

# S&P Dow Jones Indices

A Division of **S&P Global**

# TalkingPoints

## The S&P Access China Enterprises Enhanced Value Index



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The S&P Access China Enterprises Enhanced Value Index seeks to measure the performance of 100 Chinese companies with securities with attractive valuations that are eligible for the Stock Connect programs. Only one share class is selected to represent each company.

### 1. What is the rationale behind the construction of the index?

The value factor is one of the oldest and most-established risk premiums in financial markets. Historically, stocks with attractive valuations have tended to outperform the broader market over medium- to long-term periods. The value premium exists in China's A-share market<sup>1</sup> and the Hong Kong market.<sup>2</sup> With the introduction of the Stock Connect programs, new opportunities are emerging for value investors focusing on China.

The China A-share market looks expensive. As of Aug. 31, 2018, the S&P China A BMI Domestic traded at 15.7x trailing 12-month earnings versus the S&P Emerging BMI at 13.7x. More surprising, dual-listed stocks (those that trade as A-shares and H-shares) were trading at a large premium on the mainland. The premium or discount of A-shares relative to H-shares has been caused by market liquidity conditions and market participant structures and preferences, among other aspects. The prevalence of stock price differences may exist for quite some time and then tend to move toward long-term convergence.

The S&P Access China Enterprises Enhanced Value Index aims to benefit from a larger opportunity set, including onshore and offshore markets and relative premium or discount.

### 2. How does the index work?

The index is constructed from the universe of southbound and northbound trading of the Shanghai-Hong Kong and the Shenzhen-Hong Kong Stock Connect programs. This includes ChiNext stocks.

It selects the 100 Chinese companies with attractive valuations based on three fundamental measures: book value-to-price, earnings-to-price, and sales-to-price ratios. The index is weighted by the product of market cap and value score.

For dual-listed companies, only the cheaper share classes would be considered. A buffer rule is in place to reduce turnover of existing constituents—the index does not switch share classes unless the premium is more than 5% at the rebalancing every six months.

<sup>1</sup> [Examining Factor Strategies in China's A-Share Market](#), 2015.

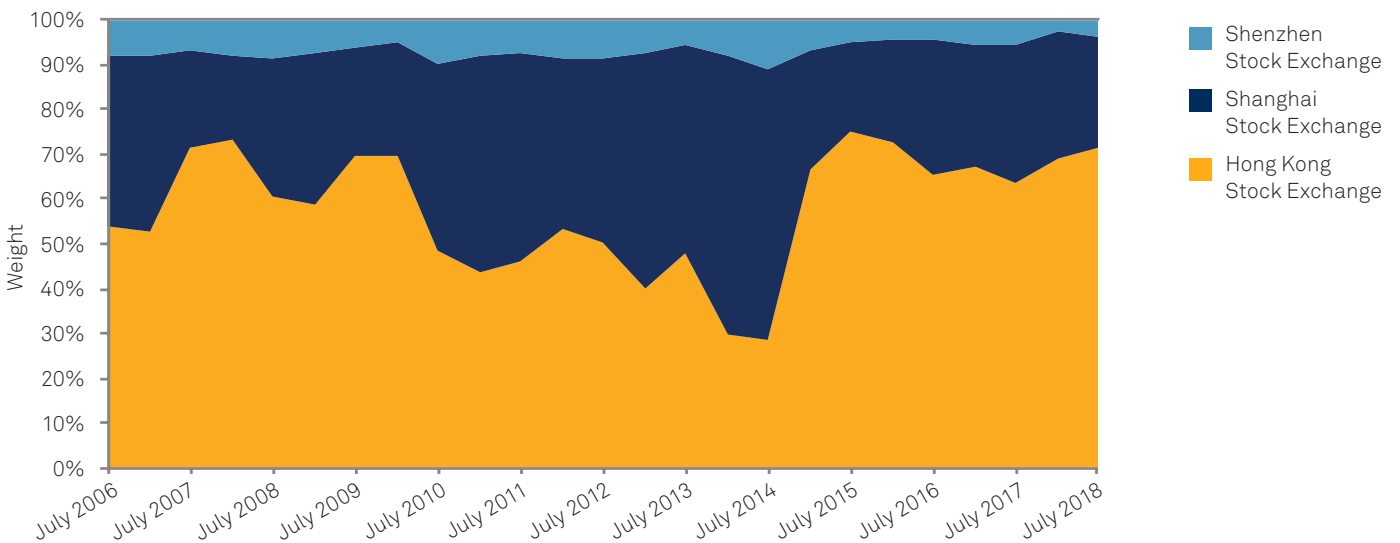
<sup>2</sup> [How Smart Beta Strategies Work in the Hong Kong Market](#), 2017.

### 3. What are the key characteristics of the index?

#### Capture the Arbitrage Opportunity Between Two Markets

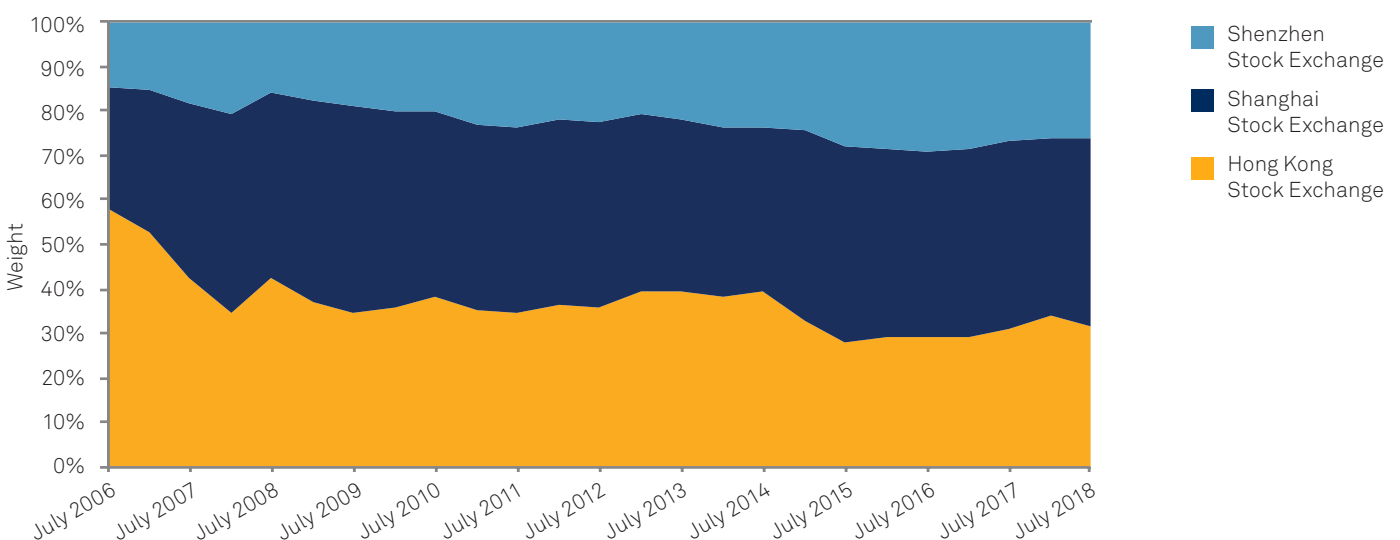
The S&P Access China Enterprises Enhanced Value Index dynamically allocates to the A-share and Hong Kong markets according to valuation. When the A-share market continuously hit new highs and became significantly overvalued in 2015, the strategy quickly moved from A-shares to the Hong Kong market (see Exhibits 1 and 2). There is also a persistent underweight in Shenzhen-listed stocks, which are known for their high valuation and high volatility.

**Exhibit 1: Exchange Weights of the S&P Access China Enterprises Enhanced Value Index**



Source: S&P Dow Jones Indices LLC. Data from July 24, 2006, to July 23, 2018. Past performance is no guarantee of future results. Chart is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

**Exhibit 2: Exchange Weights of the S&P China A BMI Domestic and S&P Hong Kong-Listed China Combined**



Source: S&P Dow Jones Indices LLC. Data from July 24, 2006, to July 23, 2018. Past performance is no guarantee of future results. Chart is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

### Better Risk-Adjusted Return

Over the 12-years plus period studied, the [S&P Access China Enterprises Enhanced Value Index](#) outperformed the A-shares market (represented by the [S&P China A BMI Domestic](#)) and the Hong Kong China enterprises market (represented by the [S&P Hong Kong-Listed China](#)) by 4.28% and 7.27% per year, respectively. It also outperformed both broad market indices by 0.20 and 0.24 in terms of risk-adjusted return over the same period (see Exhibit 3).

### Exhibit 3: Risk/Return of the S&P Access China Enterprises Enhanced Value Index, S&P China A BMI Domestic, and the S&P Hong Kong-Listed China

Statistic	S&P Access China Enterprises Enhanced Value Index	S&P China A BMI Domestic	S&P Hong Kong-Listed China
<b>August 2018 Return (%)</b>	-2.41	-5.93	-2.64
YTD Return as of Aug. 31, 2018 (%)	1.32	-19.82	-3.28
<b>ANNUAL RETURN (%)</b>			
Past 1 Year	1.07	-20.10	5.37
Past 3 Years	12.79	-3.84	14.16
Past 5 Years	18.67	8.20	10.70
Past 10 Years	11.44	6.45	5.91
From July 31, 2006, to Aug. 31, 2018	15.31	11.02	8.04
<b>ANNUAL VOLATILITY (%)</b>			
Past 1 Year	17.64	11.80	13.54
Past 3 Years	16.65	21.74	14.72
Past 5 Years	23.05	24.70	17.32
Past 10 Years	25.06	27.77	22.87
From July 31, 2006, to Aug. 31, 2018	27.78	31.57	25.81
<b>RISK-ADJUSTED RETURN</b>			
Past 1 Year	0.06	-1.70	0.40
Past 3 Years	0.77	-0.18	0.96
Past 5 Years	0.81	0.33	0.62
Past 10 Years	0.46	0.23	0.26
From July 31, 2006, to Aug. 31, 2018	0.55	0.35	0.31

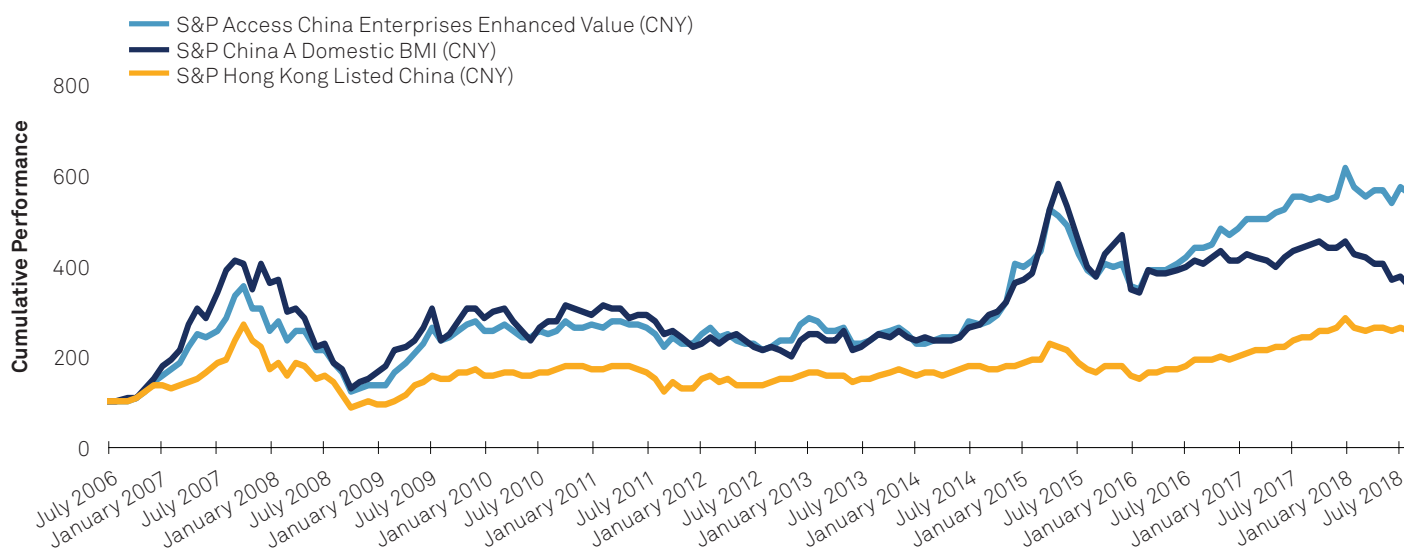
Source: S&P Dow Jones Indices LLC. Data from July 31, 2006, to Aug. 31, 2018. Index performance based on monthly total return in CNY. Past performance is no guarantee of future results. Table is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

### Reduced Drawdown

Over the 12-years plus period studied, the maximum drawdown of the S&P Access China Enterprises Enhanced Value Index was 66.2%, slightly lower than the A-shares market and the Hong Kong China enterprises market (see Exhibit 3 and 4). When the A-share stock market dipped in Q2 2015, the index also maintained a drawdown lower than both markets. Two possible explanations are the underweight in volatile Shenzhen-listed stocks and the significant shift to the Hong Kong market since 2015, which mitigated the loss from the Chinese stock market turbulence in 2015-2016.

It is worth noting that when the A-shares market sell-off that began at the end of January 2018, the drawdown of the S&P Access China Enterprises Enhanced Value Index was 12.6%—significantly lower than the 17.6% of the A-shares market. Clearly, the allocation to the Hong Kong-listed Chinese stocks was beneficial, as they tended to be significantly less volatile than the A-shares.

**Exhibit 4: Wealth Curves of the S&P Access China Enterprises Enhanced Value Index, S&P China A BMI, and S&P Hong Kong Listed China**



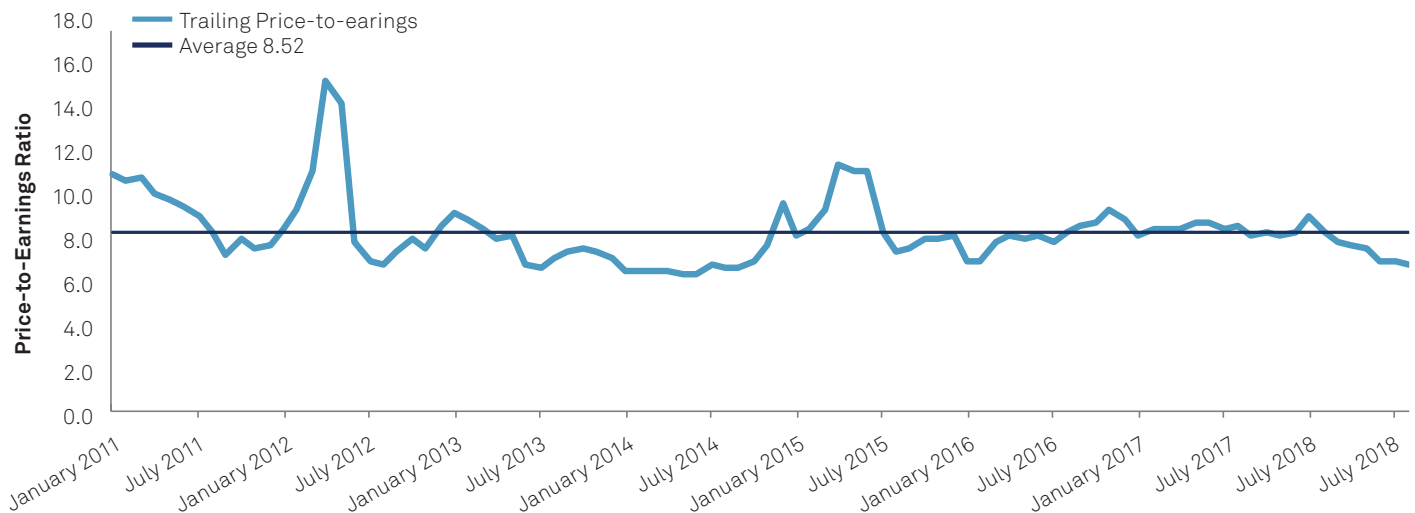
Index	Largest Drawdown (October 2007– October 2008)	2nd Largest Drawdown (April 2015– February 2016)	3rd Largest Drawdown (January 2018– June 2018)
S&P Access China Enterprises Enhanced Value Index (CNY)	-66.2%	-33.5%	-12.6%
S&P China A BMI Domestic (CNY) Return	-67.9%	-34.7%	-17.6%
S&P Hong Kong Listed China (CNY) Return	-67.8%	-34.0%	-9.2%

Source: S&P Dow Jones Indices LLC. Data from July 31, 2006, to Aug. 31, 2018. Index performance based on monthly total returns in CNY. Past performance is no guarantee of future results. Chart and table are provided for illustrative purposes and reflect hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

## Price-to-Earnings Ratio

As of Aug. 31, 2018, the [S&P Access China Enterprises Enhanced Value Index](#) traded at 7.1x trailing 12-month earnings, versus the S&P China A BMI Domestic at 15.7x and the [S&P Hong Kong-Listed China](#) at 11.3x. Having risen approximately 58.6% in price from February 2016 to Aug. 31, 2018, the index has been quite reasonably valued, with a price-to-earnings ratio 17% below the historical average. Over the period studied, the average trailing price-to-earnings ratio of the S&P Access China Enterprises Enhanced Value Index was 8.52 (see Exhibit 5).

### Exhibit 5: Historical Trailing Price-to-Earnings of the S&P Access China Enterprises Enhanced Value Index



Source: S&P Dow Jones Indices LLC. Data from Jan. 31, 2011, to Aug. 31, 2018. Past performance is no guarantee of future results. Chart is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

#### Performance Disclaimer

The S&P Access China Enterprises Enhanced Value Index was launched on April 3, 2017. The S&P China A BMI Domestic was launched on November 27, 2013. All information presented prior to an index's Launch Date is hypothetical (back-tested), not actual performance. The back-test calculations are based on the same methodology that was in effect on the index Launch Date. However, when creating back-tested history for periods of market anomalies or other periods that do not reflect the general current market environment, index methodology rules may be relaxed to capture a large enough universe of securities to simulate the target market the index is designed to measure or strategy the index is designed to capture. For example, market capitalization and liquidity thresholds may be reduced. Complete index methodology details are available at [www.spdji.com](http://www.spdji.com). Past performance of the Index is not an indication of future results. Prospective application of the methodology used to construct the Index may not result in performance commensurate with the back-test returns shown.

S&P Dow Jones Indices defines various dates to assist our clients in providing transparency. The First Value Date is the first day for which there is a calculated value (either live or back-tested) for a given index. The Base Date is the date at which the Index is set at a fixed value for calculation purposes. The Launch Date designates the date upon which the values of an index are first considered live: index values provided for any date or time period prior to the index's Launch Date are considered back-tested. S&P Dow Jones Indices defines the Launch Date as the date by which the values of an index are known to have been released to the public, for example via the company's public website or its datafeed to external parties. For Dow Jones-branded indices introduced prior to May 31, 2013, the Launch Date (which prior to May 31, 2013, was termed "Date of introduction") is set at a date upon which no further changes were permitted to be made to the index methodology, but that may have been prior to the Index's public release date.

The back-test period does not necessarily correspond to the entire available history of the Index. Please refer to the methodology paper for the Index, available at [www.spdji.com](http://www.spdji.com) for more details about the index, including the manner in which it is rebalanced, the timing of such rebalancing, criteria for additions and deletions, as well as all index calculations.

Another limitation of using back-tested information is that the back-tested calculation is generally prepared with the benefit of hindsight. Back-tested information reflects the application of the index methodology and selection of index constituents in hindsight. No hypothetical record can completely account for the impact of financial risk in actual trading. For example, there are numerous factors related to the equities, fixed income, or commodities markets in general which cannot be, and have not been accounted for in the preparation of the index information set forth, all of which can affect actual performance.

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