CHINA

The Best Capital Appreciation Opportunity of the 21st Century

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Carlos Diez

Carlos founded MarketGrader in 1999 and built a quantitative research engine to rate public companies using a fundamentals-based scoring system that follows a growth-at-a-reasonable-price (GARP) methodology. In 2003 the firm developed a family of U.S. equity indexes, with stock selection based on MarketGrader's fundamental scores, weighing all constituents equally rather than by market capitalization. It partnered with Barron's and Dow Jones Indexes in 2006 to construct the Barron's 400 Index, which collects the most fundamentally attractive companies in the U.S. It then successfully launched the Barron's 400 ETF (NYSE: BFOR) in partnership with ALPS Advisors, in 2013. Today MarketGrader rates 35,000 public companies in 93 countries and publishes over 50 global indexes utilizing its proprietary GARP methodology.

Carlos earned a BS in Economics from Pepperdine University.

Carlos Diez
CEO and Founder
MarketGrader.com Corp.
diez@marketgrader.com

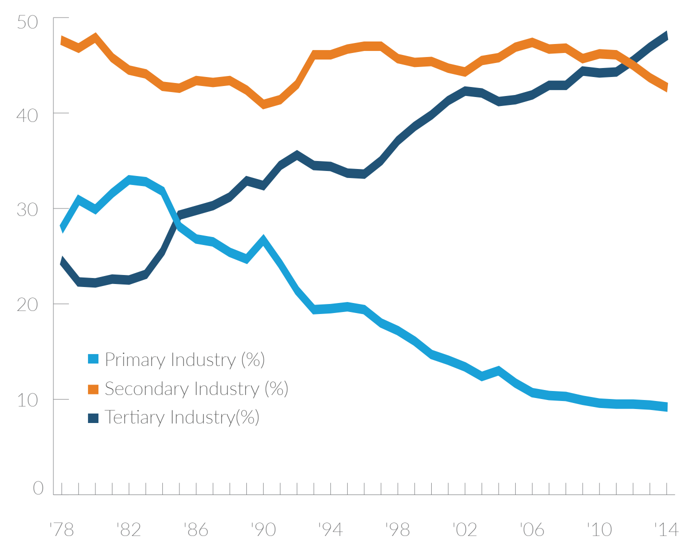
> “The report of my death was an exaggeration.”
>
> Mark Twain, 1897

Economic news out of China this year have been largely dominated by two newspaper-selling headlines: the deceleration of GDP growth to barely 7%, in line with Chinese government estimates, and the dramatic summer swoon in Chinese A-Shares. While both of these themes have obviously played major roles in the performance of equity markets around the world, at MarketGrader we have been closely watching the trends underlying both developments for what they represent to China's ongoing economic transformation, which we believe represents the best capital appreciation opportunity in this young century. Mark Twain's famous, and often-misquoted response to a false report about his impending demise, thus offers an amusing parallel to today's exaggerated accounts of China's imminent collapse. He wrote it in response to a June 1, 1897 story in the ***New York Herald***, which reported him to be "grievously ill and possibly dying. Worse still, we are told that his brilliant intellect is shattered and that he is sorely in need of money." He went on to live for another 13 years, passing away at the ripe old age of 74, an eternity by 19th century standards.

Let's start with China's GDP growth, which did indeed decelerate in the third quarter to a rate of 6.9%, the slowest pace since 2009. This should not, however, be much news to observers of China's economy, as it comes on the heels of back-to-back quarters of 7% growth, as the government has been advertising since 2014. Much of this deceleration can be attributed to a marked slowdown in fixed investments, notably real estate, as the Chinese government focuses on rebalancing its economy toward consumption, services and high value added manufacturing. This is where we think the real story lies.

In 1978, when Deng Xiaoping became China's supreme leader, what the Chinese classify as 'Primary' industry, or agriculture, still accounted for 28% of China's GDP, while 'Secondary' industry, which encompasses mining, manufacturing and construction, accounted for almost 48% of GDP. 'Tertiary' industry, comprised of "all other industries," or consumption and services, barely accounted for 24% of GDP[1]. And while China's economic miracle happened largely on the back of Secondary industry growth, the development and rise of a robust Tertiary industry has been largely overlooked and is seen as a thing of the future. Today, that future has arrived: in addition to reporting in October that third quarter GDP grew at a year-over-year rate of 6.9%, the government has also reported that, for the first time ever, Tertiary industry accounts for more than 50% of the country's GDP, which, by the way, is now 175 times larger than when Deng took over. Figure 1 illustrates this remarkable transition.

Figure 1. Composition of China's GDP by Three Strata of Industry, 1978-2015



Source: National Bureau of Statistics of China

The story, of course, goes beyond the mix of industries that comprise GDP and the market and social repercussions of China's economic policies are many. Our focus, however, is on the Chinese equity market, which we see not only as a beneficiary of this ongoing rebalance and transformation but in fact, a catalyst for it. While we were among many of the market observers that were disappointed by the government's hasty response to last summer's stock market collapse, our biggest concern was not with the measures themselves, most of which are now being reversed or suspended, but with what we think was a major missed opportunity to educate a nascent class of shareholders on

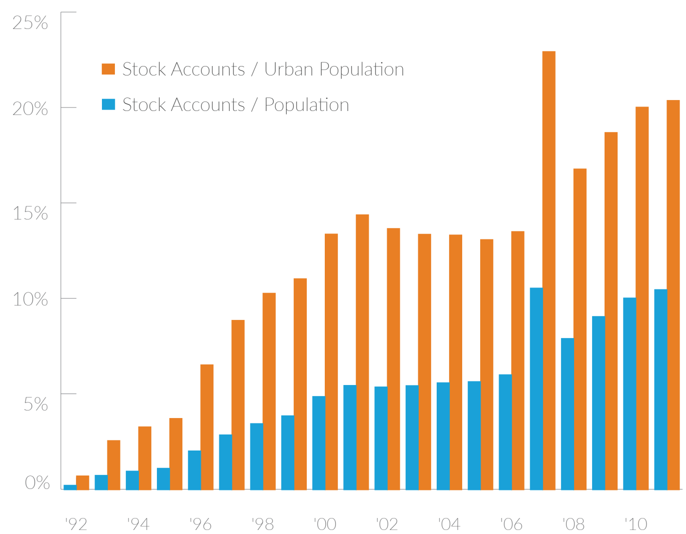
1. National Bureau of Statistics of China. "The classification of the three strata of industry is based on the 'Regulation on the Classification by Three Strata of Industry' made by the National Bureau of Statistics in 2012."

the crucial role capital formation plays in market economies. While some would argue that capital formation happens at a much earlier stage in the development of private enterprise than when a company decides to go public, that's a myopic perspective. In fact, we think a vibrant, healthy and liquid stock market, together with a futures, options and derivatives market, is at the epicenter of capital formation. It is the means by which investors in small, privately funded businesses aspire to cash out; it is also the means by which small and medium enterprises (SMEs) gain access to the capital they need to compete on a large scale, not to mention globally; it is also the provider of the currency (publicly-listed shares) by which companies are able to acquire peers or competitors in order to gain scale and fuel their growth. China's leaders understand this and yet, mysteriously, they encouraged rampant speculation and the blatant abuse of margin financing in the spring to help small-time speculators inflate a bubble in their equity market. Capital formation and the role private investors play in stoking the fires of private enterprise was largely absent from their guidance to China's up and coming investor class.

The damage, though, we believe is mostly superficial given the low penetration of stock investing in the Chinese population. Only about 4% of all Chinese own stocks, or 7% among the urban population, compared to 55% of adults in the United States (although this is still down from 65% in 2007), before the financial crisis[2]. Stock accounts in China, the primary means by which investors own public shares, were held by only 10% of the population through 2011, the latest year for which data is available[3]. Figure 2 illustrates the growth in stock accounts in China since 1992.

We believe that the development of a true shareholder class in China is the biggest opportunity, not only for global investors and financial intermediaries, but also for the Chinese economy. The development and growth of sound, transparent and liquid capital markets will be instrumental in helping China build private enterprise that will effectively compete with its bloated State Owned Enterprises (SOEs); provide the tools with which to build a sustainable retirement system and safety net for its aging population; let the market direct credit to where it will be most productive; attract foreign capital to help finance the next phase of the country's growth; and, overall, transition its economy to a true market-based system.

Figure 2. Brokerage Accounts in China 1992-2011



Source: National Bureau of Statistics of China

Converting Savers to Shareholders

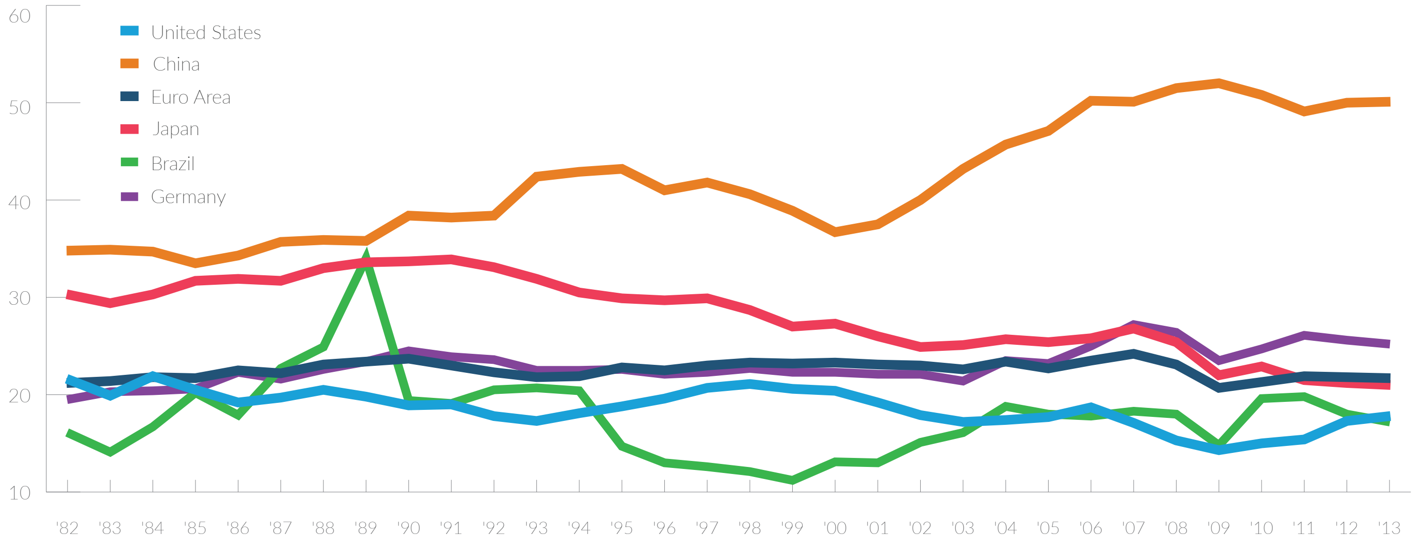
China's economic miracle has been largely defined by the growth in the country's total GDP, which is either second only to the U.S. (National Bureau of Statistics of China) or which it has surpassed based on a purchasing power parity calculation (International Monetary Fund). Either way, the country's economic growth since 1978 has been nothing short of breathtaking. China's leaders, though, understand that the next leg of growth will be harder to achieve and that it should be based on the growth of GDP ***per capita*** rather than GDP alone. This year, according to the IMF[4], China's per capita GDP is expected to reach $8,211 in current dollars, an almost five-fold increase over the last decade. While this rate of growth is remarkable, the country still has a long way to go to reach levels associated with developed economies. By comparison, 2015 per capita GDP in the U.S. is expected to be $57,045, also in current dollars.

2. Gallup News Service. ***Gallup Poll Social Series: Economy and Personal Finance***. Jeff Jones, Lydia Saad, April 9-12, 2015.

3. National Bureau of Statistics of China.

4. International Monetary Fund. World Economic Database, October 2015.

Figure 3. Gross Savings as a Percentage of Gross National Income

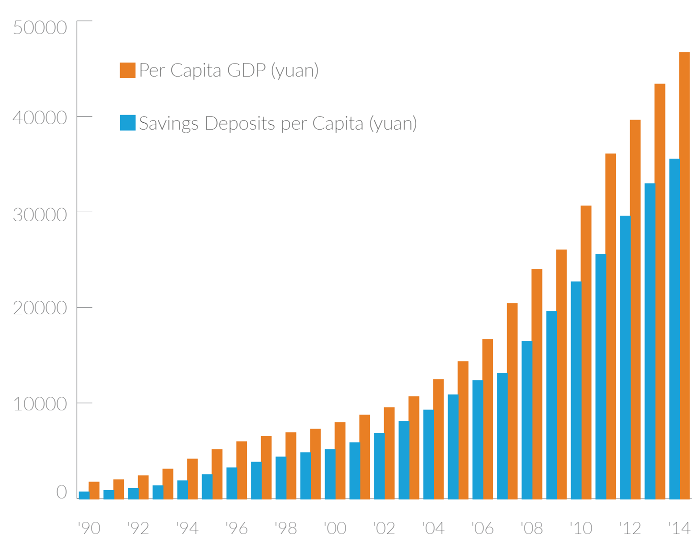


Source: Federal Reserve Bank of St. Louis, Gross saving as a percentage of gross national income (U.S.) World Bank, Gross savings as a percentage of gross national income (China, Euro Area, Japan, Brazil, Germany).

In our view, in addition to the government's willingness to implement financial reform (more on this later), the key ingredient in fostering the development and maturation of its capital markets—and thus fuel growth in the country's private sector—is China's ability to tap its vast household savings. Today, among major large economies, none comes close to saving a larger share of their income than the Chinese. In fact, Germany, which comes the closest, saves a quarter of its income, only ***half*** of what the Chinese save as a percentage of Gross National Income (GNI). The Chinese save a remarkable 50% of what they earn. Americans, despite a savings rate that has been creeping higher since the financial crisis of 2008, save less than 18% of income, not much higher than Brazil. Figure 3 shows the vast difference between the Chinese and most of the world's other large economies.

There are two primary reasons for such an elevated savings rate. One is cultural, as China is largely a Confucian society, a value system with thrift as one of its cornerstones. Additionally, many of the Chinese that have come of age in the last three decades of unsurpassed growth have clear, personal memories of massive poverty before the country's reform and opening up began under Deng. Think of it this way: in terms of age, those who saw the disastrous consequences on Chinese living standards of the Great Leap Forward (1958-1960) are the equivalent of the U.S.'s baby boom generation; and those who lived through the Cultural Revolution (1966-1976), which ended less than 40 years ago, are the equivalent of our X-Generation. Therefore, the Chinese that have gained the most purchasing power in the last three decades are also the ones with perhaps the biggest incentive to save most of what they earn. Figure 4 is a powerful illustration of this phenomenon, as it shows that China's savings rate per capita has not tailed off with GDP growth but has largely kept up with rising incomes. In fact, total savings deposits as a percentage of GDP have more than doubled since 1990, from 37.9% to 76.3% in 2014.

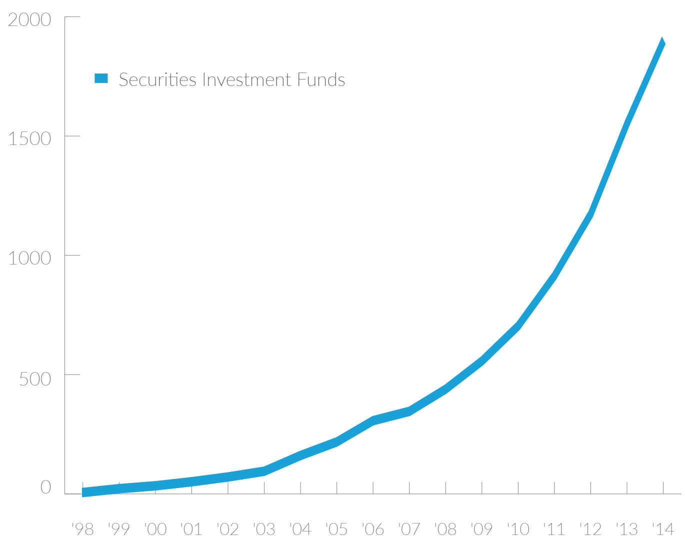
Figure 4. China's Savings Deposits Relative to Per Capita GDP



Source: National Bureau of Statistics of China

Whereas, the first reason for such a high savings rate was cultural, the second reason is structural. In a normally functioning market economy, savings make their way through capital markets as the main source of both equity and debt financing. In China, before 1992, there were no stock or bond markets to speak of. And even as the government began to loosen restrictions on personal ownership of stocks, there was no investment management industry that would provide a new class of shareholders with the means to convert savings into investing. In fact, investment management, as we know it in the U.S., was not an actual industry until 1998 when the government first allowed the formation and marketing of investment funds, as can be seen from Figure 5.

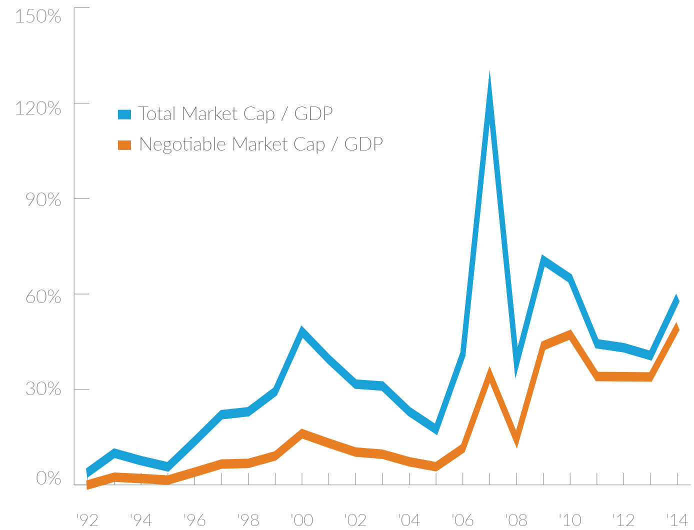
Figure 5. Securities Investment Funds in China



Source: National Bureau of Statistics of China

While Figure 5 shows an almost meteoric rise in the number of securities investment funds available in China, from an asset perspective they only represent a small portion of the country's massive untapped potential. In fact, a better way of looking at growth in China's equity market is by measuring total market cap as a percentage of GDP, which, through the end of 2014, stood at 58%. By comparison, aggregate market cap for U.S. equities now stands at about 115% of GDP, down from a recent peak of about 128%, earlier this year. The U.S. all-time high was almost 150%, achieved in March 2000. Figure 6 illustrates the trend of China's equity market relative to GDP since its stock market was created in the early 1990s.

Figure 6. China's Aggregate Stock Market Capitalization to GDP

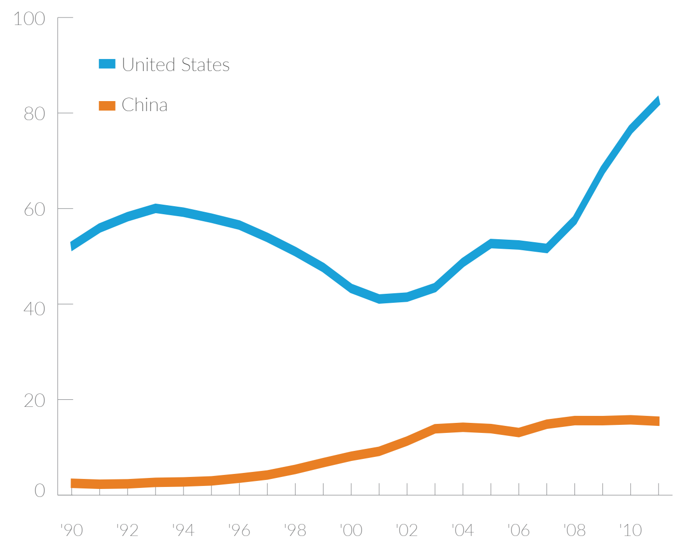


Source: National Bureau of Statistics of China

It is true that Chinese equities reached a peak of aggregate market cap as a percentage of GDP of 122% in 2007, close to where the U.S. is today. However, there is one major difference between both ratios, besides an eight-year time gap. Notice that the peak in 2007 for Chinese equities based on ***negotiable*** market cap was only 35%, compared to 122% for total market cap, which in itself belies two important trends. One is the fact that Chinese equities have much room to run relative to total economic output as the country's capital markets continue to mature. Second, and very important for the market's future health and for wider shareholder penetration among Chinese, is that the gap between total market cap and negotiable market cap (or free float), has been narrowing rapidly in recent years. As of 2014, negotiable market cap represented about 50% of total GDP, only about eight points lower than total market cap, narrow by historical Chinese standards. It is important that this trend continues as the state endeavors to divest itself of assets and as shares in privately owned enterprises continue to grow relative to the aggregate size of SOEs. From a market psychology perspective, this will help up-and-coming shareholders in China buy into the story of long-term capital appreciation through ownership of private enterprise and away from today's too prevalent view that the market is somehow manipulated by the state and only works for the well connected.

In addition to having a fully functional and vibrant equity market, China understands that it needs to allow the allocation of credit, crucial in any market-based economy, to be guided by market signals and not according to state direction. This goes hand in hand with interest rate liberalization, currently underway and the development and fostering of a deep, liquid and free-flowing bond market. Once again, a comparison between China and the U.S. offers a powerful illustration of how far the Chinese have to go. According to the Federal Reserve Bank of St. Louis, outstanding domestic public debt securities in the U.S. accounted for 82.6% of GDP in 2011, the latest year for which such data is available. In China, by comparison, the number was only 15.1%, up from 2.5% in 1990. Figure 7 illustrates this remarkable difference between both markets.

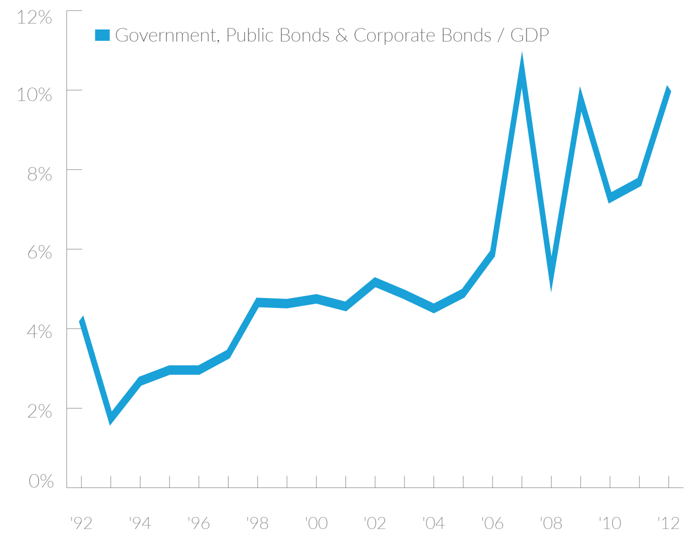
Figure 7. Outstanding Domestic Public Debt Securities to GDP



Source: Federal Reserve Bank of St. Louis

The numbers reported by the Chinese government are even smaller, as can be seen in Figure 8. According to the National Bureau of Statistics of China, as of 2012, the total value of all government, public and corporate bonds in China accounted for only 10% of the nation's GDP. Either way you look at it, the bond market also has a long way to go, especially as the Chinese government focuses on 'building' a yield curve that accurately reflects credit and economic conditions in the country and global demand for its government securities.

Figure 8. Government, Public and Corporate Bonds as a Percentage of GDP in China



Source: National Bureau of Statistics of China

Steps Toward Market Liberalization

As I mentioned earlier, the one factor more important than the country's ability to tap into the savings of its citizens to propel private enterprise growth is the government's willingness to liberalize its markets and to build and nourish the institutions that support them. We believe the country's leadership is committed to such program, as it made clear at the close of the Third Plenary Session (Third Plenum) of the 18th Central Committee of the Communist Party of China (CPC) in November 2013, in which it unveiled, in remarkable detail, perhaps the most ambitious and far-reaching reform agenda since the beginning of "reform and opening up" in the late 1970s. To wit, in the opening statements of the gathering's official communiqué, the Central Committee states "China must deepen its all-round reform with a new starting point." This remarkable document, officially titled "Decision on Major Issues Concerning Comprehensively Deepening Reforms," makes it clear that this new phase of reform will be based on the notion that "the basic economic system should evolve on the decisive role of the market in resource allocation." Below I have listed a few key points from the communiqué that support our enthusiasm for what we think will be an increasingly important role for capital markets in this new phase of reform. While a few of them speak specifically of financial market reform, others deal more broadly with "basic economic system" and "social services" reforms, both very important in setting the tone for overall market reform.

The Decision on Major Issues Concerning Comprehensively Deepening Reforms[5]

Key Points (excerpted from official document):

Basic economic system

- Complete the property rights protection system. Property rights are the key factor of ownership. The property rights of the public economy are inviolable, as are the property rights of the non-public economy.

- Support the healthy development of the non-public economy, which will play an important role in fostering growth, promoting innovation, expanding employment and increasing tax revenues. Adhere to the equality of rights, equality of opportunity and equality of rules; abolish all forms of unreasonable regulations on the non-public economy, eliminate hidden barriers and fix specific measures promoting non-public enterprises entering franchising fields. Encourage non-public enterprises to participate in SOE reform.

Modern market system

- Make market rules that are fair, open and transparent ... Reform the market regulation system, erasing regional protection, illegitimate favorable policies and monopoly. Perfect the market exit mechanism to promote the survival of the fittest.

- Perfect a mechanism where prices are determined by the market. Any price that can be affected by the market must be left to the market.

- Improve financial markets. Further open up the financial industry. Allow qualified private capital to set up financial institutions such as small-and medium-sized banks, under enhanced supervision ... Promote reform toward a registration-based stock-issuing system and increase the proportion of direct financing. Improve market-based exchange rate formation mechanisms for the renminbi. Accelerate interest rate liberalization and capital account convertibility. Build a deposit insurance system and complete the market-based exit system for financial institutions.

- Deepen science and technology system reform ... Strengthen intellectual property application and protection. Explore ways to set up intellectual-property courts ... Improve the venture capital system.

Further opening-up

- Efforts are to be made to facilitate overseas companies' entry to China and Chinese companies' expansion abroad.

- Widen investment access. The finance, education, culture and medical sectors will enjoy an orderly opening-up to market access.

Social services

- Optimize the income distribution system. Improve collective bargaining between capital and labor to decide salaries and pay raises. **Protect investors' legal rights and improve the investment return system for listed companies. Increase residents' income by diversifying investment channels** [my emphasis].

- Establish a fairer and more sustainable social welfare system. Stipulate policies for gradually suspending the retirement age of employees. **Speed up reform of pension programs for employees in public institutions affiliated with government departments. Diversity investment vehicles for the national social security fund** [my emphasis].

5. People's Daily Online.

It is very telling that the cryptic references in the document to the role capital markets will increasingly play in the development of the country's pension plan, retirement and social security systems appear under the 'Social services' section of the communiqué. Along with the virtual elimination of the one-child policy, it shows the leadership's recognition of one of China's biggest long-term problems, which is shared by most of the world's large developed economies: the aging of its population and the drastic reduction in the ratio of workers to retirees. As estimated by the Paulson Institute[6], by 2050 China will have 1.6 active workers per retiree, well below today's 4.9 to 1 ratio. Without a proper pension, retirement and social security system in place, this could escalate into a social catastrophe that would irreparably damage the social contract between the CPC and China's people. This situation thus brings together, in our view, the two key factors presented in this paper as the primary drivers of the development of China's capital markets. If done right, pension reform could be the catalyst by which the country's vast pool of savings can not only propel the growth of private enterprise but also provide the basis on which a truly reliable retirement system can be built. In order for capital markets, and specifically equities, to support these changes, innovative products that can capture and harness the country's dynamic growth will be needed.

China Equity Indexes as Measures of the Efficiency of Markets

We believe that broad investor participation in China will have to go hand in hand with the development of a broad index fund industry, not unlike in large developed markets such as the United States, Japan and Europe. While we're not suggesting that active management has no role to play in this development, as the equity markets become more efficient, the lion's share of large asset investment flows by institutions such as pension funds, insurance companies and the country's social security system into the country's equity market will happen through index funds, using both passive and rules-based intelligent approaches. Discretionary active management will play an important role too, particularly in the development of wealth management products and of a robust research community, as well as the creation of innovative and specialized products as the underlying market instruments develop. In our view, in light of the government's commitment to financial market reform and as a result of the recent upheaval in China's stock market, we believe the country is ready to embrace a more prominent role for index providers in this development for three primary reasons.

First, as described before, the government's primary task will be to form, educate and nurture a new class of shareholders around the principles of capital formation, free enterprise and a level playing field. In order to build investor confidence, especially in the early phases of this development, indexes will play a crucial role since they adhere to rules-based, transparent and replicable methodologies. This, of course, isn't new to China at all, as evidenced by the remarkable growth of the country's leading index provider, China Securities Index Co. (CSI), a joint venture between the Shanghai and Shenzhen Stock Exchanges[7]. Established only 10 years ago, the company has quickly become the leading index provider in China and has created a broad family of indexes, across asset classes and market segments, with an index lineup that rivals those of the largest index providers in other parts of the world. The company, we expect, will continue to play a central role in the government's push to develop the country's capital markets.

Second, considering the youth of China's investment management industry, and despite a considerable amount of young talent, the average tenure of fund managers in China is still very short compared to those of more mature markets. According to a report by Meng Liu, a journalist for the China Securities Times, through the end of April, 2015, there were 1,051 equity portfolio managers in China, 28% of whom had less than a year of experience managing portfolios. Only 36 of all fund managers, according to the

6. Paulson Policy Memorandum. Paulson Institute. "Tackling the Chinese Pension System." Robert C. Pozen. July 2013

7. China Securities Index Co. Ltd. www.csindex.com.cn

report, had more than eight years experience in the field[8]. Separately, at a June 2015 forum hosted by the Chinese Association of Securities Investment Funds, an official from China Securities Regulatory Commission (CSRC) reported that only 10% of the country's fund managers had been on the job for more than five years, while 60% had yet to reach their three-year marks[9]. Investors are thus unlikely to allocate very significant amounts of capital to a cadre of mostly unproven managers with relatively low institutional memory of the asset management industry. So, while we expect domestic active managers to grow significantly over the next decade, we believe the process will be gradual. In the meantime, large institutional investors are likely to rely extensively on index products to express their views on specific segments of the market within their asset allocation frameworks.

Lastly, as China continues to emulate and learn from the experience of developed capital markets such as the U.S., Japan and Europe, it is likely to adopt some of the best practices from such markets. As keen observers of global market trends, the Chinese are therefore likely to develop products in line with growing international trends, especially as the country further opens up access to its domestic markets for foreign institutional investors. Among these trends are two worth highlighting that are relevant to MarketGrader and to our ongoing work in China. The first, of course, is the migration in the last decade of a large amount of assets into passive products or index funds. Today, market cap-weighted index funds account for $1.8 trillion in global assets. Second is the impressive growth of assets in alternative indexes, which weigh their components by factors other than market capitalization. While there are many variants of such products, the industry has categorized them as smart beta or strategic beta. Such products have grown globally, in the last five years, at an annual rate of 39% per year, to $400 billion in assets, according to a recent report by ETFGI[10], twice the rate of growth in traditional market cap-weighted indexes. China, we would argue, will not be immune to such trend.

As the government tries to instill a sense of confidence in its equity market among domestic savers and investors, we believe fundamental investing will play a significant role in investors' portfolios, like it has for decades in the rest of the world. As investors in China discover the power of long-term capital appreciation and compound returns, they will learn of the importance of following intrinsic value in the entities in which they invest. Fundamentals-based investing, thus, should become a central theme among Chinese investors as they tap into their own country's economic growth and development story.

Today Chinese investors can be forgiven for cynically thinking that capital appreciation does not exist in China, given the market's heretofore boom and bust cycles, clearly accentuated by this year's roller coaster ride. As mentioned in the opening paragraph of this paper, this was one of the events that dominated the China financial news cycle this year. So what exactly transpired? The Shanghai exchange opened the first day of trading in 2015 with the composite at 3350.52. In little more than five months, the composite increased 54% hitting a YTD high of 5166.35 on June 6th. After that prices dropped sharply with the index falling 49% in a period of 10 weeks when the index hit a YTD low of 2927.29 on August 26th. Since then the Shanghai index has recovered substantially closing trading for the month of November at 3445.41, only slightly higher than its price at the start of the year.

Table 1. What Happened? The 2015 Chinese Equity Correction January 1, 2015 through October 31, 2015

Composite	Open	High	Low	Close
Shanghai (CNY)	3350.52	5166.35	2927.29	3445.41
Date	January 5	June 6	August 26	November 30
Shenzhen (CNY)	1436.86	3051.96	1580.26	2203.61
Date	January 5	June 5	September 15	November 30

Source: Bloomberg

8. Securities Times Online, April 29, 2015.

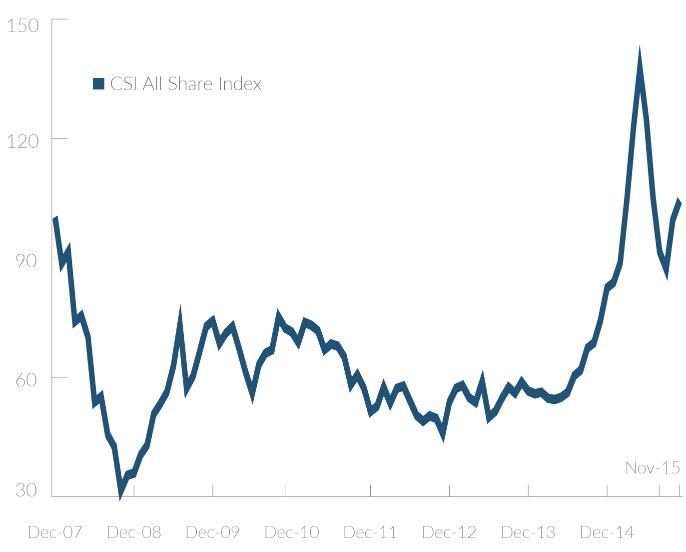
9. Sina Finance, June 18, 2015.

10. ETFGI. Global Smart Beta ETF and ETP Insights. October 2015.

The Shenzhen composite experienced a very similar trajectory, only with more volatility. It opened on the first day of trading in 2015 at 1436.86, climbing 112% and reaching a YTD high of 3051.96 on June 5th. Then came the bust. Prices fell rapidly with the composite hitting a YTD low of 1580.26 on September 15th – a decline of 48%. Since then the index has recovered some of the losses (since volatility also helps with the recovery). It closed trading for the month of November at 2203.61 for a YTD gain of 56%.

In less than a decade the Chinese stock market has put investors through two gut wrenching moves (the first was in 2008), with little or no capital appreciation to show for it. Put another way, in one of the most volatile markets in the world, investors have not only endured a wild ride but, more significantly, they have not been compensated for owning such volatility. Figure 9 illustrates the growth of CNY100 invested in the CSI All Share Index on December 31, 2007, before the 2008 crisis, through the end of November 2015 (excluding transaction costs).

Figure 9. Growth of CNY100 Invested in The CSI All-Share Index - December 31, 2007 through November 30, 2015



Source: China Securities Index Co.

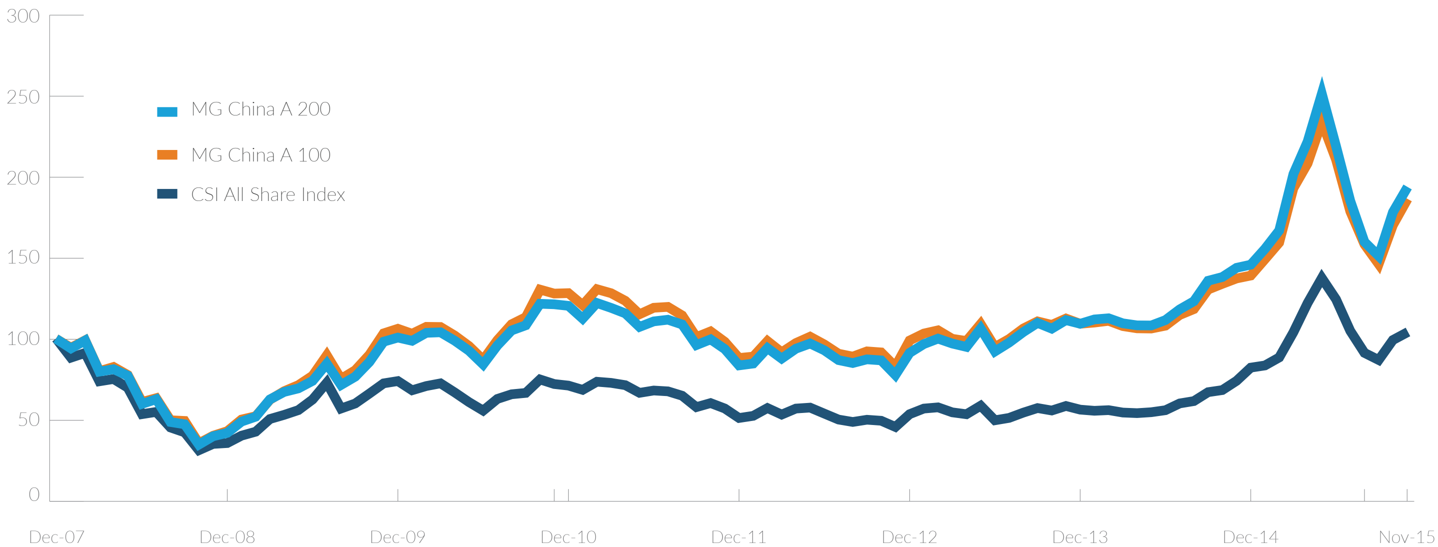
So it is hardly surprising that Chinese investors feel the need to trade around their market volatility rather than to be invested for the long-term, focusing on capital appreciation and letting the power of compound returns work for them. Our view, of course, is quite different. To the question of whether China's equity market is worthy of a strategic asset allocation, MarketGrader's unequivocal answer is 'yes.' Furthermore, we believe not only that capital appreciation would have been possible in Chinese equities in the past but that Chinese stocks will offer investors the best long-term capital appreciation opportunity of all major markets around the world in the coming decades. To this effect, MarketGrader announced in early 2014 two core China equity indexes, the MarketGrader China A-Shares 100 Index and the MarketGrader China A-Shares 200 Index. Both of these are comparable to core indexes we have published in the United States for over a decade. They are multi-cap, equally weighted indexes, rebalanced twice a year, whose components, notably, are selected based on the strength of their underlying fundamentals as graded by MarketGrader. For more on our fundamental analysis and rating methodology, please visit Global.MarketGrader.com.

MarketGrader's two core China indexes were not, of course, immune to the market's drawdown earlier this year, as they both fell, from peak to trough, by 48% (average decline of the two). Nor were they spared form the 2008 drawdown either, having fallen by more than 50% each in that year, although they outperformed the CSI All Share Index by more than 700 basis points each. Despite both of these drawdowns, though, both indexes have maintained a significant advantage in long-term capital appreciation relative to the country's overall market as measured by CSI's All Share Index. Figure 10 illustrates their performance advantage.

This performance can be attributed in large measure to MarketGrader's fundamental analysis methodology and, more specifically, to our focus on growth at a reasonable price (GARP). In China, in particular, this has allowed us to systematically identify names with significant and sustainable earnings growth, trading at reasonable valuations, over the course of the last eight years[11]. In July 2015, MarketGrader Capital published a paper by Francis Gupta,

11. Prior to this launch, the MarketGrader Mainland China Indexes family consisted of the MarketGrader China A-Shares 100 Index and the MarketGrader China A-Shares 200 Index. MarketGrader started calculating these indexes in 2014 and introduced them to the marketplace in April 2015. Go to Global.MarketGrader.com for more on these indexes.

Figure 10. MarketGrader Core China A-Share Indexes and CSI All Share Index, December 31, 2007 through November 30, 2015.



Sources: MarketGrader.com; China Securities Index Co.

Senior Advisor and my colleague, that provides a complete analysis of the performance of the MarketGrader China A-Shares 200 Index and highlights the role played by GARP in the stock selection that has led to its performance[12]. We believe that as the growth of private enterprise is fueled by a deepening and more accessible equity market, a GARP methodology will serve investors well as a means to systematically tap into China's growth story and benefit from long-term capital appreciation of its equity market. This is particularly true in helping investors gain exposure to the areas of the market offering the best risk/reward trade-offs into the future.

From an institutional perspective, it is important for investors to have the appropriate tools with which to express their views across market segments in combination with an alternative index methodology that combines fundamental selection and equal weighting. Such tools should serve as complements to the existing market cap-weighted benchmarks that give investors exposure to all market segments in proportion, of course, to the market's aggregate capitalization.

12. MarketGrader Capital. "The MarketGrader China A-Shares 200 Index: An eGARP Lens to the Mainland Equity Markets of the World's Largest Economy." Francis Gupta, July 2015.

Tools for Asset Allocation

In order to complement MarketGrader's two Core China A-Shares indexes, we are hereby introducing a complete family of A-Share indexes across Exchange, Size and Sector classifications to cover the full spectrum of the China A-Shares opportunity set. These 12 new indexes seek to provide investors with the tools with which to express their views across all market segments while combining attributes of GARP from an investment strategy perspective. The complete list of MarketGrader's Chinese indexes appears below.

- MarketGrader China A-Shares 100 Index
- MarketGrader China A-Shares 200 Index
- MarketGrader China Shanghai 80 Index
- MarketGrader China Shenzhen 80 Index
- MarketGrader China A-Shares Large Cap 80 Index
- MarketGrader China A-Shares Small Cap 120 Index
- MarketGrader China Consumer Discretionary 30 Index
- MarketGrader China Consumer Staples 30 Index
- MarketGrader China Energy 30 Index
- MarketGrader China Financials 30 Index
- MarketGrader China Health Care 30 Index
- MarketGrader China Industrials 30 Index
- MarketGrader China Materials 30 Index
- MarketGrader China Technology 30 Index
- MarketGrader China Overseas 100 Index

Additionally, we're introducing a three-part research paper series in support of our new China indexes titled "The MarketGrader China A-Share Indexes – Tools for Strategic & Tactical Asset Allocation." Readers may access and download them at
http://www.marketgrader.com/mg_blog/category/whitepapers/

Table 2 illustrates the long-term capital appreciation potential of our complete family of A-Share indexes.

Table 2. MarketGrader China Indexes, December 31, 2007 through November 30, 2015

	Annualized Return	Cumulative Return	Annualized Std. Dev.	Return / SD
Core Indexes				
MG China A-Share 100	8.16%	86.06%	32.41%	0.25
MG China A-Share 200	8.69%	93.44%	32.70%	0.27
CSI All Share Index	0.52%	4.21%	32.12%	0.02
Exchange Indexes				
MG Shanghai 80 Index	7.67%	79.52%	32.48%	0.24
Shanghai Composite	-5.21%	-34.52%	29.49%	-0.18
MG Shenzhen 80 Index	12.31%	150.72%	33.34%	0.37
Shenzhen Composite	5.40%	51.60%	33.96%	0.16
Size Indexes				
MG China A-Share Large 80 Cap	7.51%	77.42%	31.65%	0.24
CSI 300 Index	-3.38%	-23.86%	32.14%	-0.11
MG China A-Share Small Cap 120 Index	18.01%	271.06%	36.29%	0.50
CSI 500 Index	5.95%	57.97%	34.84%	0.17
Sector Indexes				
MG China Consumer Discretionary Index	9.15%	100.07%	30.30%	0.30
CSI 300 Consumer Discretionary Index	2.14%	18.24%	31.02%	0.07
MG China Consumer Staples Index	9.79%	109.43%	30.19%	0.32
CSI 300 Consumer Staples Index	0.97%	7.98%	27.28%	0.04
MG China Energy Index	0.95%	7.75%	42.22%	0.02
CSI 300 Energy Index	-13.25%	-67.54%	37.07%	-0.36
MG China Financials Index	-1.78%	38.98%	38.70%	-0.05
CSI 300 Financials Index	-1.78%	-13.27%	36.68%	-0.05
MG China Health Care Index	18.16%	274.70%	32.05%	0.57
CSI 300 Health Care Index	6.59%	65.74%	27.85%	0.24
MG China Industrials Index	12.15%	147.84%	34.99%	0.35
CSI 300 Industrials Index	-4.90%	-32.81%	36.37%	-0.13
MG China Materials Index	5.89%	57.31%	37.28%	0.16
CSI 300 Materials Index	-10.50%	-58.45%	37.94%	-0.28
MG China Technology Index	18.87%	293.03%	36.92%	0.51
CSI 300 Information Technology Index	-0.96%	-7.35%	35.54%	-0.03

All figures are total returns, except for Core and Exchange Indexes, which are price-only returns. All returns are in RMB.
Sources: MarketGrader.com; China Securities Index Co.

Conclusion

China has come a long way in a relatively short period of time, especially for a country its size. For almost forty years the country's leadership has focused almost exclusively on boosting the nation's output, in the process lifting hundreds of millions out of poverty. As China became the world's factory, GDP grew to rival, in size, that of the United Stated, no matter which measure of scale you use. Today the country is at a crossroads and, to its credit, is led by a government that recognizes it and appears willing to make the necessary adjustments to rebalance its economy, mainly in function of raising living standards and of broadening prosperity across its entire population. The remarkable growth path the country has followed in the last four decades was paved by the work of the millions of Chinese that became the backbone of industry and the productive engine of the nation. These same workers are the savers that, through the country's developing capital markets, will become its shareholders and the primary beneficiaries of ownership in the new China.
It is only fair that it be so. By becoming investors, Chinese workers and savers will be able to partake in the growth and prosperity of the companies they work for, and whose products and services they consume. In essence, this is one of the key aspects that differentiates an emerging economy from a developed one.

p | +1.888.529.1767
e | research@marketgrader.com
w | marketgrader.com

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