Investment Insight

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ARIA | CAPITAL

China in your hand: *It should come as no surprise that China's impact on the financial markets is growing. There may well be bumps along the road, indeed there are strong expectations of a correction at some point in the next two years. However, investors around the world are more attuned than ever to China's growth story, its credit system, its stock market movements and the value of its currency.*

In ***The Inside Track*** *we explore China's ongoing financial evolution in some detail through the thoughts of PIMCO's Luke Spajic.*

Lords Spiritual and Temporal: *With a flourish of her plume, and "by and with the advice of Lords Spiritual and Temporal" Queen Victoria signed several Acts into law in 1871. Among them were The British North American Act, which authorised the Canadian parliament to expand its provinces, and the The Lunacy Regulation (Ireland) Act, which amended the law in Ireland relating to "commissions of lunacy". However, this weekend we enjoy an extended sojourn which traces its origins to the 1871 UK Bank Holidays Act. Ya wha' Gay? Yes, as eruditely analysed in the* ***Pic of the Week****, it's the August bank holiday weekend!*

Quoted...

"Life moves pretty fast. If you don't stop and look around once in a while, you could miss it." – Ferris Bueller

The Inside Track

PIMCO's Luke Spajic's has some interesting thoughts on the region and the growing importance it should play in investor portfolios. He believes that over the next 12 to 24 months Asia, led by China, will become a far more significant part of capital markets and investment portfolios. The following are some extracts from Luke's recent writings on China and Emerging Asia.

Currently the world's second-largest economy by GDP, China is clearly the force propelling Asia's markets onto the global stage. China has the largest banking system in the world by assets. It has the second-largest equity market by market capitalization at well over $7 trillion, the second-largest corporate credit market and the third-largest government bond market. With foreign participation in China's local markets so low, growth in investment in China over the next few years has the potential to be the fastest in the history of capital markets.

While its offshore markets have been traded widely for some years, China is now focused on opening its onshore, local currency markets. Starting in 2015, the People's Bank of China (PBOC) fully liberalized access to the onshore fixed income market for official entities like central banks and sovereign wealth funds. Others have gained access through the country's institutional investor programs, direct yuan investment quotas and bilateral agreements.

The government announced in 2016 that it would expand foreign access to the bond market, and in early July this year, opened the "Bond Link" program to allow foreign investors to buy domestic bonds from mainland Chinese issuers through a link with Hong Kong. The country's "Stock Connect" programs, introduced in 2014 for the Shanghai Stock Exchange and 2016 for Shenzhen, similarly link investors to mainland equity markets via Hong Kong.

As China's markets become more accessible, its securities are set to be included in the major stock and bond indices – the key to participation for many global investors. Demand is expected to increase dramatically as investors buy the securities in the indices, or very similar ones, to mirror their portfolio benchmarks. One of the largest index providers, MSCI, decided in June it will begin including more than 200 China A-shares (issued by the country's biggest and most well-known companies) in its global emerging market equity indices starting in May 2018. Estimates for flows into equities as a result of the MSCI "benchmark effect" range from $200 billion-$400 billion.

For fixed income markets, the inclusion in indices will be crucial: Flows could increase by the same amount over multiple years. For emerging market investors, Chinese yields would tend to be lower than their emerging market index averages, but for global investors, China's yields would be two to three times higher.

Greater demand typically spurs greater supply in the capital markets, and the potential for growth in issuance in China's capital markets is huge (Figure 5). Standard & Poor's has estimated that China's share alone of global corporate debt outstanding will rise to 43% in 2020 from 35% in 2015. Even as GDP growth slows – we project growth of around 6.5% for 2017 – China's economy is still on track to surpass the U.S. economy in size within a decade.

Pic of the Week

Market View

	Last 7 days	Last 12 mths	YTD	5Y Ann.
Global equities	+0.0%	+15.9%	+10.0%	+10.2%
US equities	-0.0%	+14.5%	+10.7%	+12.2%
European equities	-0.9%	+12.8%	+4.3%	+6.8%
EM equities	+0.1%	+23.2%	+24.1%	+2.3%
Irish equities	-1.7%	+16.4%	+2.1%	+15.9%
Commodities	-0.7%	-6.7%	-4.4%	-10.2%
Hedge funds	+0.1%	+5.5%	+3.6%	+2.0%

Economic indicators	*Bond yields*	*Inflation*	*GDP YoY*
Ireland	+0.7%	-0.4%	+6.1%
Germany	+0.5%	+1.7%	+1.7%
USA	+2.2%	+1.6%	+2.1%
China	+3.6%	+1.5%	+6.9%

Currencies	*Current*	*YTD Δ*
EUR:USD	1.19	+12.7%
EUR:GBP	0.90	+5.8%
EUR:CNY	7.97	+8.6%
GBP:USD	1.31	+6.4%
Bitcoin	2,738.73	+187.7%

Week ahead: Key events

07/08 Eurozone Investor Confidence & US Labour Market Conditions
08/08 US JOLTS Job Openings Data
09/08 US Mortgage Applications & Wholesale Inventories
10/08 UK Production Data
10/08 US Initial Jobless Claims
11/08 Germany & US CPI

Commodities	*Current*	*YTD Δ*
Gold	1,267.24	+10.0%
Copper	6,322.25	+14.5%
Oil	52.55	-10.6%
Wheat	456.75	+2.0%

Central Bank rates	*Current*
Eurozone	0.00%
USA	1.25%
UK	0.25%

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