

Sevens Report Alpha Webinar:

China Update with KraneShares CIO Brendan Ahern

Wednesday, September 1st, 2021

Tom Essaye, President Sevens Report Research



KraneShares

Market Volatility Update and Q&A With KraneShares

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Introduction to KraneShares

About KraneShares

Krane Funds Advisors, LLC is the investment manager for KraneShares ETFs. Our suite of China focused ETFs provides investors with solutions to capture China's importance as an essential element of a well-designed investment portfolio. We strive to provide innovative, first to market strategies that have been developed based on our strong partnerships and our deep knowledge of investing. We help investors stay current on global market trends and aim to provide meaningful diversification. Krane Funds Advisors, LLC, is a signatory of the United Nations-supported Principles for Responsible Investing (UN PRI). The firm is majority owned by China International Capital Corporation (CICC).





KraneShares™

Investment Strategies to Capture China's Growing Importance In Global Portfolios



China Thematic

China Internet ★

China Health Care ★

China Clean Technology

China 5G & Semiconductor

China Consumer

SSE STAR 50 ★



China Core

MSCI China A ★

MSCI China ESG Leaders ★

MSCI All China



EM Thematic

MSCI Emerging Markets ex China

Emerging Markets Consumer Technology

Emerging Markets Healthcare



China Fixed Income

RMB-Denominated China ★
Bond Inclusion

Asia Pacific High Yield USD Bond



Global Thematic

Inflation Protection

Global Carbon Credit

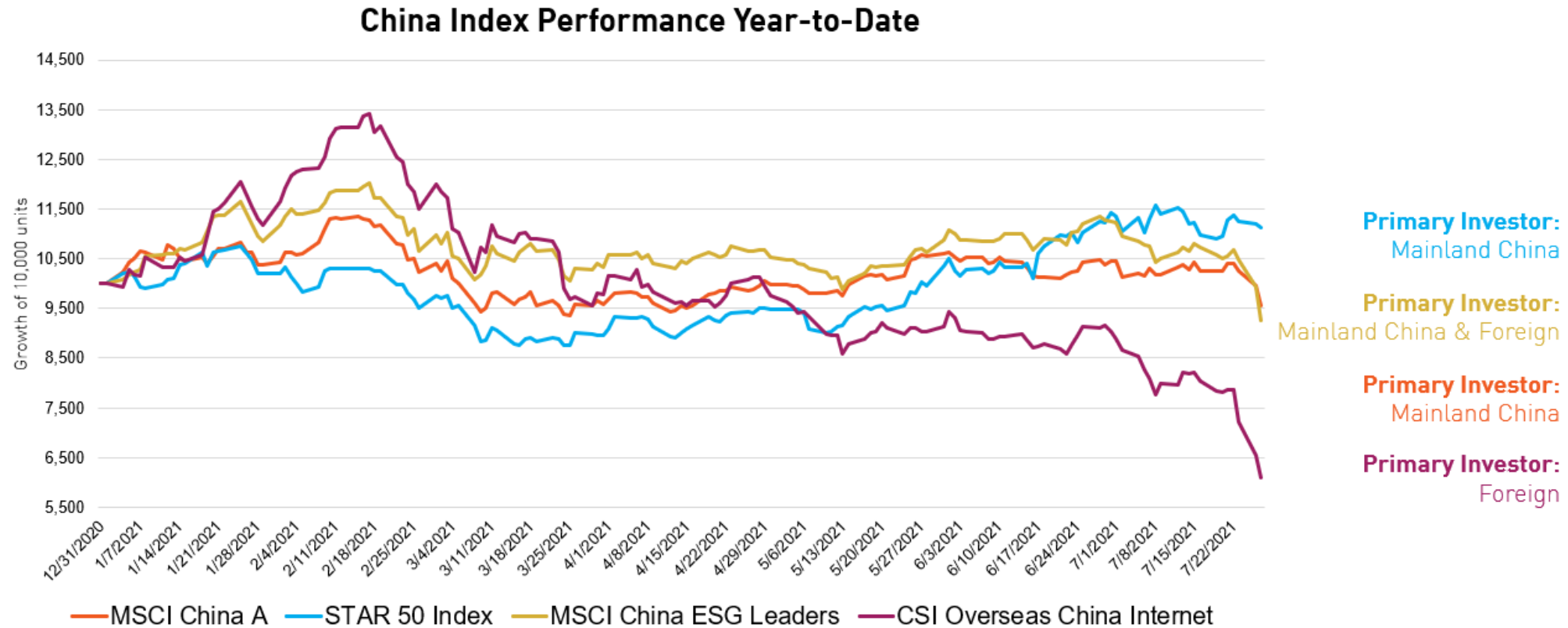
Electric Vehicles & Future Mobility

One Belt One Road

★ Starred Strategies Also Available in UCITS



2021 YTD – Investors' different perceptions of China's capital markets created performance dispersion in the equity market



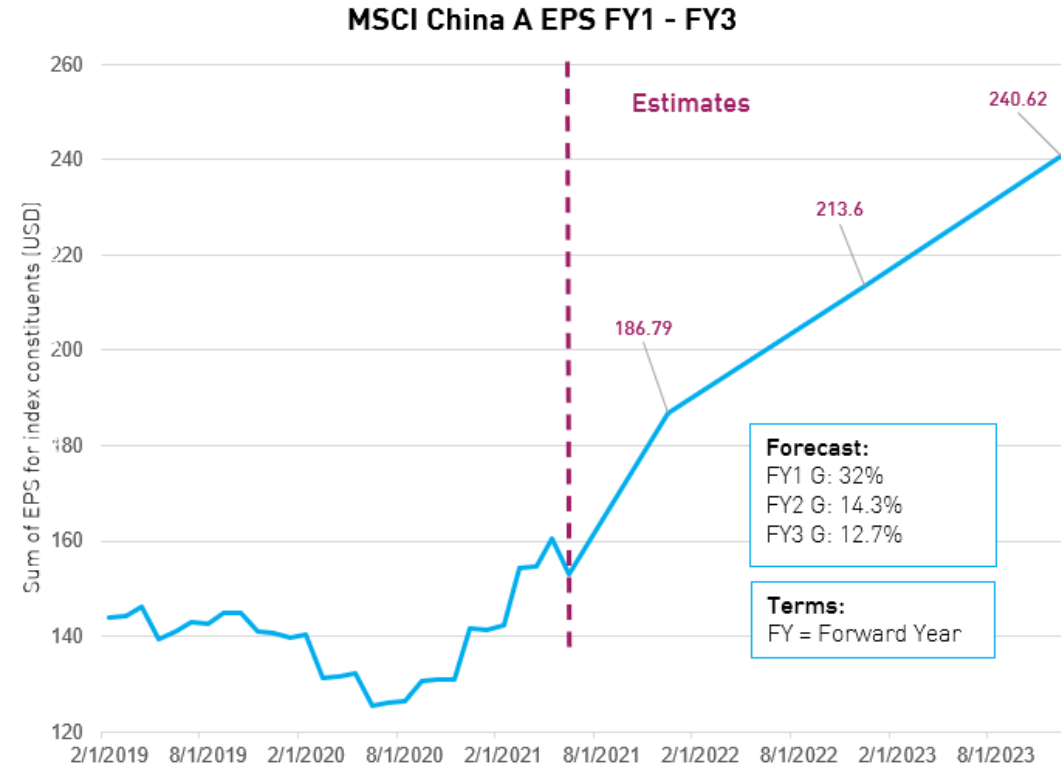
Data from Bloomberg as of 7/27/2021. Index returns are for illustrative purposes only and do not represent actual Fund performance. Indexes are unmanaged and one cannot invest directly in an index. Index returns do not reflect fees or other costs associated with investing. Past performance does not guarantee future results. See end of presentation for index definitions.



What are investors in China focused on?

- China has administered at least 1.5 billion doses of COVID vaccines so far. Assuming every person needs 2 doses, that's enough to have vaccinated about 52.1% of the country's population¹. The government's goal is to have 1.2 Billion people, or 80% of the population, vaccinated by end of year.²
- China's Gross Domestic Product (GDP) grew 7.9% in the second quarter; retail sales beat expectations³. We believe strong economic data could flow through to quarterly company earnings.
- Unexpected reserve requirement ratio (RRR) cut on July 14th injected \$1 trillion RMB in liquidity aimed at supporting small / medium size enterprises.⁴
- New bond issuance typically leads Fixed Asset Investment by 3 – 6 months. We have seen a pickup in local government issuance over the past several months, which indicates government domestic spending could remain strong until year end.⁵
- E-CNY rollout may increase efficacy of stimulus by targeting those most in need.
- Beijing Winter Olympics 2022 is right around the corner.

Analysts are projecting strong 2021 earnings for companies within the MSCI China A Index



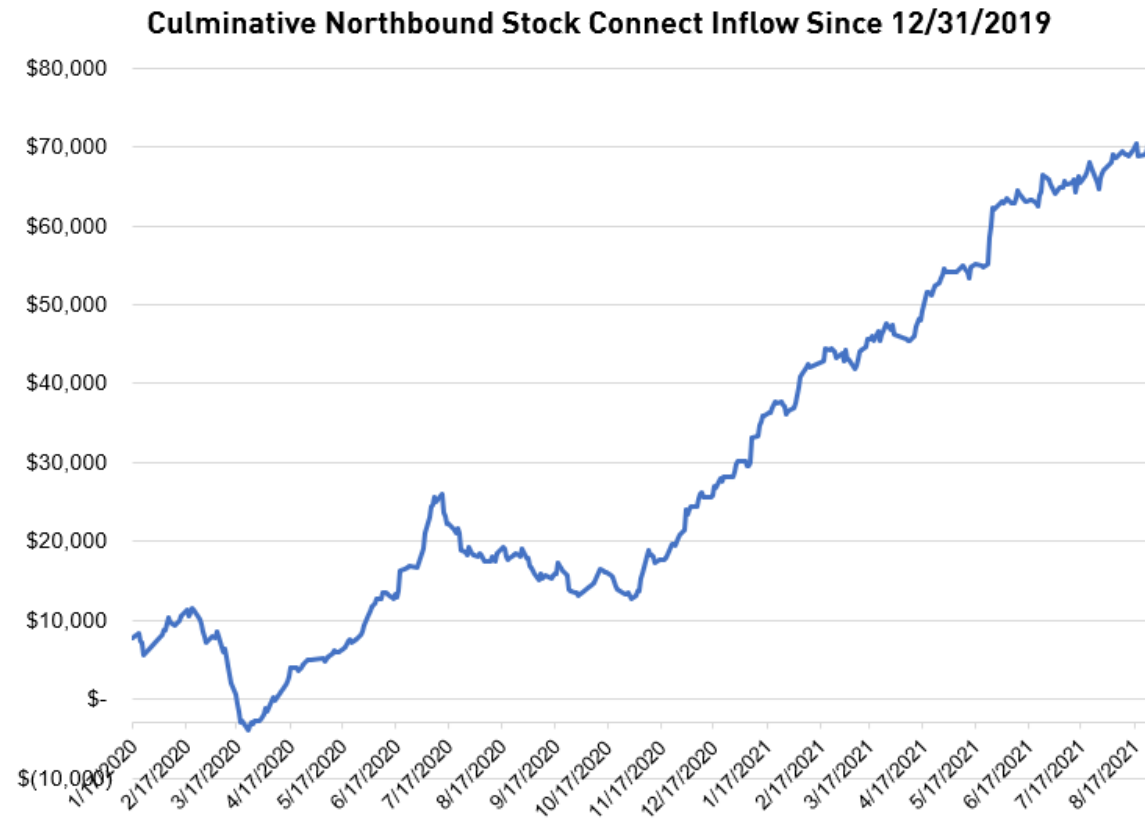
Indexes are unmanaged and one cannot invest directly in an index. Index constituents are subject to change. See end of presentation for definitions.

1. Reuters COVID-19 Tracker as of July 19, 2021.
2. GT Staff Reporters. "China passes 1b shots mark; eyes herd immunity by Dec," Global Times. June 20, 2021.
3. Cheng, Evelyn. "China's GDP grew 7.9% in the second quarter; retail sales beat expectations," CNBC. July 14, 2021.
4. "China's surprise RRR cut gets markets pondering rate cuts, other easing" Reuters. July 14, 2021.
5. Ma Jingling. "Local govts issue \$264.5 billion bonds to support economy" Global Times. May 10, 2021.



Foreign inflows into China's Mainland equity market remain strong

Foreign investors bought \$74.01868 billion worth of A-shares through Stock Connect between 12/31/19 to 9/1/21 and \$43.013 billion worth of inflows occurred between 12/31/20 to 9/1/21.



Data from Bloomberg as of 9/1/2021. Please see the end of the presentation for definitions.



How the market reflects the US-China relationship today?

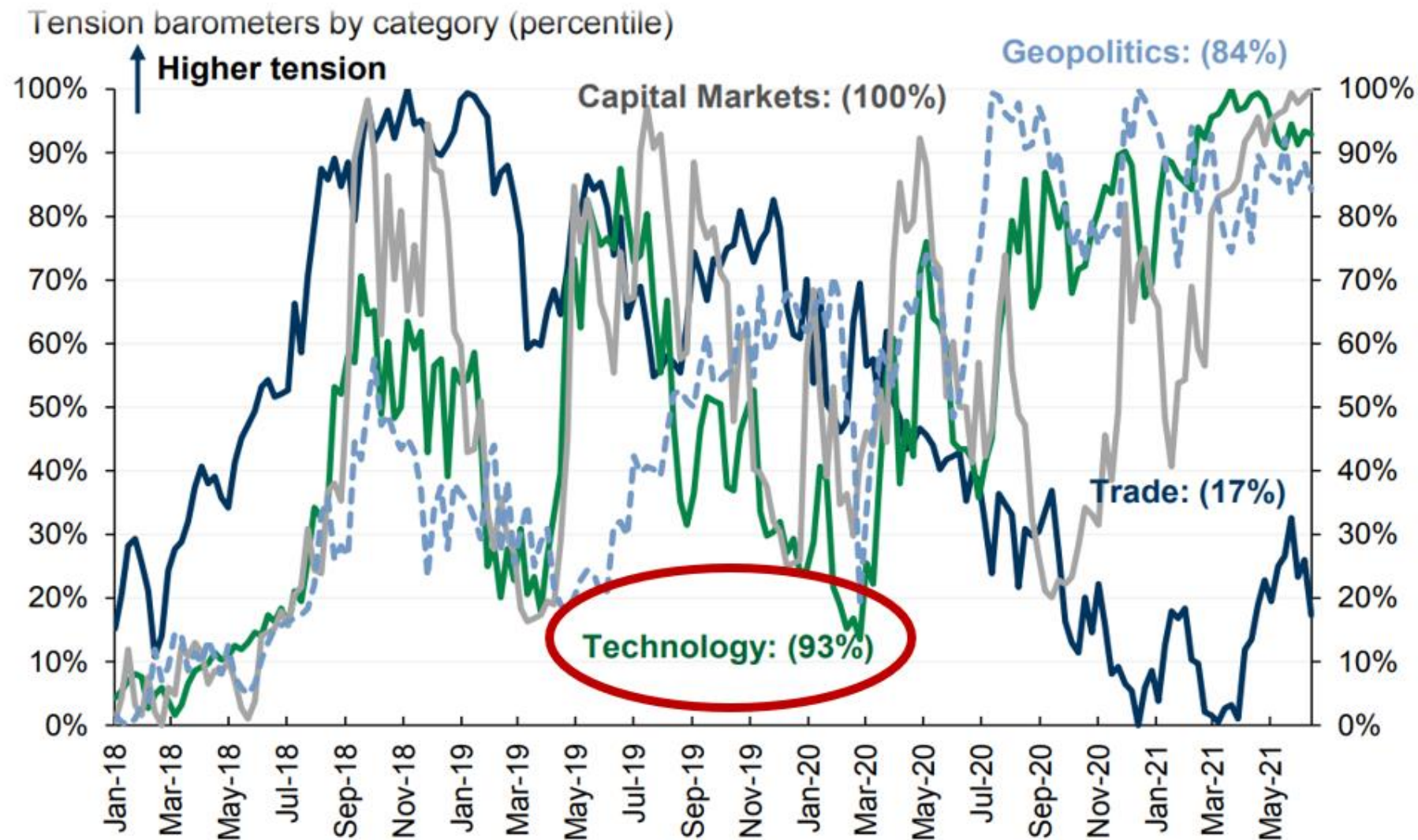
- The Goldman Sachs US-China Relationship Barometer Index is at a level of 94 near its all time high and close to the maximum of 100.
- We believe US-China Political tensions are already priced in.



Chart from Bloomberg and Goldman Sachs as of Jul 9, 2021.

The key components of Goldman Sachs US-China relationship barometer index

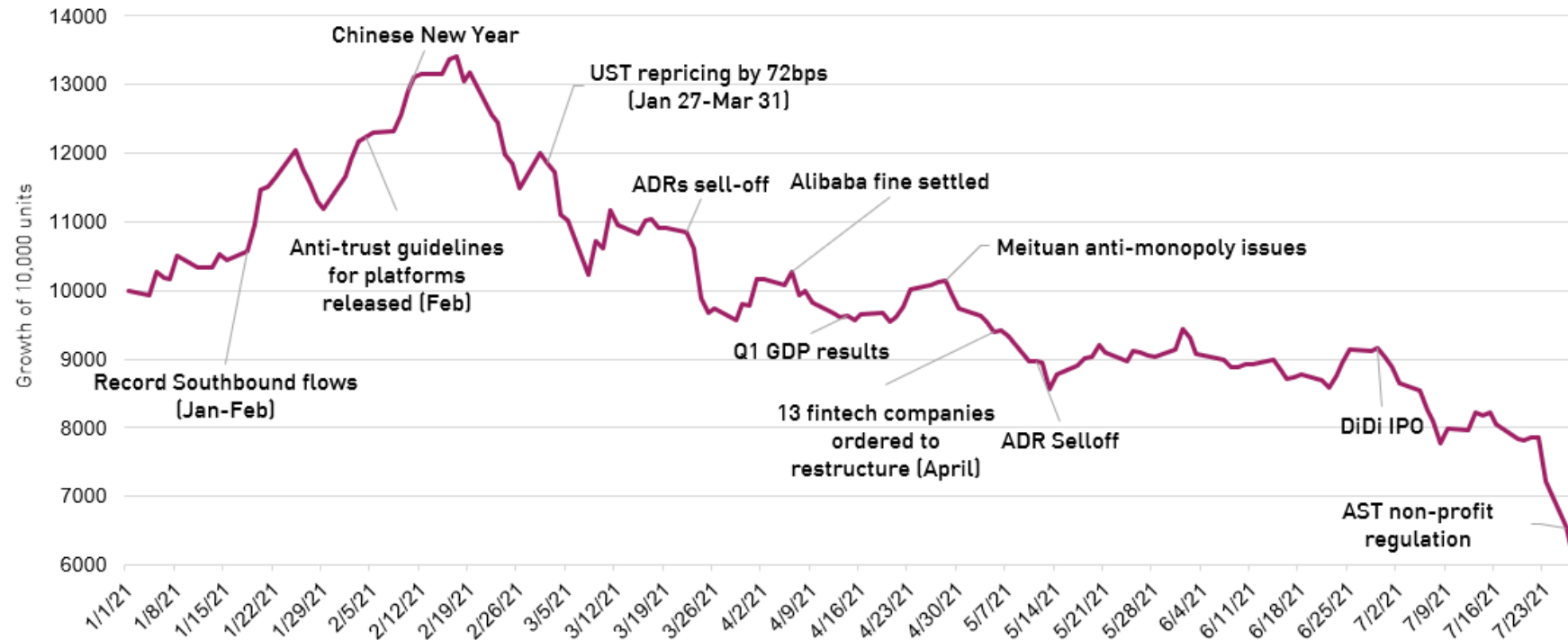
- Within Goldman Sachs US-China Relationship Barometer Index, technology (green line) is particularly high currently at 93%.
- This implies equity technology sectors have been impacted significantly.
- Meanwhile, trade tension with China has decreased significantly since its high in September 2018 and is currently at 17% in the index.





What are investors outside of China focusing on - Regulation and political tension

CSI Overseas China Internet Index Performance



Terms:
 UST = US Treasury
 ADR = American
 Depository Receipt
 AST= After school tutoring

Data from Bloomberg as of 7/28/2021. Index returns are for illustrative purposes only and do not represent actual Fund performance. Indexes are unmanaged and one cannot invest directly in an index. Index returns do not reflect fees or other costs associated with investing. Past performance does not guarantee future results. See end of presentation for index definitions.



Governments around the world are recognizing that regulation has not kept up with technology and have taken measures to regulate internet platforms. China is no exception.

Recent regulations in China fall under four categories*:



Education

Ensuring that students have a more equal footing and that households are not burdened by expensive tutoring courses

- tutoring agencies must register as non-profit organizations and spin out their K-12 education businesses into a non-publicly traded units
- new applications for learning centers will not be accepted
- non-academic tutoring (i.e. arts, physical ed.) may be excluded from these new regulations, but these agencies offering such courses may still need to be registered and approved by regulators



Anti-trust

Protecting the market environment and small business. Also includes consumer protection and workers' conditions

- Removal of platform exclusivity requirements
- Alibaba fined for monopolistic practices
- Alibaba and JD.com must allow vendors the opportunity to switch between platforms freely
- Alibaba and Tencent must accept each others' mobile payment methods (Alipay, WeChat Pay)



FinTech

Introduce more stringent capital requirements on FinTech

- New Restrictions on consumer credit
- Ant Group and others required to restructure as financial holding company to be regulated as a bank



Data security

Eliminate misuse and misappropriation of personal information; Safeguard national cybersecurity

- Foreign IPOs of technology companies with over 1 million users must undergo data security reviews before listing
- Customer data on Mainland Chinese citizens must be housed in China
- Didi required to submit to data security review



Chinese internet companies are adhering to new regulations

Number one is, we operate in strict compliance with rules and regulations and that's both in form as well as in substance.

We are very prudent in our risk management. We have been, have always been optimizing for quality and risk management rather than pursuing scale.

We focus on product and services that benefits consumers and merchants, and we also emphasize cooperation with financial institutions as opposed to disruption.

We felt that with these healthier regulations, at the end of the day, the entire industry will be healthier, and it will be sustainable for longer-term growth.

– Martin Lau comments from Q4 2020 earnings call on 3/24/2021



Martin Lau
President, Tencent



Where can you find these rates of growth elsewhere in the world?

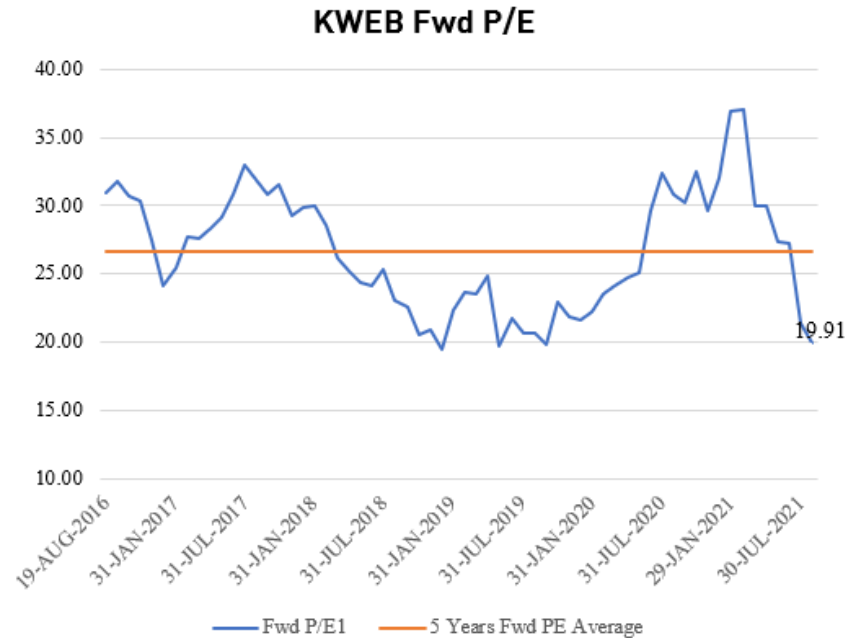
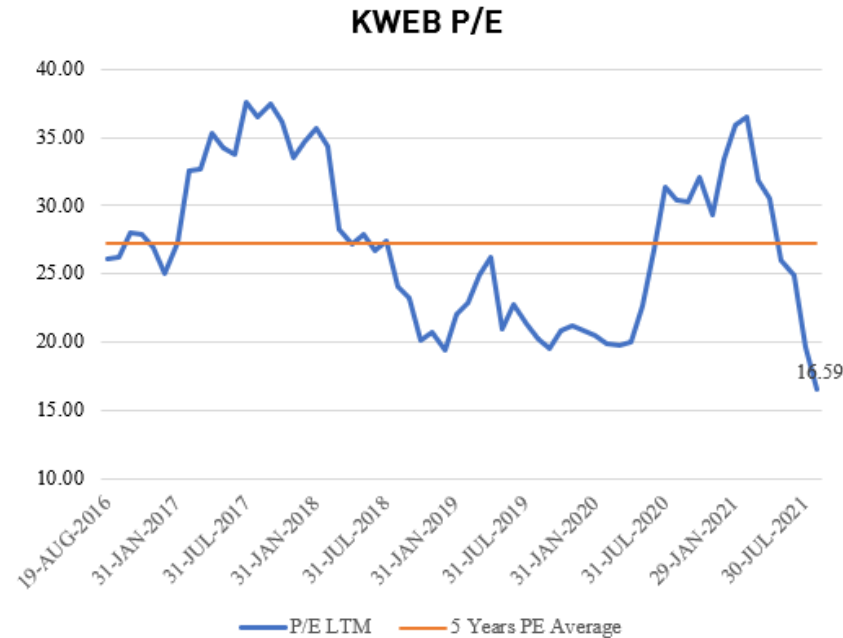
CSI Overseas China Internet top ten constituents' Q1 2021 revenue growth metrics

Top 10 Index Constituents	Revenue (\$ B)	Net Income (\$ B)	Revenue Growth [%]	Earnings per Share (\$)
Tencent (700 HK)	20.94	5.13	25.21	0.76
Alibaba (BABA)	29.01	4.40	63.93	1.60
Meituan (3690 HK)	5.71	-0.56	120.94	-0.15
Pinduoduo (PDD)	3.43	-0.29	238.89	-1.52
Baidu (BIDU)	4.36	0.67	24.79	1.89
Trip.com (TCOM)	0.64	-0.03	-13.17	-0.17
KE Holdings (BEKE)	3.20	0.23	190.70	0.17
NetEase (NTES)	3.18	0.79	20.20	1.14
JD.com (JD)	31.45	0.61	38.97	0.38
Bilibili (BILI)	0.60	-0.10	81.40	-0.29
	Total		Weighted Average	
	102.52	10.85	49.05	0.30

Financial data from Bloomberg as of 3/31/2021. CSI Overseas China Internet Index constituents and weights are as of 3/31/2021. Indexes are unmanaged and one cannot invest directly in an index. Index constituents are subject to change. Conversions using exchange rates as of 6/29/2021.



China internet is at its most attractive valuation in 5 years.



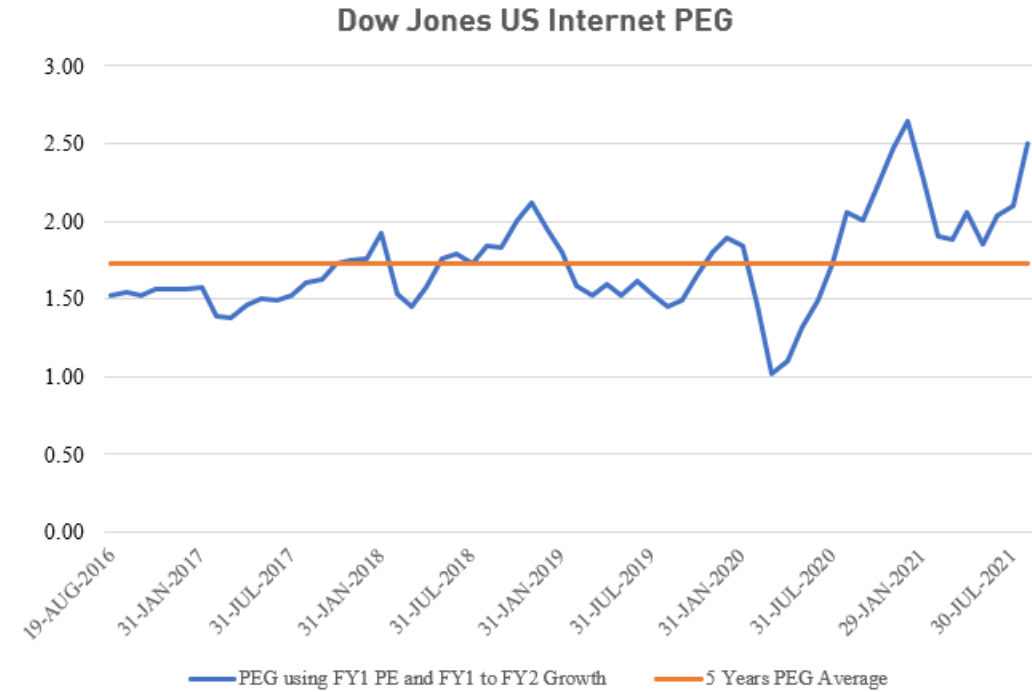
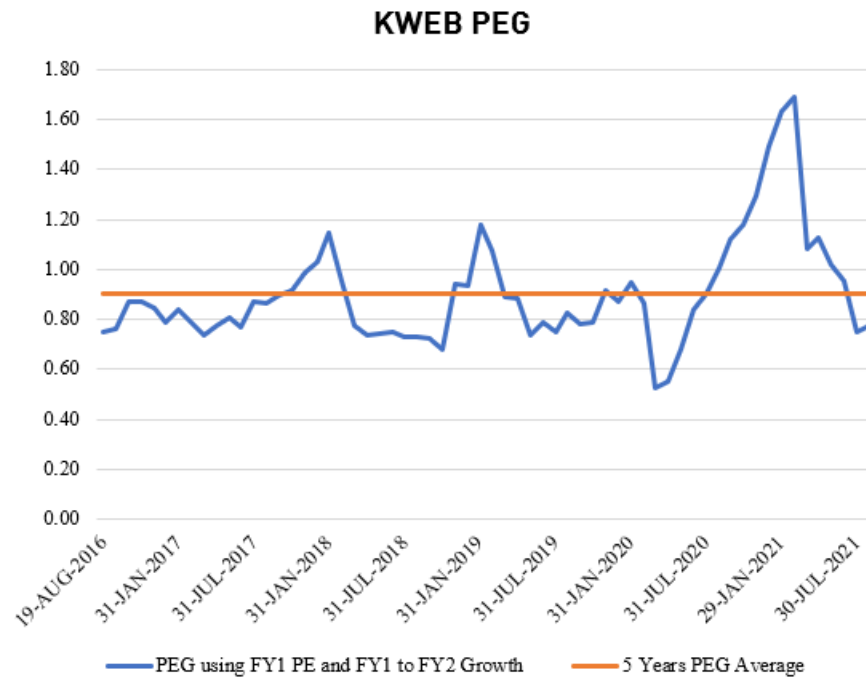
LTM = Last 12 months

Source: FactSet. Forward P/E Data as of 8/23/2021. See end of presentation for definitions. Indexes are unmanaged and one cannot invest directly in an index. Index constituents are subject to change.



China Internet earnings growth revised higher

China technology growth offered at a discount compared to US internet growth

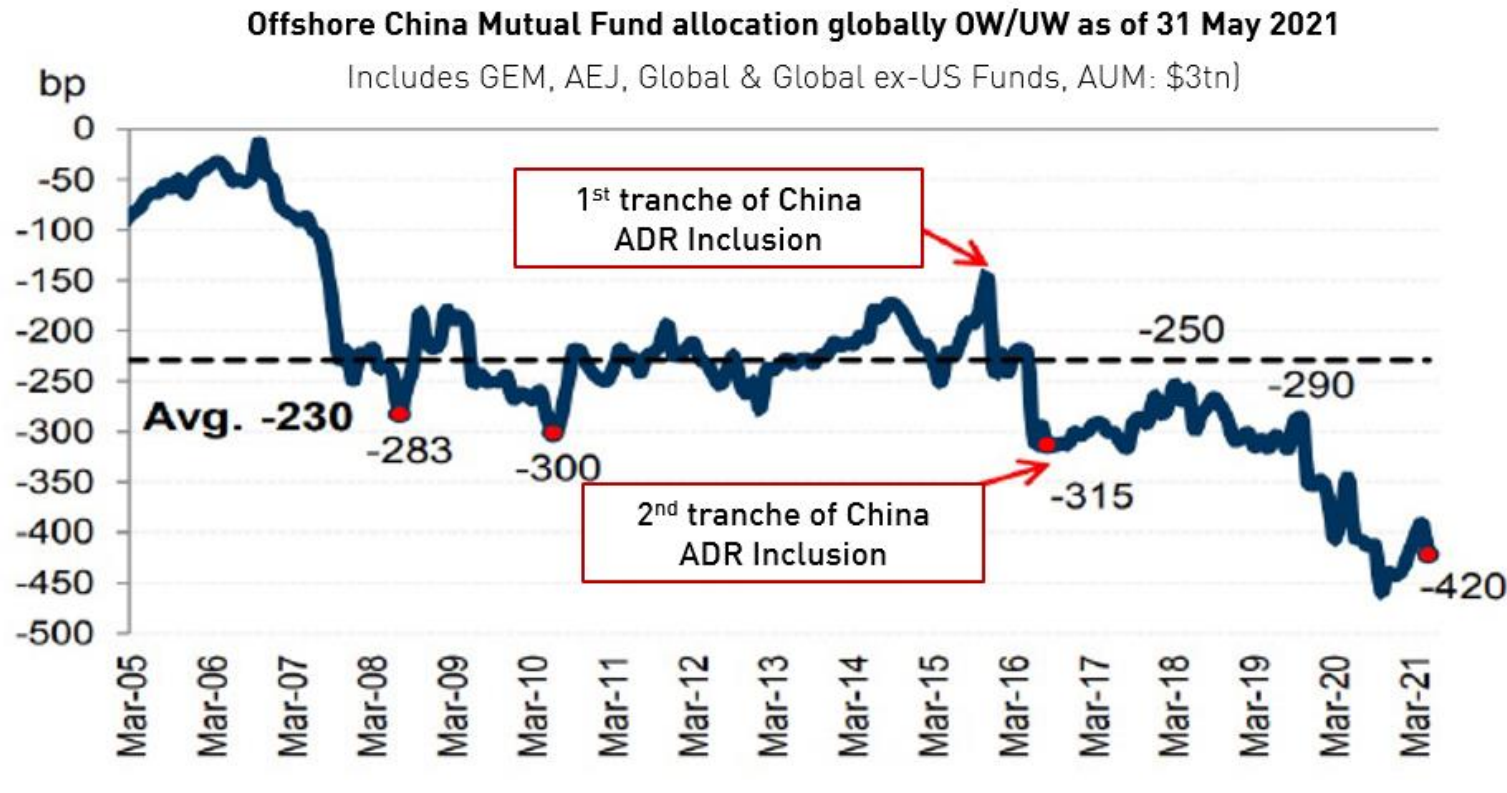


*US internet represented by Dow Jones US Internet Index. See end of presentation for definitions. Source: FactSet. Data as August 23, 2021.

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Active managers' exposure to offshore China equity is at a 16-year low. A normalization to the historical average could mean significant inflows.

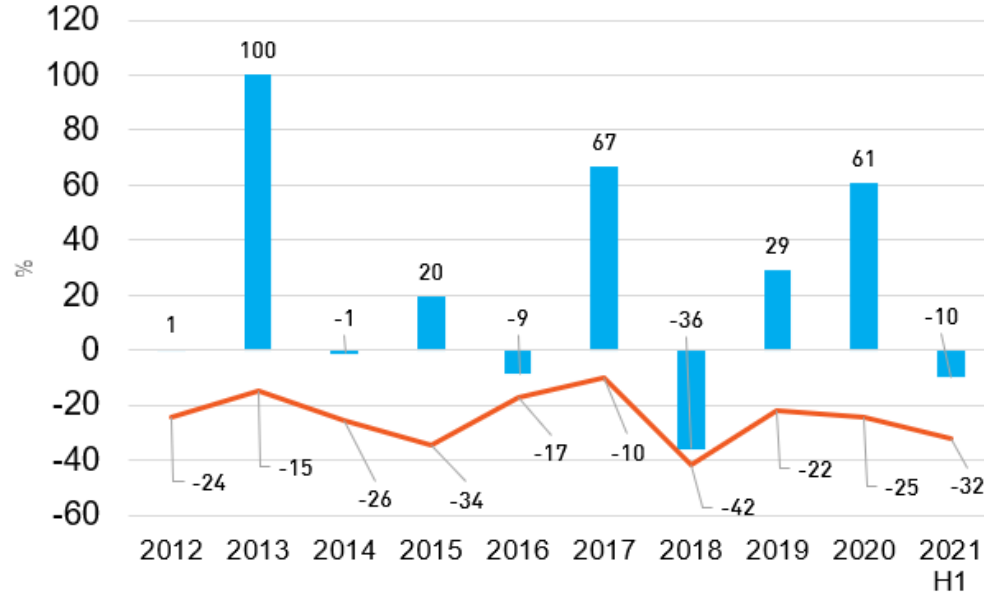


Source: EPFR, MSCI, Goldman Sachs Global Investment Research Data as of 5/31/2021.



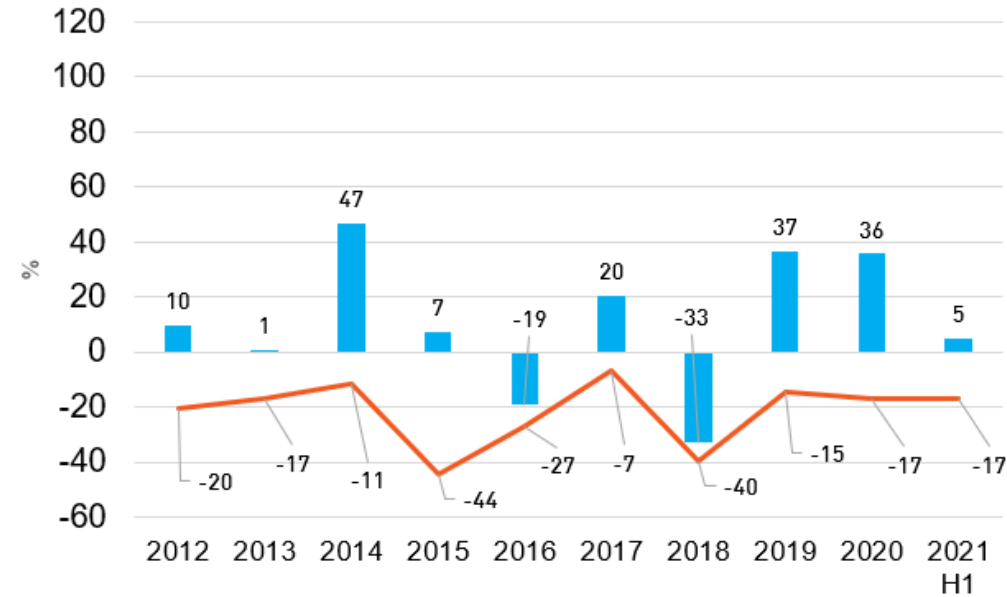
Tactically investing in China Equity is difficult. A long-term approach is more appropriate and beneficial to portfolios.

CSI Overseas China Internet Index Annual Return & Max. Drawdown



Index Cumulative Return (12/31/2011 to 6/30/2021): 367%

MSCI China A Onshore Index Annual Return & Max. Drawdown

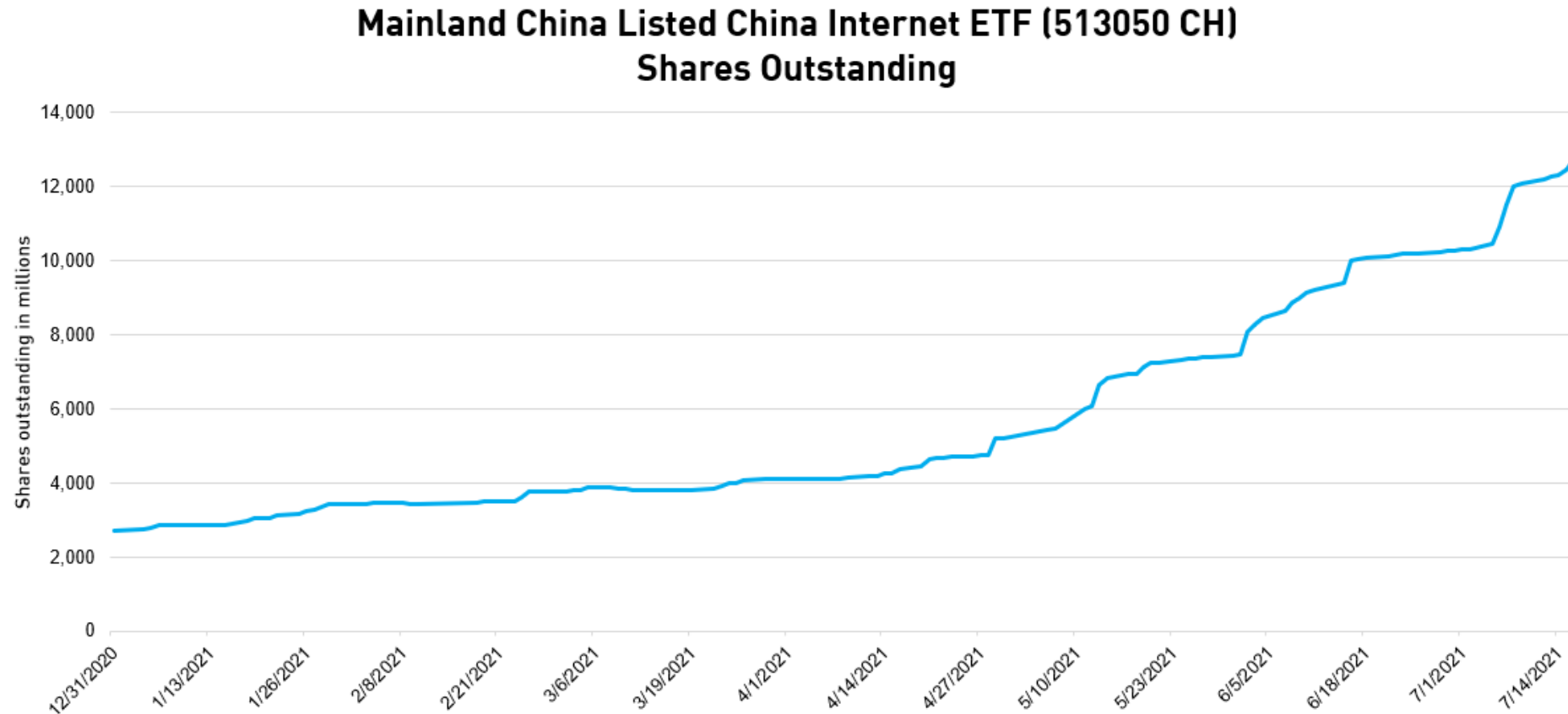


Index Cumulative Return (12/31/2011 to 6/30/2021): 132%

■ Annual Return — Max. Drawdown



Mainland investors continue to buy China internet





2H of 2021: Stay in Play

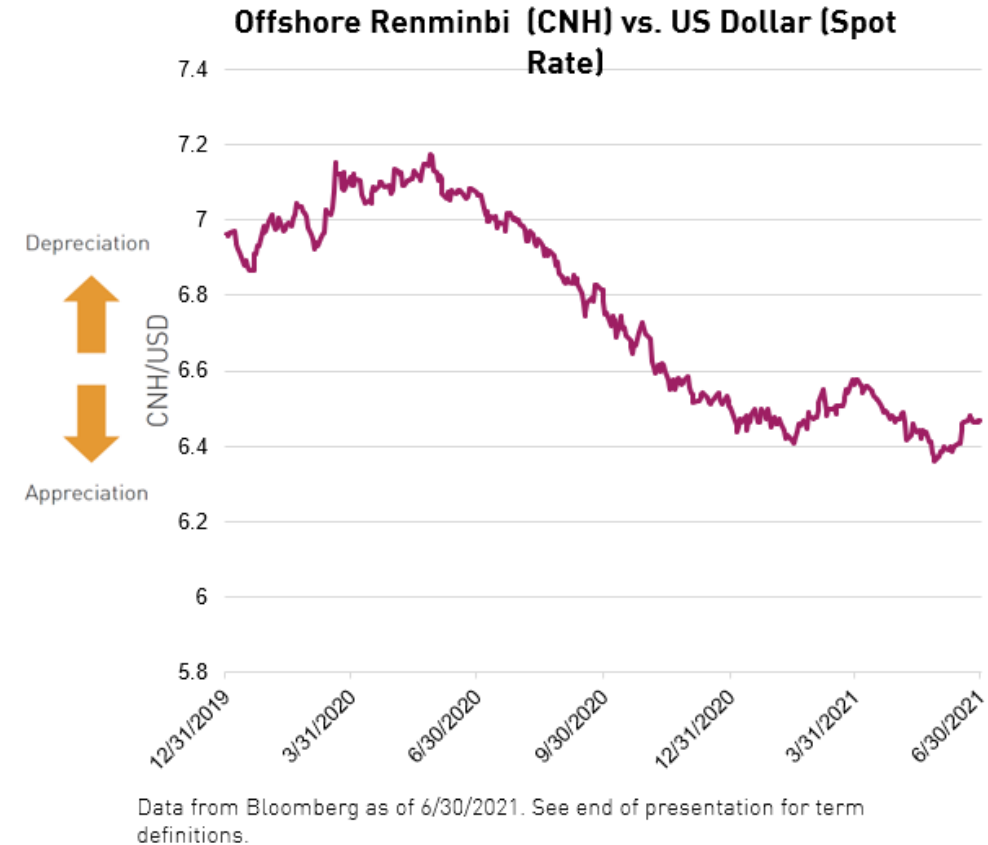
US China Tension:

- China was the US's number one trading partner in 2020 ahead of Mexico and Canada¹
- We believe economic ties between the US and China remain strong despite rhetoric

Regulations:

- We believe similar regulatory changes are occurring everywhere in developed markets
- We believe China regulations align with the government agenda of sustainable growth long term
- From mid February selloff – \$1 trillion of market cap was wiped in the same internet and technology companies that the government is focused on as a key driver of future growth²
- Internet companies comprise 40% of China's GDP growth³
- Mutual funds 4.2% underweight to China (typically 2% is a very high tracking error)⁴

Market consensus is China will deliver 8.5% GDP growth in 2021⁵, which might be why A-shares are outperforming foreign listings.



1. Data from US Census Bureau as of 12/31/2020.
2. [Ishika Mookerjee](#). "China Tech's Trillion-Dollar Stock Slump Signals Buyer Beware". Bloomberg. July 9, 2021.
3. [Yujie, Xue](#). "China's digital economy surges in 2020 amid pandemic, making up nearly 40 per cent of country's GDP," South China Morning Post. April 27, 2021.
4. Data from EFPR, MSCI, Goldman Sachs Global Investment Research as of June 30, 2021.
5. World Bank as of June 30, 2021.



Conclusion: Green shoots are emerging following regulatory uncertainty

Finish line for regulation is materializing

- **Near term:** China's Data Security Law will go into effect starting September 1st.¹ The Personal Information Protection Law, which protects internet user data, will go into effect on November 1st.²
- **Medium term:** The Ministry of Industry and Information Technology (MIIT) began a comprehensive six-month review of internet companies starting on July 23rd. So far, 68 leading Internet companies including Baidu, Alibaba, Tencent, ByteDance, Sina Weibo, and iQiyi have completed rectification as required."³
- **Long term:** The government will want the new laws to go into effect well before the 13th NPC and Beijing Winter Olympics.
- **CSRC issued a statement on August 20th pledging to "create conditions for audit cooperation with the U.S."**⁴
 - This is a major step forward for US-listed Chinese companies, which previously were not allowed to provide their audit papers to the PCAOB due to Chinese law and led to the passing of the Holding Foreign Companies Accountable Act (HFCA).

Our growth thesis for the China internet sector is still intact

- **Strong earnings for past few quarters**
 - Tencent revenues increased 20% to \$21.4B (QOQ)
 - Baidu revenues increased 20.4% to \$31.35B (YOY)
 - JD.com revenues increased 26.2% to \$39.9B (QOQ)
- **Seeing more stock buybacks, a sign the companies believe their stocks are undervalued**
 - Tencent has bought 650k shares in the last 3 days
 - Baidu has bought \$3B of shares since April 1
 - Alibaba increased buyback program to \$15B from \$10B
- **Online retail sales show continued growth**
 - From January to July, the national online retail sales reached 7.1 trillion yuan (1.01 trillion USD), a year-on-year increase of 21.9%.⁵

1.China Briefing, "A Close Reading of China's Data Security Law, in Effect Sept. 1, 2021", July 14, 2021.

2.Reuters, "China passes new personal data privacy law, to take effect Nov. 1", August 20, 2021.

3.Ministry of Industry and Information Technology release on 7/9/2021.

4.Bloomberg, "China CSRC to create conditions for audit cooperation with the U.S", August 20, 2021.

5.National Bureau of Statistics of China, "Total Retail Sales of Consumer Goods Went Up by 8.5 percent from January to July 2021", August 17, 2021.



Index / Term Definitions

MSCI China A Onshore Index: The MSCI China A Onshore Index captures large and mid cap representation across China securities listed on the Shanghai and Shenzhen exchanges. The index was launched on May 10, 2005.

MSCI China A Index: The MSCI China A Index captures large and mid-cap representation across China securities listed on the Shanghai and Shenzhen exchanges. The index covers only those securities that are accessible through "Stock Connect". The index is designed for international investors and is calculated using China A Stock Connect listings based on the offshore RMB exchange rate (CNH).

Shanghai Stock Exchange (SSE) Science and Technology Innovation Board 50 Index (referred to as "STAR 50 Index"): is comprised of the 50 largest securities listed on SSE Science and Technology Innovation Board (STAR Market) as determined by highest market capitalization and liquidity. Constituents are weighted by a float-adjusted market capitalization with a 10% weight limit for a single constituent, and the top five constituents total weighting cannot be more than 40%. The index is adjusted and rebalanced quarterly and the adjustment will be effective end of next trading day.

MSCI China ESG Leaders (USD Gross) Index: is a capitalization weighted index that provides exposure to companies with high Environmental, Social and Governance (ESG) performance relative to their sector peers. MSCI China ESG Leaders Index consists of large and mid-cap companies in Chinese markets. Inception date: Jul. 12, 2013.

CSI Overseas China Internet Index (referred to as "China Internet" herein): The CSI Overseas China Internet Index selects overseas listed Chinese Internet companies as the index constituents; the index is weighted by free float market cap. The index was launched on September 20, 2011.

Dow Jones US Internet Index: is designed to measure the performance of the 40 largest and most actively traded stocks of U.S. companies in the internet industry. To be eligible for the index, a company must derive at least 50% of cash flows from the internet. The index was launched on February 18, 1999.

Northbound Connect Flow: Denotes the daily value of stocks purchased on the Shanghai and Shenzhen stock exchanges in Mainland China by investors with Hong Kong accounts through the Stock Connect program.

Earnings per share ratio: calculates a company's profit divided by the outstanding shares of its common stock

Price-to-Earnings (P/E): The price-to-earnings ratio (P/E ratio) is the ratio for valuing a company that measures its current share price relative to its per-share earnings (EPS). The price-to-earnings ratio is also sometimes known as the price multiple or the earnings multiple.

Forward Price-to-Earnings (P/E): sure the overall performance of overseas listed Chinese Internet companies. The Index is within the scope of the IOSCO Assurance Report as at 30 September 2018. The index was launched Forward price-to-earnings (forward P/E) is a version of the ratio of price-to-earnings (P/E) that uses forecasted earnings for the P/E calculation. While the earnings used in this formula are just an estimate and not as reliable as current or historical earnings data, there is still benefit in estimated P/E analysis.

Price-to-Earnings Growth (PEG): The price/earnings to growth ratio (PEG ratio) is a stock's price-to-earnings (P/E) ratio divided by the growth rate of its earnings for a specified time period. The PEG ratio is used to determine a stock's value while also factoring in the company's expected earnings growth, and it is thought to provide a more complete picture than the more standard P/E ratio.

Drawdown: the measure of decline from a historical peak in some variable, typically the price of a security or index.

GS US—China Relations Barometer: Based on 15 specific equity proxies in areas of trade, technology, capital markets, and geopolitics to gauge equity-implied US-China relations.

Spot Rate: The price at which one currency can be exchanged for another presently, as opposed to a forward, which is a contract to buy or sell a currency at an agreed upon rate on a future date.

Gross Domestic Product (GDP): The total value of goods produced and services provided in a country during one year

The "Reserve Requirement Ratio" (RRR): Is the percentage of customer deposits and other liquid assets that commercial banks must store, within it's own institution or with the central bank, and refrain from using for lending.

E-CNY: is a central bank digital currency issued by China's central bank, the People's Bank of China.



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