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 or offshore 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. Funds focusing their investments on certain sectors and/or regions increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. 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.