

Benefits of China A-Shares for active ETF investors



The long-term growth opportunities in Chinese A-shares are compelling, but gaining exposure to the key themes that are driving this growth requires active management rather than a passive index approach. The unique features of China's onshore market present an unparalleled opportunity for active managers to generate alpha over the long term. To capitalise fully on

the opportunities provided by this deep, liquid and diverse market requires an active ETF that taps into locally-based stock research to uncover attractive alpha opportunities whilst maintaining index-like characteristics through robust risk management.

Diverse long-term growth opportunities for active ETF investors

The A-share market is both broad and liquid, with over 3,500 listed stocks to choose from, which is similar to the combined number of stocks listed on US exchanges. According to the World Federation of Exchanges, in 2022 the average daily turnover of the Shanghai and Shenzhen markets was over \$130 billion, compared with \$427 billion for US equity markets. An opportunity set that is both broad and liquid means two key prerequisites for successful stock selection are met.

This breadth of opportunity extends across a wide range of sectors, with the A-share market offering active investors abundant opportunities to gain access to long-term trends in the Chinese economy. For example, with China's expanding middle class both supporting and demanding an increasingly sophisticated set of premium consumer goods, the power of domestic brands is increasing. Identifying industry leaders that will benefit as China transitions towards a consumer based, services led economy will help uncover rewarding investment opportunities that deliver sustainable growth.

Demand for electric vehicles (EVs) is a case in point. EV penetration of new car sales in China reached 26% by the end of 2022, which is much higher than in most of the rest of the world. But it is not just Teslas that you'll see while walking the streets of Shanghai, domestic manufacturers such as NIO and BYD are just as popular. It's our expectation that EV penetration in China as a whole will double to close to 50% nationwide by 2026. The opportunities for investors are huge: China has a comprehensive EV supply chain that we can access, ranging from downstream EV manufacturers all the way to makers of the batteries and components that go into an electric car.

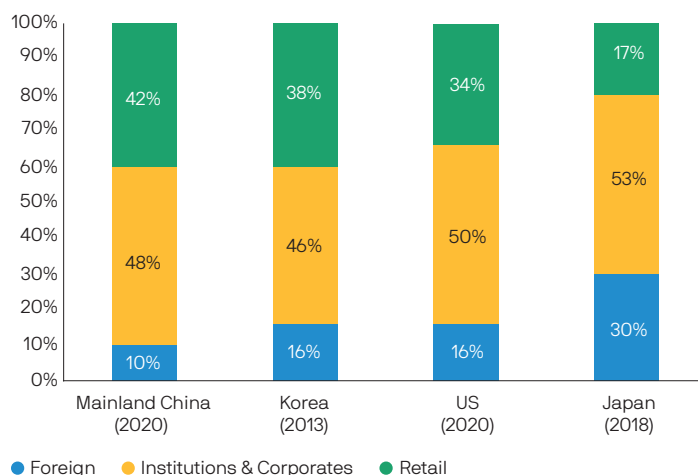
Another key theme in China is the digitalisation of old, analogue processes. Chinese companies, supported by the government, are being encouraged to move from traditional record keeping and analysis into cloud/server-based data management. This transformation is a major global trend but one that is accelerating particularly strongly in China.

Inefficiencies bring opportunities

The unique features of China's onshore market present an unparalleled opportunity for bottom-up stock selectors to generate alpha. One such attribute is its high retail participation rate which is unmatched by any other major exchange. Retail investors make up 42% of the holding value of the Chinese A-shares free- float and contribute over 80% of its trading volume. The speculative nature of retail investors means this market is often moved by rumours rather than company fundamentals. Related to the dominance of retail investors, another key attribute of the Chinese A-shares market is its very high turnover. Index funds are unable to mitigate the impact of the market's high turnover, and the short-term investment horizon of its investor base, which can lead to a tendency towards periods of over exuberance or over pessimism. These market inefficiencies create opportunities that can be exploited by active managers with local market knowledge, a long-term investment horizon that looks through short- term volatility, and a rigorous valuation framework.

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Selected economies' stock market investor structure by holding value



Source: People's Bank of China, Federal Reserve, TWSE, KRX, JPX, Goldman Sachs Global Investment Research, Gao Hua Securities Research. Data as of 31 December 2021. Mainland China data reflects free-float market cap, while other markets are based on total market cap.

Navigating the ESG landscape

Sustainability is another key area where active ETFs have an advantage when it comes to allocating to China's onshore market. While Chinese capital markets are still in their infancy, Chinese companies are improving their environmental, social and governance (ESG) disclosures at a rapid pace. Over 85% of the 300 largest onshore companies now produce corporate sustainability reports.

Disclosure is improving

86%

Number of CSI 300 companies publishing separate ESG Reports

Source: SynTao Green Finance as of 15 June 2020; includes reports labelled as "sustainability", "CSR" etc.

A-shares typically do not have ADRs

Chinese stock performance by listing



Past performance is not indicative of current or future results.

Source: Bloomberg L.P., Wind, J.P. Morgan Asset Management. Chinese ADRs: American depository receipts that represent shares of U.S.-listed Chinese companies. Guide to China. Data are as of January 31, 2023.

However, ESG disclosures can often be in Mandarin only, with inconsistent metrics that require interpretation. Locally-based analysts that are able to delve into the data and actively engage with company management can help encourage better disclosure in key areas, such as carbon emissions and science-based targets for decarbonisation, and ensure underlying investments are better aligned with clients' sustainability objectives. We believe strongly that the consideration of financially material ESG risks and opportunities is an important foundation of any process supporting long-term investment.

JPM China A Research Enhanced Index Equity (ESG) ETF*

JREC*, our China A Research Enhanced Index (REI) Equity ETF seeks to exploit stock-specific insights in the onshore Chinese equity market while maintaining index-like characteristics through robust risk management — all within a rigorous ESG framework. J.P. Morgan Asset Management has a long history managing Research Enhanced Index strategies, spanning over three decades and a variety of regions including the US, Europe, Emerging Markets and Japan. The active ETF allows investors to capitalise on locally-based stock research and active stock picking to uncover alpha opportunities in China's A share market.

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J.P. Morgan Asset Management's Greater China team consists of 26 investment professionals located in Shanghai, Hong Kong and Taipei. The Mandarin-speaking research analysts spend their time conducting on-the-ground research and in-depth analysis on companies.

JREC also benefits from low tracking error market exposure and a cost-efficient investment approach. The fund managers aim for a tracking error of between 1.0% and 2.0% against the MSCI China A Index. The TER of 0.40% means the fund offers cost efficient access to an active approach to the onshore market in China. JREC is Article 8 under the SFDR regulation, due to its exclusion of controversial industries and integrating ESG factors throughout the investment process.

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LV-JPM54160 | 03/23 | 09hc221402151813
