



China ETFs In Focus

Investing In the World's Most Important Economy

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China's Red Hot Economy

Investment opportunities abroad are generally associated with lucrative rewards and handfuls of volatility; however, the world's second-largest economy may be an exception to the rule, offering a generous amount of potential coupled with manageable risk. China's economy has grown on average 10% annually for the last 30 years and the world leader in manufacturing remains on an upward path of expansion while most developing economies lag behind.

China's rapid expansion has been fueled by favorable demographic trends that are expected to continue to play out for the foreseeable future. Once a country of widespread rural areas, China has seen a massive influx of migrants from the undeveloped countryside to sprawling metropolises over the last several decades. China now has nearly 200 cities with populations of at least 1 million. By comparison, the U.S. has only nine.

As millions of Chinese citizens have moved from the isolated countryside, they have contributed to a swelling middle class that has powered the local economy. Urban relocation coincides with taking on non-agricultural employment for the first time, which translates into a new level of disposable income and increased demand for everything from automobiles to protein to electronics.

While urbanization has surely transformed the Chinese economy, there is still additional opportunity in this demographic shift. China's percentage of urban population is relatively small compared to the U.S., and the middle class is expected to continue an impressive rate of expansion in coming years.

Increasing rates of urbanization fueled by favorable demographic trends and rising income levels are just a few of the economic factors pointing to a positive outlook for the growing giant. Additionally, the Chinese government is taking an active role in promoting healthy and sustainable economic development moving forward, by taking steps to tighten monetary policy and avoid common pitfalls associated with booming market economies. China's latest 5-Year Plan (2011-2015), released earlier this year in March, emphasizes commitment to maintain near double-digit growth, the need to rebalance its sources of growth towards domestic demand, reduce income inequality, and promote environmentally friendly industries.

After moving from a centrally-planned economy to a more market based system in the late 1970s, China's impact on global trade has since escalated and today the country holds a key role as an economic superpower. Reforms during the 1980s helped improve the standard of living, increase productivity, and drove foreign investments to help fuel economic growth. However, the country still faced rising unemployment, lacked the legal infrastructure necessary to promote significant private investments, and its banking sector was largely unorganized and plagued with bad loans. It wasn't until after the Asian financial crisis and into the early 2000s when investors finally started taking notice of the unparalleled potential brewing overseas.

Why China Matters

China is a crucial part of the global financial system and is currently the second biggest economy in the world with a GDP that is just over \$10 trillion (in PPP terms). Not only is the country one of the biggest in terms of raw size, but it is also one of the ten fastest growing nations; GDP grew by 10% last year and it has increased by at least 9% in both of the previous two years as well. While that pace likely will not be maintained indefinitely, China's economy is expected to grow more quickly than the rest of the world for the foreseeable future.

Why China Matters
Second biggest economy in the world
One of the ten fastest growing nations
Largest labor force in the world
Per capita GDP still lower than world average
Underweighted in most U.S.-based portfolios

China Risks

Like any emerging market, China is fraught with a number of risks that stand as hurdles to a continuation of the country's impressive growth going forward. At the forefront of these concerns is the red hot rate of inflation in the country, as the level of price increases is accelerating at a clip of roughly 5.5% year--well above the country's target figure. Since much of the country is still very poor, such a high level of inflation has the impact of making it very tough for the average person to survive without seeing a massive decline in their standard of living.

Beyond inflationary concerns, there is always the risk of further unrest in the One-Party State stemming from issues such as a lack of political freedom and relative scarcity of high quality jobs for the growing class of Chinese college graduates that have very few options. Should either of these situations bubble over into a Tiananmen Square style protest, it could have a huge impact on the outlook for the Chinese economy and lead to further calls for reform to the political system.

Additional political issues could hit Mainland China from any number of regional tensions that plague the nation. First and foremost is the ongoing issue with Taiwan, which China considers to be a 'providence in rebellion' that must eventually be brought back under the rule of Beijing. Any tensions with Taiwan, which is a close ally of the U.S., could spark fears into investors and lead to a great deal of panic selling.

Beyond Taiwan, China is surrounded by a number of unstable nations as well as rising powers making the quest for resources and influence fraught with uncertainty. India and much of Southeast Asia are rising very quickly in world standing, while concerns along China's western borders with large Muslim populations have led to several protests in recent years. Turning east, the situation on the Korean peninsula seems likely to shift in the near future although one has to wonder to what and if further conflict will be seen between the North and the South. Additionally, it remains to be seen how Japan, a traditional rival of China, will react to an increasingly influential China, especially considering Japan's near dominance of the Near East region for the better part of the last century.

Beyond these issues, some investors are growing increasingly worried over a Chinese property bubble. However, unlike the American situation in 2008-2009, which was largely driven by overleveraging, the Chinese bubble is driven by overbuilding. Residential property prices have fallen by about 5% from the year ago period after years of double digit growth, worrying many investors since the property construction business accounted for nearly 13% of GDP in 2010, according to the [Wall Street Journal](#).

Although there are a number of pressing risks facing China, the future remains bright in the country for a number of reasons. China has great flexibility in terms of its policy decisions as the country still has very low debt load, and it has massive foreign exchange reserves as well. By either deploying this cash or raising money in

China Risks
Runaway Inflation
Scarcity of High Quality Jobs
Political Risk (One Party State)
Geopolitical Tensions
Property Bubble
Shortage of Commodities
Low Quality Local Government Debt

the bond market, China can continue to expand its rapidly improving infrastructure or increase safety nets for the poorer members of the nation that have been left out of the boom over the last few decades. By doing this, China can tap into its high savings rate and encourage more citizens to develop the consumer economy. Currently, the savings rate in the country is close to 40%, nearly eight times higher than the U.S. level. If China is able to encourage its citizens to spend even a fraction of this, an internal economy is likely to take off, further helping the country to lessen its dependence on foreign exports.

Beyond this opportunity, much of the Chinese interior remains extremely underdeveloped, especially when compared with the booming coastal regions of Shanghai and Guangzhou. The Chinese government has taken steps to encourage investments in this area by helping corporations set up and stimulate growth in the countryside. Wages tend to be far cheaper in this region and with infrastructure development likely to continue, we could see a more equitable distribution of China's growth story. If this happens, investors could see even higher rates of growth out of China and a drastic increase in consumer spending as well. This could potentially create a second boom in China and led to a massive increase in nation's standing on the global economic stage.

Yet, possibly the greatest potential for China stems from its currency, the yuan, which is currently trading in a narrow band against the U.S. dollar at roughly 6.48 yuan to one greenback. Many analysts believe that this is significantly less than what a yuan would fetch on the open market with some suggesting that the yuan could see an increase in value by close to 50% if allowed to trade freely. If ever allowed to move outside this tight band, exports would likely fall but imports would surge and the domestic economy will in turn take off.

Additionally, the yuan could also find itself as a pillar of global trade, used in international transactions alongside the U.S. dollar and to a lesser extent the euro. If that

happens, demand for the Chinese currency is likely to skyrocket making the nation's quest for more resources and commodities that much easier thanks in large part to a stronger currency.

China's Potential Rewards
Consumer Potential: Unlocking High Savings Rate
Current Account Surplus / Foreign Reserves
Low Public Debt
Undeveloped Interior
Yuan Issues

Overall, China has the potential to be the most dominant and important economy in the world. But before it can reach this apex, the nation must survive a plethora of issues and challenges in order to unseat the U.S. as the world's preeminent economic superpower. Luckily for China, the nation has a number of advantages stemming from decades of solid management and investment that could allow the country to take its place at the top of the economic pecking order.

The China Problem...

China is now the world's second-largest economy, and is expected to surpass the U.S. at some point in the not-so-distant future. The country accounts for a huge portion of global GDP growth, and has contributed to the expansion of countless economies around the globe thanks to its insatiable appetite for raw materials.

Yet many U.S. investors are drastically underexposed to the Chinese stock market; the allocations afforded to this country in most investor portfolios simply do not correspond to the current economic footprint of China or the country's long-term growth potential.

Consider a simplified equity portfolio comprised of equal allocations to U.S. stocks (through VTI), developed markets outside North America (through EFA), and emerging markets (through VWO):

Ticker	ETF	Allocation
VTI	Total Stock Market ETF	33.3%
EFA	MSCI EAFE Index Fund	33.3%
VWO	Emerging Markets ETF	33.3%

This equity portfolio would make an allocation of about 5% to China's stocks market. Yet on a PPP basis, China's economy accounts for about 14% of the total global economy. In simple population terms, China accounts for nearly 20% of the world total.

It is a similar story in ETFs that purport to offer one stop exposure to the global economy. China makes up less than 3% of the portfolio of the iShares MSCI All Country World Index Fund (ACWI) and only about 4% of the All Country World ex-U.S. Index Fund (ACWX).

Moreover, achieving exposure to China through broad-based products focused on emerging markets or the global economy generally results in overweight exposure to large cap stocks. That means that most U.S.-based investors achieve the entirety of their exposure to China, a major source of growth potential, through a small handful of mega cap oil companies and banks. This approach may include firms that are owned in large part by the Chinese government, and will more than likely include access that is limited in terms of sector balance and long-term capital appreciation.

...And China ETF Solution

Fortunately, there are a number of easily accessible tools available for investors looking to address the limitations in their China exposure. For investors looking to establish a more balanced China profile that includes all corners of the economy, there are nearly two dozen exchange-traded products that allow for both broad-based and targeted access to the Chinese economy.

Of course, not all China ETFs are created equal. Some are more appropriate for investors maintaining a long-term, buy-and-hold approach, while others may be ideal for those with a more specific short-term outlook on various segments of the Chinese market. The following sections of this report highlight some of the critical questions to ask when evaluating the various options out there, as well as valuable comparative metrics and analyst insights.

China ETFs: Factors To Consider

Interest in accessing the Chinese stock market has surged in recent years—and with good reason. China is home to one of the world’s biggest and fastest-growing economies; it is difficult to challenge the notion that China is one of the most important components of the global economy.

Not surprisingly, ETFs have become extremely popular as a means of establishing exposure to Chinese equity markets; the combination of this asset class with the cost efficiency and impressive liquidity of the exchange-traded structure results in an appealing proposition to investors.

There are approximately two dozen ETFs offering exposure to the Chinese economy, and each features a unique risk/return profile; some are most effective as trading vehicles or short term tactical plays, while others are designed for longer-term, buy-and-hold portfolios. The following sections outline the important factors to consider when browsing the roster of China ETFs, providing a guide to determine which fund is most consistent with your investment objectives.

Depth Of Holdings

This consideration is applicable to analysis of any group of ETFs, but is particularly important when considering the options available for accessing Chinese stocks. ETFs are popular in part because they offer instant diversification; through the purchase of a single ticker, investors can access dozens or hundreds of stocks. But some China ETFs are more balanced and diversified than others; at the shallow end of the spectrum are ETFs with only a couple dozen holdings, while others have more than 300 individual components. As the table in the following section shows, depth of holdings varies dramatically among the various China ETF options.

Type Of Securities

It should be no surprise that China’s stock market is unique in many ways from the U.S. exchanges. Many Chinese securities are not available to international investors; the securities held by most ETFs, including the ultra-popular FXI, are listed on stock exchanges in Hong Kong (not mainland China).

There are several different types of Chinese stocks, including:

- **A-Shares:** These securities are traded on the Shanghai and Shenzhen Stock Exchanges in renminbi, the currency of mainland China (sometimes referred to as the “yuan”). Historically, the Chinese government had placed restrictions on A-Shares in an effort to regulate the movement of capital into and out of the country, but these restrictions have eased in recent years (more on this below).
- **B-Shares:** These securities are also traded on the Shanghai and Shenzhen Exchange, but are denominated in foreign currencies besides the renminbi; in Shanghai B-Shares are traded in U.S. dollars, while in Shenzhen they are traded in Hong Kong dollars. B-Shares are available to both Chinese citizens and foreign investors.
- **N-Shares:** This term refers to companies listed on U.S. exchanges, including the NASDAQ, New York Stock Exchange, and American Stock Exchange, but that have their main business operations in mainland China. Examples of N-Shares include China Telecom (NYSE: CHA), China National Offshore Oil Corp (NYSE: CEO), and China Precision Steel (NASDAQ: CPSL).
- **H-Shares / Red Chips:** These securities are stocks of companies incorporated in mainland China that are traded on the Hong Kong Stock Exchange and denominated in Hong Kong dollars (it is not uncommon for companies to have shares listed on both the HKSE and one of the two major exchanges in mainland China). H-Shares often trade at a considerable discount to the related A-Shares, a result of the restrictions put in place by the Chinese government.

Some portions of the Chinese equity market are difficult to access for any investor who is not a Chinese citizen. Most ETFs, for example, won’t include A-Shares (PEK is the lone exception) but will instead hold B-Shares, N-Shares, or “Red Chips.”

That doesn’t necessarily diminish the investment experience; securities listed in New York or Hong Kong still derive their revenues from mainland China and are very much representative of the Chinese economy. But there may be limited options for accessing some smaller Chinese companies listed only on local exchanges, and the choice of security may have an impact on the risk/return profile realized.

A quick examination of the fund prospectus should tell you exactly where the underlying holdings are listed. For example, the regulatory documents for FXI indicate that “all of the securities in the underlying index currently trade on the Hong Kong Stock Exchange.”

State Ownership

Another unique aspect of Chinese stocks is the frequent presence of the Chinese government as a major shareholder in certain companies. For example, the Chinese government holds significant ownership interests in oil giant CNOOC and financial company China Construction Bank—among many others.

Historically, some government-owned companies have not been consistently operated with the best interest of shareholders in mind, creating a potential deterrent to international investors and drag on long-term stock returns. This issue has [diminished somewhat](#) in recent years, though it still warrants consideration when choosing from the China ETFs available to U.S. investors. Those looking to steer of state-owned firms would be better off focusing on smaller companies; ETFs dominated by mega cap stocks (such as FXI) are much more likely to be dominated by state-owned companies.

Sector Biases

When considering any international ETF, it is important to examine the sector allocation of the portfolio to determine whether an ETF offers balanced exposure or is tilted towards certain corners of the economy. This is particularly important when analyzing China ETFs, as many funds maintain biases towards some sectors (generally financials and energy) while overlooking some altogether.

The best example of this is FXI, which is by far the most popular China ETF. Almost half of the FXI portfolio is in financial stocks, while technology, utilities, real estate, consumer discretionary, consumer staples, and health care receive zero weighting in the index. That obviously limits the appeal to investors looking to achieve broad-based exposure to the Chinese economy, especially since some of the overlooked sectors (consumer companies in particular) may maintain the most promising long-term outlook.

While FXI is the most extreme example, it isn't the only instance of major sector biases. Finding a well-rounded China ETF can be challenging and the presence of some

of the sector-specific options can come in handy when trying to build a balanced portfolio. The Global X China Consumer ETF (CHIQ), for example, offers a way to beef up consumer exposure, while there are multiple options for technology exposure (CQQQ, CHIB).

Beyond The Mainland

Finally, some investors may wish to consider “indirect” options for gaining exposure to Chinese equities. There are a number of ETFs offering exposure to the Hong Kong stock market, including EWH and HKK. Moreover, both EWT and TWON offer exposure to the Taiwanese equity market. Honk Kong is a special administrative region (SAR) of China, while Taiwan's political status is somewhat uncertain and subject to interpretation.

Regardless of the official classification, both Taiwan and Hong Kong have close economic ties to China, and companies headquartered in these economies conduct significant operations and derive significant sales from Chinese consumers and factories. Because Hong Kong and Taiwan are both developed markets, they offer potentially less volatility while still affording investors with access to China's promising economy.

Additional Reading

For investors looking to learn more about the nuances of China ETFs, the following resources may be useful:

- [Investment Case For China A-Shares](#) from vaneck.com

China ETFs: Facts & Figures

The following sections provide a metrics-based overview of China ETFs, including discussions of expenses, historical returns, and other key data points to consider when evaluating this particular asset class.

Vital Stats

Investors looking for the right China ETF for their portfolio may feel overwhelmed when presented with the list of all the exchange traded options available, but sorting through key statistics will help identify which fund is right for you. Those concerned with liquidity, a product's age, and its assets under management, can sort through these important stats of the China ETF space to pick which product fits best with their investment criteria.

The following table highlights all of the China ETFs available to U.S. investors as of June 30, 2011, as well as certain expense and other information for each:

Ticker	Name	Inception	ADV*	AUM**
FXI	FTSE China 25 Index Fund	2004-10-05	16,208,400	\$6,590.60 M
GXC	SPDR S&P China ETF	2007-03-19	105,350	\$738.92 M
PGJ	Golden Dragon Halter USX China Portfolio	2004-12-09	82,119	\$364.36 M
HAO	China Small Cap ETF	2008-01-30	185,370	\$273.54 M
FNI	ISE Chindia Index Fund	2007-05-08	44,063	\$145.09 M
YAO	China All-Cap ETF	2009-10-19	21,691	\$95.17 M
FCA	China AlphaDEX Fund	2011-04-19	1,199	\$2.69 M
FCHI	FTSE China (HK Listed) Index Fund	2008-06-24	6,175	\$53.76 M
MCHI	MSCI China Index Fund	2011-03-29	8,679	\$29.10 M
ECNS	MSCI China Small Cap Index Fund	2010-09-28	5,269	\$21.50 M
PEK	Market Vectors China ETF	2010-10-13	32,803	\$21.44 M
EWH	MSCI Hong Kong Index Fund	1996-03-12	4,928,780	\$2,069.95 M
HKK	IQ Hong Kong Small Cap ETF	2011-05-18	16,334	\$1.88 M
CHIQ	China Consumer ETF	2009-11-30	126,819	\$203.81 M
CHIE	China Energy ETF	2009-12-15	7,698	\$6.38 M
CHIM	China Materials ETF	2010-01-12	16,110	\$3.68 M
CHII	China Industrials ETF	2009-11-30	7,907	\$5.86 M
CHIX	China Financials ETF	2009-12-10	25,242	\$5.81 M
CHIB	China Technology ETF	2009-12-08	5,164	\$6.66 M
TAO	China Real Estate ETF	2007-12-18	35,758	\$23.95 M
CQQQ	China Technology ETF	2009-12-08	32,489	\$37.74 M
CHXX	INDXX China Infrastructure Index Fund	2010-02-17	16,583	\$19.13 M

Data as of 07/22/2011

Analyst Commentary

FXI is the oldest and most popular ETF for gaining exposure to China, proven by the more than \$6 billion in assets under management. As evidenced by the impressive daily trading volume in this ETF, FXI has appeal to short-term traders looking to establish or exit a position quickly. More recent additions to this list have divided the market into targeted segments; investors can now allocate their assets to a fund that invests in a particular market sector, such as energy or financials, allowing for a concentrated play on the various aspects of this booming emerging economy.

Though the creation/redemption mechanism allows for spontaneous liquidity in exchange-traded products, investors should note the relatively low volumes of some China funds; when utilizing products that trade somewhat infrequently (e.g., FCA), investors would be wise to use limit orders. Those interested in a large position might want to enlist the services of an alternative liquidity provider.

Expenses

The expenses of the various China ETF options vary considerably, meaning that the choice between these products can have a potentially significant impact on bottom line returns. Furthermore, certain China ETFs are available commission free on various platforms, allowing investors to eliminate fees that must be considered when calculating the total cost of an ETF investment:

Ticker	Name	ER	Commission Free
FXI	FTSE China 25 Index Fund	0.72%	Firstrade, TD Ameritrade
GXC	SPDR S&P China ETF	0.59%	TD Ameritrade
PGJ	Golden Dragon Halter USX China Portfolio	0.60%	n/a
HAO	China Small Cap ETF	0.70%	n/a
FNI	ISE Chindia Index Fund	0.60%	n/a
YAO	China All-Cap ETF	0.70%	n/a
FCA	China AlphaDEX Fund	0.80%	n/a
FCHI	FTSE China (HK Listed) Index Fund	0.72%	n/a
MCHI	MSCI China Index Fund	0.61%	n/a
ECNS	MSCI China Small Cap Index Fund	0.65%	n/a
PEK	Market Vectors China ETF	0.72%	n/a
EWH	MSCI Hong Kong Index Fund	0.53%	n/a
HKK	IQ Hong Kong Small Cap ETF	0.69%	n/a
CHIQ	China Consumer ETF	0.65%	Interactive Brokers
CHIE	China Energy ETF	0.65%	Interactive Brokers
CHIM	China Materials ETF	0.65%	Interactive Brokers
CHII	China Industrials ETF	0.65%	Interactive Brokers
CHIX	China Financials ETF	0.65%	Interactive Brokers
CHIB	China Technology ETF	0.65%	Interactive Brokers
TAO	China Real Estate ETF	0.65%	n/a
CQQQ	China Technology ETF	0.72%	n/a
CHXX	INDXX China Infrastructure Index Fund	0.85%	n/a

Analyst Commentary

CHXX ranks as the most expensive product on this list, and with good reasons. Infrastructure is perhaps the most specialized segment that is currently available through an exchange traded structure. On the other side of the cost spectrum, GCX is the cheapest option for exposure to China (EWH focuses on Hong Kong companies). It should be noted that FXI's extreme popularity is not due to its cost efficiency; the massive China ETF is relatively expensive compared to some of the smaller alternatives.

When it comes to managing your portfolio's expenses, commission free trading should not be overlooked, especially for those who are actively moving in and out of positions. FXI and GXC are both included in TD Ameritrade's broad commission free platform, and all Global X ETFs are eligible for commission-free trading in Interactive Brokers accounts.

Performance

Historical performance is often one of the most important metrics for an investor to look at, as it sheds light on how a product has performed in certain environments. The table below outlines the performances of the China ETFs, which have varied considerably.

Ticker	Name	YTD*	2010	2009	2008
FXI	FTSE China 25 Index Fund	-0.52%	3.51%	47.28%	-47.73%
GXC	SPDR S&P China ETF	2.55%	7.58%	60.45%	-48.72%
PGJ	Golden Dragon Halter USX China Portfolio	-0.57%	11.31%	63.14%	-56.13%
HAO	China Small Cap ETF	-8.98%	15.85%	96.55%	n/a
FNI	ISE Chindia Index Fund	1.72%	18.17%	82.55%	-57.06%
YAO	China All-Cap ETF	2.14%	8.81%	n/a	n/a
FCA	China AlphaDEX Fund	n/a	n/a	n/a	n/a
FCHI	FTSE China (HK Listed) Index Fund	-0.94%	6.89%	48.49%	n/a
MCHI	MSCI China Index Fund	n/a	n/a	n/a	n/a
ECNS	MSCI China Small Cap Index Fund	-11.70%	n/a	n/a	n/a
PEK	Market Vectors China ETF	-2.51%	n/a	n/a	n/a
EWH	MSCI Hong Kong Index Fund	-1.28%	24.16%	54.94%	-50.29%
HKK	IQ Hong Kong Small Cap ETF	n/a	n/a	n/a	n/a
CHIQ	China Consumer ETF	0.70%	10.79%	n/a	n/a
CHIE	China Energy ETF	2.97%	5.98%	n/a	n/a
CHIM	China Materials ETF	-16.26%	n/a	n/a	n/a
CHII	China Industrials ETF	-9.26%	7.50%	n/a	n/a
CHIX	China Financials ETF	-1.59%	-4.31%	n/a	n/a
CHIB	China Technology ETF	2.15%	9.34%	n/a	n/a
TAO	China Real Estate ETF	-1.96%	10.68%	71.93%	-55.40%
CQQQ	China Technology ETF	2.61%	7.46%	n/a	n/a
CHXX	INDXX China Infrastructure Index Fund	0.86%	n/a	n/a	n/a

**Performance data as of 7/22/2011*

Analyst Commentary

Unfortunately, most of these funds are less than three years old, making it difficult to compare them over a long term basis. But for those that were trading in 2008, the noticeable drop in performance comes from the global financial crisis. As for the 2009 and 2010 performances, most products had strong years, as did many various emerging markets. Looking to 2011, some products have struggled, as inflationary concerns among other issues have begun to hit the Chinese economy.

For ETFs that were around during the most recent recession and subsequent recovery, the huge gaps in performance highlight the nuances of the various China ETF options available. Investors should also note the big performance differentials between the various sector-specific ETFs, at least on 2011. Both technology funds have done quite well, while the materials and industrials-based products have had a tough time in 2011 so far.

Holdings

It is important to take a look at the holdings of each portfolio, as certain products may feature a bias towards a particular set of holdings, leaving the fund with little diversity. Investors looking for a healthy diversity should consider the depth of holdings as well as the balance given to them when identifying which product is the best fit for their particular needs.

Ticker	Name	Holdings	% In Top 10
FXI	FTSE China 25 Index Fund	28	59.9%
GXC	SPDR S&P China ETF	151	44.6%
PGJ	Golden Dragon Halter USX China Portfolio	225	50.7%
HAO	China Small Cap ETF	200	13.9%
FNI	ISE Chindia Index Fund	50	57.7%
YAO	China All-Cap ETF	193	43.4%
FCA	China AlphaDEX Fund	50	33.1%
FCHI	FTSE China (HK Listed) Index Fund	115	57.5%
MCHI	MSCI China Index Fund	147	48.7%
ECNS	MSCI China Small Cap Index Fund	353	9.8%
PEK	Market Vectors China ETF	300	21.6%
EWH	MSCI Hong Kong Index Fund	43	56.2%
HKK	IQ Hong Kong Small Cap ETF	100	21.1%
CHIQ	China Consumer ETF	42	49.1%
CHIE	China Energy ETF	29	70.2%
CHIM	China Materials ETF	32	50.8%
CHII	China Industrials ETF	40	44.8%
CHIX	China Financials ETF	37	66.5%
CHIB	China Technology ETF	30	52.4%
TAO	China Real Estate ETF	47	51.0%
CQQQ	China Technology ETF	40	61.0%
CHXX	INDXX China Infrastructure Index Fund	31	54.1%

Data as of 7/6/2011

Analyst Commentary

Again, there is a huge gap between the various China ETFs in terms of diversification offered. Note the big concentration issues in FXI and EWH, the two most popular products on the list. Unfortunately, many large products tend to overweight top holdings, potentially resulting in a top-heavy portfolio. Investors should also consider that both of these products are relatively old by ETF standards, and may be a little behind the curve when it comes to the diversity that many new funds offer. For those seeking the most diverse options, PEK presents itself as a standout in terms of exposure thanks to its inclusion of A-shares securities which are unavailable to most western investors. Another important factor to take into considerations is that many small cap products like ECNS and HAO carry a healthy amount of diversity when it comes to the weight of their individual holdings.

Not surprisingly, many sector-specific China ETFs are relatively concentrated, relying on a relatively shallow basket of securities to deliver the bulk of exposure.

Concentration

In China in particular, it's important to consider allocations to certain sectors as this can have a significant impact on the returns of a particular fund. As noted above, there are several ETFs with major concentration issues when it comes to the distribution of their overall holdings. The following table takes into account sector-specific and stock-specific issues that can make all the difference in how a fund performs.

Ticker	Name	Largest Holding	Biggest Sector Allocation
FXI	FTSE China 25 Index Fund	China Construction Bank (9.5%)	Financials (51%)
GXC	SPDR S&P China ETF	China Construction Bank (7.1%)	Financials (28%)
PGJ	Golden Dragon Halter USX China Portfolio	Baidu, Inc. (6.1%)	Technology (24%)
HAO	China Small Cap ETF	China Shanshui Cement Group (1.5%)	Industrials (24%)
FNI	ISE Chindia Index Fund	Baidu, Inc. (8.6%)	Technology (35%)
YAO	China All-Cap ETF	Baidu, Inc. (5.9%)	Financials (27%)
FCA	China AlphaDEX Fund	Evergrande Real Estate (3.91%)	Financials (23%)
FCHI	FTSE China (HK Listed) Index Fund	China Construction Bank (9.8%)	Financials (41%)
MCHI	MSCI China Index Fund	China Mobile (7.6%)	Financials (32%)
ECNS	MSCI China Small Cap Index Fund	Digital China Holdings (1.3%)	Industrials (19%)
PEK	Market Vectors China ETF	Ping Insurance Company Of China (3.6%)	Financials (34%)
EWH	MSCI Hong Kong Index Fund	AIA Group (8.5%)	Real Estate (32%)
HKK	IQ Hong Kong Small Cap ETF	Skyworth Digital Holdings (2.2%)	Consumer Discretionary (24%)
CHIQ	China Consumer ETF	Dongfeng Motor Group (5.9%)	Consumer Discretionary (48%)
CHIE	China Energy ETF	PetroChina Company (10.8%)	Energy
CHIM	China Materials ETF	Dongyue Group (5.7%)	Basic Materials
CHII	China Industrials ETF	Anhui Conch Cement Company (5.4%)	Industrials
CHIX	China Financials ETF	China Life Insurance Company (10%)	Financials
CHIB	China Technology ETF	China Telecom Corp (6.1%)	Technology
TAO	China Real Estate ETF	China Overseas Land & Investment (5.8%)	Real Estate
CQQQ	China Technology ETF	Baidu, Inc. (10.8%)	Technology
CHXX	INDXX China Infrastructure Index Fund	Anhui Conch Cement Company (6.8%)	Basic Materials (27%)

Data as of 7/6/2011

Analyst Commentary

Investors should note that some of the most popular Chinese ETFs also tend to overweight sectors which may be undesirable for some. FXI dedicates over half of its assets to financials, leaving investors with something to be desired when it comes to the diversity of its holdings. The funds that allocate the majority of their assets to a particular segment also tend to be the large cap products, a typical bias common amongst emerging market funds, which have a nasty habit of overweighting financials and energy. On the other hand, many of the small cap funds offer high allocations to other sectors that may be more difficult to gain exposure to otherwise. ECNS presents the best diversity in sectors, as its top weighted sector makes up less than 20% of the fund, but the majority of these products tend to overweight one market segment or another.

Investors should also note that Baidu appears to be the most popular holding for several of these products. Baidu is a search engine giant in China comparable to Google or Yahoo! Another popular holding is China Construction Bank; the second largest bank in the People's Republic of China, and one of the "big four" banks for the entire nation. Those weary of putting too much in any one company might do well to stay away from products that feature these companies as their top holding.

In-Depth Analyst Reports: China ETFs

The following section includes detailed analyst reports for ETFs offering broad-based exposure to the Chinese economy.

ETFs covered in this section include:

- iShares FTSE China 25 Index Fund (FXI)
- SPDR S&P China ETF (GXC)
- PowerShares Golden Dragon Halter USX China Portfolio (PGJ)
- Guggenheim China Small Cap ETF (HAO)
- iShares MSCI China Small Cap ETF (ECNS)
- First Trust ISE Chindia ETF (FNI)
- Guggenheim China All Cap ETF (YAO)
- First Trust China AlphaDEX Fund (FCA)
- iShares FTSE China Index Fund (FCHI)
- iShares MSCI China Index Fund (MCHI)
- Market Vectors China ETF (PEK)
- iShares MSCI Hong Kong Index Fund (EWH)
- IQ Small Cap Hong Kong ETF (HKK)

iShares FTSE China 25 Index Fund (FXI)

FXI is one of the earliest China ETFs to hit the market, and still remains one of the most popular ways for establishing exposure to the Chinese economy. FXI has close to \$7 billion in assets, and more than 16 million shares trade hands every day. But FXI is not without its flaws; for investors seeking long-term China exposure, there are much better options available than this iShares ETF.

Under The Hood

It may be a mistake to assume that the massive size of FXI reflects its superiority as a means of establishing exposure to Chinese stock markets. While this ETF is useful in certain circumstances, the nature of the underlying portfolio limits its usefulness to those looking to build a long-term, buy-and-hold portfolio.

The first potential drawback is the shallow nature of the portfolio. As the name suggests, FXI has only about 25 components at any one time. That represents only a very small portion of the Chinese equity market, and results in some significant concentrations in individual stocks that increase company-specific risk. By comparison, ECNS holds more than 300 individual stocks, and GXC invests in more than 150.

Also of concern is the sector breakdown. Almost half of FXI's portfolio consists of financial stocks, a huge weighting to afford to any one industry. Telecoms, energy firms, and materials companies account for much of the remainder, leaving little room for consumer companies, health care stocks, or technology firms. FXI overlooks some of the promising sectors of the Chinese economy entirely, a bias that may be less than ideal for those looking to achieve broad-based exposure to China.

It should also be noted that many of FXI's components are large and mega cap stocks, and that the Chinese government holds positions in many of the component companies. For investors looking to tap into the true growth potential of China, it's important to include smaller companies and allocations to the consumer, health care, and technology companies.

Finally, it is important to consider that all of the component companies in the underlying index trade on the Hong Kong Stock Exchange, resulting in limited "pure play" exposure to smaller companies in the Chinese economy (as well as exposure to the Chinese currency).

FXI At A Glance

Issuer:	iShares
Structure:	ETF
Expense Ratio:	0.72%*
Inception Date:	10/5/2004
Largest Holding	China Construction Bank**
Weight:	9.5%**
# Of Holdings	28**
AUM:	\$6.591 billion*
ADV	16.2 million*
2010 Gain (Loss):	3.51%
2009 Gain (Loss):	47.28%
2008 Gain (Loss):	-47.73%

*As of 7/22/2011. **As of 7/6/2011

Pros

The biggest advantage of FXI is the unparalleled liquidity. More than 16 million shares change hands every day; the average daily volume corresponds to about 10% of the shares outstanding, reflecting the popularity of this product among short-term, active traders who value liquidity above all else. If you're looking to establish exposure to China and time is critical, FXI might be worth a close look.

It's also worth noting that FXI options are quite liquid; investors looking to implement a strategy involving options may gravitate towards this ETF.

Cons

Besides the potential drawbacks in the portfolio highlighted above, this ETF doesn't stack up well in terms of expenses either. Given the massive size of this ETF, FXI is relatively expensive. With an ER of 0.72%, FXI is actually above the average for the China Equities ETFdb Category. That is especially remarkable considering that FXI has nearly twice the assets of the other 12 ETFs in this ETFdb Category combined.

Final Verdict

For investors looking to execute a trade in a China ETF quickly at narrow spreads, FXI might be the perfect fund. But for anyone looking to build a long-term portfolio or achieve well rounded exposure to China, this ETF is probably not the best option available. The shallow portfolio, heavy tilts towards the financial sector, and mega cap bias will prevent investors from achieving exposure to the true China growth story.

Full Report Available Only To ETFdb Pro Members

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- 100% Access to the ETF Head-to-Head Comparison Tool, including descriptive data for more than 1,300 ETPs
- More than 60 ETFdb Category reports, highlighting price drivers, noteworthy ETFs, and correlation statistics
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