

The MarketGrader China All-Cap Growth Leaders – September 2020 Rebalance Notes

The MarketGrader China All-Cap Growth Leaders Index completed its most recent semi-annual reconstitution and rebalance on September 18th, replacing 123 of its 200 constituents. This represented a turnover by count of 61.5%, which was significantly above its historical average of 44%. In fact, this turnover was the highest on record since the inception of the index at the start of 2008. The highest turnover by count prior to the most recent reconstitution was during the September 2017 reconstitution, when the Index turned over 58% of its constituents.

Before discussing individual stock picks in the newly reconstituted Index, it is useful to examine the sector composition changes that resulted from the rebalance. Such changes were, of course, the result of MarketGrader’s bottom-up stock selection methodology based on our GARP analysis of the entire Chinese investable universe rather than a top-down sector weighting approach. This is important as the implied sector composition of the Index speaks to the financial condition of all of China’s economic sectors as a whole, based on the fundamentals of the companies within those sectors thereby affording investors a unique view of where quality growth in Chinese equities is available at a reasonable price.

Sector Changes

The table below summarizes the sector composition of the September 2020 reconstituted and rebalanced Index and compares it to the prior version of the Index that was selected during the March 2020 rebalance.

Table 1. MarketGrader China All-Cap Growth Leaders Index: Sector Composition

Sector	March 2020	September 2020		Change	Turnover*
	Count	Count	Deletes		
Consumer Discretionary	28	13	24	9	80%
Consumer Staples	25	27	12	14	50%
Energy	4	2	3	1	67%
Financials	27	18	19	10	64%
Health Care	26	34	14	22	60%
Industrials	37	40	25	28	69%
Materials	31	36	13	18	46%
Technology	19	30	10	21	63%
Utilities	3	0	3	0	100%
Total	200	200	123	123	0

Source: MarketGrader Research. *For the purposes of this table, “Turnover” is defined as the sum of “Adds” and “Deletes” divided by the sum of the “March 2020 Count” and the “September 2020 Count”.

Here are the key takeaways from the changes in the sector composition of the Index:

1. In terms of company count, the consumer discretionary sector not only lost the most companies from the Index, but also experienced one of the highest turnovers. The

sector went from having 28 companies in the prior version of the Index to having only 13 companies in the reconstituted version, for a net loss of 15 companies. More specifically, the rotation out of consumer discretionary names was pretty drastic, given that 24 of the 28 companies from the March class were deleted and only nine new names were added to the Index. This trend away from consumer discretionary names aligns with what we have seen across most global markets given the draconian economic shutdowns imposed by governments around the world in an attempt to limit the spread of the novel coronavirus since the beginning of the year. And while such shutdowns have affected company fundamentals across most sectors, consumer discretionary companies have been hit the hardest. This weakening in fundamental is being translated into lower MarketGrader Scores which explains both the loss in representation within the Index and the high turnover in consumer discretionary names.

2. The other sector clearly impacted by the shut-down was financials. It went from 27 companies in the prior version of the Index down to 18 in the new version, for a net loss of nine companies. The Index also turned over a lot of names in the sector, deleting 19 of the prior names and adding 10 new companies.
3. The loss of the consumer discretionary and financials sectors was, on the flip side, a gain for the technology and health care sectors. Going from 19 companies in the March 2020 Index to 30 companies in the September 2020 Index, technology had a net gain of 11 companies. Similarly, the health care sector went from 26 names to 34 names for a net gain of eight companies. Since the MarketGrader China All-Cap Growth Leaders Index is free float market cap weighted with no company accounting for more than 5% of the Index's weight, technology's overall weight in the Index, however, is much higher than its company count representation as a result of the size of some of the companies in it. More specifically, while the 30 technology companies account for only 15% of the Index's 200 constituents, when their free float market capitalization is taken into account according to the Index's weighting methodology, the total weight of the sector is 24.4%, the largest across all sectors. It is not a coincidence that in the middle of a global pandemic, an Index driven by bottom-up stock selection has shifted away from consumer and financial stocks that are driven by "wants" in favor of technology and health care companies that are driven by "needs".
4. Represented by 40 companies (20% by count) in the reconstituted Index, industrials continued to enjoy the most favored sector status (biggest representation by constituent count). Going from 37 companies in the prior version to 40 companies in the new version, industrials only gained three companies, but even this sector was not immune from the huge turnover. Deleting 25 of the prior names and adding 28 new names speaks to the breadth and depth of industrials within the Chinese economy; it also confirms where the Chinese government's fiscal policy tends to have the most immediate impact in times of duress, as many of these names are often involved in public works, infrastructure and real estate development work. Despite this broad representation by company count, however, the sector only accounts for 8.2% of the

Index's total weight. In other words, while MarketGrader's methodology is clearly finding plenty of quality growth among industrials in China, it does so among smaller private publicly traded companies rather than the very large industrials in the country, most of which tend to be State-Owned Enterprises.

5. Second to industrials, materials continue to have the second most representation in the reconstituted Index based on company count. The sector's company count had a net increase of five names going from 31 to 36 following the rebalance. Like industrials, though, the sector's weight is much lower than its company count representation; based on the free float market cap of the companies, materials represent only 7.5% of the entire Index.
6. Finally, consumer staples experienced a marginal gain of two companies and continue to have a significant count in the Index with 27 companies in the reconstituted Index. And while based on company count this represents only 13.5% of all Index constituents, based on free float market cap the sector is the second largest, accounting for 23.6% of the portfolio's total weight.
7. Bringing up the rear, Energy lost two names going from four to two companies, while utilities were left without any representation as the reconstituted Index dropped all of the three utility companies from the prior version, without selecting any replacements.

Companies Added, Deleted and Retained

The sector composition of the MarketGrader China All-Cap Growth Leaders is helpful in providing a bird's eye view of the evolution of company fundamentals by sector for the broad Chinese equity market. However, as mentioned earlier, the Index actually behaves as a stock picker with the fundamentals and GARP metrics of individual companies driving the stock selection. Consequently, at each rebalance, the companies that are added, deleted and retained can be thought of as the 'buys,' 'sells' and 'holds' as suggested by the Index methodology for the China all-cap portfolio.

As mentioned earlier, the MarketGrader China All-Cap Growth Leaders is free float market cap weighted with no company accounting for more than 5% of the Index's weight. This weighting constraint is included in order to limit concentration risk, especially since the Index is an all-cap portfolio. Keeping this mind, it is useful to focus on the largest companies that were added, deleted or retained as these are the companies that have the most impact on the Index's performance.

Table 2 presents the 10 largest companies (of the 123) added to the Index that had a market cap greater than USD 10 billion at the time of the reconstitution. By far the largest company in this group is Tencent Holdings Ltd. with a market cap of USD 625.5 billion. These 'buys' come from technology (3 companies) and consumer staples (2 companies), and one company each from consumer discretionary, financials, health care, industrials and materials. Combined, these

10 companies make up 75% of the total market cap of the 123 companies that were added to the Index.

Table 2. MarketGrader China All-Cap Growth Leaders Index: 10 Largest Companies Added

Name (Market cap larger than USD \$10 Billion)	Sector	Industry	Market Cap (Billions	
			of USD)	MG Score
Tencent Holdings Ltd.	Technology	Internet Software/Services	626.5	72.2
JD.com, Inc. Sponsored ADR Class A	Consumer Discretionary	Internet Retail	105.6	69.1
China Life Insurance Co. Ltd. Class H	Financials	Life/Health Insurance	\$66.7	68.1
Inner Mongolia Yili Industrial Group Co., Ltd. Class A	Consumer Staples	Agricultural Commodities/Milling	\$35.1	69.9
Wen's Foodstuff Group Co., Ltd. Class A	Consumer Staples	Agricultural Commodities/Milling	\$21.1	72.4
Wuhu Sanqi Interactive Entertainment Network Technology Group Co., Ltd. Class A	Industrials	Auto Parts: O.E.M.	\$13.0	74.2
Citic Pacific Special Steel Group Co., Ltd. Class A	Materials	Steel	\$12.6	73.8
Shanghai Baosight Software Co., Ltd. Class A	Technology	Computer Peripherals	\$11.4	69.6
BYD Electronic (International) Co., Ltd.	Technology	Electronic Components	\$11.1	71.5
Zhejiang NHU Co. Ltd. Class A	Health Care	Pharmaceuticals: Other	\$10.2	73.2
Total			\$913.2	
% of Total Adds			75%	

Source: MarketGrader Research.

Table 3 presents the 25 largest companies (of the 123) deleted from the Index that had a market cap greater than USD 10 billion at the time of the reconstitution. By far the largest company in this group is Kweichow Moutai Co., Ltd. with a market cap of USD 317 billion. By sector, these 25 'sells' cover consumer discretionary (4), consumer staples (3), financials (9), health care (2), industrials (5) and technology (2). Combined, these 25 companies make up 81% of the total market cap of the 123 companies that were added to the Index. Notice that the MG Scores for some of the deleted names are still fairly high (anything with an MG Score[®] above 60 is rated 'buy' in our grading scale). This speaks to the breath of the high-quality names within some of the sectors of the Chinese economy.

Table 3. MarketGrader China All-Cap Growth Leaders Index: 25 Largest Companies Deleted

Name (Market cap larger than USD \$10 Billion)	Sector	Industry	Market Cap (Billions of USD)	MG Score
Kweichow Moutai Co., Ltd. Class A	Consumer Staples	Beverages: Alcoholic	\$317.0	64.03
China Merchants Bank Co., Ltd. Class A	Financials	Regional Banks	\$135.8	60.61
Hangzhou Hikvision Digital Technology Co., Ltd Class A	Industrials	Miscellaneous Commercial Services	\$49.8	68.68
Industrial Bank Co., Ltd. Class A	Financials	Major Banks	\$49.2	60.36
Gree Electric Appliances, Inc. of Zhuhai Class A	Consumer Discretionary	Electronics/Appliances	\$48.4	41.25
China Vanke Co., Ltd Class A	Financials	Real Estate Development	\$48.4	61.91
China Pacific Insurance (Group) Co., Ltd. Class A	Financials	Multi-Line Insurance	\$42.4	58.65
Haidilao International Holding Ltd.	Consumer Discretionary	Restaurants	\$36.8	41.90
Longfor Group Holdings Ltd.	Financials	Real Estate Development	\$32.1	65.58
Bank of Ningbo Co., Ltd. Class A	Financials	Regional Banks	\$29.1	64.58
Hansoh Pharmaceutical Group Company Limited	Health Care	Pharmaceuticals: Major	\$27.1	54.37
ANTA Sports Products Ltd.	Consumer Discretionary	Apparel/Footwear	\$26.2	51.25
Zhangzhou Pientzhuang Pharmaceutical Co., Ltd. Class A	Health Care	Pharmaceuticals: Other	\$21.6	61.11
Shanghai International Airport Co., Ltd. Class A	Industrials	Other Transportation	\$21.3	29.15
Hengli Petrochemical Co., Ltd. Class A	Industrials	Industrial Machinery	\$20.0	70.00
ZTO Express (Cayman) Inc. Sponsored ADR Class A	Industrials	Air Freight/Couriers	\$19.2	62.56
Sunac China Holdings Ltd.	Financials	Real Estate Development	\$19.2	60.78
Bank of Shanghai Co., Ltd. Class A	Financials	Regional Banks	\$17.5	54.78
Anhui Gujing Distillery Co., Ltd. Class A	Consumer Staples	Beverages: Alcoholic	\$17.2	51.10
Tongwei Co. Ltd. Class A	Consumer Staples	Agricultural Commodities/Milling	\$14.5	35.20
Bank of Nanjing Co., Ltd. Class A	Financials	Regional Banks	\$12.4	62.72
China National Building Material Co. Ltd. Class H	Materials	Construction Materials	\$11.9	61.53
Shenzhen Goodix Technology Co., Ltd. Class A	Technology	Computer Peripherals	\$11.5	61.88
Li Ning Company Limited	Consumer Discretionary	Apparel/Footwear	\$10.3	64.45
Autohome, Inc. Sponsored ADR Class A	Technology	Internet Software/Services	\$10.2	62.21
Total			\$1,049.2	
% of Total Deletes			81%	

Source: MarketGrader Research.

Tables 2 and 3 together suggest that the Index added fewer large companies (market cap greater than USD 10 billion) than it deleted. Though that was true, the total market cap of the companies deleted and added was approximately the same: The total market cap of all of the 123 companies deleted from the index was USD 1.29 trillion while that of the 123 companies added to the index was USD 1.22 trillion. This means that even though many more large companies were deleted from the Index, many more mid-size companies were added to the Index. This is typical of a GARP strategy: buy undervalued small/mid companies with strong growth characteristics and cash-in gains from the larger companies that have limited growth to offer.

While the MarketGrader China All-Cap Growth Leaders replaced 123 of its 200 components at the September 2020 reconstitution, it also retained 77 of the companies from the March 2020 version. These are high quality companies that continue to be attractive from a GARP perspective. Table 4 presents the 22 largest companies (of the 77) retained from the Index that had a market cap greater than USD 10 billion at the time of the reconstitution.

Table 4. MarketGrader China All-Cap Growth Leaders Index: 22 Largest Companies Retained

Name (Market cap larger than USD \$10 Billion)	Sector	Industry	Market Cap (Billions of USD)	MG Score
Alibaba Group Holding Ltd. Sponsored ADR	Consumer Discretionary	Internet Retail	\$761.3	79.3
Wuliangye Yibin Co., Ltd. Class A	Consumer Staples	Beverages: Alcoholic	\$128.9	73.1
Foshan Haitian Flavouring & Food Co., Ltd. Class A	Consumer Staples	Food: Specialty/Candy	\$76.7	71.0
Jiangsu Hengrui Medicine Co., Ltd. Class A	Health Care	Pharmaceuticals: Other	\$70.8	67.0
NetEase, Inc. Sponsored ADR	Technology	Internet Software/Services	\$67.1	67.2
Luxshare Precision Industry Co. Ltd. Class A	Technology	Electronic Components	\$53.5	66.1
Anhui Conch Cement Company Limited Class A	Materials	Construction Materials	\$45.2	83.4
Muyuan Foods Co., Ltd. Class A	Consumer Staples	Agricultural Commodities/Milling	\$44.6	80.6
LONGi Green Energy Technology Co Ltd Class A	Technology	Semiconductors	\$34.5	79.7
Luzhou Laojiao Company Limited Class A	Consumer Staples	Beverages: Alcoholic	\$32.6	69.7
Chongqing Zhifei Biological Products Co., Ltd. Class A	Health Care	Pharmaceuticals: Other	\$31.1	75.2
Sany Heavy Industry Co., Ltd. Class A	Industrials	Trucks/Construction/Farm Machinery	\$27.6	81.1
Henan Shuanghui Investment & Development Co., Ltd. Class A	Consumer Staples	Food: Meat/Fish/Dairy	\$27.3	69.5
Shanxi Xinghuacun Fen Wine Factory Co. Ltd. Class A	Consumer Staples	Beverages: Alcoholic	\$24.1	70.4
Changchun High & New Technology Industry (Group) Inc. Class A	Health Care	Biotechnology	\$24.1	79.9
Country Garden Services Holdings Co. Ltd.	Financials	Real Estate Development	\$18.7	72.2
Sunny Optical Technology (Group) Co., Ltd.	Technology	Electronic Components	\$16.3	74.3
Hundsun Technologies Inc. Class A	Technology	Packaged Software	\$15.7	71.4
Yihai International Holding Ltd.	Consumer Staples	Food: Specialty/Candy	\$14.0	78.1
Jiangsu Hengli Hydraulic Co., Ltd. Class A	Industrials	Industrial Machinery	\$12.3	75.4
Shaanxi Coal Industry Co., Ltd. Class A	Energy	Coal	\$11.4	66.2
Seazen Holdings Co., Ltd. Class A	Financials	Real Estate Development	\$11.2	70.5
Total			\$1,548.9	
% of Total Retains			92%	

Source: MarketGrader Research.

These companies can also be thought of as the ‘holds’ based on the MG Score[®]. By far the largest company in this group is Alibaba Group Holdings Ltd. with a market cap of USD 761.3 billion. The sectors with the most companies among this cohort are consumer staples (7), technology (5) and health care (3), followed by financials and industrials with two companies each, and consumer discretionary, energy and materials each with one company apiece. Together these 22 companies total a market cap of USD 1.55 trillion and make up 92% of the total market cap of all the 77 companies retained. Since they cover all of the sectors, they tell a story of the continued resilience of the Chinese economies and the relative strengths of the underlying sectors.

The Workhorse Companies

At any given time, there are companies that serve as the core to the exposure of any equity market. In the case of the MarketGrader China All-Cap Leaders portfolio these are the companies that have been in the portfolio continuously for the longest period. These companies, which may be seen in Table 5, are different from those that have been selected the most number of times, which could also be considered part of the portfolio’s core set of holdings (for the most frequently selected companies click [here](#)).

Table 5. MarketGrader China All-Cap Growth Leaders Index: 17 Longest Serving Companies

CompanyName	Sector	ConsecutiveYears	MG Score
Zhejiang Meida Industrial Co., Ltd. Class A	Consumer Discretionary	5	80.4
Sunny Optical Technology (Group) Co., Ltd.	Technology	5	74.3
China Medical System Holdings Ltd.	Health Care	5	67.2
Anhui Conch Cement Company Limited Class A	Materials	3	83.4
Jiangxi Wannianqing Cement Co., Ltd. Class A	Materials	3	83.1
Yihai International Holding Ltd.	Consumer Staples	3	78.1
Gansu Shangfeng Cement Co., Ltd. Class A	Materials	3	77.4
Jiangsu Hengli Hydraulic Co., Ltd. Class A	Industrials	3	75.4
YiChang HEC ChangJiang Pharmaceutical Co. Ltd. Class H	Health Care	3	74.3
Zhejiang Weiming Environment Protection Co., Ltd. Class A	Industrials	3	74.2
Wuliangye Yibin Co., Ltd. Class A	Consumer Staples	3	73.1
Logan Group Co., Ltd.	Financials	3	72.0
Ovctek China, Inc. Class A	Health Care	3	70.1
Luzhou Laojiao Company Limited Class A	Consumer Staples	3	69.7
Jiangsu Hengrui Medicine Co., Ltd. Class A	Health Care	3	67.0
Huaxin Cement Co., Ltd. Class A	Materials	3	66.6
Shaanxi Coal Industry Co., Ltd. Class A	Energy	3	66.2

Source: MarketGrader Research.

These 17 companies cover a range of sectors with four companies each from the health care and materials sectors; three companies from consumer staples; two from industrials; and, one company each from consumer discretionary, energy, financials and technology. This diversity in the work horse companies sheds light on the breadth and strength of the Chinese economy and equity markets.