MARKETING DOCUMENT - FOR PROFESSIONAL AND QUALIFIED INVESTORS ONLY

Expert's view

More tailwinds for China

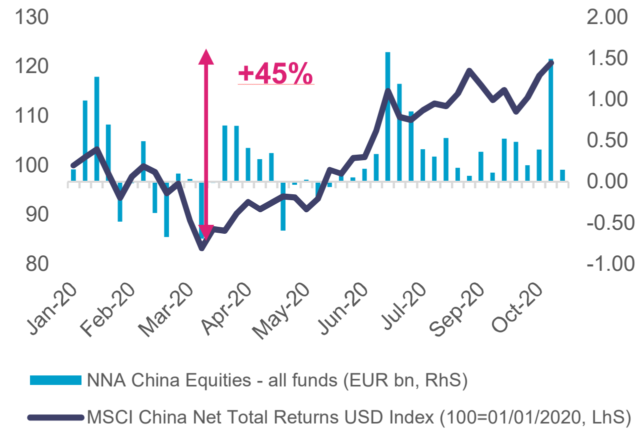
Chinese equities have posted stellar performance since the market trough in late March. The performance has been increasingly supported over the summer by net inflows into ETFs and funds. In this report, we review the outlook for Chinese equities, and then go on to explain how to navigate China's complex capital market structure.

Our key takeaways

1. **Chinese equities have stepped up a gear**: Chinese equities have led the recovery since the market downturn in March, supported by tailored fiscal and monetary stimulus.
2. **Valuations remain moderate in the context of earnings:** Despite the strong recovery and corporate earnings (expected to exceed 2019 levels by more than 20% by the end of 2021), Chinese equities are still trading at moderate valuations relative to other regions and to their own history.
3. **China's market structure is complex:** China's onshore equity market is the second-largest stock market in the world. Yet it remains largely closed to foreign investors, with around two-thirds of equity value still unavailable for trading. The investable universe for foreign investors includes 3,108 stocks traded on several exchanges, with shares split into numerous share classes.
4. **MSCI China for an 'all China' exposure:** There are important distinctions between 'onshore' and 'offshore' equity listings in China, including sector exposure, accessibility, and free float. MSCI China provides a blended exposure to the whole Chinese equity market. The index could benefit from both the expanding internationally-focused Tech sector and further recovery of the domestic Chinese economy.

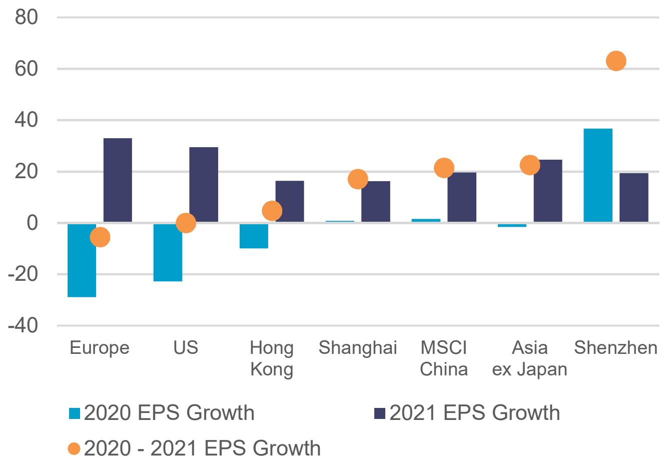
China stepped up a gear

Chinese equity performance & weekly flows into equity funds and ETFs (US and EU domiciled, in EUR)



China's earnings growth to lead the game in 2021

YoY 2020 & 2021 EPS growth forecasts (IBES consensus, %)



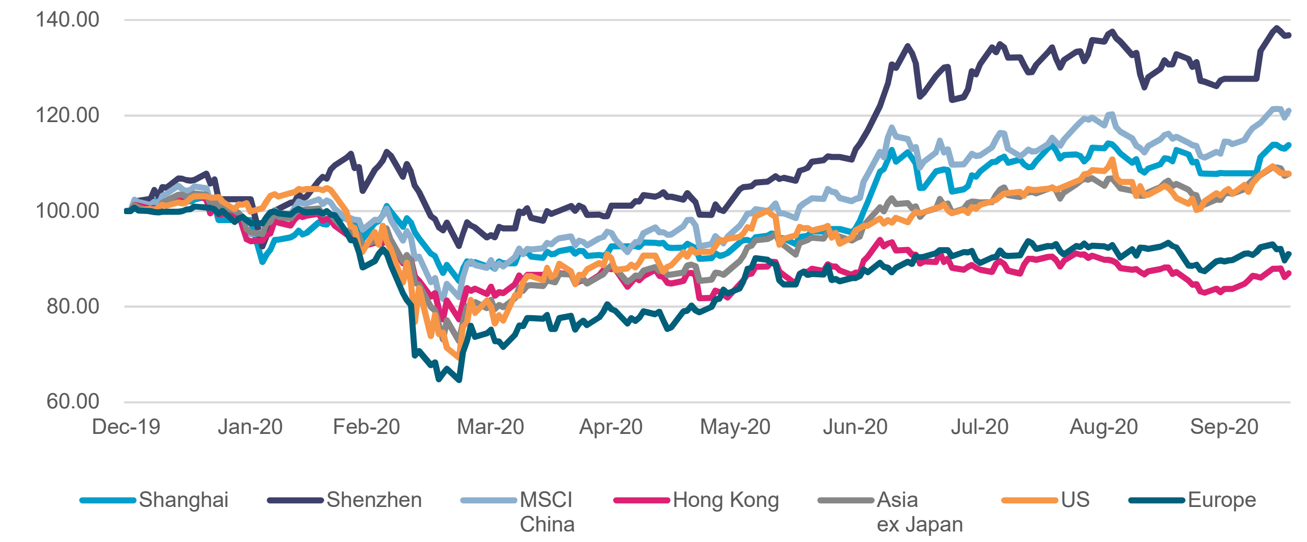
Source: Morningstar, Bloomberg, Refinitiv, IBES. Lyxor International Asset Management. Fund flows and performance as at 16/10/2020, other data as at 30/09/2020. Past performance is not a reliable indicator of future returns.

Chinese equities have stepped up a gear

Global equities, and China in particular, have made a strong recovery following March lows

Global equity markets have rebounded from the lows seen in March, fuelled by the gradual reopening of economies, the provision of near-unlimited liquidity (which has pushed yield-seeking investors to equities) and optimism that the peak of the Covid-19 pandemic has passed.

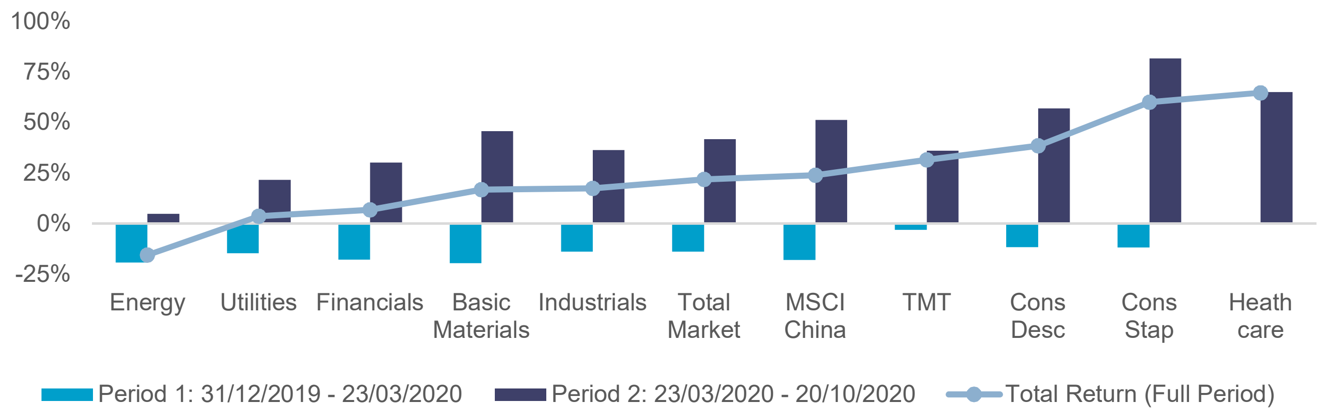
Chart 2: Chinese equities are thriving while most other major markets are still in recovery
Price performance (USD): 31/12/2019 – 13/07/2020



Sources: Lyxor International Asset Management, Bloomberg, Refinitiv. Data as at 16/10/2020.
Past performance is not a reliable indicator of future returns.

Chinese equities (Shanghai, Shenzhen, MSCI China) have led the way during the equity market recovery. They are soaring to new heights for the year, having benefited from a quick emergence from the virus lockdown measures and tailored fiscal and monetary stimulus. The Shenzhen market has been the top performer year-to-date (+37%), followed by MSCI China (+21%) and Shanghai (+14%).

Chart 3: Health Care, Consumer & Tech sectors are driving China's recovery
Price performance (USD): 31/12/2019 – 20/10/2020



Sources: Lyxor International Asset Management, Bloomberg, Refinitiv. Data as at 20/10/2020.
Past performance is not a reliable indicator of future returns.

MARKETING DOCUMENT - FOR PROFESSIONAL AND QUALIFIED INVESTORS ONLY

The year-to-date performance of Chinese equities was driven by the Consumer Staples, Consumer Discretionary, Technology and Health Care sectors (see Chart 3). These sectors benefited from the lockdown environment, outperforming during the initial outbreak of Covid-19 and as markets rebounded post-March. The outperformance of these sectors relative to the traditional investment-led sectors (Industrials, Utilities, Financials, Energy) reflects the broader transition under way in China, towards a consumer-led economy.

Valuations remain moderate in the context of earnings growth resilience

The strong performance of Chinese equities may be attributed to the resilience shown in corporate earnings. While 2020 earnings growth expectations for the major markets were positive in January, only Chinese equities had delivered positive 2020 earnings growth expectations by September (see Chart 4).

Chart 4: China EPS growth resilient through the crisis
YoY 2020 EPS growth forecast (IBES consensus, %)

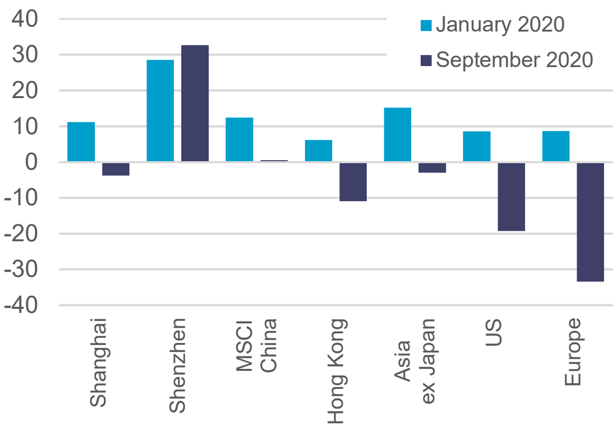
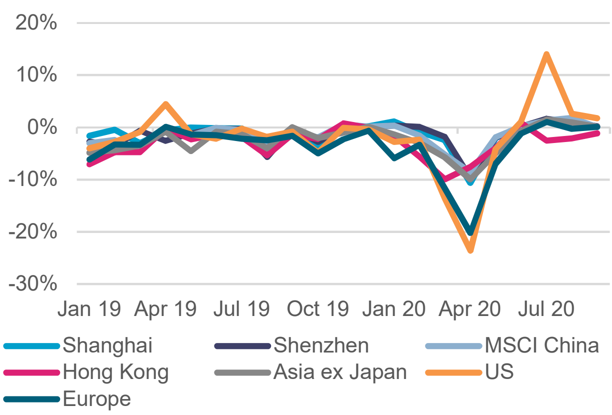


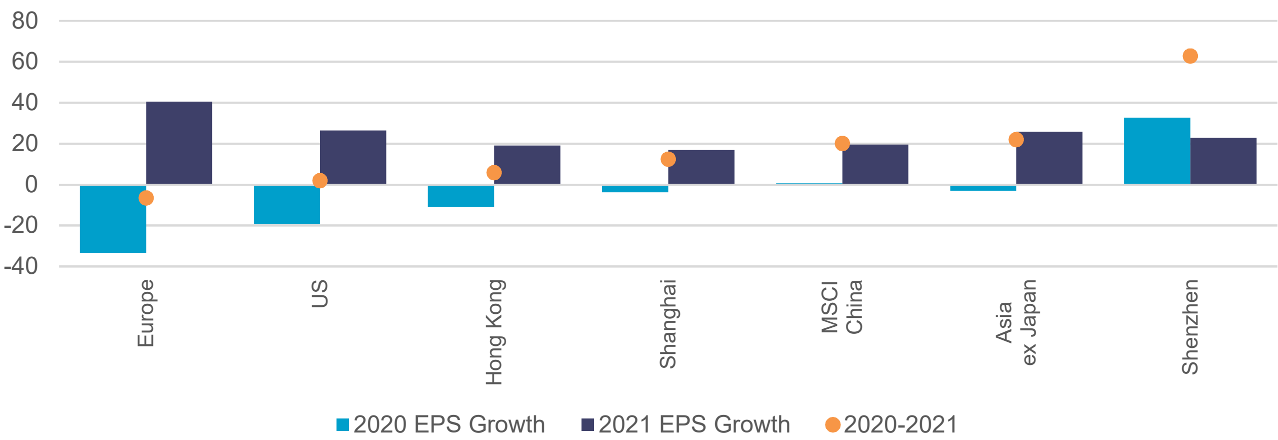
Chart 5: Earnings sentiment also remained firm
12m forward Earnings Revision Ratio (IBES consensus)



Sources: Lyxor International Asset Management, Bloomberg, Refinitiv. Data as at 30/09/2020.
Past performance is not a reliable indicator of future returns.

Notably, for the Shenzhen market, growth expectations for the current year have been revised upwards. The development of the earnings revision ratio, a measure of the number of earnings upgrades to downgrades, similarly displays the resilience of Chinese corporate earnings through the crisis (see Chart 5).

Chart 6: Earnings growth of Chinese equities expected to be higher than peers through 2021
YoY 2020 & 2021 EPS growth forecasts (IBES consensus, %)

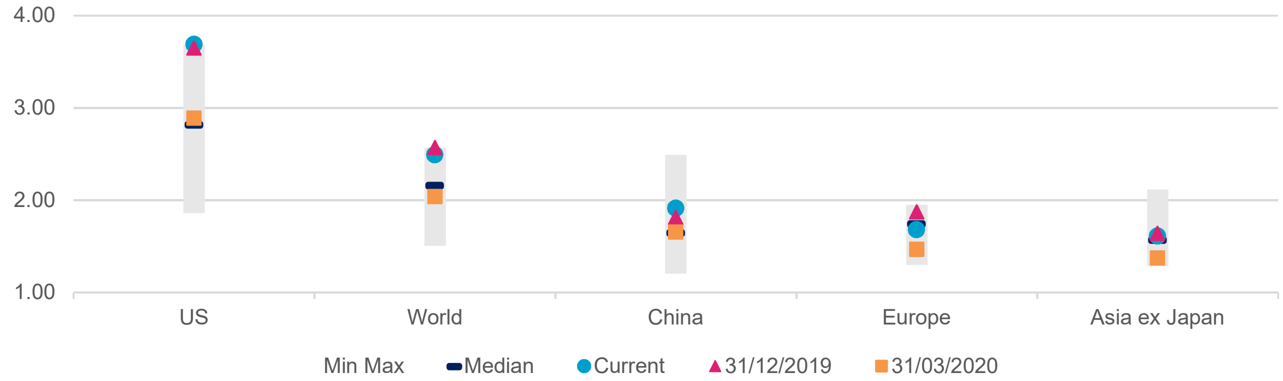


Sources: Lyxor International Asset Management, Bloomberg, Refinitiv. Data as at 30/09/2020.
Past performance is not a reliable indicator of future returns.

MARKETING DOCUMENT - FOR PROFESSIONAL AND QUALIFIED INVESTORS ONLY

While earnings in Europe and the US are expected to stage a robust recovery next year, they look unlikely to reach pre-Covid levels (see the orange dot on Chart 6). In contrast, corporate earnings in Asia ex Japan and China are expected to exceed 2019 levels by more than 20%. Expected earnings growth for the Shenzhen market totals 63% through 2021.

Chart 7: Valuations for Chinese equities remain moderate relative to peers and to its history
Trailing P/B Ratio (June 2010 - June 2020)



Sources: Lyxor International Asset Management, Bloomberg, Refinitiv. Monthly P/B data as at 30/09/2020. A higher value signifies a more expensive valuation. Past performance is not a reliable indicator of future returns.

Prior to the Covid-19 outbreak, valuations of Chinese equities were lower than global peers, potentially as a result of US trade tensions and lingering concerns regarding the pace of macroeconomic growth. As in most markets, Chinese valuations have now returned to their pre-Covid levels. While earnings have proved resilient, Chinese equities are trading at valuations that are not overtly rich – both relative to other regions and to its own history.

China's capital markets

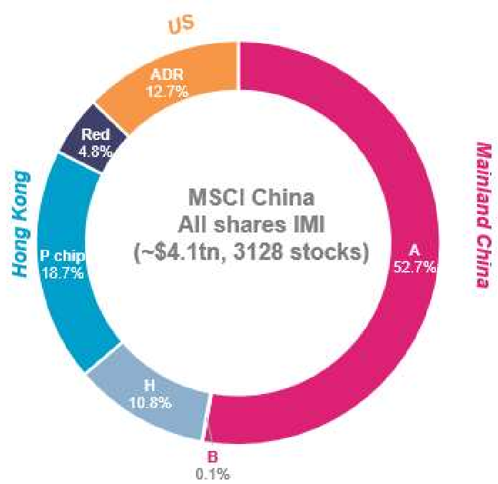
A unique capital market structure

While China is the second largest economy in the world, accounting for 16% of global GDP, its equity market remains vastly underrepresented in global equity indices. China's share of the MSCI ACWI index accounts is just 5% as of 30 June 2020.

The Chinese 'onshore' equity market is the second largest stock market in the world. Yet until recently, most of it has been largely closed to foreign investors. About two-thirds of Chinese equity value is still not available for trading. Unlike the US stock market, most financing for Chinese corporates comes from bank loans and debt. Stocks financing is estimated at only 5% of Chinese companies' balance sheets.

The investable universe for foreign investors is valued around $4.1trn and includes 3,128 stocks, that are traded on several exchanges in Mainland China, Hong Kong and in the US. Shares are also split into seven share classes. Of these about half are onshore equities (A & B share classes).

Chart 8: Anatomy of the China's free float equity market
MSCI China All shares IMI – breakdown by share class

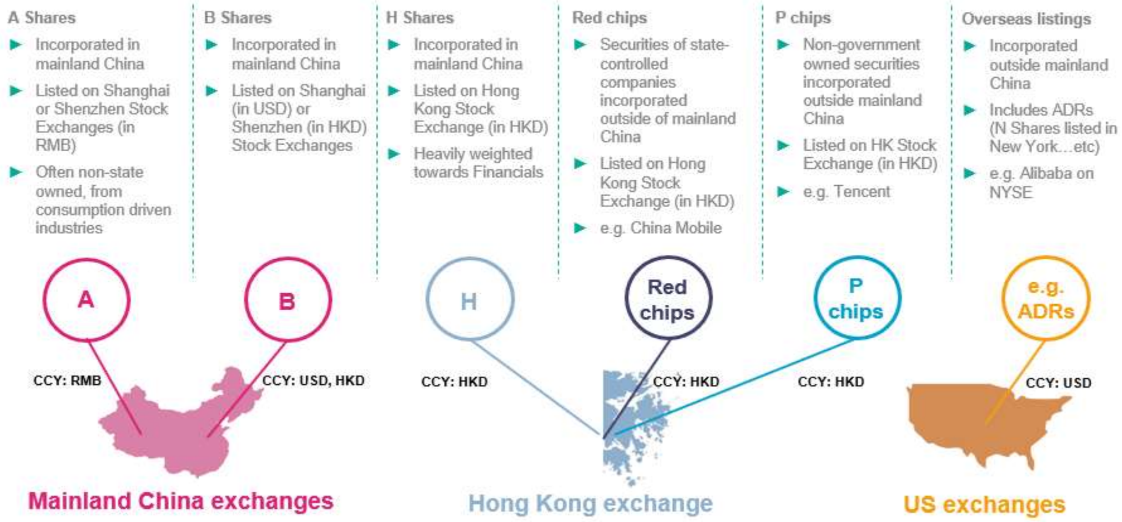


Source: MSCI, Lyxor International Asset Management. Data as at 30/06/2020

MARKETING DOCUMENT - FOR PROFESSIONAL AND QUALIFIED INVESTORS ONLY

Some corporates have dual listings on A and H (Hong Kong) share classes and are mainly part of the financial sector. Chinese tech companies are regularly listed in the US via American Deposit Receipts (ADRs). ADRs represent a bit more than 10% of the overall free float market – see chart 8 & 9 for more details.

Chart 9: Understanding Chinese share classes
Digesting the alphabet soup

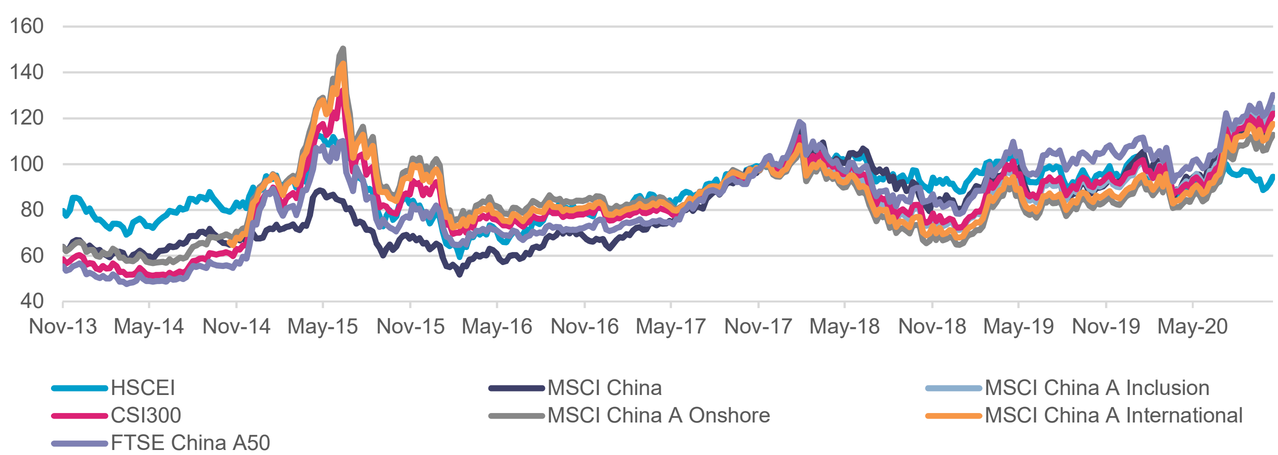


Sources: Lyxor International Asset Management.

Same country, different exposures

Most of China's exposure in global equity benchmarks reflects the 'offshore' universe of stocks listed in Hong Kong and the United States, not the 'onshore' A share market. According to MSCI calculations, only one-third of A share market capitalisation is free floating. The market is concentrated in State-Owned Enterprises (SOEs), with most of the shares held by the government. This compares to the much larger free float of offshore listed stocks. Tencent (the largest HK listed stock) has about 60% of free float and Alibaba's (the largest US listed stock) has about 50%. Overall, the free float outstanding for the All-China universe is around 40%. This compares to more than 75% for MSCI ACWI and around 50% for MSCI EM ex China, highlighting that low free float is an issue for EM companies in general.

Chart 10: China indices have very different risk-reward profiles
China indices price return in USD (base 100 = 08/11/2017)



MSCI China A Inclusion start date: 08/11/2017. Sources: Bloomberg, Lyxor International Asset Management. Data as at 20/10/2020. Past performance is not a reliable indicator of future returns.

MARKETING DOCUMENT - FOR PROFESSIONAL AND QUALIFIED INVESTORS ONLY

Free float reflects the investable portion of the market and helps prevent distortions in index performance. Stocks with limited free float are arguably more volatile and prone to overshoots; this partially explains the greater volatility of A shares compared to other China listings. In this context, a preference for broad Chinese equities indices could allow for reduced portfolio volatility.

Table 1: risk-reward profile of Chinese indices

	HSCEI	MSCI China	MSCI China A Inclusion[1]	CSI300	MSCI China A Onshore	MSCI China A International[2]	FTSE China A50
1Y Perf	-1.3%	37.3%	38.1%	33.0%	36.8%	37.7%	24.7%
3Y Perf	-3.5%	27.0%	24.7%[1]	26.9%	15.1%	20.5%	37.5%
5Y Perf	11.6%	79.4%	N/A	41.3%	17.3%	26.1%	70.6%
3Y vol	20.8%	22.7%	22.8%	22.6%	23.0%	22.5%	22.8%
5Y vol	21.2%	21.1%	N/A	20.9%	21.4%	20.9%	20.9%
3Y Sharpe (rf=0)	-0.06	0.36	0.34	0.36	0.21	0.29	0.49
5Y Sharpe (rf=0)	0.10	0.59	N/A	0.34	0.15	0.23	0.54
Max DD	-47.16%	-41.46%	-36.09%	-47.35%	-56.89%	-52.77%[2]	-41.17%
Start DD date	17/04/2015	24/04/2015	26/01/2018	12/06/2015	12/06/2015	12/06/2015	12/06/2015
End DD date	12/02/2016	12/02/2016	21/12/2018	29/01/2016	28/12/2018	28/12/2018	05/02/2016

[1] start date : 08/11/2017. [2]start date : 17/10/2014. Full analysis based on weekly returns in USD.
Source: Bloomberg, Lyxor International Asset Management. Data as at 16/10/2020. Past performance is not a reliable indicator of future returns.

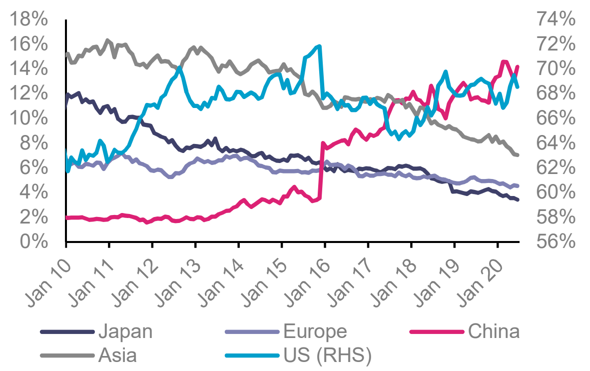
Pick your sector bias

China's technology sector has grown so quickly in the last decade that it now competes with the United States' long-held position at the top. Innovations by companies like Huawei, WeChat, Baidu, Tencent, and others such as Meituan Dianping are helping the Chinese economy grow at an unprecedented rate and are increasingly influencing the global economy.

The recent outperformance of Chinese tech companies points to the fact that technology now holds a predominant place in broad China indices. Much has been made about the influence of the Technology sector on US markets over the last several years, considering the so-called FAANG stocks (Facebook, Apple, Amazon, Netflix and Google) represent about 16% (just over 21% when including Microsoft) of the MSCI USA as at 30 September 2020.

Chart 11: The rising share of China's tech sector

Regional weight in the global tech sector



Source: MSCI, SG Cross Asset Research/Equity Strategy; *Stocks that have moved out of technology sector in the June 2018 MSCI reclassification have been included in the sector, data as at June 2020.*

China broad equity indices such as MSCI China hold the greatest exposure to the Tech sector. Conversely, indices bearing a large exposure to H or A shares tend to include greater exposure to Financials.

Table 2: Sector breakdown of Chinese indices

	MSCI China	CSI 300	MSCI China A	HSCEI	MSCI China A Int.	FTSE China A 50	MSCI China A Onshore
Consumer. Discretionary	37.3	9.0	6.2	4.9	6.2	9.1	8.5
Consumer Staples	4.1	14.7	17.4	4.2	16.9	22.8	14.3
Energy	1.8	1.3	1.5	5.2	1.6	1.4	1.2
Financials	**13.3**	26.7	22.1	35.7	21.4	42.4	21.6
Healthcare	5.3	8.5	11.3	3.1	11.3	5.7	10.8
Industrials	4.6	10.4	12.0	2.5	12.5	3.2	12.0
Information Technology	5.1	12.1	14.2	24.5	14.7	6.3	16.0
Materials	1.9	10.0	7.0	0.0	7.0	2.9	7.9
Real Estate	4.2	3.4	3.3	9.6	3.4	4.4	3.4
Communication Services	20.6	2.1	2.4	7.3	2.7	0.7	2.5
Utilities	1.7	1.9	2.6	3.1	2.4	1.2	1.7

Source: MSCI, FTSE, Hang Seng Indexes, China Securities Index Company. Data as at end September 2020

MSCI China for an all China exposure

There are many ways to access Chinese equities, and each index retains its own features. There are important distinctions between 'onshore' and 'offshore' listings, as described in the previous section, which are still salient to expected performance. We expect this difference to fade eventually, if China continues to open its market over the coming years. For now, choosing the right exposure on Chinese equities matters. MSCI China provides a blended exposure to both markets. The index could benefit from both the expanding Technology sector and the recovery of the domestic Chinese economy.

Table 3: Related indices for an allocation in Chinese equities

Index Name	Share classes	Onshore or offshore	No. of stocks	Bloomberg ticker
MSCI China	H Shares, B Shares, Red Chips, P Chips, ADRs and 5% float adjust A Shares	Both	711	NDEUCHF Index
MSCI China A	A Shares which are listed on the Shanghai and Shenzhen indices and accessible through Stock Connect	Onshore	473	NU718708 Index
Hang Seng China Enterprise	H Shares	Offshore	50	HSCEINH Index
FTSE China A 50	A Shares	Onshore	50	XINA50NC Index

Source: Lyxor International Asset Management. Data as at 22/10/2020

For more details, please contact your local Lyxor sales representative.

MARKETING DOCUMENT - FOR PROFESSIONAL AND QUALIFIED INVESTORS ONLY

Knowing your risk

It is important for potential investors to evaluate the risks described below and in the fund prospectus on our website www.lyxoretf.com

Capital at risk

ETFs are tracking instruments: Their risk profile is similar to a direct investment in the Underlying index. Investors' capital is fully at risk and investors may not get back the amount originally invested.

Replication risk

The fund objectives might not be reached due to unexpected events on the underlying markets which will impact the index calculation and the efficient fund replication.

Counterparty risk

With synthetic ETFs, investors are exposed to risks resulting from the use of an OTC swap with Societe Generale. In-line with UCITS guidelines, the exposure to Société Générale cannot exceed 10% of the total fund assets. Physically replicated ETFs may have counterparty risk if they use a securities lending programme.

Concentration Risk

Thematic and Smart Beta ETFs select stocks or bonds for their portfolio from the original benchmark index. Where selection rules are extensive it can lead to a more concentrated portfolio where risk is spread over fewer stocks than the original benchmark.

Underlying risk

The Underlying index of a Lyxor ETF may be complex and volatile. For example, when investing in commodities, the Underlying index is calculated with reference to commodity futures contracts exposing the investor to a liquidity risk linked to costs such as cost of carry and transportation. ETFs exposed to Emerging Markets carry a greater risk of potential loss than investment in Developed Markets as they are exposed to a wide range of unpredictable Emerging Market risks.

Currency risk

ETFs may be exposed to currency risk if the ETF is denominated in a currency different to that of the Underlying index they are tracking. This means that exchange rate fluctuations could have a negative or positive effect on returns.

Liquidity risk

Liquidity is provided by registered market-makers on the respective stock exchange where the ETF is listed, including Societe Generale. On exchange, liquidity may be limited as a result of a suspension in the underlying market represented by the Underlying index tracked by the ETF; a failure in the systems of one of the relevant stock exchanges, or other market-maker systems; or an abnormal trading situation or event.

MSCI

The MSCI indexes are the exclusive property of MSCI. MSCI and the MSCI index names are service mark(s) of MSCI or its affiliates and have been licensed for use for certain purposes by Lyxor International Asset Management. None of the MSCI parties makes any representation or warranty, express or implied, to the issuer or owners of this fund or any other person or entity regarding the advisability of investing in funds generally or in this fund particularly or the ability of any MSCI index to track corresponding stock market performance. MSCI or its affiliates are the licensors of certain trademarks, service marks and trade names and of the MSCI indexes which are determined, composed and calculated by MSCI without regard to this fund or the issuer or owners of this fund or any other person or entity. None of the MSCI par-ties has any obligation to take the needs of the issuer or owners of this fund or any other person or entity into consideration in determining, composing or calculating the MSCI indexes. None of the MSCI parties is responsible for or has participated in the determination of the timing of, prices at, or quantities of this fund to be issued or in the determination or calculation of the equation by or the consideration into which this fund is redeemable. Further, none of the MSCI parties has any obligation or liability to the issuer or owners of this fund or any other person or entity in connection with the administration, marketing or offering of this fund.
Although MSCI shall obtain information for inclusion in or for use in the calculation of the MSCI indexes from sources that MSCI considers reliable, none of the MSCI parties warrants or guarantees the originality, accuracy and/or the completeness of any MSCI index or any data included therein. None of the MSCI parties makes any warranty, express or implied, as to results to be obtained by the issuer of the fund, owners of the fund, or any other person or entity, from the use of any MSCI index or any data included therein. None of the MSCI parties shall have any liability for any errors, omissions or interruptions of or in connection with any MSCI index or any data included therein. Further, none of the MSCI parties makes any express or implied warranties of any kind, and the MSCI parties hereby expressly disclaim all warranties of merchantability and fitness for a particular purpose, with respect to each MSCI index and any data included therein. Without limiting any of the foregoing, in no event shall any of the MSCI parties have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages.

MARKETING DOCUMENT - FOR PROFESSIONAL AND QUALIFIED INVESTORS ONLY

MARKETING DOCUMENT - FOR PROFESSIONAL AND QUALIFIED INVESTORS ONLY

An investment in collective investment schemes involves significant risks that are described in each prospectus or offering memorandum. Each potential investor should read the entire prospectus or offering memorandum and should carefully consider the risk warnings and disclosures before making an investment decision.
Any benchmarks/indices cited in this document are provided for information purposes only.
This document is not the result of a financial analysis and therefore is not subject to the "Directive on the Independence of Financial Research" of the Swiss Bankers Association.
This document does not contain personalized recommendations or advice and is not intended to substitute any professional advice on investments in financial products.

Important information for German and Austrian Investors
For professional investors - not suitable for private investors
This publication is an advertising client information and is for informational purposes only and does not constitute an individual investment recommendation or an offer to buy or sell or trade securities or other financial instruments. This information does not meet all legal requirements for the impartiality of investment recommendations and is not subject to any prohibition of trading prior to publication. All sources of information have been classified as reliable and no guarantee is given for external sources of information. This elaboration alone does not replace individual investor- and investment-oriented advice. Before investing in the funds, the investor should seek independent financial, tax, legal and, where appropriate, accounting advice. As an investor, you should consider the risks you face with investing in ETFs. In particular, when subscripting and purchasing ETF shares, the investor should be aware that ETFs involve certain risks and that the repayment may be below the value of the capital used and that, at worst, a total loss may occur. A comprehensive description of the fund's terms and conditions and associated risks can be found in the respective prospectus and the key investor information (KIID, in German), which, like the annual and semi-annual reports in paper form, available free of charge from Lyxor International Asset Management S.A.S. Deutschland (Lyxor Deutschland), Neue Mainzer Strasse 46-50, 60311 Frankfurt am Main, in Austria from Erste Bank der österreichischen Sparkassen AG, Am Belvedere 1, A-100 Vienna, who acts as paying agent and tax representative and under www.lyxoretf.com in English. The tax treatment depends on the individual circumstances of each investor and may change in the future.
The current composition of the investment portfolio of the respective ETF can be found under www.lyxoretf.com. The indicative net asset value is published on the corresponding websites for the ETF product of Reuters and Bloomberg and, if applicable, also reported on the websites of the exchanges on which the product is listed.
Professional advice should be sought before making an investment decision. The drafting is not intended for distribution to or use by persons or entities having the citizenship of a country or domicile dwell in a country or judicial district where the distribution, publication or use of such information is prohibited. Each investor is responsible for verifying that he/she is entitled to subscribe or investment in the respective ETFs. The fund is not registered under the United States Securities Act of 1933 or the United States Investment Company Act of 1940 and may not be registered, directly or indirectly, in the United States of America, including its territories and properties. or other jurisdictions under its jurisdiction or to or on the basis of any U.S. citizen. This document is confidential and may not be passed on or reproduced in whole or in part to third parties without the prior written permission of Lyxor Germany.

This document is issued by Lyxor International Asset Management (LIAM), a French limited-liability company established on 12 June 1998 by the French Autorité des Marchés Financiers ("AMF") as a management company. registered office in 17 Cours Valmy, Tour Société Générale, 92800 Puteaux, France and registered with the Registre de Commerce et des Sociétés in Nanterre.