



KraneShares™

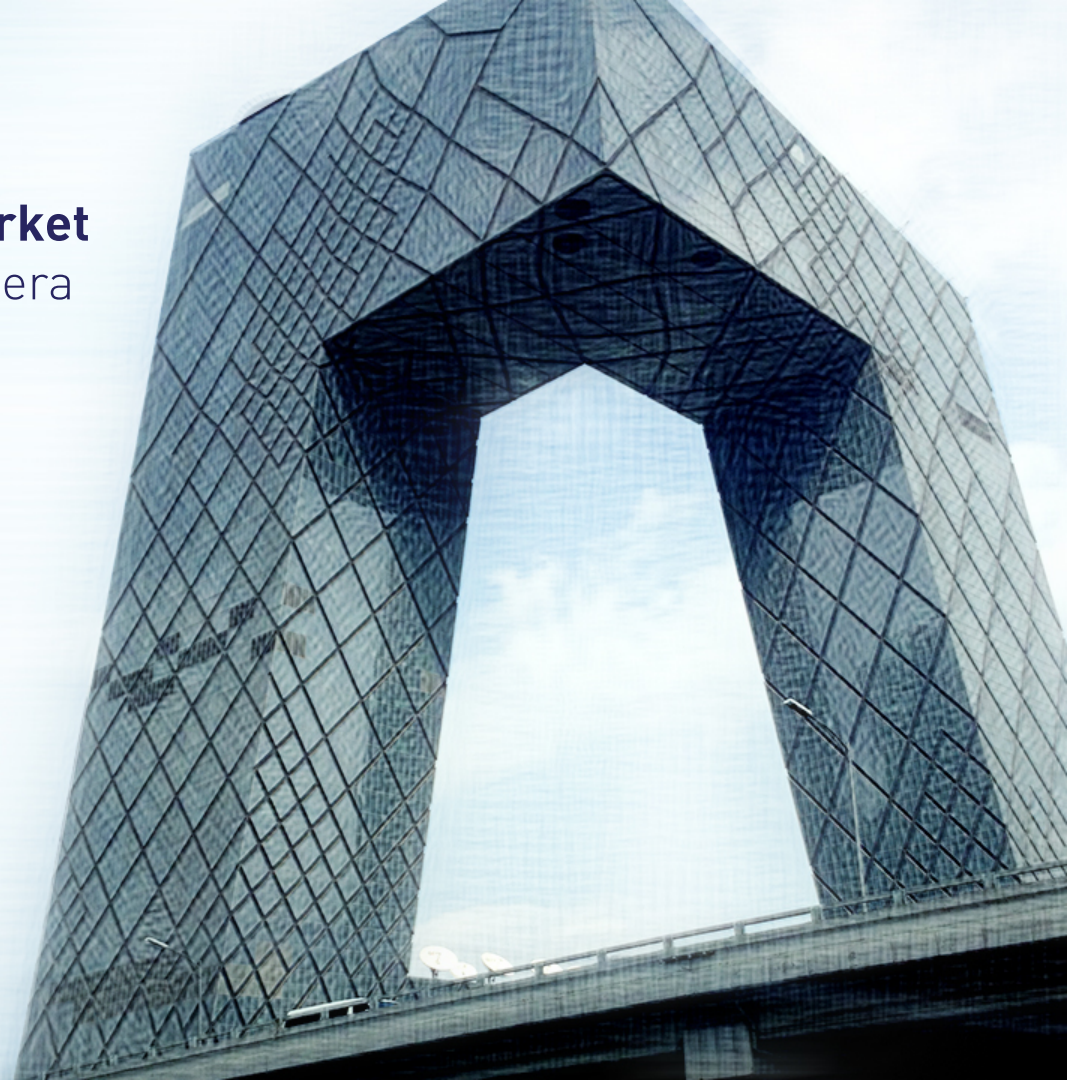
# Understanding China's Onshore Market

An Overview of the KraneShares Bosera  
MSCI China A ETF (ticker : KBA)



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## Understanding China's Underweight In Indices

## China Stock Market Is Small Relative to the Size of the Economy

Country	Size of Stock Market (Market Cap)	GDP	Market Cap/GDP Ratio
U.S.	\$25.18 trillion	\$17.42 trillion	145%
<b>China</b>	<b>\$6.83 trillion</b>	<b>\$10.36 trillion</b>	<b>66%</b>
Japan	\$5.05 trillion	\$4.60 trillion	110%
U.K.	\$3.83 trillion	\$2.94 trillion	130%
Germany	\$1.94 trillion	\$3.85 trillion	50%
Switzerland	\$1.74 trillion	\$685 billion	254%

The Definition of China for many investors has been 145 Chinese companies (\$994 billion market cap) listed on the Hong Kong Stock Exchange, which is a small percentage of Chinese stocks.

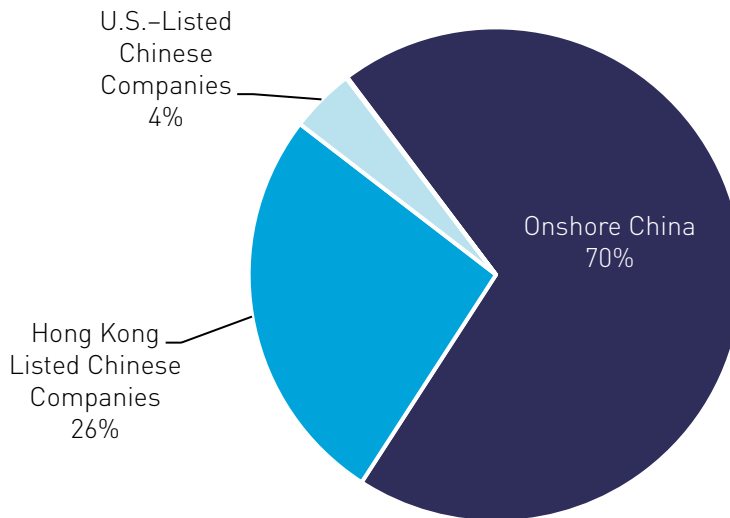
**MSCI China**  
 145 Stocks  
 \$994 Billion Market Cap

**MSCI All China IMI**  
 2,519 Stocks  
 \$1.15 Trillion Market Cap

% of Stocks In Current China Definition: 5.7%

% of Market Cap In Current Definition: 26%

**China Share Class Breakdown of MSCI All China IMI**



Source: MSCI June 30, 2015

## Chinese Companies Listed In Hong Kong Are Not representative of China's Economy

The onshore equity market is more aligned with China's economic growth than Chinese companies listed in Hong Kong

GDP Growth and Equity Return – BRICS Countries (1994 – 2013)		
Country	GDP Growth CAGR* (%)	Equity Market Growth CAGR (%)
China	15.9	2.0
China A	15.9	11.9
Brazil	7.7	10.3
India	9.5	7.3
Russia	9.2	13.4
South Africa	5.1	8.1

\*The compound annual growth rate (CAGR) is a useful measure of growth over multiple time periods. It can be thought of as the growth rate that gets you from the initial investment value to the ending investment value if you assume that the investment has been compounding over the time period.

Source: MSCI and World Bank as of 12/31/2013 (World Bank data on a 1 year lag)

Note: The equity market return refers to the USD total return of MSCI standard indices.

Limited access to Onshore Chinese stock exchanges & rapid growth of U.S. listings have created an underweight to China within indices & investor portfolios

### Offshore Market

Comprised of Chinese companies listed on the Hong Kong, Nasdaq & New York Stock Exchange

Hong Kong  
Stock Exchange

NASDAQ

New York  
Stock Exchange

### Onshore Market

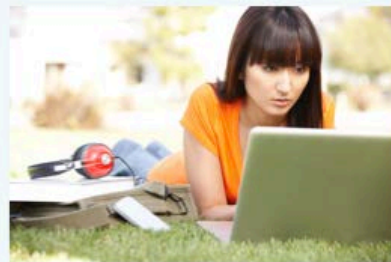
Comprised of Chinese companies listed on the Shanghai & Shenzhen Stock Exchange

Shanghai  
Stock Exchange

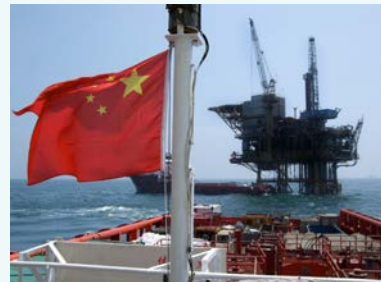
Shenzhen  
Stock Exchange

There are two distinct investment opportunities within the onshore & offshore markets:

### Technology & Domestic Consumption



### Traditional Sectors





## While There Are Exceptions, We Believe:

### Onshore = Traditional Sectors



### Offshore = Growth Sectors



China's exchanges are organized into a multi-tier system that categorizes listed companies based on specific qualifications.

**Main Board**

Comprised of large cap stocks that are predominantly state owned enterprises. Requires 3 years of profitability.

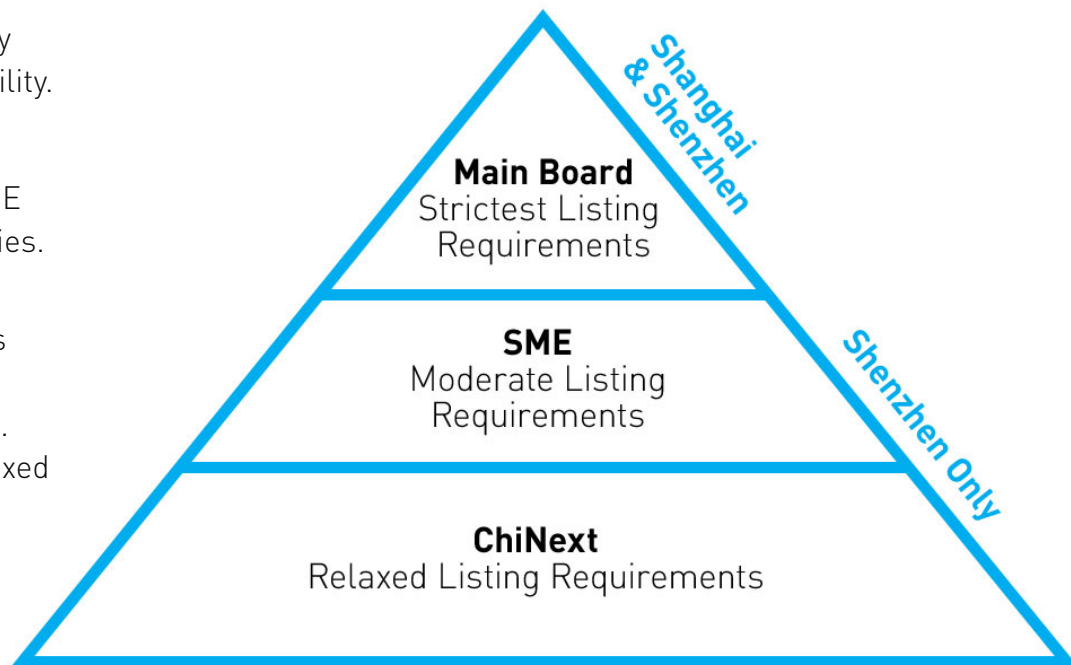
**Small Medium Enterprise (SME)**

limited to only the Shenzhen stock exchange. The SME tier is primarily composed of manufacturing companies.

**ChiNext**

limited to the Shenzhen stock exchange. ChiNext was created to help encourage entrepreneurship, inspire creativity, and popularize innovative business models. The financial requirements to list on ChiNext are relaxed compared to the other two boards.

**China's Multi-tier Capital Market**



## Why Might Investors Add Onshore China To Their Portfolios Today?

2015 Economic Policy Goals\*:

- Renminbi Internationalization
- Streamlining of State Owned Enterprises
- Increase Domestic Consumption
- Mitigate Export Dependency
- Increase household participation in the stock market

*“Our people love life and expect better education, more stable jobs, better income, more reliable social security, medical care of a higher standard, more comfortable living conditions, and a more beautiful environment.*

*They hope that their children can grow up better, work better and live better. People's yearning for a good and beautiful life is the goal for us to strive for.” – Xi Jinping*

\*Source: english.gov.cn – Full Text: Report on the Work of the Government (2015)



Xi Jinping – 习近平  
President of the People's  
Republic of China

## **Overview of the KraneShares Boserá MSCI China A**

**KraneShares and our China partners' senior executives have extensive industry experience, industry relationships, exchange traded product expertise and experience in China.**



**\$50b AUM**



**Steven Wang**  
Bosera Funds  
Head of Passive &  
Quantitative  
Investments



**Conrad Cheng**  
CEO-HK &  
and Chief Portfolio  
Strategist

**Bosera Quick Facts:**

- **China located:** Headquartered in Shenzhen with offices in Beijing, Shanghai and Hong Kong
- **Chinese professionals:** 120 person investment team residing in China
- **Established in 1998, Bosera was among the 1st** Chinese asset management companies approved to do business in Mainland China (est 1998)
- **\$50b** in assets under management; one of the top five asset managers by assets in Mainland China
- **#1:** in number of portfolios managed in China's National Social Security Fund
- **17 million** clients globally
- **30 funds** offered including ETFs, open end mutual funds and closed end funds

## Onshore Chinese Equities Have Exhibited Low Correlation to other Indices Historically

- As Emerging Markets (EM) become more correlated with Developed Markets over the years, the diversification benefits of EM investing have largely diminished
- Frontier Markets (FM) still have relatively low correlations with the rest of the world
- Remarkably, China A-shares exhibit an even lower correlation than Frontier Markets - MSCI's "China A-shares: Too Big to Ignore" September 2014

## MSCI Indices Correlation to MSCI China A

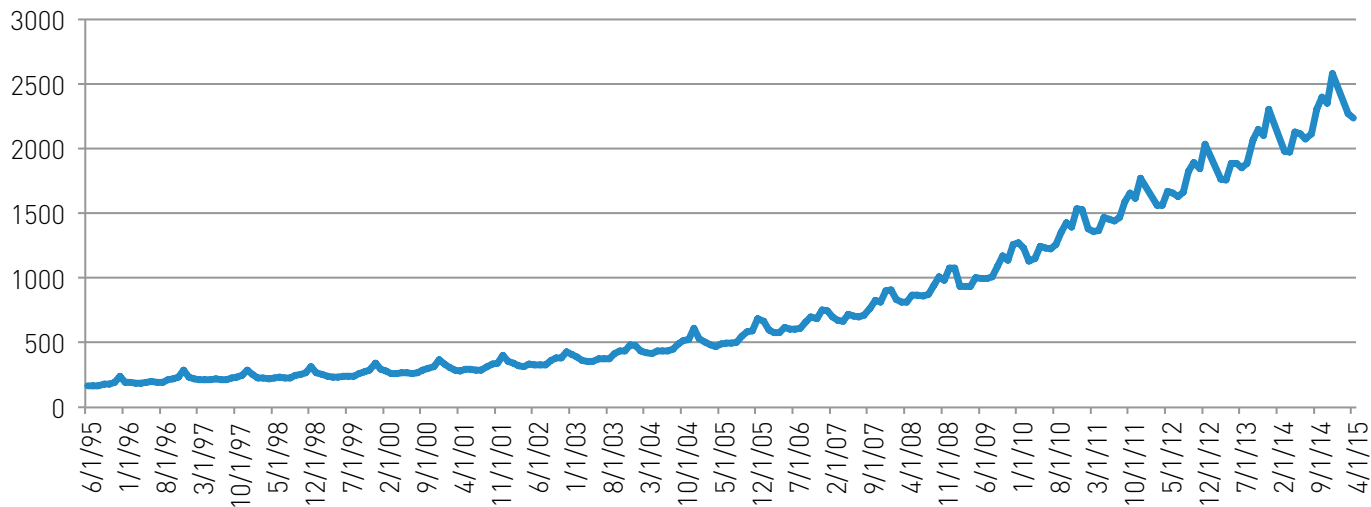
	ACWI	EAFE	EM	USA	China	Frontier	China A
ACWI	1						
EAFE	0.96	1					
EM	0.88	0.86	1				
USA	0.94	0.83	0.75	1			
China	0.68	0.68	0.84	0.55	1		
Frontier	0.40	0.41	0.39	0.34	0.33	1	
<b>China A</b>	<b>0.15</b>	<b>0.17</b>	<b>0.27</b>	<b>0.09</b>	<b>0.46</b>	<b>0.15</b>	<b>1</b>

- ACWI - All Country World Index
- EAFE - Europe, Australasia, Israel and Far East
- EM - Emerging Markets
- China - Chinese companies listed in Hong Kong
- Frontier - Frontier Markets
- China A - Chinese companies listed on Shanghai and Shenzhen Stock Exchanges

## Government Support for the Onshore Bull Market

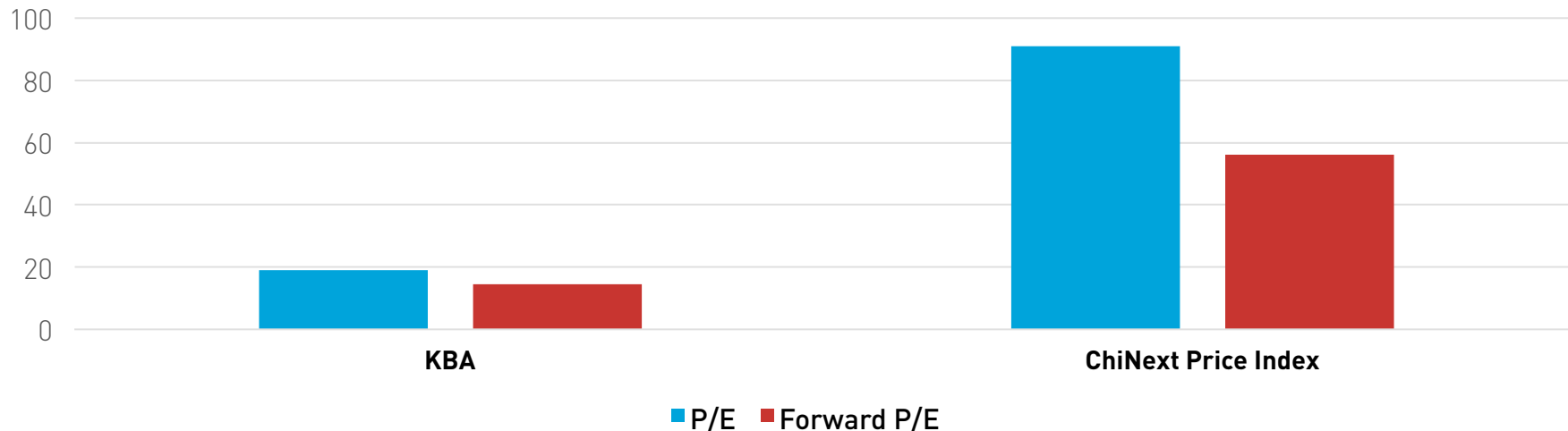
- Over the last year \$3.5 trillion of Wealth Has Been Created In China
- Raising Domestic Consumption A Key Initiative
- Increased Foreign Participation

**Value of Monthly China Retail Sales Index In US \$**  
 [6/30/1995 – 5/30/2015]



## China's Stock Market Valuation Disparities Are Large Between Large Cap and Small Cap Stocks

### Valuations In China



Price-to-earnings (P/E): A valuation ratio of a company's current share price compared to its per-share earnings. The Forward Price to Earnings (PE) Ratio is similar to the price to earnings ratio. While a regular P/E ratio is a current stock price over its earnings per share, a forward P/E ratio is a current stock's price over its "predicted" earnings per share.

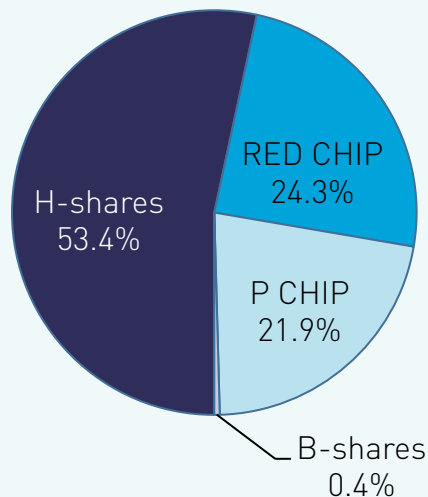




## **MSCI's Review of the Onshore Equity Market**

## The Definition of China Has Been Chinese Companies Listed In Hong Kong

Share Class Breakdown of MSCI China Index



**H-Shares:** Chinese securities incorporated in Mainland China, listed on the Hong Kong Stock Exchange.

**Red Chip:** Chinese securities of State Owned Enterprises incorporated outside of Mainland China, listed on the Hong Kong Stock Exchange.

**P-Chip:** China Securities of non-government owned companies incorporated outside of Mainland China listed on the Hong Kong Stock Exchange.

**B-Shares:** China securities incorporated in Mainland China listed on Shanghai Stock Exchange and Shenzhen Stock Exchange.

**Onshore Equities & U.S-listed Chinese Companies Are Excluded From the Definition of China. This means most index funds and ETFs missed:**

**The Largest Initial Public Offering In US History**



Source: Investopedia, "Top 10 Largest Global IPOs Of All Time" 01/12/2015.

**The third and fifth largest exchanges by market cap**

Rank	Exchange	Market cap (USD bn) <sup>3</sup>
1	NYSE	19 686 944.94
2	NASDAQ OMX	7 378 758.35
3	Shanghai SE	5 903 863.24
4	Japan Exchange Group - Tokyo	5 004 759.72
5	Shenzhen SE	4 368 478.57
6	Hong Kong Exchanges	3 966 069.18
7	Euronext	3 496 579.69
8	TMX Group	2 114 803.59
9	Deutsche Börse	1 823 127.04
10	SIX Swiss Exchange	1 614 938.04

Source: [www.world-exchanges.org](http://www.world-exchanges.org) as of 5/31/2015. Based on equity exchanges with reported data.

## New Access to the Mainland Markets – The Shanghai-Hong Kong Stock Connect

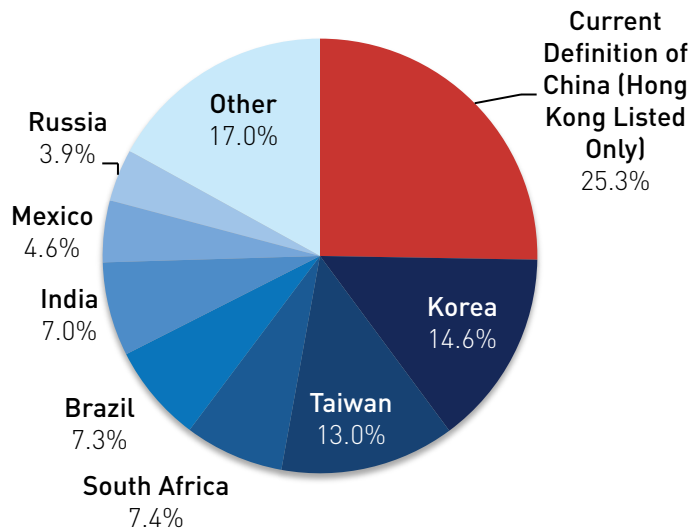
Shanghai-Hong Kong Stock Connect Program Allows Foreign Investors Access to the Shanghai Stock Exchange without Qualified Foreign Institutional Investor (QFII) quota. It also provides access to the Hong Kong Stock Exchange for Mainland investors.

### Key points regarding the Shanghai-Hong Kong Stock Connect:

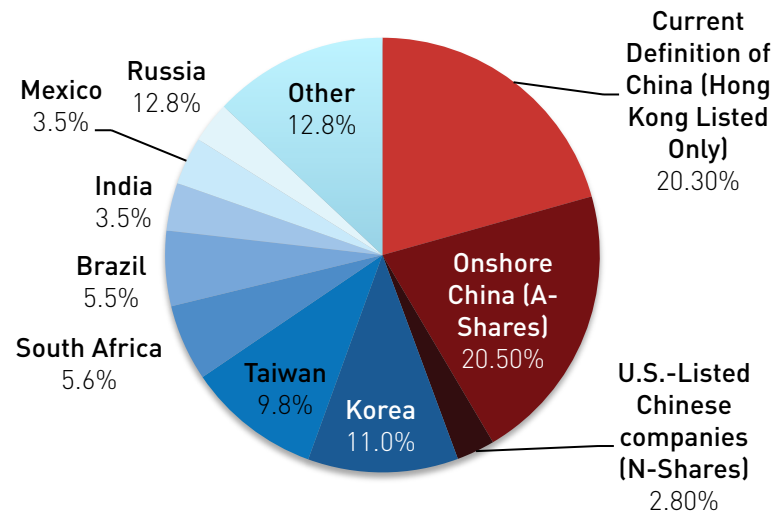
- On November 17, 2014, 568 Stocks on the Shanghai Stock Exchange (SSE) became eligible for purchase by Hong Kong Investors
- These stocks represent 90% of the SSE market capitalization & 80% of Average Daily Turnover
- Within these 568 stocks, 66 are dually listed on the SSE and Hong Kong Stock Exchange
- Aggregate Connect Quota Renminbi (RMB) 300 billion (~US \$48.7 billion)
- Aggregate Quota = Aggregate Buy Trades + Aggregate Sell Trades
- RMB 13 billion Daily Quota (~US \$2.1 billion)
- Daily Quota = Buy Orders + Sell Trades + Adjustments (e.g. Buy Order cancelled, Buy Order rejected by SSE, Buy Order executed at a better price)

## China A Shares are currently being reviewed for inclusion in broad MSCI Indices including MSCI Emerging Market Index

**Current Status**



**Potential Full Inclusion (100%\*)**



Source: MSCI \* The percentage number refers to the Inclusion Factor applied to the free float-adjusted market capitalization of China A share constituents in the pro forma MSCI China Index. As of 6/30/2015

## Trouble with numerical based approach to weighting the onshore markets

The CSI 300, a popular onshore index, captures the 300 largest stocks in the onshore markets by market cap. In 2005 this approach represented 86% of the free float-adjusted market capitalization of the onshore markets. Due to the large amount of new listings over the past 10 years, by 2015 this number has shrunk by almost one-third to 54%<sup>1</sup>.

### Number of Stock listings in the onshore markets

12/31/2001 – 6/30/2015



1.) All data from Wind as of 6/30/2015

## KBA's Liquidity Is Driven By the Liquidity of the Underlying Basket

Market makers buy the underlying securities to create ETF shares. Bloomberg developed a function to ascertain when an ETF purchase become 25% of any the underlying stocks' 30 day average volume.

Using the Bloomberg tool, it would take a trade of 29 million shares of KBA, a value of \$1.4 billion, for a trade to hit the 25% in one of KBA's underlying stocks.

Source: Bloomberg's ETFL function as of June 30, 2015

### KBA's most traded holdings by 30 day average trading volume as of 6/30/2015

Security Name	KBA Weight (as of 6/30/15)	30 Day Average Volume
BOE Technology Group Co Ltd	0.74%	2,248,027,000
Bank of China Ltd	1.44%	1,865,826,000
Agricultural Bank of China Ltd	1.22%	1,577,054,000
GD Power Development Co Ltd	0.57%	1,215,343,000
Bank of Communications Co Ltd	1.36%	1,028,326,000
China Everbright Bank Co Ltd	0.90%	961,427,500
China State Construction Engin	1.04%	889,671,900
Industrial & Commercial Bank o	1.39%	871,207,700
China Petroleum & Chemical Cor	0.47%	753,347,500
CRRC Corp Ltd	0.98%	730,005,400



## Conclusion

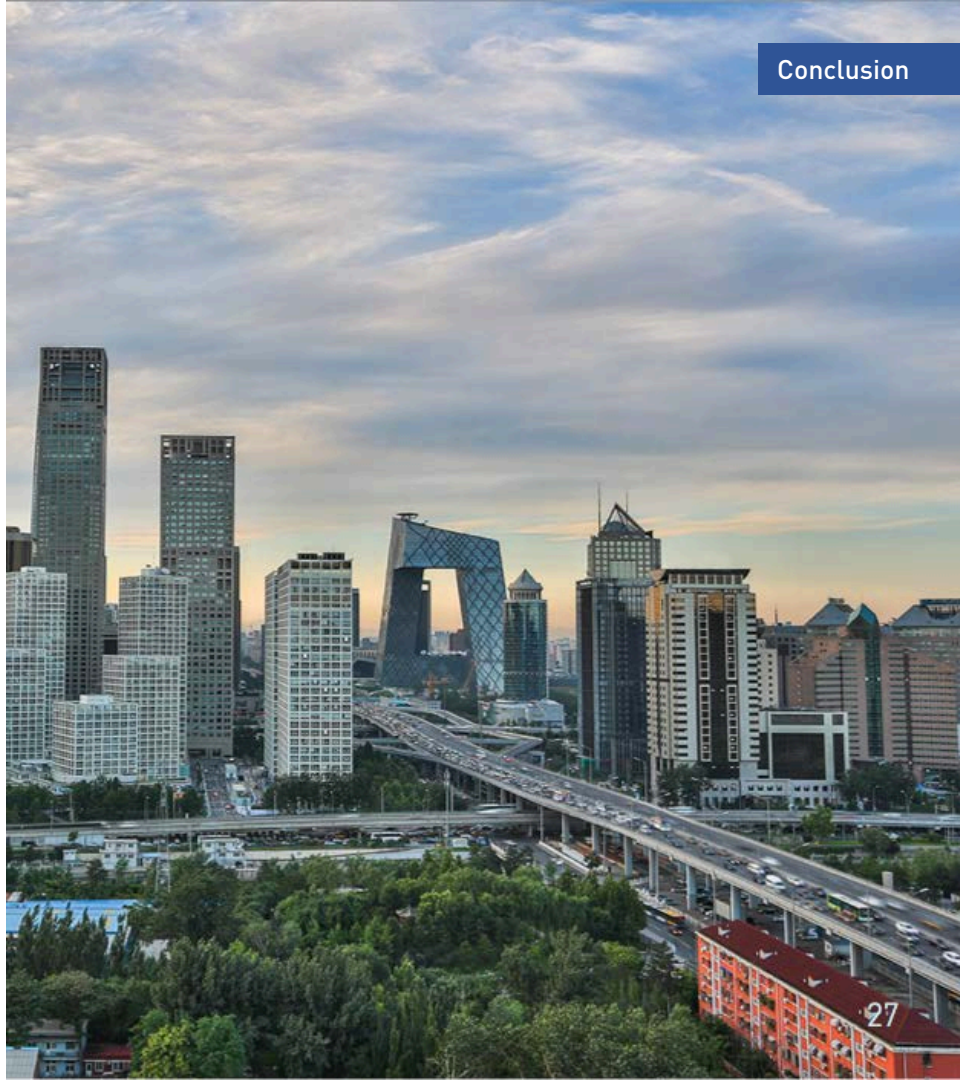


## What's ahead for China in 2015?

- President Xi is a Crucial Figure To Watch
- Continued Reforms in State Owned Enterprises and Increasing Domestic Consumption
- Domestic Agenda Focused On Middle Class Growth
- Bloomberg 2015 China GDP Forecast 7.01%
- Chinese cell phone manufacturer Xiaomi may go public in 2015<sup>1</sup>
- Shenzhen Hong Kong Stock Connect Launch

1.) Source: South China Morning Post, Nov. 2014

**There is no guarantee that any security will be added to an index or a Fund.**





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**Carefully consider the Funds' investment objectives, risk factors, charges and expenses before investing. This and additional information can be found in the Funds' prospectus, which may be obtained by visiting [www.kraneshares.com](http://www.kraneshares.com) or by calling 1-855-8KRANE8.**

**Read the prospectus carefully before investing.**

Investing involves risk, including possible loss of principal. There can be no assurance that a Fund will achieve its stated objective. The Funds focus their investments primarily with Chinese issuers and issuers with economic ties to China. The Funds are subject to political, social or economic instability within China which may cause decline in value. Fluctuations in currency of foreign countries may have an adverse effect to domestic currency values. Emerging markets involve heightened risk related to the same factors as well as increase volatility and lower trading volume. Current and future holdings are subject to risk.

Narrowly focused investments and investments in smaller companies typically exhibit higher volatility. Internet companies are subject to rapid changes in technology, worldwide competition, rapid obsolescence of products and services, loss of patent protections, evolving industry standards and frequent new product productions. Such changes may have an adverse impact on performance.

The KraneShares ETFs are distributed by SEI Investments Distribution Company, which is not affiliated with Krane Funds Advisors, LLC, the Investment Adviser for the Fund.



The ability of the KraneShares Bosera MSCI China A ETF to achieve its investment objective is dependent on the continuous availability of A Shares and the ability to obtain, if necessary, additional A Shares quota. If the Fund is unable to obtain sufficient exposure due to the limited availability of A Share quota, the Fund could seek exposure to the component securities of the Underlying Index by investing in depositary receipts. The Fund may, in some cases, also invest in Hong Kong listed versions of the component securities and B Shares issued by the same companies that issue A Shares in the Underlying Index. The Fund may also use derivatives or invest in ETFs that provide comparable exposures. Investments in derivatives, including swap contracts and index futures in particular, may pose risks in addition to those associated with investing directly in securities or other investments, including illiquidity of the derivatives, imperfect correlations with underlying investments, lack of availability and counterparty risk. The use of swap agreements entails certain risks, which may be different from, and possibly greater than, the risks associated with investing directly in the underlying asset.