Institutional Investors Symposium 2017

Panel Discussion: Extracting Total Returns from High Volatility and Low Yields

China's recent moves to open up its capital account will result in fund flows over the next ten years to rival the emergence of the Eurodollar market thirty years ago, says Piyush Gupta, Chief Executive of of DBS.

Chinese authorities have recently made a number of reforms to the country's capital markets, such as opening up the domestic interbank bond market to global investors and the creation of the Stock Connect programme which enables direct trading of Chinese equities via Hong Kong.

Speaking at the DBS Institutional Investor Symposium in Singapore on June 22, Gupta said these actions represented a "profound change" for global capital markets.

"China's opening up of its trading account between 2010 and 2015, via steps such as the internationalisation of the renminbi, was important and it helped grow a lot of business activity in Asia," said Gupta.

"But what will happen in the next 10 years will dwarf the previous five, as China becomes integrated into the global capital markets. The impact on capital flows, both in and out of China, will be extreme and rival the growth of the Eurodollar markets 30 years ago."

The Eurodollar market refers to US dollar deposits held outside of the United States, which are generally considered to fund 90 per cent of global trade flows.

According to Gupta, developments such as the renminbi's inclusion into the International Monetary Funds SDR - Special Drawing Rights - international reserve asset, and the recent decision by MSCI to include China A shares in its benchmark indexes, are proof that China will take a greater role in the global financial system.

"The Chinese are systematically and methodically, trying to integrate into global capital markets. And President Xi in particular is seeking to establish a leadership position, so that China will become the engine of globalisation.

And in doing that China will make a lot of things happen. It is close to being the largest global economy in purchasing power parity terms, and is certainly the second largest in nominal terms, and in the next decade it will make a major impact on global markets."

Gupta said that DBS had a made a conscious decision to allocate capital across a variety of business lines in order to adapt to the changing capital market dynamics. He said this capital allocation included, but wasn't limited to, Chinese mergers and acquisitions, equity and debt capital markets and public and private fund raising activities.

Gupta's view was backed by a number of other speakers at the event. Earlier in the day, Neeraj Seth, Asia Head of Credit for asset manager Blackrock, made a forceful case why recent Chinese capital market reforms, meant the country's bond market will be the, "biggest fixed income story of the next decade"

Seth, was responding to a question from the floor, when he said it didn't matter if you had a bullish or bearish view on China's bond market, "you can't ignore it".

Chinese authorities have taken a number of steps in the last 18 months to make it easier for global investors to access the Onshore Interbank Bond Market (CIBM). Institutional investors are now not only able to directly invest in the CIBM, they also have access to a broad range of products to hedge the attendant interest and foreign exchange risk.

The latest move came last week with the People's Bank of China releasing temporary rules for a Bond Connect programme, that will enable institutional investors to access fixed income markets in a similar manner to the much vaunted Stock Connect.

"You have to look at what is happening in China from both a macro-economic and capital market perspective," said Seth. "Overall this is by far the biggest fixed income story investors will see in the next decade".

Fellow panelist Andrew Ng, head of treasury and markets for DBS, supported Seth's view on the importance of capital market reforms. Ng highlighted both the recent Bond Connect announcement and earlier hedging rule changes as significantly easing global investors ability to access the CIBM.

The positive noises from speakers at the symposium contrasted with a loss of confidence by global investors in China, over the past 24 months. This is due to concerns over credit quality and currency volatility, but Ng says that these fears have been overplayed.

"Look at the headlines over the last two years", said Ng. "Investors have been underweight China because of a number of issues. However, the government has done a good job in deleveraging, and the renminbi has been stable for the last six months, with some investors now predicting the currency will appreciate."

Ng also pointed to the strong global investor appetite for offshore bonds issued by Chinese companies. "A lot of money is chasing offshore Chinese bonds, at the moment. I am not a pessimist about China at all."

Despite the bullishness over China's prospects, Gupta said that he expected there to be some "choppiness" in the near term, and this view was reflected in a lack of enthusiasm by speakers over the initial impact of MSCI's benchmark change.

MSCI's decision was made after it had previously rejected inclusion, reportedly due to global investors concern at volatility in Chinese equity markets. And while the index provider's latest move has generated a lot of headlines, both globally and regionally, some panelists were not convinced that this was represented of a short term investment opportunity.

Teng Ngiek Lian, Chief Executive of boutique investor Target Asset Management, declared himself unexcited by the news, saying that his firm was already able to source all its China A share requirements via the existing Stock Connect mechanism.

While Dr Peng Chen, Asia Chief Executive of Dimensional Fund Advisors, went further and said that despite the long term strategic significance of MSCI's move, it reduced the short term attractiveness of the A share market.

"A share inclusion in the MSCI is a big deal. China is the world's second largest economy, and second biggest stock market and over time this will definitely impact investor behaviour.

But an index reconstitution is the worst time to buy a market, because everyone knows what stocks will be included and there will be a lot of demand on liquidity. We are already seeing people front-run the market."