



# Should China Be in Your Portfolio?

## *A Discussion on Opportunities, Risks and Party Politics*

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Positioned to outperform?  
An update on asset class opportunities  
October 7 & 8

# CHINA AT A GLANCE

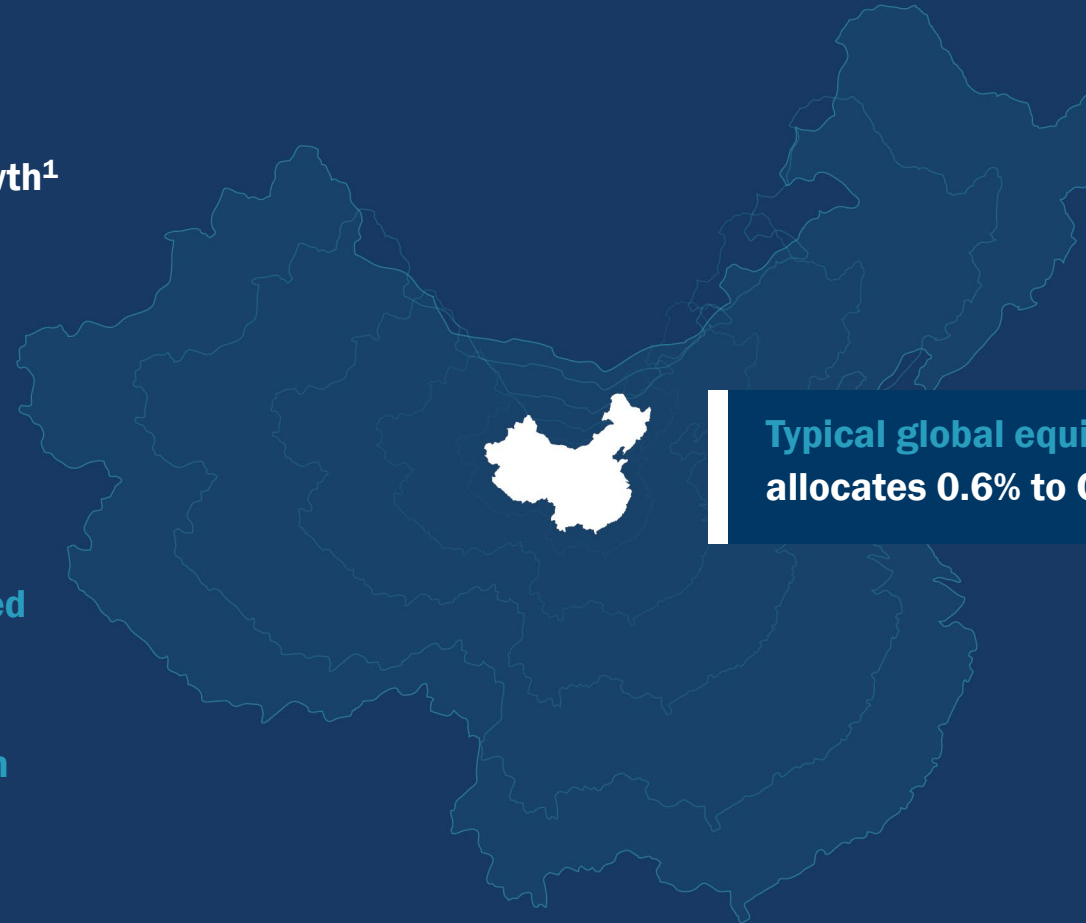
China contributes  
30% of global economic growth<sup>1</sup>

China is home to  
39% of the world's unicorns<sup>2</sup>

China consumes  
36% of global luxury goods<sup>3</sup>

China A market cap surpassed  
\$12 trillion<sup>4</sup>

China's middle class to reach  
1.2 billion by 2027<sup>5</sup>



Typical global equity portfolio  
allocates 0.6% to Chinese A shares<sup>6</sup>

<sup>1</sup> International Monetary Fund (2019)

<sup>2</sup> Hurun Research Institute (2020). A "unicorn" is a privately held startup valued at >1B USD.

<sup>3</sup> McKinsey (2017)

<sup>4</sup> World Federation of Exchanges (2020)

<sup>5</sup> The Brookings Institution (2020)

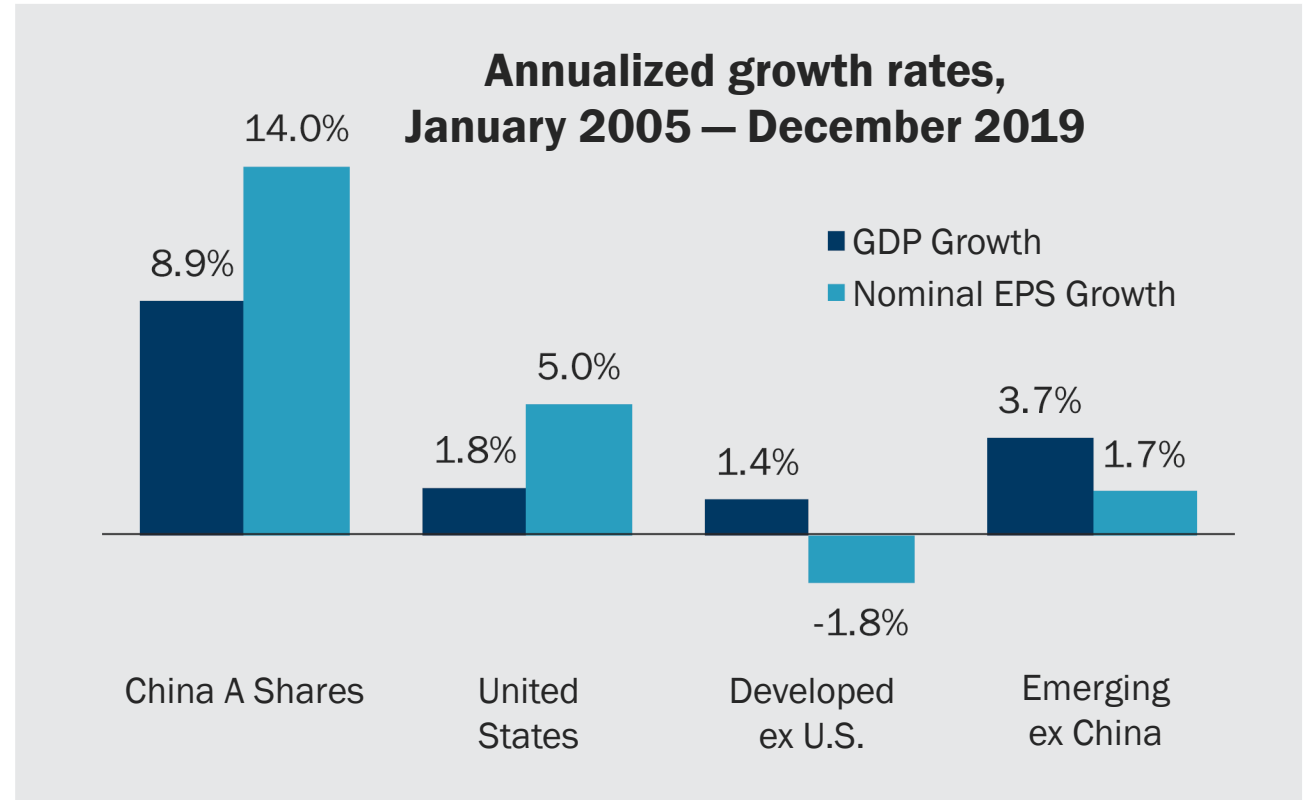
<sup>6</sup> The typical global equity portfolio is assumed to track the MSCI All Country World Index, as of December 31, 2020.



# WHY CHINA?

## Accessing Growth

China's economic expansion translates to rapid earnings growth for onshore-listed companies. Most major markets can't compare.



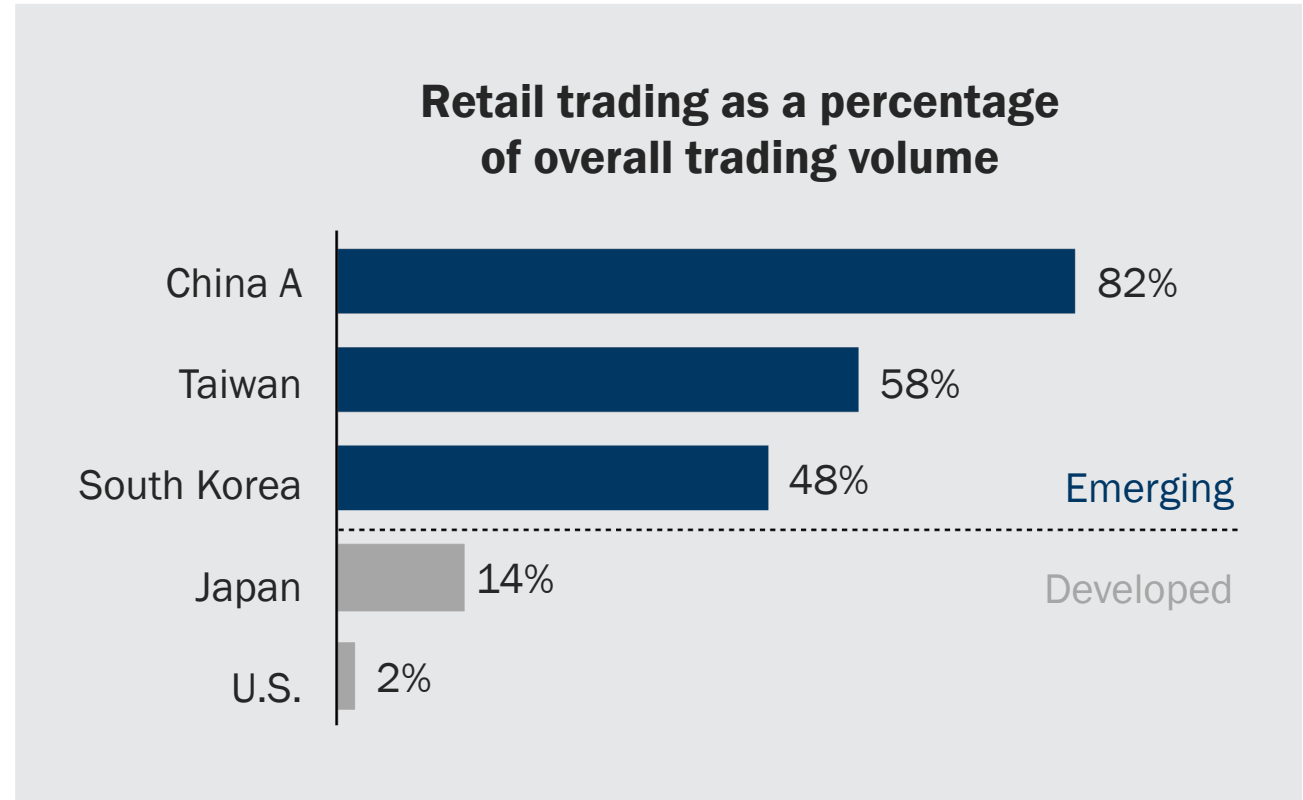
**Source:** Rayliant Research, Bloomberg, as of Mar. 31, 2020. U.S. data references the S&P 500 Index; Dev. ex-U.S. references MSCI World Ex-USA Index; China Onshore references the CSI 300 Index; China Offshore references the MSCI China Index, which primarily trades H shares, B shares, Red chips, P chips, and foreign listings, including ADRs; EM ex-China references the MSCI EM ex-China Index. It is not possible to invest directly in an index. Past performance is not indicative of future performance.



# WHY CHINA?

## Capturing Alpha

Amateur speculators account for 80-90% of onshore trading volume. The resulting inefficiency offers a substantial opportunity for professional managers to generate “alpha.”



**Source:** Rayliant Research, as of Jun. 30, 2020. Data on retail trading come from stock exchange website, factbooks, academic literature, and industry reports.



# WHY CHINA?

## Reducing Risk

China A shares have low correlation with global equities. Diversifying into A shares reduces overall portfolio risk.

Global equity market correlations, April 2005 – March 2020

	United States	Developed ex U.S.	Emerging Markets	China Offshore
China A Shares	0.38	0.41	0.48	0.62
United States		0.89	0.77	0.63
Developed ex U.S.			0.89	0.74
Emerging Markets				0.87

**Source:** MSCI EM Index is used in lieu of MSCI EM ex-China Index. "China Offshore" are Chinese stocks listed outside of Mainland China. It is not possible to invest directly in an index. Past performance is not indicative of future performance.

# Why China? Behavioral Alpha Source

- Retail trading makes up 80–90% of volume in the Chinese stock market

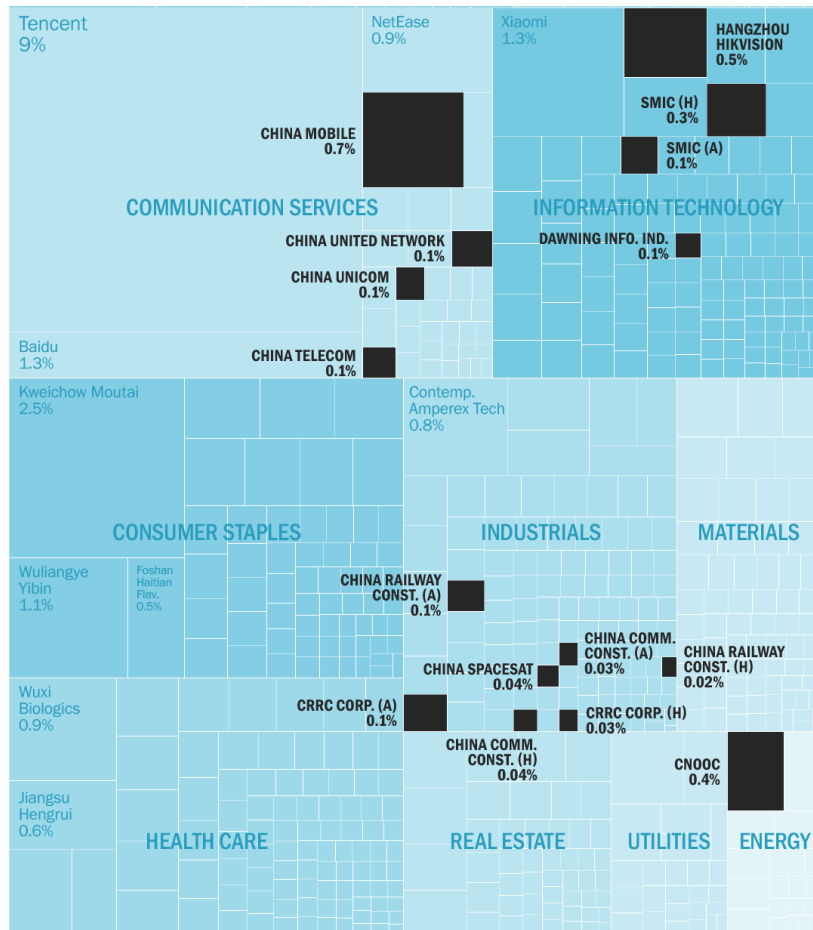


Brokerage  
Hainan Province, China



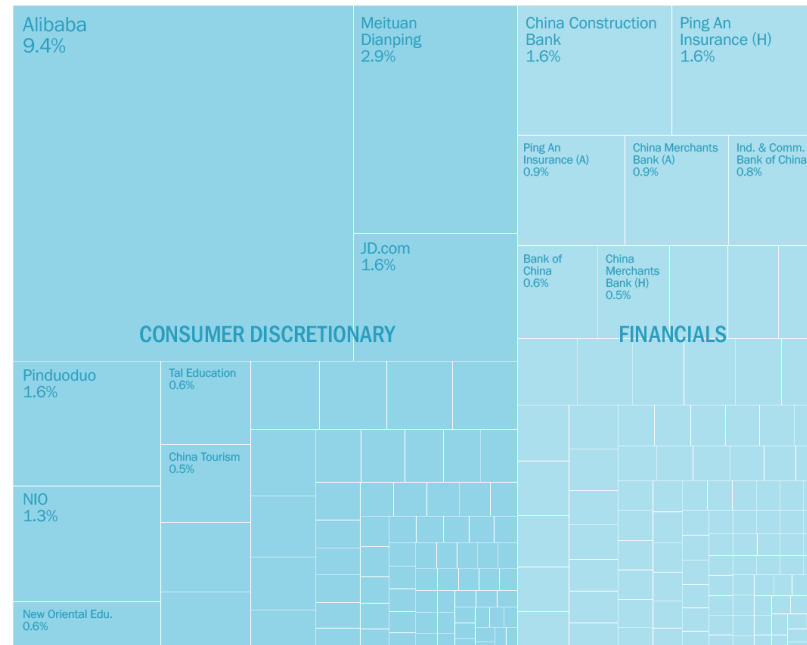
Horse track  
New York, USA

# Executive Order Mapping the U.S. ban on Chinese stocks



The average China investor's portfolio (as of 8 Jan 2021)

*This chart is for informational purposes and should not be relied upon for investing decisions. The banned stocks herein may be incomplete, and additional stocks may be banned in the future. Please consult a legal professional before determining specific banned securities.*



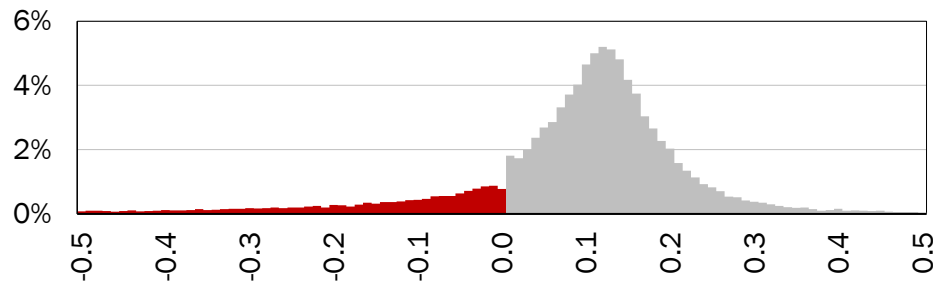
■ Denotes stocks banned under U.S. executive order.

# Localization Aggressive Accounting

- Financial reporting in the U.S. has improved immensely in last 40 years, China lags far behind

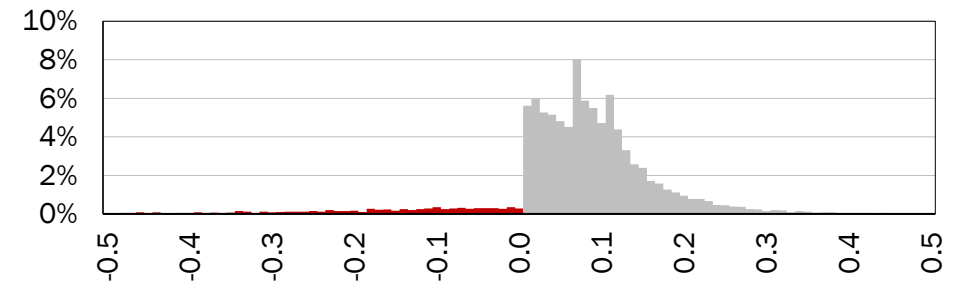
**Return on Equity (ROE): United States, "Past" FY 1984 – 2001**

Percentage of annual earnings reports at various levels of ROE



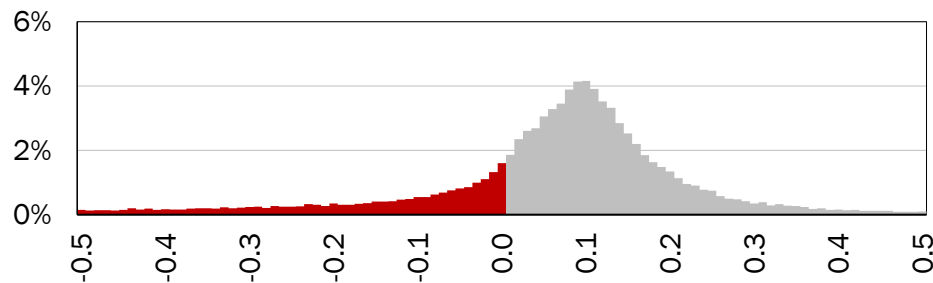
**Return on Equity (ROE): China A, "Past" FY 1998 – 2009**

Percentage of annual earnings reports at various levels of ROE



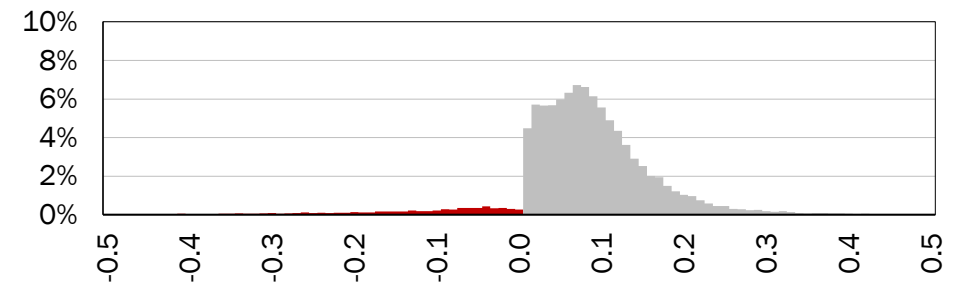
**Return on Equity (ROE): United States, "Recent" FY 2002 – 2018**

Percentage of annual earnings reports at various levels of ROE, FY 1984 – 2018



**Return on Equity (ROE): China A, "Recent" FY 2010 – 2018**

Percentage of annual earnings reports at various levels of ROE



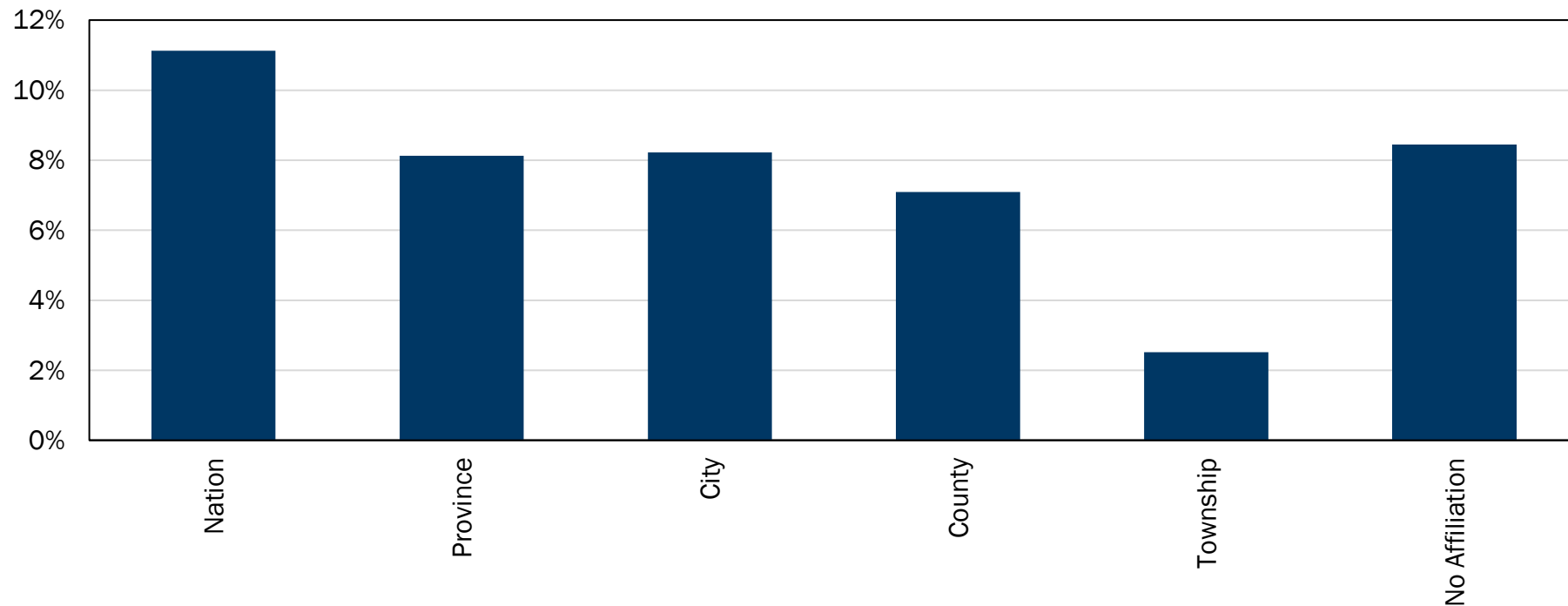


# Localization Political Connections

- Is there a relationship between Chinese managers' political affiliations and future stock returns?

## Returns of Chinese stocks in the year subsequent to observing various forms of political affiliations

Political affiliation assessed as highest title held by Chairman or CEO, tested using data covering 2000 - 2015

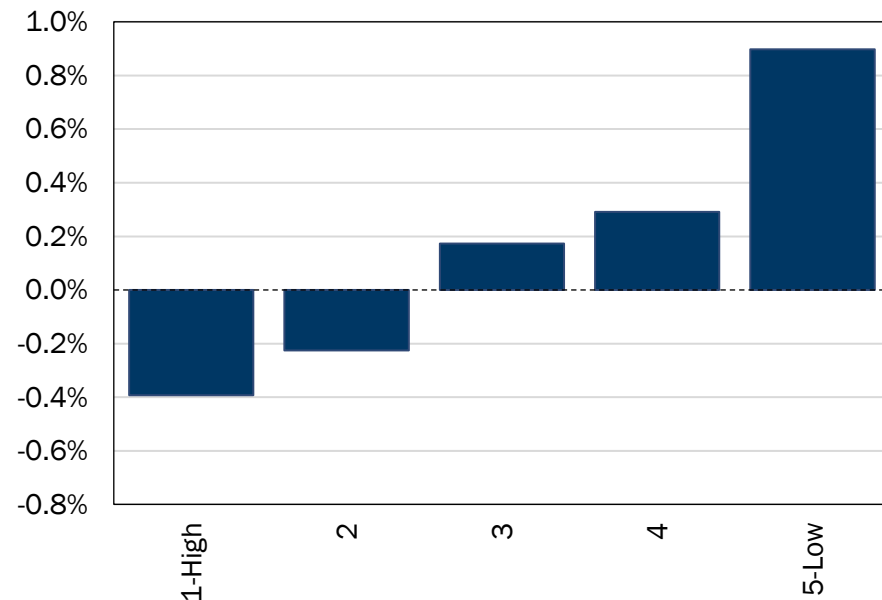


# Localization Trading by Retail Investors

- In certain markets, we're able to directly observe retail investor trading of individual stocks

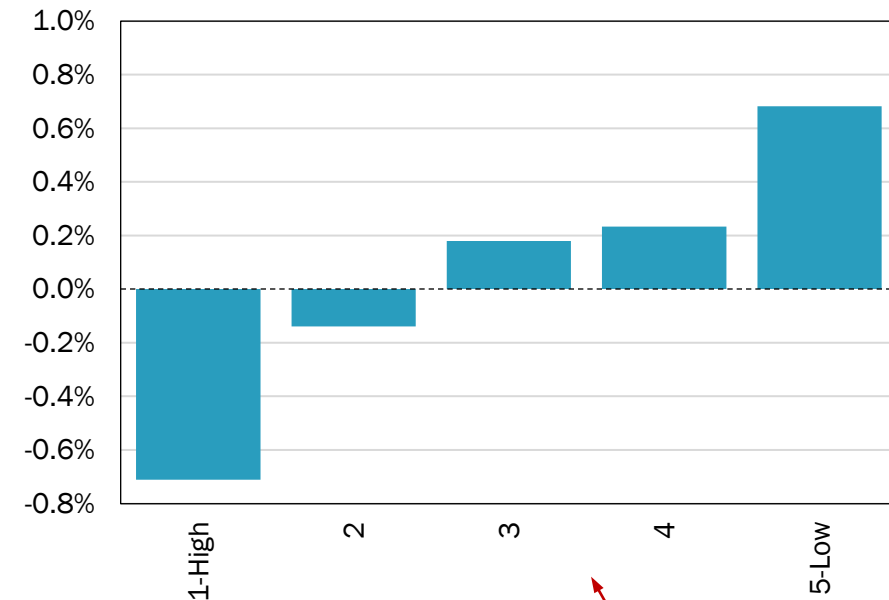
Portfolios sorted on China retail trading signal

Monthly FF3 alpha, 2012/7 - 2019/10



Portfolios sorted on Taiwan retail trading signal

Monthly FF3 alpha, 2000/7 - 2019/10

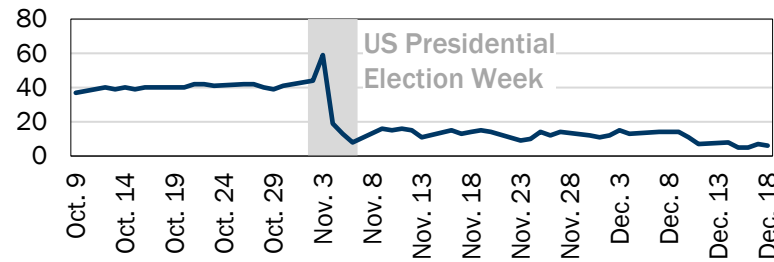


To be great inside China, important to be great outside China—overcoming short sample of Chinese data by testing strategies for robustness in other emerging markets

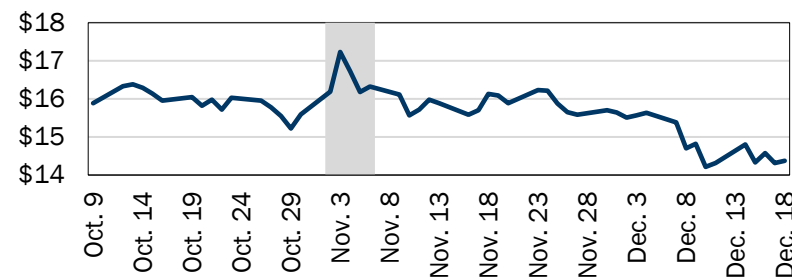
# Research Insights Retail Trading in US vs. China

- Retail trading is a *persistent* feature of China's market, often looks more like a "game" than investing

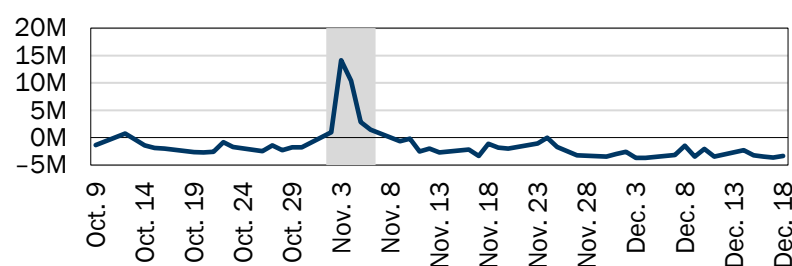
Prediction market probability  
of Trump election victory  
Oct. 9, 2020 - Dec. 18, 2020



Wisefsoft (002253.SZ)  
price per share  
Oct. 9, 2020 - Dec. 18, 2020



Wisefsoft (002253.SZ)  
abnormal trading volume  
Oct. 9, 2020 - Dec. 18, 2020



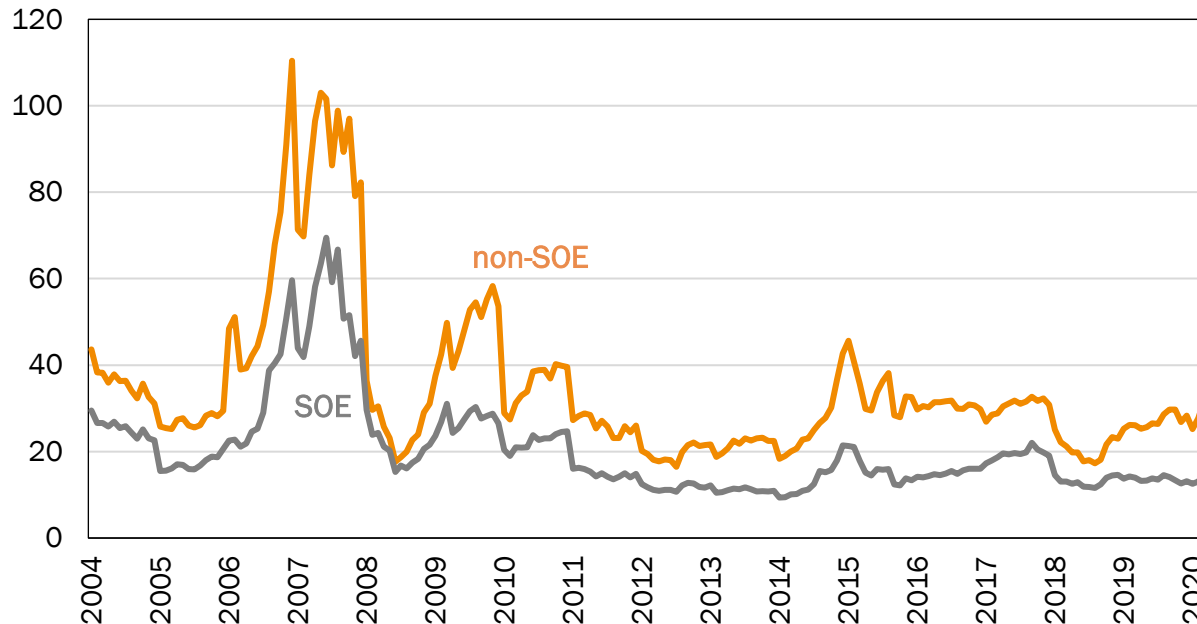
Air traffic control software company's Chinese name is: 川大智胜 "chuān dà zhì shèng" vs. 川普 "chuān pǔ".

When Donald Trump runs for president, its share price tracks his election odds more closely than its own fundamentals.

# Localization SOE Value Traps

- State-owned enterprises (SOEs) trade at perennially lower multiples, often “cheap for a reason”

**Average price-to-earnings ratio, Chinese stocks**  
Monthly value-weighted avg., top 80% A share by mkt. cap.



Value strategies create unintended tilt towards SOEs, despite state-owned firms frequently representing value traps

**THANK YOU!**  
**WE WELCOME YOUR FEEDBACK.**

**FOLLOW OUR RESEARCH**

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## **Quantitative Investments**

Investments that are managed according to a quantitative model can perform differently from the market as a whole.

## **International and Emerging Markets**

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