金瑞基金 KraneShares

China's New Roar in the Year of the Tiger

OUTLOOK

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China's New Roar in The Year of The Tiger

China's roar has changed entering the year of the tiger. China will now emphasize quality over speed, not GDP growth at all costs. In the internet sector, blindly adding new users will take a backseat to innovation and quality of engagement. The transition to renewables and consideration for the environment is taking priority over increasing industrial production. Rather than focusing on low-end exports, China is on the brink of a technological renaissance. In this outlook, you will find an in-depth look at the changes occurring in these areas and investment opportunities for 2022 and beyond.

2021 Recap

2021 was a challenging year for China. At the same time, it was just a single year in the context of a much bigger opportunity. While we expected monetary and policy tightening going into 2021, we underestimated the intensity and reach of the tightening cycle. We have always been constructive on China, especially in the long term. Still, rapid developments are harder to predict, especially during a year of regulatory reconfiguration for the internet industry, one of China's most lucrative sectors. Because short-term volatility can cloud the larger growth picture, we encourage investors not to view

China as a trade but rather as a long-term investment. We also continue to encourage diversification* between offshore and onshore stocks and across multiple industries.

2020 feels more like a decade ago than a year ago. The strong results provided by China equities and bonds along with the strong appreciation of the Renminbi fueled our optimism going into 2021. We were not alone in our optimism as many investors believed a more balanced China policy under then President-elect Biden would occur.

Asset	Change in 2020
KWEB	+59.66%
KBA	+42.39%
CNY/USD	+6.26%
10-Year China Government Bond Yield	Unchanged

Data from Bloomberg as of 12/31/2020.

KraneShares CSI China Internet ETF

Cumulative %	Data as of: 12/31/2021		
	Fund NAV	**Closing Price**	**Index**
1 Month	-11.12%	-10.89%	-11.01%
3 Month	-16.72%	-17.04%	-16.52%
6 Month	-43.67%	-43.75%	-43.50%
Since Inception	67.93%	67.92%	70.71%
Avg Annualized %	Data as of: 12/31/2021		
	Fund NAV	**Closing Price**	**Index**
1 Year	- 49.33%	-48.88%	-48.98%
3 Year	1.51%	1.66%	1.99%
5 Year	3.33%	3.33%	3.69%
Since Inception	6.35%	6.35%	6.56%

Total fund operating expense: 0.70%. Fee waivers are contractual and in effect until August 1, 2022. Inception Date: 7/31/2013.

The performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when sold or redeemed, may be worth more or less than their original cost and current performance may be lower or higher than the performance quoted. For performance data current to the most recent month end, please call +1 (855) 8KRANE8 or visit our website at www.KraneShares.com.

KraneShares Bosera MSCI China A 50 Connect Index ETF

Cumulative %	Data as of: 12/31/2021		
	Fund NAV	**Closing Price**	**Index**
1 Month	1.49%	1.65%	1.38%
3 Month	3.20%	3.65%	3.15%
6 Month	-1.61%	-0.90%	-1.35%
Since Inception	127.64%	128.73%	144.80%
Avg Annualized %	Data as of: 12/31/2021		
	Fund NAV	**Closing Price**	**Index**
1 Year	2.70%	3.31%	3.20%
3 Year	25.29%	25.68%	26.10%
5 Year	13.29%	13.68%	12.53%
Since Inception	11.09%	11.16%	12.11%

Total fund operating expense: gross: 0.59% net: 0.79%. Fee waivers are contractual and in effect until August 1, 2022. Inception Date: 3/4/2014.

The performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when sold or redeemed, may be worth more or less than their original cost and current performance may be lower or higher than the performance quoted. For performance data current to the most recent month end, please call +1 (855) 8KRANE8 or visit our website at www.KraneShares.com.

The mid-February, post-Chinese New Year correction in internet stocks began with the liquidation of highly leveraged US hedge fund Archegos, which held five US-listed China internet stocks. The internet correction coincided with a value sector rally in the Mainland equity market, driven by high commodity prices, which caught many investors who had been significantly overweight to growth stocks off guard. In March, a significant performance disparity between the **KraneShares CSI China Internet Index ETF (Ticker: KWEB)** and the **KraneShares Bosera MSCI China A Share ETF (Ticker: KBA)** developed and persisted throughout 2021. The disparity is noteworthy as the relative outperformance of China's Mainland equity market was mostly ignored by the American financial media.

Asset	Change in 2021
KWEB	-48.88%
KBA	+3.31%
CNY/USD	+2.62%
10-Year China Government Bond Yield	-0.37%

Data from Bloomberg as of 12/31/2021.

The regulation of China's internet sector weighed significantly on KWEB throughout the spring and summer, while US regulation weighed on the securities held in the Fund in the fall and fourth quarter. While the media narrative says China is sacrificing these technology leaders, their balance sheets and income statements tell a different story.

KWEB Top 10 Holdings by Weight – Q3 Year Over Year (YoY) Revenue Growth			
Top 10 Holdings	**KWEB Weight (%)**	**Revenue Growth (%)**	**Earnings per Share (CNY)**
Tencent	10.12	27.77	16.84
Meituan	8.24	17.70	0.81
JD.com	6.81	29.28	32.70
Alibaba	5.96	40.72	55.63
Baidu	5.76	-0.32	66.70
Kanzhun	4.97	94.70	0.46
Kuaishou	4.27	50.24	-1.71
Pinduoduo	4.16	97.37	-6.04
Full Truck Alliance	3.74	4.36	0.01
KE Holdings	3.66	53.17	0.32
		Average	
		41.50	**16.57**

Data from Bloomberg as of 9/30/2021. KWEB weights as of 12/16/2021. Fund holdings are subject to change.

The disparity between overseas-listed internet companies and Mainland-listed A-shares is particularly noteworthy. China-based investors are the major holders of A shares, while foreign investors predominantly hold the Hong Kong and US-listed stocks held in KWEB. The sharp contrast between the two Funds reflects investor sentiment inside China and that outside of China, which could not be more different. Concerns about regulation and delisting drove investment decisions among US investors, leading many to overlook the A share markets' resilience in 2021. Meanwhile, a strong economy that had a head start in recovering from the pandemic drove investment decisions among China-based investors. Despite the home bias that emerged among US investors in 2021, the US and China have never been more intertwined economically than they are today.

Going into 2022, we are optimistic about many China investment themes. One of the highlights for KraneShares in 2021 was the launch of the **KraneShares China Innovation ETF (Ticker: KGRO)**, which invests in many of the themes highlighted below. It is a "one-stop shop" for China growth themes, offering exposure to consumers, internet, health care, the green economy, and technology.

2022 China Outlook

China's roar may change its tone in 2022, but we believe it will remain as loud as ever. 2022 is an important year politically for China. President Xi is expected to secure a third term during the Chinese Communist Party Congress (CCPC) assembly in the fall of

2022 and the Beijing Olympics is scheduled to take place in February. We believe the government will seek to strike a positive tone in politics and business as the country continues its transition to high-quality growth. The political importance of 2022 is why we believe China adopted a rapid-fire approach concerning internet regulations in 2021. China's policy darlings, which include health care, clean technology, 5G, and semiconductors, will continue to see support based on the most recent statement from the latest Central Economic Work Conference, which sets the government's economic and financial policy framework each year. We also believe 2022 will be a year of looser monetary policy.

US-China Relations

US-China relations may see a moderate improvement in 2022 after their, albeit limited, progress over the past year. As time passes, we will learn more about President Biden's approach to China. Is he simply continuing his predecessor's policy of confrontation, or will he revert to President Obama's approach of cooperation first? We believe the answer is somewhere in the middle. The Biden administration’s approach seems to center around setting international competition rules first and focusing collaboration later, but without causing any catastrophes. For this approach to work, the Biden administration believes they need to strengthen the US' domestic front economically and rebuild international coalitions with allies. Will this strategy work in the long term? We will have to wait and see as China likes to play the long game, especially when it believes that momentum is on its side. In lieu of a willingness to seek catastrophic confrontation, we believe the impact of US-China relations on markets will be neutral in 2022.

In addition, 2022 is also a crucial political year for the US due to midterm elections. While they may have different approaches, the one issue that both political parties in the US can agree on is China. Human rights, Taiwan, and the race for technology supremacy will continue to be points of conflict. Meanwhile, we may see more companies added to the Executive Order list. We were pleased to see President Biden narrow the scope of the list in 2021 by removing companies that are not involved with the military, including Xiaomi. He also removed Bytedance's TikTok and Tencent's WeChat from the banned list.

We believe there is a good chance that trade and climate provide areas of cooperation between the two countries. Rising inflation in the US may justify a partial retraction of the tariffs on Chinese goods. Cooperation in these areas may serve as a good entry point for more fruitful negotiations, lifting investor sentiment from a bearish base case for US-China relations in 2022.

Macro

The takeaways from the Central Economic Work Conference, which was attended by senior political leaders in China, emphasized the stability, speed, and quality of growth in 2022. The conference acknowledged that China's economy faces three pressures: demand contraction, supply shocks, and expected weakness. The panel recommended that policy support, whether fiscal or monetary, be frontloaded in 2022, which explains the reserve requirement ratio (RRR) cut and loan prime rate (LPR) cuts in December, which we believe have set the tone for 2022.

China's macroeconomic backdrop began to show signs of life in the last stretch of 2021 after a tough third quarter. China's leading indicators surprised to the upside in November, led by a slight recovery in retail sales[1]. China's November manufacturing PMI swung into expansion for the first time in months, and input prices declined by 19 points[1], signaling significant relief from energy cost surges seen in the fall. At the same time, monetary policy appears to be loosening.

Data from Bloomberg, National Bureau of Statistics, KraneShares. Data as of December 2021

However, growth targets for 2022 will be more challenging to attain this year compared to last, especially as the favorable base effect recedes. We believe China will do whatever it takes to maintain the sentimental 5%[2] level of GDP growth. We know skeptics will sound the alarm on the GDP level dipping below 5% for the first time. However, slowing GDP growth is to be expected, given the level of development that China has already achieved. Grumbling about GDP growth slowing is akin to a Yankees fan who continuously wants more from the team despite their having won a record number of world series over the past couple of decades and having made it to the playoffs almost every year. Generating 5% growth in a 16.8 trillion-dollar economy is like adding an economy the size of Germany every 3 to 4 years.†

Given the challenging growth environment, we believe total social financing (TSF), a measure of overall credit in the economy, will remain stable at around 10.5%[2] with an upside bias due to looser monetary policy and despite the lower nominal GDP growth expectations. That means the credit impulse will recover. Also, the producer price index (PPI) may decline during the first half of the year as energy shortages continue to ease. Inflation in China is likely to remain stable, as will interest rates, which attracted significant attention from global bond investors in 2021.

†Based on Germany's 2020 GDP according to the World Bank.

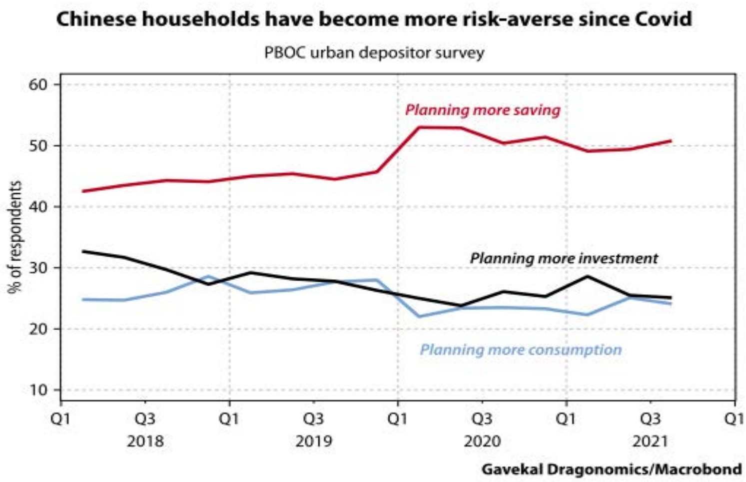
	Average 2014-2019	2020A	2021A	2022E
Real GDP % Change (Annual)	6.7	2.3	7.8	5.5
Consumption	3.4	-0.5	5.3	3.6
Investment	3.5	2.2	1.7	1.8
Net Trade (% of GDP)	-0.2	0.7	0.8	0.2
Consumer Prices	2.7	2.5	0.9	2.0

A = Actual E = Estimate. Data from National Bureau of Statistics, KraneShares. Data as of December 2021

Risks

Consumer sentiment, the property sector, and China's zero covid policy are some of the risks facing China in 2022. The recent earnings season in China confirmed consumers' fatigue. With savings rates at record highs, China's consumers are not spending like their US counterparts. The sporadic lockdowns in various Chinese cities and ports due to COVID-19 outbreaks hurt consumption and the feeling of security. As a result, Chinese savings surged since 2020.

Furthermore, real estate regulations aimed at setting a new normal in the property market also hurt consumer sentiment. An average of 65%[3] of household wealth is tied to real estate in China, compared to only 30% in the US. While we expect China to ease real estate regulations slightly in 2022 to allow for a smoother transition, it will not reverse course. Real estate is considered one of the three "mountains," or critical difficulties, for families considering having children. High home prices have been partially blamed for the country's less than ideal birth rate. However, we believe that much of the adjustment to real estate prices has already occurred. If anything, we may see a slight recovery in prices as China relaxes some of the requirements and makes it easier for first-time buyers and young families to acquire properties.



Valuation and Growth

We believe China looks exceptionally attractive on a valuation basis compared to global markets. While the US, EU, and Japan are significantly overvalued on a historical basis, valuations in some industries in China, such as the internet industry, are extremely depressed. China's earnings expectations have come down considerably in 2021, and positioning among investors is at a multi-year low[4]. The consensus earnings expectation for China in 2022 is close to 15%[1]. A combination of earnings growth and multiple reratings could make China an attractive investment in 2022, especially relative to global equities.

Source: EPFR Global as of 9/30/2021, Active Emerging Market Weight to China Weighted by Fund AUM versus MSCI Emerging Market Index Weight to China

Internet

China's internet sector found itself in the eye of the regulatory storm and was the worst-performing sector in 2021. Internet companies were the targets of a broad regulatory campaign in China, addressing anticompetitive behavior, cybersecurity risks, consumer data protection, and the financial risks posed by previously unregulated fintech companies. We believe that regulatory uncertainty for China's internet companies may subside next year. It is essential to recognize that many elements of the regulations introduced in China this year mirror regulations either implemented or being considered by the US and EU governments. These include the General Data Protection Regulation (GDPR) in the EU and the ongoing Federal Trade Commission (FTC) lawsuits against Google and Facebook in the US.

The 3-year clock for US-listed Chinese companies to allow their audit papers to be inspected by the Public Company Accounting Oversight Board (PCAOB) as stipulated by the Holding Foreign Companies Accountable Act (HFCAA) starts on January 1 of 2022[5]. This means that if US and Chinese regulators do not reach a compromise, companies would not face delisting until late 2024 or 2025[5]. The commotion is driving all Chinese technology companies to relist or consider relisting in Hong Kong to avoid becoming a political football that China or the US can kick around to make political statements.

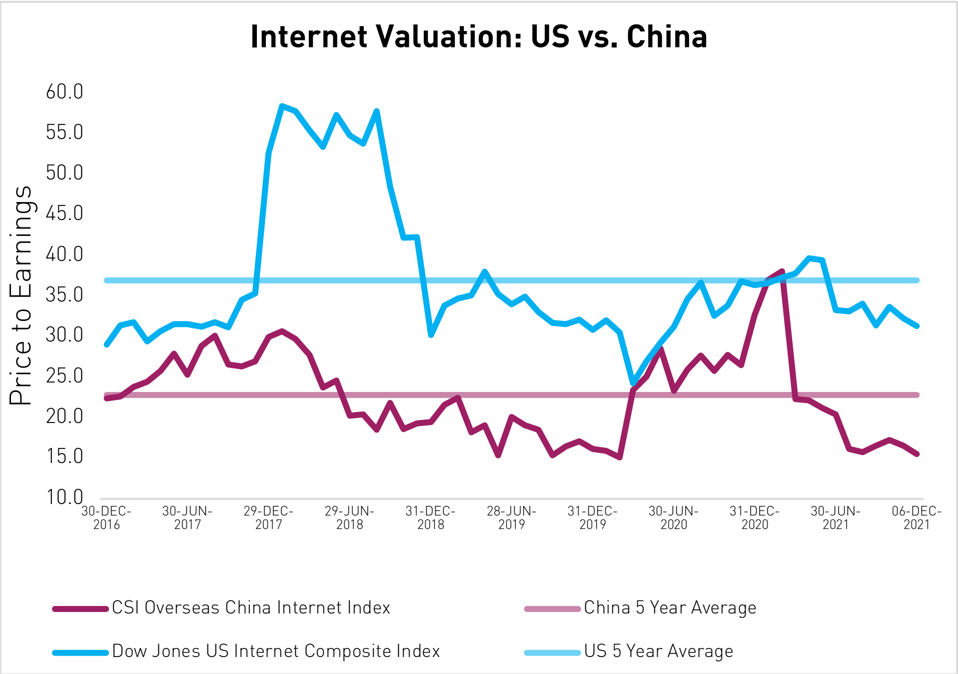
Beyond the HFCAA, concerns emerged that China may ban the use of variable interest entities (VIEs), a legal structure that can allow greater access to foreign capital. VIEs are popular among many Chinese companies listing in Hong Kong, Mainland China, and the United States. We do not believe that China is considering banning the use of the structure. In fact, the China Securities Regulatory

Commission (CSRC) is working to better regulate VIEs. Going forward, companies will be subject to CSRC approval before listing in Hong Kong or the US. As for the outstanding VIEs, the government will focus on the operational aspects of enforcement and on strengthening the link between the VIE legal structure and the companies themselves. A common misconception is that Chinese companies specifically use the VIE structure to list in the US. However, there are also VIEs listed in Hong Kong and Mainland China. For more details on delisting, VIEs, and regulations, please read our recent *KWEB FAQ*.

At KraneShares, we have worked hard all year to keep up with these developments and keep investors appraised of the situation. From the start, our stance has been that China will not kill its golden gooses, which put it on the map globally. We were not entirely correct here. China was not as worried about the economic ramifications of regulation as we expected. Instead, the government focused on implementing its strategy and vision of a fair and commonly prosperous China. These are noble goals that will ultimately benefit consumers and investors in the long term, but pain may be felt in the short term.

We believe China is in the process of implementing what remains of its transformative policies for the sector. We now understand the framework for E-Commerce and fintech industry regulations. However, that does not mean we will not see some fine-tuning in the future. The Ministry of Industry and Information Technology (MIIT) announced that the regulatory crackdown might last six months in July[6]. Meanwhile, the CSRC has been proactive in informing investors of the intentions behind its most recent decisions. The CSRC's increased transparency led many Wall Street banks to upgrade China's internet sector and China in 2021.

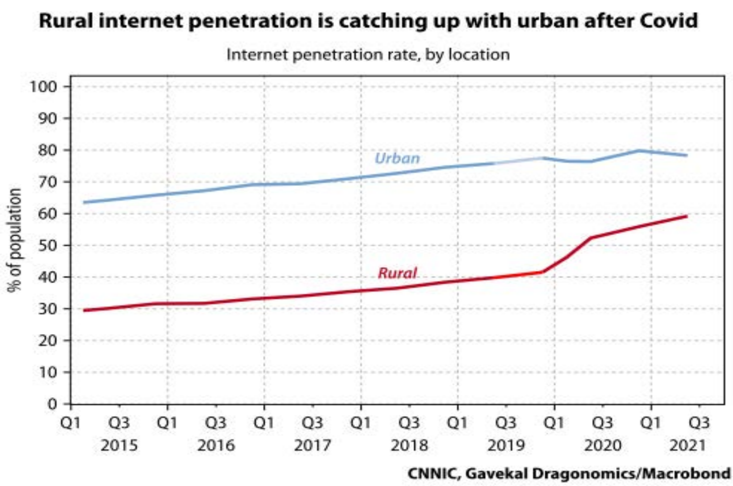
China's internet sector is currently trading at half the multiple of its US counterparts. This is driven by the fact that China's leading internet companies continue to grow revenues year-over-year despite some headwinds from the consumer slump. Therefore, share price declines have not been rooted in fundamental downturns. We believe this striking valuation gap will correct itself as policy risks recede and the consumer regains confidence.



Data from FactSet as of 12/6/2021.

As E-Commerce penetration expands in rural areas, user growth will become less of a focus for E-Commerce platforms. Companies will now have to focus on capturing users' attention and increasing the average value extracted per user. With its super application WeChat, Tencent has a strong advantage in keeping users engaged. Recent earnings reports revealed the issues facing Alibaba, key among them is increasing competition. Also, antitrust rules allow merchants to list on different E-Commerce platforms, especially JD.com and Pinduoduo, steepening competition in the industry.

Furthermore, the success of short video platforms such as Douyin (China's Tiktok) and Kuaishou, especially in the cosmetics and apparel categories, has turned these previously media-centric platforms into formidable competitors for Alibaba's core E-Commerce business.

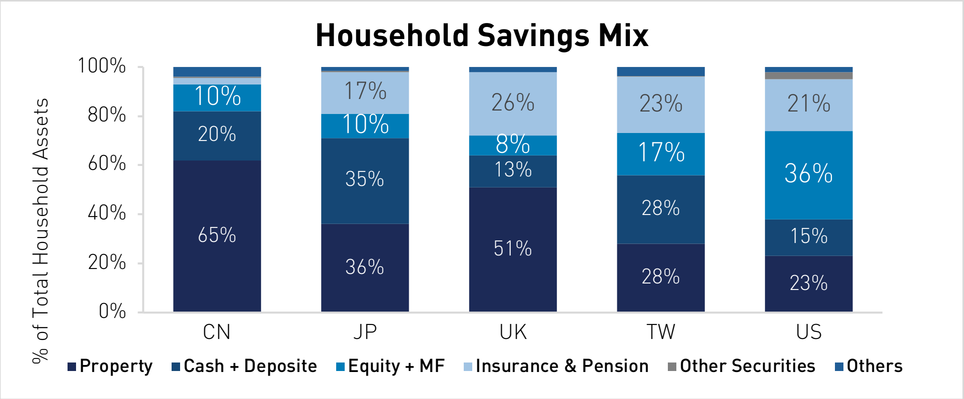


Outside of E-Commerce, we believe cloud and the metaverse will be the next frontier of growth for internet companies, especially Alibaba, Tencent, and Baidu. With 5G and autonomous driving around the corner, businesses will need more cloud space to store the data. Also, if the metaverse vision materializes, these three companies are perfectly positioned to bring together their technological prowess and the popularity of their ecosystems to create a superior metaverse product.

The **KraneShares CSI Overseas China Internet Index ETF (Ticker: KWEB)** can help investors capture China's technological and digital evolution. The Fund provides a basket approach to China's internet companies listed in the US and Hong Kong and offers exposure to the rising consumption from the emerging Chinese middle class.

A-Shares

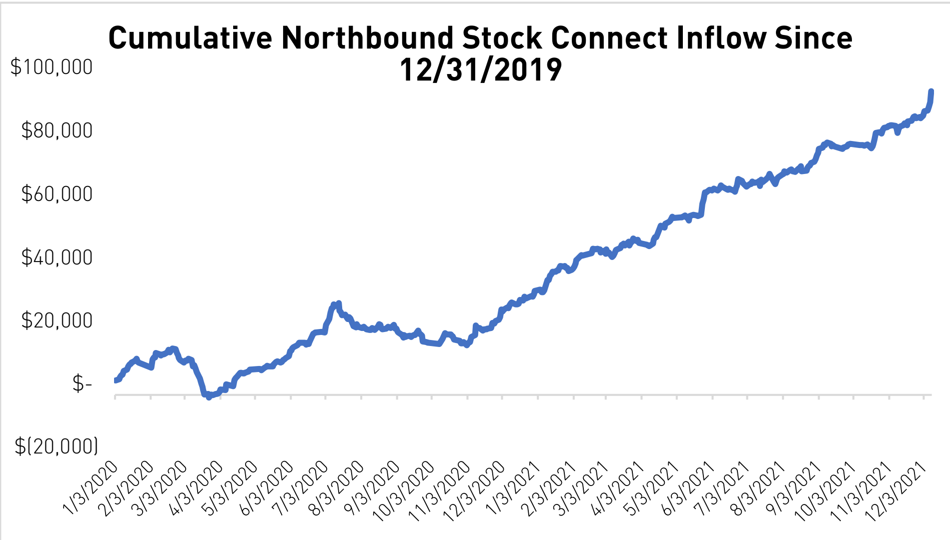
China A-shares started the year strong and continued their rise unabated in the face of regulatory noise in China and inflation fears in the US. The consumer, health care, clean technology, and technology sectors performed well, as China recovered from the pandemic. The policy backdrop for A-shares industries was highly favorable, especially for clean technology. However, the market rally began to stall in the summer as regulations intensified, Evergrande stumbled, and energy shortages began to surface. The market gave up most of its gains as a result but fared much better than China's offshore stocks for the year.



Source: NFID, CEIC, Wind, Japan Cabinet Office, Halifax, Goldman Sachs. Data as of August 2021

A positive macro backdrop has often benefitted the A-shares market in the past. The A-shares market continues to be under-owned by domestic and foreign investors alike. Domestically, real estate investments constitute most assets[7] of a typical household portfolio. Internationally, restrictions on access and lack of inclusion in global indexes are prohibiting foreign investors from increasing allocations. More than 62%[7] of total urban households are invested in real estate compared to 23% in the US and 36% in Japan.[7] We believe the fallout from Evergrande will ultimately result, either directly or indirectly, in the diversion of real estate assets to the A-shares market. With the crackdown on property in China, we believe the wealth creation mechanism will shift to capital markets.

The CSRC gave the green light to list A-Shares futures on the Hong Kong exchange in November of 2021, allowing investors to hedge and manage the risk of their A-Share exposure. We believe this represents a significant breakthrough and raises the odds of more A-shares inclusion in 2022 by global index providers. Access to derivatives, which enables investors to hedge risk, was a top concern for MSCI. Also, the pressure on offshore Chinese equities benefitted Mainland listed equities in 2021 and made them more popular with foreign investors, as indicated by the record flows through Northbound stock connect. However, the charged political environment in the US during an election year may act as a counter factor to this trend in 2022. For more information on A Shares, please read *Do All Roads Lead to A-Shares: Evergrande, Inclusion,* *and more!* where we cover real estate and potential index inclusions in-depth.



Data from Bloomberg as of 12/13/2021. Please see the end of the presentation for definitions.

China A share earnings are expected to grow 17%[1] in 2022, while revenues are expected to grow by 13%[1]. The easing of the producer price index (PPI) will reduce cost pressure on Chinese companies and consequently lift margins in the coming year. Valuations remain attractive on the A-shares market, in line with its long-term average. However, the price to earnings growth (PEG) ratio is hovering close to 1[9], which is considered cheap especially compared to US equities.

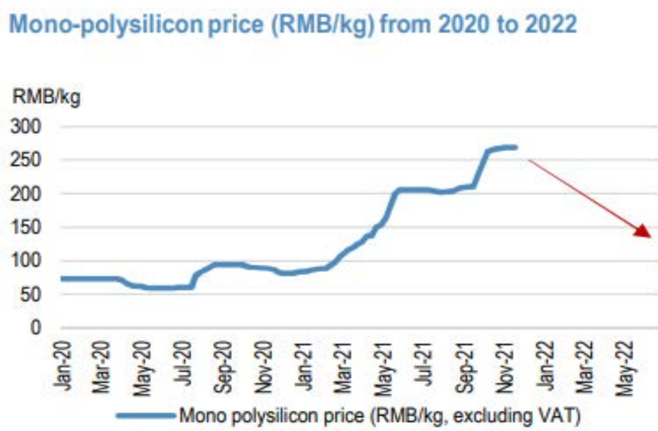
The **KraneShares Bosera MSCI China A 50 Connect Index ETF (Ticker: KBA)** tracks China's Mainland stocks. We believe KBA is well positioned to potentially benefit from the Mainland's performance drivers such as enhanced 5G infrastructure, and the consumer, in addition to any future inclusion announcements from global index providers.

Clean Technology

China's clean technology sector continued to advance in 2021. The industry was a top performer in China and one of two strategic industries with gains for the year[1]. Policy support and innovation continue to be the main drivers. However, the road to carbon neutrality is not without risks and the potential for disruptions.

Solar

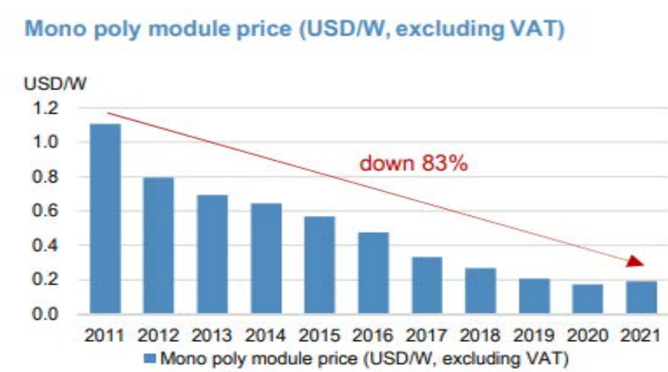
The clean technology industry in China continued to receive policy support all year, leading to gains for the sector in 2021. China increased the 2030 targets beginning of the year and committed to 1200 gigawatts (GW) of capacity by 2030, up from the current 450GW.[9] In June of 2021, China's National Energy Administration (NEA) announced a rooftop solar project, setting target penetration rates for government, commercial, and residential buildings. In October, President Xi also announced a batch of new solar projects[9] in West China starting this year. Lastly, the NEA announced a mechanism for wind and solar projects to sell electricity to industrials at a market price directly.



Source: Chart Mono-Polysilicon price. PVInfoLink, J.P. Morgan estimates December 2021

However, the solar industry faced many challenges over the past year. The US banning of products using polysilicon from some companies based in Xinjiang led to the confiscation of products of Chinese companies at US customs. The energy crunch, which began to appear during the year's third quarter, exacerbated the rise in the price polysilicon, an essential commodity for the solar industry. Polysilicon spot prices averaged $37/kg in the week of November

24, up 30% from late September and 236%[9] in 2021. As a result, 2021 saw solar panels prices rise, erasing some progress in cost reduction. The rise in prices also impacted demand as many projects expected to be completed in December were pushed to next year.



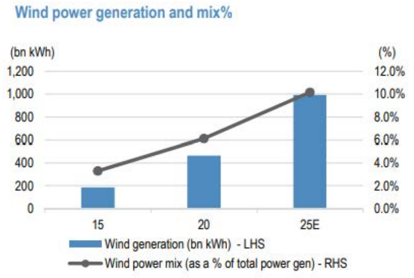
Bloomberg Finance LP, CEC, J.P. Morgan estimates. December 2021

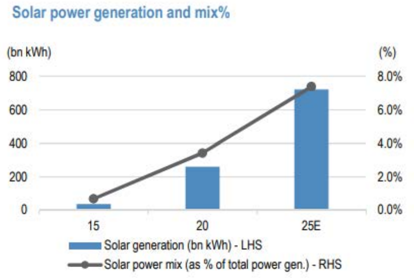
As the power crunch eases in 2022, the price of Polysilicon is expected to decline. Also, Polysilicon supply is expected to increase from about 586,000 metric tons in 2021 to over 800,000 tons[9] in 2022. The highly sought-after commodity is already showing signs of price depreciation as new supply comes online, solar demand dwindles, and wafer inventories are built up. In turn, wafer prices are expected to drop by 20% to 25% next year, along with solar modules, returning to their previous downward price trend.[9]

Vertically integrated Solar companies, with operations and investment in upstream and downstream businesses, had the advantage this year as they were the least impacted by the shortages. Policy support will continue in 2022 as more megaprojects are announced. The PBOC recently announced the initiation of a green lending program that allows for lending to green businesses at a low interest rate of 1.75%[9]. This is significantly lower than typical rates of around 4% for state-owned firms and the even higher rates charged to private companies.

Wind

Both wind power projects and capacity increased in 2021. The impact of the shortages on the industry was benign. Enthusiasm for wind continues despite the end of national subsidies in 2021. The projects and targets announced should help the industry maintain its luster. Also, technological advancement in turbines and capacity are placing wind and solar among the cheapest sources of electricity.

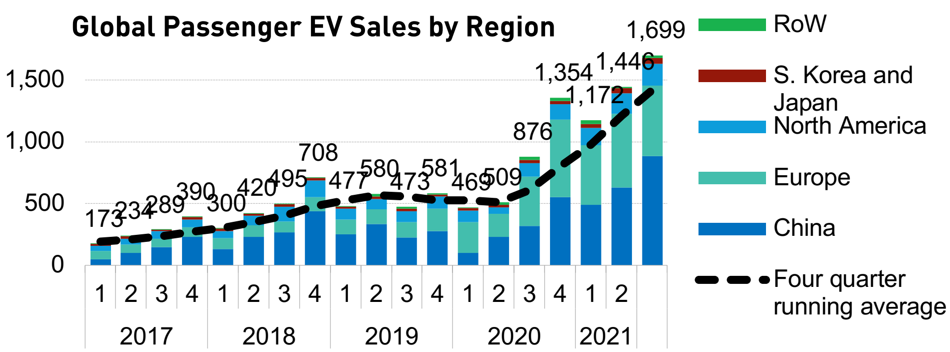




Both Charts - Bloomberg Finance LP, CEC, J.P. Morgan estimates December 2021

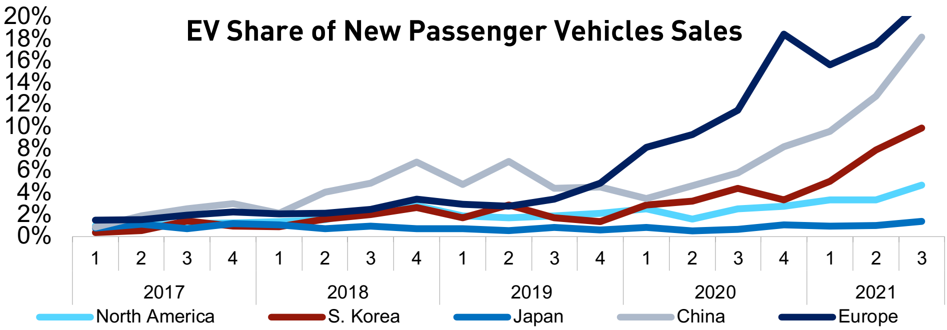
Electric Vehicles

What a couple of years it has been for the electric vehicle (EV) industry. EV sales did not skip a beat in 2021, after an impressive 2020. China EV sales are expected to reach 2.5 million units sold, up from 1.2 million[9] in 2020. The Wuling by automaker SAIC-GM (pictured above) took some cities by storm in 2021, outselling Tesla's model 3. The success of the Wuling is attributed to its affordability and customizability based on clients' preferences of color, interior, and even cartoon characters on the exterior. The car costs close to $5,000, has a top speed of 62 miles per hour, and comes in two ranges: 120 or 170 miles. Automaker BYD was the leading brand again this year, selling 317,000[10] cars as of November. SAIC-GM and Tesla came in second place, selling 294,000[10] vehicles each. NIO sold 66,894[10] cars, up from 44,493[10] in 2021, Li auto sold 55,270[10] cars, up from 31,160[10] in 2020, and Xpeng sold 56,160[10] cars, up from 26,556[10].



Source: BloombergNEF. Data as of September 2021

2022 is poised to be another great year for electric vehicles in China. Per our recent conversation with BYD management, the company projects battery electric vehicle (BEV) and plug-in hybrid electric vehicle (PHEV) sales to reach 1.5 million vehicles in 2022.[10] November auto sales data revealed that EV sales as a percentage of total vehicles sales in China reached 20% for the first time.[11] More models are expected to launch in 2022, including the highly anticipated ET7 from NIO. Xpeng, Li Auto, and NIO are also likely to launch new SUVs in 2022[10]. Another highly anticipated car was the Zeekr 007 from Geely, which was launched last September. For more information on the electric vehicles industry, please read our recent article *The Unstoppable EV Ecosystem and How to Invest*.



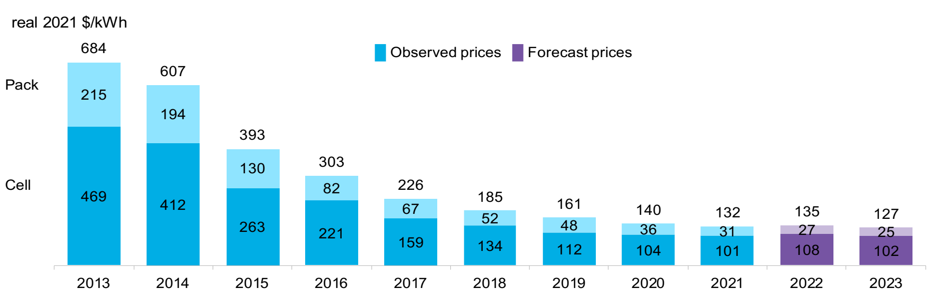
Data from Bloomberg New Energy Finance (BNEF) as of September 2021

China continues to build charging infrastructure reaching close to 1,000,000 connector chargers[9] (80% of global chargers). NIO just announced the completion of its 700th battery swapping station.[10] So far, companies have managed the chip shortages and the rise of raw materials prices. However, if disruptions continue, we may see some production impact in 2022.

Batteries

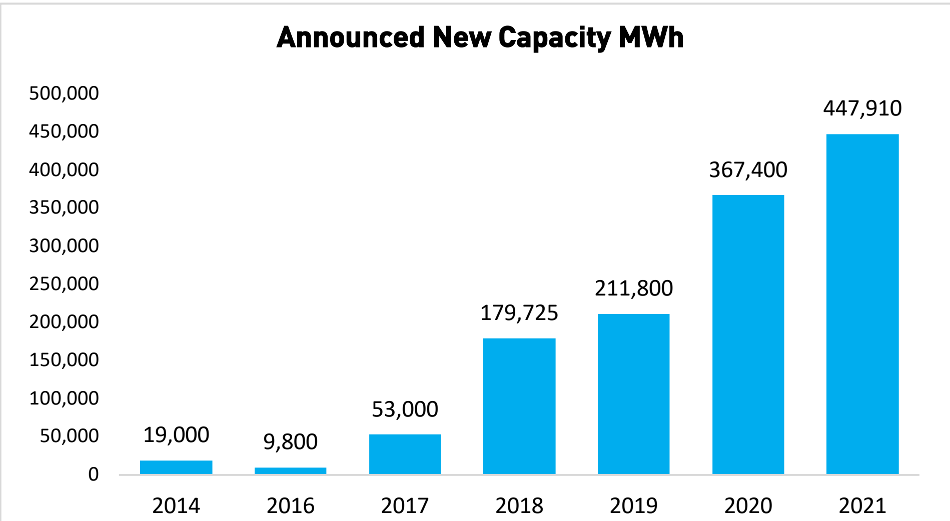
According to the Bloomberg New Energy Finance (BNEF) yearly lithium Survey, which was published at the end of November, the volume-weighted average price for a lithium-ion battery pack declined to $132/kilowatt hour (kWh)[9] in 2021, down from $140/kWh the year before, marking the 9th year of consecutive battery price decline. The $132/kWh came in worse than analysts' expectations of $127/kWh5 price due to rising raw material prices. However, the 9-year strike is expected to be disrupted in 2022 as battery prices are expected to increase by $3/kWh as commodity shortages begin impacting the industry.[9] BYD already announced a price increase of 20% on its Blade battery in September.[10]

Global Battery Prices



Source: BloombergNEF. As of December 2021. Note: Observed prices are in real 2021 $/kWh, forecast prices are in nominal $/kWh

Fortunately, more energy storage is expected to come online soon, easing the shortages for 2023 and beyond. New battery production capacity has more than doubled from 211,800 megawatt hours (MWhs) per year in 2019 to 447,910 MWh5 per year in 2021, equivalent to the production capacity of approximately 6.5 million Tesla Model 3 Long Range Dual Motor batteries annually.[9] CATL, Tesla, and BYD are leading the way.



Source: BloombergNEF. Data as of November 2021

The quest for battery cost reduction continues. It will be mainly driven by innovation in chemistry, pack design, and cell improvement. Battery research is like cooking. It is focused on producing the right recipe that both improves energy density and reduces cost. The most popular chemistry today is the lithium-ion-based lithium iron phosphate (LFP), followed by the nickel-based lithium-nickel-cobalt-aluminum-oxide (NCA) and the lithium-nickel-manganese-cobalt oxides (NCM). Batteries are made of two main components: the cells and the pack. Tesla announced during its Battery Day in 2020 that it is working on integrating the battery cells in the body of the car.[10] This means more cost reductions as packs are not needed anymore. CATL has announced similar plans and is also working on a new Sodium-Ion battery, which is expected to relieve pressure on lithium demand in the future.[10]

Health Care

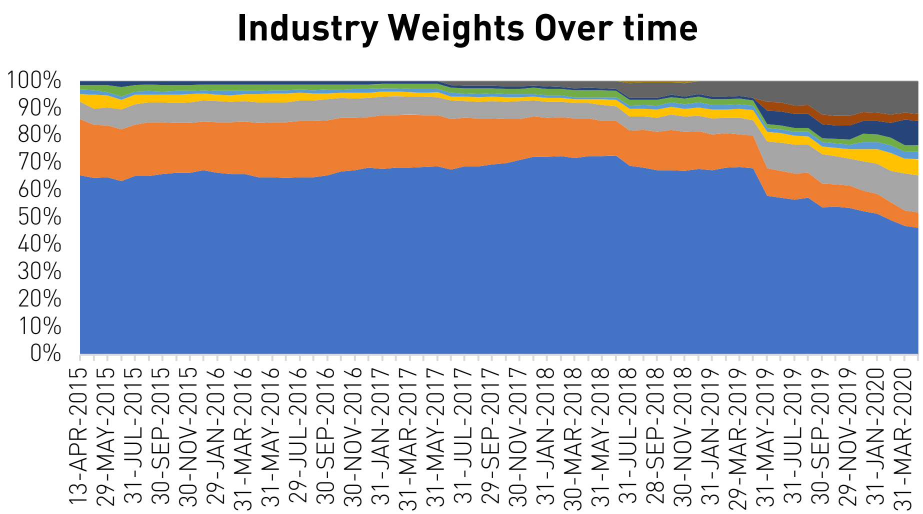
2021 was a negative year for healthcare despite the sector's significant long-term potential. The ghost of regulation haunted the industry all year and was particularly relevant to the share price performance of health care technology companies (telemedicine and online pharmacies). Investors' biggest fear was regulations in the biotechnology industry as it could derail the long-term secular opportunity. However, through communication with companies, analysts, and policymakers, we quickly determined that the health care industry is somewhat shielded from transformative regulations.

For one, the industry is no stranger to regulation. The recent implementation of the Central Procurement program in 2018, which resulted in price pressure for many pharmaceuticals, rattled the markets. We believe this will be the primary mechanism for the government to control costs and encourage competition going forward. This year, injectables and medical devices were added to the program, sending companies including Jiangsu Hengrui (a top integrated pharma company) and Mindray (the leading medical devices firm) tumbling.

We believe it is hard to regulate the biotechnology industry. Regulations may derail the progress made in transitioning China's health care system from generic drugs to innovative drugs targeting sophisticated diseases including cancer, cardiovascular disease, autoimmune disorders, etc. China's alternative would be relying on multinational companies for innovative medicines. The same applies to Life Science and Contract Organizations, which assist pharma and biotechnology throughout the R&D process (from molecule discovery to commercialization) and help cut the cost of research. We may see fine-tuning in other health care subsectors such as hospitals, but that is unlikely to have a material impact on the industry.

Health care technology is a new sector with solid backing from the government even since before the pandemic. Telemedicine, online pharmacies, and patients' data management programs are vital solutions for a highly complex health care system. Telemedicine has allowed health care providers to cut patients' wait time from 3 hours to 8 minutes on average and allowed people living in rural areas access to high-quality doctors and drugs.[10] The government highlighted the benefits of these services multiple times in 2020 and 2021, which we believe is a clear sign of support.

We expect the shift from generic to innovative drugs to gain steam in 2022 as more innovative medicines for oncology and others are approved. 2021 saw many multinational companies seeking to license Chinese molecules for further research or sale outside China. Pharmaceutical companies may continue to lose market share to biotechnology and Life Sciences companies. The recent regulation raising the quality bar on pharmaceutical companies seeking to develop innovative drugs may accelerate the process at the expense of small, less established pharmaceuticals.



Data from FactSet as of 4/14/2020. Based on the industry weights within the MSCI China Health Care Index. See below for index definitions.

The drivers remain the same, but the valuations look more attractive. China's total healthcare spending per capita is close to $501 versus $10,304 in the US, $4,000 in Japan, and $3,000 in Europe.[12] The demand for health care becomes apparent as more people join the middle class and age. However, China's government will take great care in keeping costs low for patients. But, with a new and complex industry like biotechnology, it is hard to tap the breaks. The recent announcement of a potential pill treatment for COVID-19 by Pfizer hurt the share prices of some vaccine companies in China, which led to even lower valuations. Analysts expect health care earnings to grow by 23.10% and revenues to increase by 15.24%.[8] We also expect valuations to recover as fear over regulations dissipates.

Semiconductors

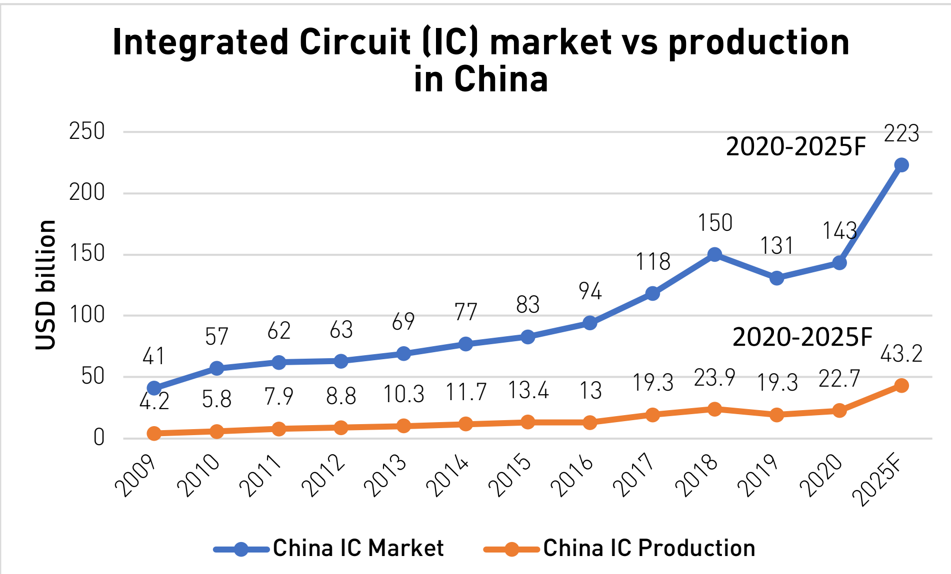
A global chip shortage materialized in 2021 driven by supply-side disruption and high demand from digitalization. Stimulus packages distributed by global governments and the transition to remote working have created a massive demand for electronics. Meanwhile, 2021 saw a significant increase in chip demand from automakers.

Taiwan Semiconductor and Samsung electronics are moving up the value chain. As a result, the shortage of less advanced chips has created an opportunity for Chinese players to catch up. China's semiconductor boom has increased its market share in many long-tail segments, including semiconductor equipment, materials, microcontroller units, and image sensors. Over the past year, the average 1-year revenue growth was over 44%[1] for the companies in the **KraneShares CICC China 5G & Semiconductor ETF (Ticker: KFVG)**.

Most automobile and consumer electronics CEOs are estimating that the global chip shortage may continue in 2022. It will take some time for companies to expand their capacity and reorganize their supply chains to meet global demand.

China views its reliance on chip imports as a severe national security liability, just like the US. Both the US and China have emphasized the localization of their respective semiconductor ecosystems. The development of the semiconductor industry is a priority in the 14th Five Year Plan and is targeting 70% import substitution by 2025 and complete import substitution by 2030.[13] The Chinese government has put over $81 billion to help the domestic semiconductor industry, together with a 5-10 years tax-exemption for local semiconductor companies.[14]

We expect to see the localization trend continue in China in 2022 as currently only 16% of China's demand for integrated circuits can be met domestically.[15]



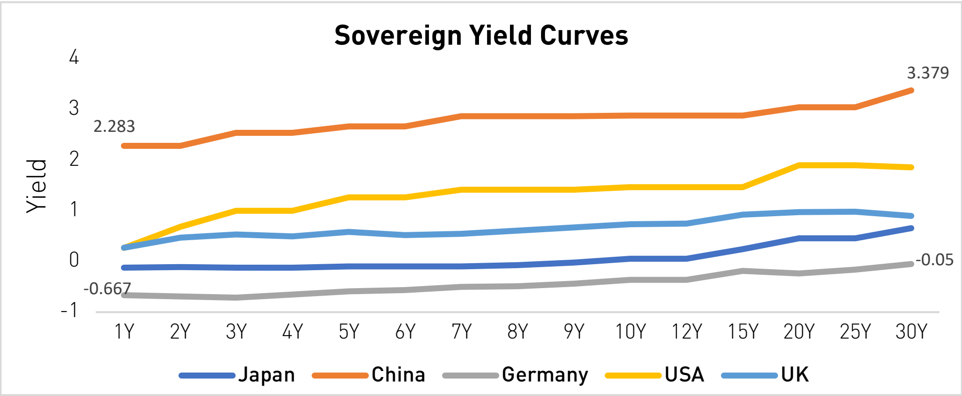
Data from IC Insights as of 12/31/2020.

Many Chinese semiconductor companies enjoy lower costs and a faster idea-to-market cycle than global peers. We think that will help these players to serve the huge domestic addressable market. For more information, please read *From Zero to One: The Rise of China's Semiconductor Industry.*

Fixed Income

China's government bonds continue to offer a substantial pick-up in yield compared to the US and developed economies. After enduring the pandemic at a yield of above 3%, the 10-year China Government Bond (CGB) yield declined somewhat in 2021 and is currently at just over 2.80%.[16] We expect yields in China to remain stable in 2022 but may end up slightly lower by the end of the year as monetary conditions ease. However, rising rates in the US may apply upward pressure on yields in China. Moody continues to rate China as an A1 sovereign issuer with a stable outlook.[17]

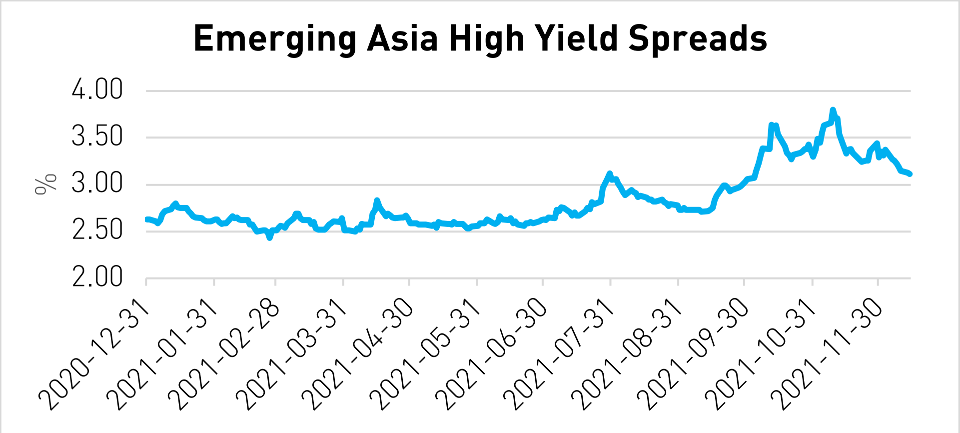
Low inflation in China relative to the US and globally and the strength of China's currency are likely to benefit the bond market throughout 2022. Furthermore, foreign inflows into China's bond market remain strong as index inclusion continues unabated. JP Morgan completed its inclusion of China government bonds in 2020, driving approximately $20 billion[18] into the market, and FTSE Russell began its inclusion of China government bonds this year, which will be implemented over a three-year period and is expected to result in inflows of up to $130 billion.[19]



Bloomberg: Data as of December 2021

The **KraneShares Bloomberg China Bond Inclusion Index ETF (Ticker: KBND)** offers access to China's higher-yielding investment grade and government bonds denominated in local currency.

High yield spreads in Asia are currently above 3%, a level not seen since July 2020.[20] This is mainly due to the run-up in risks in China's real estate sector, which accounts for a significant portion of high yield debt issuance. The increase in risk was caused by policy changes limiting real estate lending that, in turn, led to the restructuring of property developer Evergrande. Real estate prices have mostly stabilized, and we expect spreads to decline significantly in 2022. Nonetheless, we anticipate the potential for additional credit events in the China real estate sector, though the fallout from Evergrande has been mostly contained. We believe Asia's high yield bond market is currently exhibiting inefficiencies that shrewd active management is apt to exploit. Read our recent article *KHYB: Adding Growth and Income to your Bond Strategy* for more information.



Data from St. Louis Federal Reserve as of 12/4/2021

The **KraneShares Asia Pacific High Income Bond ETF (Ticker: KHYB)** offers access to emerging Asian high yield bonds and is actively managed by Nikko Asset Management (NAM). Approximately 50% of KHYB is invested in China's high yield, predominantly in what we believe are high-quality real estate companies, as of Q3 2021.

Consumer Brands

The resurgence of COVID-19 in China and its zero-covid policy pressed retail sales in 2021. The recovery of offline consumption was not smooth, especially for restaurants, hotels, and leisure activity operators. China is likely to try to double down on its zero-covid policy in 2022. However, omicron and the new treatment may force policymakers to adopt a new strategy.

China currently has a low consumer price index (CPI) and a high producer price index (PPI). The surge in producer prices has failed to translate to higher costs to consumers because of strict restrictions on energy prices and China's ability to export consumer price inflation. We believe PPI may decrease while CPI may increase in 2022 on the back of policy easing, though China's CPI may fall well short of that seen in the US. As a result, consumer brands in food & beverage, home appliances, and apparel may improve their earnings due to higher sales prices and lower purchasing costs.

We saw an average of 25% revenue growth over the last year for companies in the **KraneShares CICC China Consumer Leaders Index ETF (Ticker: KBUY)**.[21] Many brands are thinking about adding capacity to meet the growing demands. For example, dairy producer Yili Group raised $1.9 billion through a private placement in 2021 to increase its milk production capacity, eyeing higher dairy consumption per capita in China in coming years.[22]

In the premium and luxury segment, brands have carried out price hikes due to tight supply and rising demand. The premium liquor brand Kweichow Moutai raised its price in 2021. The market price of its flagship Feitian is now around RMB 3000 compared to RMB 1800 four years ago.[23] Furthermore, China's consumer brands are likely to leverage a more efficient online distribution channel and increase penetration with the help of new anti-monopoly regulations in 2022.

We think the market concentration rate will increase in 2022 as leading brands dominate the mindshare in their respective categories. Local brands may also continue to benefit from an improving perception of Chinese brands by local consumers. As the country with the largest middle-class consumption, China consumer brands are ready to grow with an established moat and branding power. For a more information on consumer products in China, please watch our informational video *Spirits, Fashion, and the Power of China's Consumer*.

Conclusion

China's roar may change its tune in 2022, but we believe it will be as loud as ever in the year of the tiger. As Joe Tsai, Alibaba's co-founder and Executive Chairman put it during Alibaba's investors day, "China is not going away." The event's tone was geared towards innovation and the future, without legacy industries hindering their progress. In our opinion, it represented what China is all about: innovation and progress.

In 2022, the country will continue to advance on many fronts, including climate, electric vehicles, health care, the internet, cloud, high-end manufacturing, and more. However, China's leading industries, especially the internet sector, are undergoing an important shift from simply capturing ever more consumer spending to a focus on material innovations and the localization of import-reliant supply chains. China's behemoth economy indeed suffers from imbalances with internal and external regulatory risks that could cost investors, especially in the short term. Fortunately, we believe the government is committed to dealing with these imbalances through reform and regulations. Nonetheless, we believe diversifying* between offshore and onshore listed equities and investing in multiple industries may help reduce risks.

We hope to serve as your trusted guide to China's capital markets in 2022 and beyond.

**Diversification does not ensure a profit or guarantee against a loss*

Citations

1. Data from Bloomberg as of 11/30/2021.
2. KraneShares estimate.
3. Data from JP Morgan as of 12/31/2020.
4. EPFR Global as of 9/30/2021
5. SEC announcement in December of 2021
6. Ministry of Industry and Information Technology release on 7/9/2021.
7. Goldman Sachs August 2021
8. FactSet December 2021
9. Bloomberg New Energy Finance (BNEF) 12/1/2021.
10. Company Data as of December of 2021
11. Data from China Passenger Car Association as of 11/30/2021.
12. Data from The World Health Organization as of 4/7/2020.
13. US Chamber of Commerce. "Made in China 2025: Global Ambitions Built on Local Protections," 2017.
14. Zhang, Jane. "China unveils major tax incentive policy to encourage innovation in domestic semiconductor industry," South China Morning Post. August 5, 2020.
15. "China Forecasts to Fall Short of its 'Made in China 2025' Goals for ICs," IC Insights. January 6, 2021.
16. Data from Bloomberg as of 12/20/2021.
17. Moody's Investor Service as of 12/13/2021.

18. Data from JP Morgan as of 11/2020.
19. Galbraith, Andrew. "China bonds set to billions of dollars after FTSE WGBI approval," Reuters. March 29, 2021.
20. Data from St. Louis Federal Reserve as of 12/4/2021.
21. Data from Bloomberg as of 9/30/2021
22. Cornall, Jim. "Yili raises $1.8bn from shares," Dairy Reporter. December 16, 2021.
23. Data from Sohu.com as of December 2021.

Companies Mentioned:

1. Jiangsu Hengrui (4.46% of KURE Net Assets as of 12/17/2021)
2. Mindray (6.10% of KURE Net Assets as of 12/20/2021)
3. Kweichow Moutai (16.66% of KBUY Net Assets as of 12/17/2021)
4. Xiaomi (0% of KBA Net Assets & 1.29% of KGRO Net Assets as of 12/20/2021)
5. Tencent (0% of KBA Net Assets & 2.69% of KGRO Net Assets as of 12/20/2021)
6. JD.com (0% of KBA Net Assets & 1.79% of KGRO Net Assets as of 12/20/2021)
7. Pinduoduo (0% of KBA Net Assets & 1.12% of KGRO Net Assets as of 12/20/2021)
8. Kuaishou (0% of KBA Net Assets & 1.10% of KGRO Net Assets as of 12/20/2021)
9. Alibaba (0% of KBA Net Assets & 2.44% of KGRO Net Assets as of 12/20/2021)
10. Baidu (0% of KBA Net Assets & 1.58% of KGRO Net Assets as of 12/20/2021)
11. Evergrande (0% of KBA Net Assets, 0% of KGRO Net Assets, and 0% of KBND Net Assets as of 12/20/2021)
12. SAIC-GM (0% of KARS Net Assets as of 12/20/2021)
13. BYD (2.50% of KARS Net Assets as of 12/20/2021)
14. NIO (2.33% of KARS Net Assets as of 12/20/2021)
15. Tesla (5.09% of KARS Net Assets as of 12/20/2021)
16. Li Auto (2.04% of KARS Net Assets as of 12/20/2021)
17. Geely (1.77% of KARS Net Assets as of 12/20/2021)
18. Contemporary Amperex Technology (CATL) (5.49% of KARS Net Assets as of 12/20/2021)

19. Taiwan Semiconductor (0% of KFVG Net Assets as of 12/20/2021)
20. Samsung (0% of KFVG Net Assets as of 12/20/2021)
21. Yili Group (5.03% of KBUY Net Assets as of 12/20/2021)

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Index & Term Definitions:

CSI Overseas China Internet Index: 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 can measure 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 on September 20, 2011.

Dow Jones Internet Composite Index: The Dow Jones Internet Composite 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.

MSCI China Health Care Index: The MSCI China Health Care Index captures large and mid cap representation across China H shares, B shares, Red chips and P chips. Currently, the index also includes Large Cap A shares represented at 10% of their free float adjusted market capitalization. All securities in the index are classified in the Health Care sector as per the Global Industry Classification Standard (GICS®). The index was launched on January 1, 2001.

Price to Earnings Ratio (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 earnings per share (EPS).

Price to Earnings Growth Ratio (PEG): A stock's price to earnings ratio (P/E) divided by the growth rate of its earnings over a specific period of time.

Producer Price Index (PPI): An index measuring the input costs to producers.

Consumer Price Index (CPI): An index measuring the increase in consumer prices for a set basket of goods on a month-to-month basis.

Kilowatt Hour (kWh): The kilowatt-hour is a unit of energy equal to one kilowatt of power sustained for one hour or 3,600 kilojoules.

Megawatt Hour (MWh): A megawatt hour (MWh) equals 1,000 kilowatts of electricity generated per hour and is used to measure electric output.

Important Notes

Carefully consider the Funds' investment objectives, risk factors, charges, and expenses before investing. This and additional information can be found in the Funds' full & summary prospectus, which may be obtained by visiting www.kraneshares.com. Read the prospectus carefully before investing.

Risk Disclosures

Investing involves risk, including possible loss of principal. There can be no assurance that a Fund will achieve its stated objectives. The Funds are subject to political, social, or economic instability within China which may cause decline in value. Fluctuations in currency of foreign countries may have an adverse effect to domestic currency values. Emerging markets involve heightened risk related to the same factors as well as increase volatility and lower trading volume.

The Funds may invest in derivatives, which are often more volatile than other investments and may magnify the Funds' gains or losses. A derivative (i.e., futures/forward contracts, swaps, and options) is a contract that derives its value from the performance of an underlying asset. The primary risk of derivatives is that changes in the asset's market value and the derivative may not be proportionate, and some derivatives can have the potential for unlimited losses. Derivatives are also subject to liquidity and counterparty risk.

The Funds are subject to liquidity risk, meaning that certain investments may become difficult to purchase or sell at a reasonable time and price. If a transaction for these securities is large, it may not be possible to initiate which may cause the Fund to suffer losses.

To achieve its investment objectives the Funds are dependent, in part, on the continuous availability of A Shares and the ability to obtain, if necessary, additional A Shares quota. If a Fund is unable to obtain sufficient exposure to limited availability of A Share quota, the Fund could seek exposure to the component securities of the Underlying Index by investment in other types of securities.

Narrowly focused investments typically exhibit higher volatility. The Funds' assets are expected to be concentrated in an industry or group of industries to the extent that the Underlying Index concentrates in a particular industry or group of industries. The securities of companies in an industry or group of industries could react similarly to market developments. Thus, the Funds are subject to loss due to adverse occurrences that affect one industry or group of industries or sector. The Fund may underperform other similar funds that do not consider conscious company/ESG guidelines when making investment decisions. The Fund is non-diversified.

The Fund may invest in private companies that have not yet issued securities publicly in an initial public offering ("IPO") ("pre-IPO shares"). Private companies involve greater risks than investments in securities of companies that have traded publicly on an exchange for extended periods of time. Investments in these companies are generally less liquid than investments in securities issued by public companies and may be difficult for the Fund to value.

Fund shares are bought and sold on an exchange at market price (not NAV) and are not individually redeemed from the fund. However, shares may be redeemed at NAV directly by certain authorized broker-dealers (Authorized Participants) in very large creation/redemption units. The returns shown do not represent the returns you would receive if you traded shares at other times. Shares may trade at a premium or discount to their NAV in the secondary market. Brokerage commissions will reduce returns. Beginning 12/23/2020, market price returns are based on the official closing price of an ETF share or, if the official closing price isn't available, the midpoint between the national best bid and national best offer ("NBBO") as of the time the ETF calculates the current NAV per share. Prior to that date, market price returns were based on the midpoint between the Bid and Ask price. NAVs are calculated using prices as of 4:00 PM Eastern Time.

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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 up to date 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).

ABOUT CICC

In 2017, China International Capital Corporation (CICC) formed a strategic partnership with Krane Funds Advisors, LLC, becoming the largest shareholder. CICC is a leading, publicly traded, Chinese financial services company with expertise in research, asset management, investment banking, private equity and wealth management. Founded as the first Sino-US joint venture investment bank in 1995 with Morgan Stanley and China Construction Bank as the largest initial shareholders. Today CICC is majority owned by China Investment Corporation (CIC), the second largest sovereign wealth fund with roughly $1 trillion AUM. In 2020, The CICC Research Team ranked #1 in Institutional Investor's All-China Research Category for the eighth year in a row. CICC has over 200 branches across Mainland China, with offices in Hong Kong, Singapore, New York, San Francisco, and London.

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