OPALESQUE



Opalesque Roundtable Series '14

SINGAPORE

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Editor's Note

China overtook Japan as world's second-largest stock market

In November 2014, China overtook Japan as the world's second-largest stock market. At the moment, China is still cheap and very out of favor - most people don't want to know about it. But interestingly, in the last few weeks, it does look as if the domestic Chinese market is finally beginning to break out of the slump and perform better than Europe at least.

One reason for China's recent underperformance is that the country does not have enough domestic savings in financial assets. While people talk about a lot of savings in China, those are not going into the stock market. They go into property and then into a second property, then perhaps into gold, and then into a third property and so on. Also, if you look at who owns the largest companies in China, you will see that many shares are held by foreign institutional investors - companies like Vanguard, Fidelity, etc., but very little stakes held by Chinese insurance or investment companies. But this will soon change as the domestic investor base will continue to grow.

But what about China's "ghost cities"?

Isn't there a China bubble? The truth is that Chinese governments aren't very fond of the Western media, and that's reciprocated for understandable reasons. And the net result is a lot of misunderstanding and mutual antipathy that you can see reflected if you read The Wall Street Journal, the New York Times or Financial Times, as many people in the financial community do. In those mainstream media you will get an extremely one-sided and highly negative view of almost everything in China.

Jim Chanos, one of the world's great short sellers, has highlighted the property sector, and lots of people talk about ghost cities in China. Yes, there are some, the Roundtable participants do not pretend that this problem does not exist. When you go to Ordos, you can see lots of empty buildings. ***But the problem is exaggerated on a number of levels.***

Firstly, at any time over the last 20 years, television crews could have flown into China and they would have found lots of unoccupied buildings. But if the same crew came back to the same place three years later, in many cases those buildings would have been full. There would have been lots of people living in them and there would have been economic activity. So this issue presents itself in a different light when you look at it as a time series, rather than one snapshot.

What the Western media missed or chose to ignore is the development pattern. As people build out from the center into the suburbs, houses go in first. People buy, but don't necessarily move in right away. They wait for the infrastructure and the services; retail, transport, schools, hospitals, to go in and then they come later. So the fact that there are a lot of empty buildings doesn't mean that they are going to stay empty.

The "Secrets" of the Chinese property markets

The Roundtable discloses three additional "secrets" about the Chinese property market (affordability, urbanization/migration, market becoming dominated by upgraders), the make-up and further details about how to play the property sector in China.

Japan story not over yet

While Abe's "third arrow", directed at structural reforms, will be the hardest to pull off, we should take notice that over 97% of all bills from the current administration are now getting passed at the congress, which is unprecedented in post-war Japan.

The governmental pension fund GPIF, the largest governmental pension fund in the world with USD 1.3 trillion under assets, has announced its plans to lift their 12% domestic equities allocation to somewhere in 25%. On the retail level, NISA, Nippon investment saving account, has been launched copying the U.K. policy. This roughly allows each retail investor to put about $10,000 into a tax-exempt account each year. All of that will continue to bring huge additional flows to the equity market.

While stock pickers focus on finding Japan's "hidden jewels" out of the 1500 firms that trade under book, there is also some action in the large cap segment with the new JPX-Nikkei 400 index which includes ROE considerations. This will even boost some Nikkei-225 companies. On top, many exporters benefit from the yen depreciation.

The Opalesque 2014 Singapore Roundtable, sponsored by Eurex, WTS and EuroFin Asia, took place October 23rd 2014 at the Singapore office of Deutsche Börse Group with:

1. Roland Schwinn, Eurex / Deutsche Börse Group
2. Robert Welzel, WTS
3. James Morton, Santa Lucia Asset Management
4. Roshan Francis Padamadan, Luminance Global
5. Kensuke Suzuki, Hayate Partners
6. Francois Dotta, EuroFin Asia

The group also discussed:

- Which businesses will benefit from corporate tax raises in Japan?
- Which stocks will do well in Indonesia?
- What does the return of geopolitical tensions mean to the markets?
- Why do investors love trade finance funds?
- What does the Hong Kong – Shanghai Connect really offer for long term investors?
- Rising derivatives volumes and products: Asian banks are increasingly positioning themselves not only for inbound business into Asia but also increasingly for outbound business from Asia into Europe or into the U.S.
- Why Eurex is setting up a central clearing house in Singapore? Why will Asian market participants will soon have to work out new collateral strategies?
- Is AIFMD relevant to Asian managers?
- Why is Singapore's MAS viewed as the “most reasonable” regulator, whereas European regulations are seen as protectionist and an “absolute nightmare”?

Enjoy!

Matthias Knab
Knab@Opalesque.com

Participant Profiles



(LEFT TO RIGHT)

Francois Dotta, Robert Welzel, Roland Schwinn, Kensuke Suzuki, Roshan Padamadan, James Morton, Matthias Knab.

Introduction

Roland Schwinn
Eurex, Deutsche Boerse Group

My name is Roland Schwinn. I represent the Deutsche Börse Group and Eurex. I have been with the Group since 1990, so actually it's now my 25th year. I started with the predecessor of Eurex, DTB or Deutsche Terminbörse in 1990. In 2007 I came here to start building up our business in Asia.

At the moment, we have offices in Hong Kong, Tokyo and Singapore. We have also people on the ground in Mumbai, Dubai, and Taiwan. Our main task here in Asia is to connect new customers to our platforms and markets, to support existing customers and prospective clients, and we are also in charge of exchange cooperations.

In 2010 we installed the Eurex/KOSPI Link, a cooperation between the Korea Exchange and Eurex, where the KOSPI 200 Options products are traded in Korean after hours on our platform. Open option positions are then transferred back to KRX at the end of the trading day. The product traded at an Average Daily Volume (ADV) of close to 100,000 contracts in H1 2014.

We have installed a similar cooperation in May this year with TAIFEX, the Taiwan Futures Exchange, the Eurex/TAIFEX Link, where we trade the TAIEX options and futures on Eurex during the Taiwanese after hours. The total trading volume of TAIEX products on Eurex has exceeded 150,000 contracts since launch. In addition the Bombay Stock Exchange is running their entire trading, so cash and derivatives, on Eurex-based T7 technology.

Looking into the future, we are currently building up our further Asian expansion, a new CCP, which will be domiciled here in Singapore. We will start with listing our existing core products in this time zone. They will be listed as daily expiring futures hence similar to the concepts we have in place with KRX and TAIFEX and then open positions will be settled back to Eurex Clearing in Europe where open interest will be held.

The next step will then include the launch of new products, for which we will particularly focus on Asian buy-side customers. That means we will come back to all of you and other industry participants asking for you views on what products you would be interested in, and what your demand and your needs in terms of derivatives for Asia will be.

We will also offer post-trade services to other CCPs and exchanges and the development of new collateral management services like Repo and securities lending together with Clearstream, which is also part of the Deutsche Börse Group, whose Asian operations are also based in this office here in Singapore.

Robert Welzel
WTS

My name is Robert Welzel. I am a German qualified lawyer and tax advisor and I am a partner of WTS, a law firm and tax consultancy firm.

WTS was formed 15 years ago with six colleagues, and now in Germany we have 450 colleagues and an expanding network worldwide. WTS established offices in Shanghai and Hong Kong.

I personally focus on financial services, especially asset management. We advise especially Germany institutions, family offices - if they invest worldwide, and also international funds if they try or intend to enter the German or European markets both from a regulatory and from a tax perspective. While the changes in the European regulations are clearly a burden for many, on the other hand, they also open some interesting business opportunities for managers.

Roshan Padamadan
Luminance Global Fund

My name is Roshan Francis Padamadan, I run the Luminance Global Fund which we have launched at the beginning of 2014 with a global unconstrained strategy. We are looking for value in any liquid assets, including stocks, bonds, options and futures.

Our broad mandate also takes us across developed markets, emerging markets, and frontier markets. We are global, bottom-up, macro aware, and happy to trade any kind of strategy. We might do direct trades, pair trades or hedged trades – we are aiming to exploit whatever gives us the best risk-return in any particular situation that we look at.

Francois Dotta
EuroFin Asia Group

I am Francois Dotta, one of the Partners at EuroFin Asia Group. We are an independent merchant banking organization with 11 years of solid performance. The Group is headquartered in Singapore with presence in Geneva and Dubai.

We leverage on our acute expertise and strong network in real economy businesses to offer a diverse range of investment strategies across the capital structure spectrum. This is managed through our three business lines in asset management, wealth management and private capital. The Group manages over USD800 million.

The asset management arm, which I head, originates a variety of financing strategies with a specialized focus on the commodities and natural resources financing.

James Morton
Santa Lucia Asset Management

I am James Morton, Chief Investment Officer of Santa Lucia Asset Management. I have been in financial services for nearly 40 years and in investment management for over 20, first in a family office and then founding my own company 18 years ago.

We are an Asian boutique, specializing in a value based approach to equity investing. We have about USD 1.5 billion under management in several different strategies, deep value, property long-short, and high income. We have offices in London, Singapore, Jakarta, and an associate in Hong Kong and Shenzhen.

Kensuke Suzuki
Hayate

This is Ken from Hayate. We have an investment manager based here in Singapore and also an investment advisory firm in Tokyo. We have been running an equity long-short strategy since 2006.

What we do is very simple. We interview under-researched companies and find something that the market do not identify by focusing on companies that typical sell-side banks and asset manager do not research. Once we find out something interesting, we take long and short positions.

70

percent of the world's surface is covered by water.



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Matthias Knab Volatility has come back to the market, can you give us please an update on your fund?

Kensuke Suzuki: We are focusing on Japan where since 2012 a lot has happened. Prime Minister Shinzo Abe came into office and initiated his so-called Abenomics policies. Possibly he was the first Prime Minister to put pressure on to the Central Bank of Japan. The policies have transformed Japan and attracted investors outside of Japan.

For a while before that, investors did not expressed strong interest in Japan. The country has been changing prime minister every year to the extent that it had become a challenge for history students to remember all the names of the Prime Ministers.

With the Prime Minister Abe, certain stability has returned to Japan. What we see from our side when interviewing Japanese companies is that the corporations on the ground are in fact developing a more confident outlook.

At least so far, changes in 2014 do not appear as rapid comparing to 2013, but we should note that the number of the bills from the current administration that have been passed at the congress is over 97%. This is due to the fact that the controlling Liberal Democratic Party currently has majority in both houses. While historically, Japan's upper and lower houses were dominated by different parties, so not much bills have been passed for a long time. It now became much faster for the party to enact certain policies.

We have more exciting news coming from Japan, The governmental pension fund, GPIF, the largest governmental pension fund in the world with USD 1.3 trillion under assets, has announced its plans to lift their 12% domestic equities allocation to somewhere in 25%. In April, it announced that they will place the MSCI Japan Small Cap and the Russell/Nomura Japan Small Cap into its benchmark indices. The news was positive and could bring more dynamics and flow into the Japanese equity market.



Furthermore, from 1st January this year, the country has started something called NISA, Nippon investment saving account, program, copying the UK policy. This roughly allows each retail investor to put about $10,000 into a tax-exempt account each year. On those accounts, investors will be exempted from taxes on capital gains, interest rates and dividends. This is to encourage the Japanese citizens to pull out their money under mattress and into the market, because as a matter of fact substantial amounts of money is put under the proverbial peoples' mattresses. This policy already did bring about $10 billion inflow to Japanese equities, and those inflows should continue through each year.

As for NISA, we might even see that people rush in to allocate some of the unallocated amount towards the end of the year, as it also happens in the U.K. This should bring further flow to the equity market.

Kensuke Suzuki Japan is influenced by outside economies and we have to monitor a number of factors like exchange rates. It is impossible to predict the future and no one could perfectly predict the future. We will need to be ready and prepare for different conditions that may happen in the future. Regardless of market conditions in short-term, the market will reward good companies in long-run. Therefore, what we do every day is to identify interesting companies.

Matthias Knab In the Western press you could read a lot of disbelief and criticism regarding the effectiveness of Abenomics' third arrow, which is directed toward structural reforms. Also Japan's tax raises were seen as taking the dynamism out of the economy. I wonder, as you are talking to Japanese firms all the time, what do you see, what are the companies on the ground experiencing?

Kensuke Suzuki: **We have to take note that it would take time for some policies to fully come to effects. There are some policies that could clearly contribute to growth.**

One of the policies under Abenomics to reduce corporate tax. The current tax rate for companies in Tokyo is about 35%. The administration is targeting to lower the tax rate to somewhere in 20s in some years. High tax rate is believed to be one of the causes to hinder growth for companies. Today, we see a number of reports from some sell-side analysts on how much improvement on earnings we could expect. There are some businesses that could indirectly benefit from corporate tax cut.

On the other hand, the Japanese government does not have infinite amounts of money. If you reduce the corporate tax rate by 1%, it is believed that the government will lose US$5 billion equivalent tax revenue. Therefore, the government needs to widen the tax base or increase tax in other areas to maintain the tax revenue.

One area that is going to be affected is in small businesses. The government has made the tax filing standard for sole proprietorships stricter. Some businesses like small-scale insurance agents may be knowledgeable about insurance products from insurance companies but they may not have resources for book keeping. We identified a firm called F&M which could assist such small businesses for their accounting tasks. Company like F&M could indirectly benefit from the corporate tax cut.



Another sector that could indirectly benefit from corporate tax cut is real estate. We expect households to work on tax reduction strategies if they expect tax hike, and property is one of the areas that they could focus. There is a unique property developer called Shinoken. Unlike traditional property developers who only help people with lands, this firm has solutions for potential apartment owners who do not own any land to build buildings. The firm might be able to capture people's needs in their tax reduction strategies.

Taking corporate tax cut as an example, we could say that certain policies could bring positive impacts. It is easy to picture that such tax cut could improve EPS of businesses and firms could utilize more resources. On top of such obvious ones, there are businesses like Shinoken and F&M that could indirectly benefit from policies. Such indirect impacts may not be visible at a quick glance.

James Morton: **Our two large markets at the moment – because they rotate over time – are China and Indonesia, in that order, and both have rather different dynamics.**

In Indonesia, as you will be aware, we just had a series of elections which led to a new President and a new parliament. The good news I suppose is that there is a remarkable individual now as President of Indonesia, with a wholly different character than any of the previous politicians that have been in power in that country.

The bad news is parliament is still dominated by the old timers, some of them extremely corrupt, who want to run the country in a different direction.

While in the U.S. you might say gridlock is a good thing because the politicians can't do any damage, Indonesia desperately needs politicians to do a lot of things, because there are enormous opportunities to improve the quality of life for the people, and that would translate, I believe, into good stock market performance as well.

Earlier this year when Jokowi won, the market did well. But when the investors realized that the situation was more complicated and parliament was in opposition and could neutralize some of his policies, the markets sold off again.

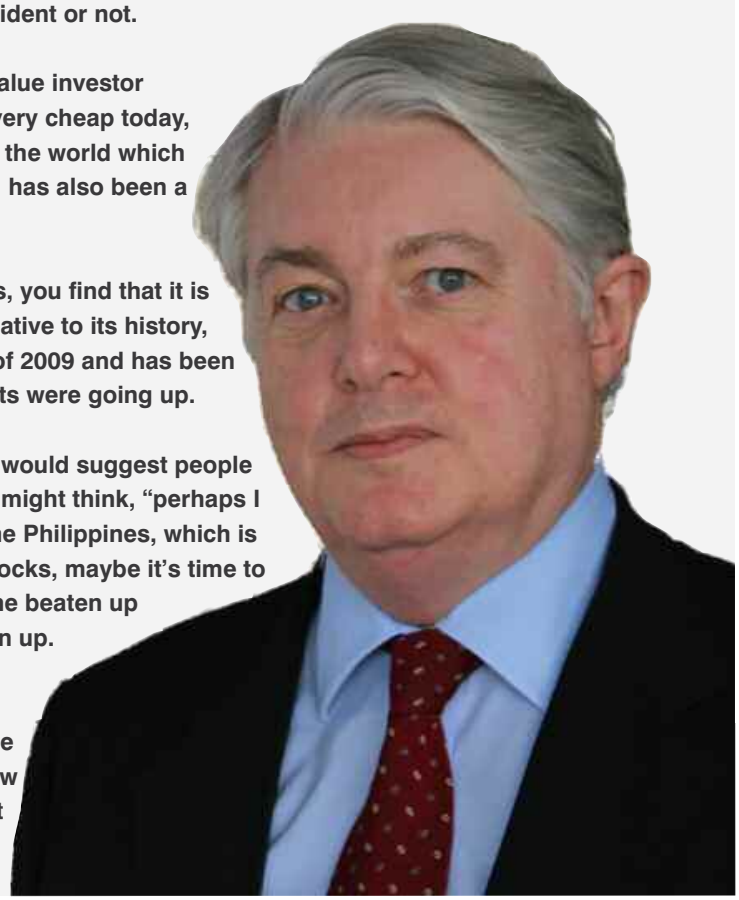
That leaves is Indonesia today valued kind of middle of the road: not expensive but not cheap either, depending on your metric. The forward earnings multiple for next year is about the ten-year average, price-to-book a little bit above. Consumer stocks look expensive; many are on 30 times multiples or more, but you can still find value in neglected sectors.

Perhaps the key issue is what is the government able to do to stimulate the economy? At least there is one area on which the faction led by former General Prabowo and Jokowi agree, and that is infrastructure.

And I do think we are going to see some of the things that were not accomplished by SBY, who started Indonesia on a better road, move forward much more quickly. In Jokowi's period as Mayor of Jakarta he revitalized the transit system in a short period of time when nothing much had been accomplished in the previous 20 years. In spite of having only a small presence in the local government that supported him, he was able to use his power as Mayor to override opposition, get road clearance moving, start to upgrade the transit system, arrest the person who was taking bribes for buying the wrong bus, move out a lot of the old style bureaucrats who were blocking progress; all sorts of positive things. And this could be the one thing that is his legacy, and clearly a key or possibly even the number one priority because the economic multiplier in Indonesia is enormous.

So I expect construction stocks will do well in Indonesia in the next two or three years. Also, operators in Indonesia have some of the highest margins in the world in the cement industry, because there's a shortage of supply at the moment and there's not much new capacity coming on until about 2017, when you will see Anhui Conch of China bringing on perhaps several million tonnes. These are areas that should flourish regardless of whether we see a more cooperative atmosphere between parliament and the President or not.

Turning to China, the current environment is for me as a value investor particularly interesting. Many listed companies there are very cheap today, partly because China is, as you know, the major market in the world which has underperformed in the last five years; and Hong Kong has also been a relative laggard.



If you look at the domestic index on a price earnings basis, you find that it is practically at its all-time low, both in an absolute sense relative to its history, and also relative to the MSCI. China peaked back in July of 2009 and has been sliding ever since while just about everywhere else markets were going up.

So that in itself – five-and-a-bit years underperformance – would suggest people could be looking at their year-end allocations in 2014 and might think, "perhaps I should do a bit of rotation. Maybe I need to move out of the Philippines, which is rather expensive, or maybe I had a good run in US tech stocks, maybe it's time to take some of that money off the table and think about some beaten up shares in China", and there are plenty of them, very beaten up.

The other thing of course is what's going on with the economy and in politics, which can't be separated from the pure value company specific analysis perspective. The new Chinese government does seem to be accomplishing a lot of interesting things with its reforms, although of course

the short-term consequence of arresting large numbers of people for corruption is that officials in China are too frightened to do much. That does slow things down if you can't get anyone to sign off on a new project because they are afraid they will be locked up next week for favoritism or suspected of taking a bribe; and we have been hearing this from a lot of companies we met over the last couple of months.

Nonetheless, I think medium-term prospects are interesting. Talking to companies in China we hear about genuine efforts to improve capital allocation, to change incentive programs with more management profit participations and less reward on base salaries; less informal compensation, more formal compensation – these are generally good things; and increasing level of automation with lots of upside productivity potential from the shop floor through logistics.

So, at the moment, China is still cheap and very out of favor. Most people don't want to know about it. But interestingly in the last few weeks, and this was profiled by CLSA in their conference in Beijing recently, it does look as if the domestic Chinese market is finally beginning to break out of the slump and perform better than Europe at least.

Francois Dotta: I would like to discuss a couple of factors that are affecting the market right now and are intimately correlated to the international trade flows of commodities, raw materials, and natural resources.

Firstly is the return of geopolitical tensions. It has been pretty much a quiet decade between the big geopolitical forces. But the developments of the past twelve months in Ukraine, Middle East and other regional conflicts have definitely had an impact on the commodity flows, especially on the energy complex related to the exports of petroleum products from Russia.

But there are some good developments, too. India and Indonesia have come up with very interesting election results, and these are major markets in commodities. We saw the same in Africa, there has not been any adverse news recently. Some countries like Nigeria have handled some of the recent health issues very well. So, there are both positive and negative factors that come into play, which all influence the trade flow routes between the producing, importing and consumer countries.

Within the energy complex, obviously the main influence and driver would be what is happening in the shale gas and crude oil markets. The United States needs exports for their energy products at some point, and Europe is going to be their main market. Everyone is building infrastructure in Europe to receive those energy products. In turn, Russia, whose natural market was always Europe, has been turning to China for deal financings against energy products. In aggregate, all those moves are changing the trade routes.



There are also questions whether the U.S. dollar will always be the only currency that will be used in trade flows as a transacting currency. A lot of people are talking about the renminbi and the euro. While this will take some time, the events over the last six months with the tensions between Russia and the rest of the world that included asset freezes and limiting access to financing, is definitely pushing some people to engineer alternatives to transact their commodity business. This has been a trend for the last ten to fifteen years, but now it is getting some momentum.

The banking liquidity for the middle segment market has just been shrinking month on month, year on year, and this is definitely not going to change, albeit all the political programs to support SMEs. It seems that all the liquidity has not really dripped to those middle segment markets, which is where we intervene with our Commodity Trade Finance Funds.

The investor community understands there is a vacuum that needs to be filled by non-banking financial institutions, such as investment funds or finance companies. There is a need to provide short-term working capital, as well as medium-term working capital to that ecosystem of middle segment, family owned businesses, which are one of the main players in any of these real economies.

As for the larger players who definitely have access to banking liquidity, they understand the need to diversify from the purely banking finance, which they have been using for 50 years. Banks have been the main providers to the commodity players. They understand that they need to access different kinds of capital; they went public, they went to raise bonds, hybrid structures, got sovereign funds and private equity firms to invest in them, worked with investment funds like ours to receive bespoke solutions and then correlate it to their main source of capital, which is absolutely a key element in the international trade. You cannot trade on your own equity. You need to receive debt and financing to be able to continue your business.

Francois Dotta The last trend which we are seeing, and is just accelerating, is that the margins in the commodity business in general have gone down. You would see that the earnings of the commodity related, natural resources-related companies in the next six months to one year. So it is back to how do you put efficiency and productivity in your business, how do you develop a niche market and get innovative, how you cut costs, etc. This is definitely going to be a driver of what is going on.

Matthias Knab You spoke about the trend that has been going on, also driven by regulation, that the banks aren't as active anymore in providing finance to the SMEs. At the same time you also see a big discussion and push, again from the regulator, about the whole sector of so-called shadow banking. How are you preparing or dealing with such a possible future regulation of shadow banking?

Francois Dotta: I think there are two parts to it. First of all, the regulators will understand pretty well that the non-bank financial institutions are not a systemic risk. All of us are already regulated in terms of AML, KYC, and we are subject to the same framework as the banks.

The only aspect where we are treated differently than a bank is that we don't have a capital adequacy ratio, for a simple reason that we don't take deposits. Rather, we deploy investors' monies after they decided to invest and take the risk of the investment strategy. So I don't think there's going to be a clamp down on investments from the asset management side.



What definitely will be more under the scrutiny of regulators are the larger companies, state-owned enterprises that take money from their banks for a specific purpose, and instead of fulfilling that purpose they are lending the money out to others. This seems to happen mostly in China where it seems it has been the main game of some of the SOEs.

Roshan Padamadan: Looking at the markets form a high-level I can say that we are moving more into value seeking style of investing at this point. We are moving away from a focus earlier this year on special situations. There was hardly any value in the beginning of this year for the first three quarters, so we were looking for spin-offs, restructuring and M&A, those kinds of situations.

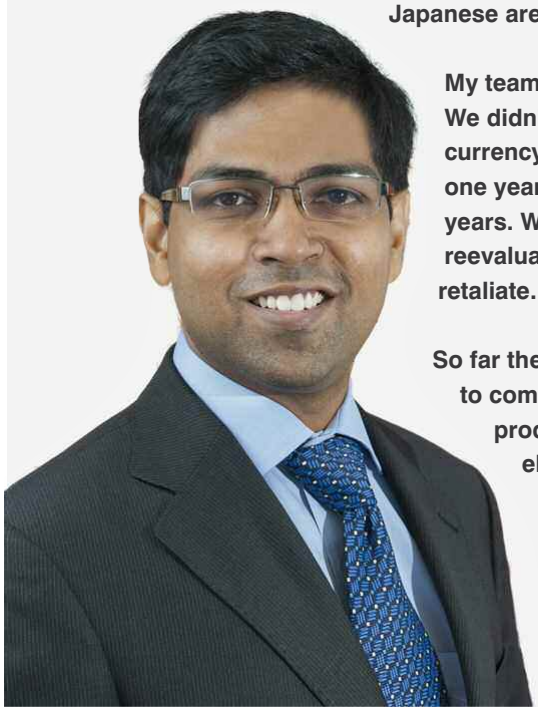
There were slim pickings, but we came across a few dollars and pennies left on the table, so we looked at those and sought to pick them up from the table.

At the moment, we are seeing some corrections in some markets – in oil, for example. Oil, or energy in general, is one of the currencies of the world. Money can be printed, but energy is energy. All economies need energy to run. So when oil comes down, that is actually a very strong signal and something we are looking at.

We are generally avoiding energy, but we do have some picks in the energy sector where with a longer term view of three to five years we are quite comfortable that those names will be fine over that time horizon. But we are not buying regular energy producers at this point because they will suffer in the short-term if energy prices stay low. We don't have a very definitive view on where energy will be in the next three months, but long-term, we do believe the market is communicating a very strong bearish signal to us that real economic growth is slowing.

From a geographical perspective, if I look at the economies in Asia, they are all going through different stages of development. Some are of course developed countries, but they have their own challenges. Japan is trying to do structural reform, the third arrow of Abenomics, which is the hardest part. Indeed, it should probably have been the first arrow, but of course you do the easier stuff first – so fiscal or monetary actions are much easier to start – but structural is very hard.

11 years ago I was actually working in Japan. I left because I thought immigrants would never be fully accepted. I am glad I left because I would have been waiting for 11 years, and it would still be the same situation. Even now, the Japanese are talking about it, but they still have a long way to go...



My team went over all the Nikkei 225 stocks over the last one-and-a-half months. We didn't find any bargains. Some of the stocks went up a lot based on the currency moves but that is not repeatable. The currency depreciated 15%-20% in one year. It is unlikely that this will happen again every year for the next three years. We are not very comfortable playing that theme, that the currency reevaluation will solve all your problems, because other countries could also retaliate.

So far the Koreans haven't done so, but if and when they choose to weaken the Won to come back into the game, then the situation will change because a lot of the products they compete on are similar to Japan's exports: steel, displays, electronics, cars, etc. So those aren't areas where Japan has an unique advantage in; perhaps the Japanese may have to move higher up the value chain over the long run. That said, there here might be some Japan-specific domestic plays which are very interesting, for example what Ken mentioned is very interesting, in terms of understanding the dynamics and specific opportunities in Japan.

Roshan Padamadan Looking at Korea, the country has some interesting blue-chip names. The key question is whether they will also start playing the currency game - that of course will then also affect stock valuations, because Korea is like Japan, predominantly export-oriented.

Roshan Padamadan: I agree with James on China, it is very misunderstood. We also think China is the cheapest large market out there, so we definitely agree with him. You can get many blue-chip names at 10 times earnings, which is maybe half or 70% below the multiples you will get around the world for similar blue-chips.

There are two reasons for that. One is that China does not have enough domestic savings in financial assets. While people talk about a lot of savings in China, those are not going into the stock market. They go into property and then into a second property, then perhaps into gold, and then into a third property and so on.

If you look at who owns the largest companies in China, you will see that many shares are held by foreign institutional investors. You will see companies like Vanguard, Fidelity, and so on, but very little stakes held by Chinese insurance or investment companies.

That is not because the Chinese institutions are investing elsewhere, it's because those insurance companies are still small. But you give them 10 years time, as the domestic savings starts moving to insurance, these companies will get also bigger and will also buy more of their country's blue-chips. At such a time, the dynamics will fundamentally change, but it will be a slow moving 10-year, becoming a multi-decadal trend after that. In countries like Malaysia or India, some of the biggest players in those market are the local pension funds and the local insurance companies. This will also be the case in China, but we are not yet there.

That means we are having an opportunity which is quite unique. China is already the world's second largest economy, but the domestic institutions are just not big enough to buy their own big companies. That means the opportunity is there for other investors who have capital.

Domestic Chinese investors, for better or for worse, they like action, they like to see things move fast, so they end up investing in high beta stocks, for lack of a better word - things which have a very fast rate of return (supposedly). They have been disappointed with the derating of the Shanghai market, because it used to have a P/E of 50 14 years back while now it is at 10. So the market has gone down about 80%.

Of course, people shouldn't be backward looking but most investors, particularly retail, do tend to look backward and upon seeing that the market has been flat or falling, they question why they should invest in that market? So people have been buying whatever they believe has been going up, and will continue to go up - which means property.



But a fundamental investor who tries to assess a future scenario will ask himself if a Chinese insurance company is correctly valued at 10 times earnings, given the savings rate, given that wages are increasing, and so forth? All ingredients for a healthy consumer trend growth are there. Generally across Asia, consumer stocks are very expensive, but in China you do find some bargains.

That is a real dichotomy. Some consumer names across emerging Asia are extremely expensive. But, it is unlikely that all of them will succeed because they are all competing against each other. That means you have an opportunity for some stock picking there, you will have to figure out which ones will do well. In China the challenge is simpler because there are some easier ways to pick winners in China, and they are all quite cheap.

Many outside investors are very skeptical about the property and banking sector, in China, and I agree that that linkage is very complicated. Banks are opaque by nature, all banks are, so you are not able to figure out the true value, and have to trust the credit appraisal process.

But because you know the big banks are government-controlled and government-directed, you can't be that sure, you can't model them, so you don't really know. So anybody having a view on banks in China is taking a policy view as well.

But even if you take out the property and the banking sectors, there are a lot of other sectors where you can do your homework.

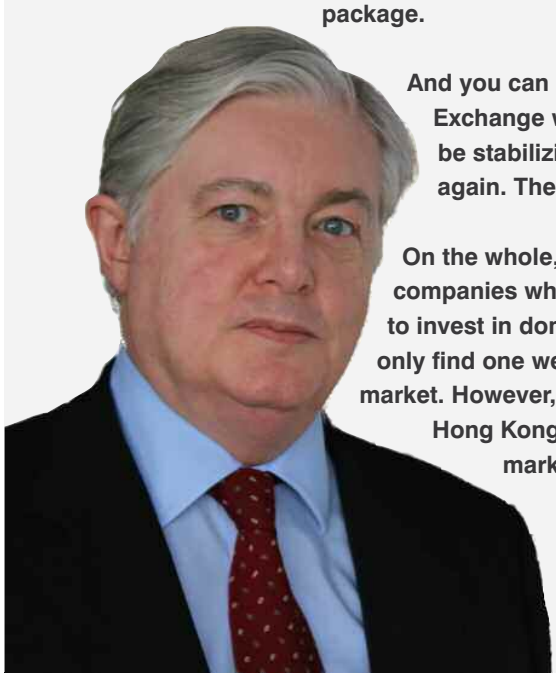
India of course is very interesting, but it has already had a large run up. A lot of the reform-related euphoria is already in the price. So what do you want to do now? It might be better to wait for some disappointment in some sectors and maybe then do some selective stock picking. That is how we look at India.

We also see some value in U.S.-listed names. You find a lot of firms which make money from across the world, including Asia and other emerging markets. So we can play Asia also through the U.S. In fact, it was very interesting for me to look at one of the biggest companies in the U.S., which we like. It actually started in Shanghai before they shifted their headquarters to U.S. – AIG was originally started in Shanghai. So is it an Asian company or an American company?

That stock is trading at 30% below book, 10 times earnings. In general, we look at all sectors including financials and non-banking financials. We generally find that there is less competition in insurance because the accounting is a little bit different, fewer investors tend to look at insurance companies, but we find that they are cheap in several continents at this point.

James Morton: Coming back on a few points Roshan made about China, I think it's important to recognize that the government doesn't have the equity market as one of its priorities. It is probably not hostile but relatively neutral. The Chinese government does of course care passionately about the banking system and the bond market.

The stock market has been disappointing for investors, and that has led to lack of local interest borne out by consumer research, which shows what are investors thinking about doing? Equity doesn't even show up on the list. Less than 5% of people are thinking of buying equities. And that is, as you say, a good thing because it means there are a lot of potential customers when they can be persuaded to recognize that China has gone from being a racy and overvalued market with high multiples to a market with some growth and lower multiples which is a much better package.



And you can see that from the number of active accounts from the Shanghai Stock Exchange which has come down by about 80% in the last five years. That appears to be stabilizing and if recent data is correct, new account openings are increasing again. Then you look at potential opportunities from the so-called "through train".

On the whole, I don't think that's a substantive change. We did a screen of all 550 companies which are going to be available to investors who are not currently qualified to invest in domestic Chinese shares but will be part of this first tranche. And we could only find one we wanted to buy that was not already available to us on the Hong Kong market. However, there's clearly going to be arbitrage backwards and forwards between Hong Kong and domestic Chinese investors which should be helpful for both markets, as well as for the brokers.

I particularly want to expand on what you said about the banks. The government has got to keep the banking system intact or the game is over for the Communist Party.

And when you look at a stock like the Bank of China, yes, nobody knows what is in it or what it's really worth, including probably the people who are running it. However, you've got a company that is provisioning much more than it has been in the past. Its coverage ratio for the NPLs (non performing loans) that they acknowledge is 208%. I don't know any bank in Europe or the U.S. that has a 200%+ coverage ratio. So what they're really saying is NPLs are quite a lot higher than they're stating through the P&L and the balance sheet. There is a fair bit of bad news in this share price.

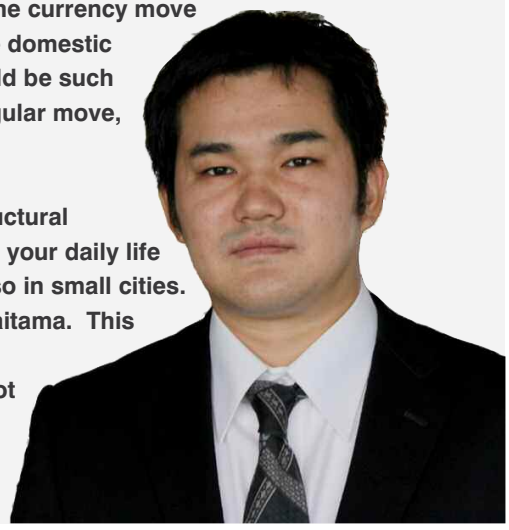
But in any case, it's inextricably linked with the politics and you can already see solutions being created though entities such as Cinda, which is a share I would hesitate to buy, and other specialized asset managers that are supposed to come and clean up the mess and take the bad loans. In the meantime, you can buy the Bank of China at below 5x reported earnings and for less than stated book. Whatever book really is, is another matter. We can debate it, but remember, Bank of China used to trade at over three times book when it just had gone public and investors back then thought it was wonderful yet you could argue that the loan book was in even worse condition then than it is today. Also you get paid 7% while people decide whether they like it or not, which to me represents the sort of opportunity in China that investors have now but didn't have five years ago.

Kensuke Suzuki: Just a quick comment on Roshan's comments about Japan. I agree with Roshan that the Nikkei 225 names are less interesting because in our view they are already over-researched. This is why we do not put primary focus on the 225 famous companies. We look for the hidden jewels. Japan has about 3,700 names listed and over 1,500 of them are traded under book value, so many are cheap and attractive from a valuation perspective.

Apart from those hidden names, some of the Nikkei 225 stocks might be interesting because of a culture change that is happening in Japan right now. Historically, Japanese firms have disregarded investors and they rather put management teams and the company first. Investors were always considered last and always being outside. It is gradually becoming common to have external board members to come in and oversee governance, and this is also one of Abenomics topics.

Companies' view on ROE is also changing. Even among the Nikkei 225 names, some are working on stock buy-backs and planning to increase dividends. Also, there is a new index called JPX-Nikkei 400. The index was created by Japan Exchange this year. Something interesting about this index is that it includes ROE considerations as part of the selection criteria for its constituents. If your company happened to be in borderline whether to be included in the index or not, you will need to put some good effort to improve ROE.

I will make another comment regarding the Yen depreciation Roshan mentioned. Yes, we may not see such a magnitude of depreciation as we have observed in 2013 again this year. But, the currency move last year helped and is still helping number of exporters today. Even for some domestic focused businesses might enjoy indirect poisitive impacts as their clients could be such exporters. Because of this, while the currency change might have been a singular move, but it could bring impacts in longer term.



Roshan also referred to immigration in Japan, which is another part of the structural changes. Today, it might be different from 11 years ago. In businesses and in your daily life at stores and restaurants, you do see more foreigners not just in Tokyo but also in small cities. I do see Brazilian families at a supermarket in my hometown, a small city in Saitama. This is something I have not seen 11 years ago. We do see that more people are welcome to work in Japan, so the windows have opened gradually. This will not be a one-day phenomenon or a one-day policy change that would turn everything on the next day, but it is rather a gradual and on-going change.

Matthias Knab Roshan also shared some insights about the Asian and international investor preferences and activities. What else do you observe regarding investors' activities?

Roland Schwinn As an exchange, we are in the middle of the markets as our customers include the largest banks of the world, the largest proprietary trading firms, CTAs, hedge funds and other direct customers, and of course market making firms. We speak to the entire spectrum of end investors and also intermediaries, so I can give you some insight about what we do observe from an exchange perspective.

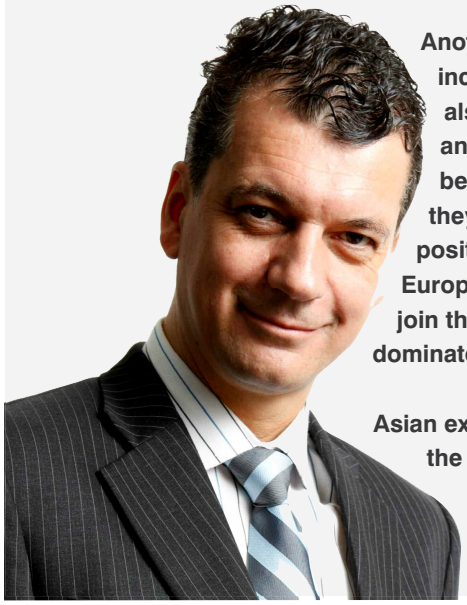
As an exchange with an European background, our main product focus is still European based and this includes, in particular, the European interest rate derivatives like Bund, Bobl, and Schatz. On the equity side, our core products are the EURO STOXX 50 Options and Futures, as well as the DAX Options and Futures.

Roland Schwinn: Historically, we always have had a 50-50 share between both asset classes -- interest rates and equity products. However, this has changed in recent years due to macroeconomic factors. As you might know the interest rates we currently have in Europe are almost flat. This has also impacted the number of transactions over the last years, meaning we have seen less activity in our traditional fixed income segment, coming down from 50% to around 32% of the total exchange volume. But during this period we have seen a strong growth in our Euro-BTP futures which is based on Italian government bonds, and also on the French equivalent, Euro-OAT futures. The trading volumes of these products have grown quite significantly since launch. Euro-BTP Futures and Euro-OAT Futures are currently trading at an ADV of more than 87,000 and 84,000 contracts respectively.

On the equity side, as we all know, over the past three years we have had very low volatility in Europe, but this has slightly changed in the last few weeks. Occasionally, we have seen some spikes in between, which were more or less event driven, but now it seems like volatility is coming back. CTAs are also seeing trends again in the market and further trading opportunities, as can be seen from their recent improved performance. You can say that in those classical segments, more or less all the volumes are influenced by trading opportunities.

Another positive development is the stronger demand from Asia for our equity index derivative products, especially our MSCI products, in particular from Hong Kong which traditionally is a strong equity trading venue.

We also see increasing demand for our FX products that we just launched in July this year. We launched physically settled contracts and might follow up with cash settled contracts later on.



Another interesting market development we have seen is that Asian banks are increasingly positioning themselves not only for inbound business into Asia but also increasingly for outbound business from Asia into Europe or into the U.S. As an example, UOB Bank, which is one of the largest banks here in Singapore, has become a General Clearing Member (GCM) of Eurex in May this year. And I think they are also applying for more memberships with other Western exchanges to position themselves to be able to catch outbound business from Asian investors into Europe and the U.S. This is a new development and that means those players will also join the international competition between the very large global investment banks who dominated this business so far, in particular in providing clearing services.

Asian exchanges are also getting more active in Europe like the acquisition of the LME by the Hong Kong exchange in July 2012. And Western exchanges like Eurex have come into Asia and are more active here. This is also part of our business expansion; Asia is one of our core markets for development over the next few years.

I have already mentioned earlier in my introduction that we are now preparing the set up of a CCP domiciled here in Singapore which will serve the Asian region and time zone. This new CCP will not only provide our products and asset classes, but also offer services to other CCPs and exchanges as I explained it earlier.

However, if we look at the expected developments when it comes to collateral management, we are all aware that due to developments like Basel III for example, and based on expectations that the interest rates will rise again sooner or later, cash will be more expensive than it is right now. Here in Singapore, for example, more than 90% of collateral is currently provided in the form of cash, which will get very expensive at some point in time. In Hong Kong the situation is quite similar and I would assume that in many other Asian markets it's done in the same way.

This is a field where we see a huge opportunity for offering our services to the banking community and also to the end customers where, together with our affiliated company Clearstream, we can further extend the collateral management services that we already have in place in Europe to Asian customers. In Europe, for example, Eurex Repo provides international secured funding and financing and securities lending. Its most successful market is GC Pooling, where collateral can be used to fund EUR and USD. In addition, GC Pooling collateral can be re-used for further money market transactions, the Eurex Clearing margining process and refinancing within the framework of European Central Bank (ECB) open market operations.

We are also seeing volatility becoming more of an asset class compared to where it was over the last few years. Eurex launched the VSTOXX volatility index back in 2012, which last month saw record volumes. Also just last month Eurex launched Eurostoxx Variance futures becoming our second volatility product. Traders are increasingly trading volatility now through those products, which is a convenient way to gain exposure in this asset class.

Just to round this up, the other segment that has been growing nicely are Dividend Futures. We have been offering these products on Eurex since June 2008. Here volumes and the number of listed dividend futures are growing. It is a particularly attractive product for the buy–side, enabling exposure to dividends for hedging purposes. We offer dividend futures on the EURO STOXX 50 index and other indices as well as individual stocks.

Robert Welzel: Turning to regulations for a moment, AIFMD affected the European alternative investment industry significantly. The AIFMD is also relevant to Asian managers who intend to market their funds products to Europe. The one year grandfathering period during which Asian funds could still approach potential clients on a private placement basis just recently elapsed. This private placement regime is more or less only applicable in U.K. and Switzerland: Germany, which had a very favorable private placement regime in the past abolished these marketing opportunities, too.



What does this mean? First; how investors still get access to interesting fund managers, and on the other side, how fund managers can approach their potential investors in Europe. There are plenty of investor pools in Europe and especially Germany institutional money, which has to be invested to generate additional returns. A significant re-allocation is on the agenda.

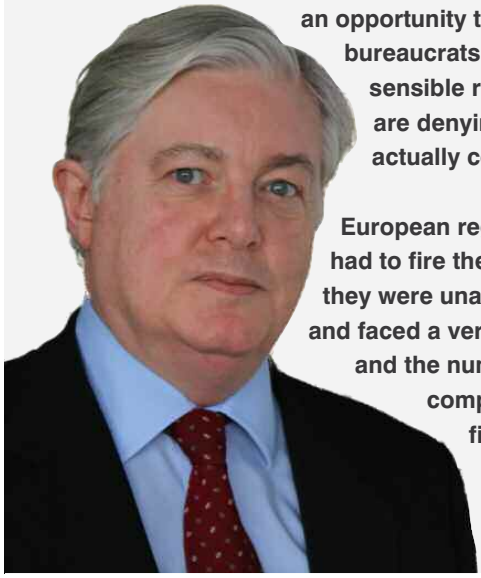
If you compare and consolidate Dodd-Frank, FATCA, EMIR and other tax and regulatory developments, I think it's very interesting how the future business models of the fund industry will be impacted. WTS has run comparisons between the U.S. regulations and the AIFMD and it is very interesting from my perspective to evaluate the upcoming tougher regulations in Asia, too. Probably the burden for managers will rise, but this might even provide for additional marketing opportunities, too.

For example, marketing in Europe: The product placement regime with exception in the U.K. and Switzerland, is more or less not existing any more. But if you compare the level of regulation in Asia, the regulatory framework is probably somehow comparable to the European AIFM level. Fund managers evaluating their specific situation might gain access to new distribution channels and to new distribution routes, especially to professional and semi-professional investors. And 60% of the money in Europe is institutional money and institutional money who can only invest in regulated fund managers. So it's quite bifurcated, and the same applies in respect of taxation.

James Morton: In fact, we have had a tsunami of regulation, and the regulators have achieved two things so far. They have reduced consumer choice and have raised costs on the industry. Whether they achieved anything else, time will tell. I would hope something positive comes from it, but so far, it has been negative for both investors and industry participants, and the regulators seem oblivious. To be fair, they are answering to political masters who want to demonstrate they are doing something. That taxpayers have not suffered as a result of the investment managers even in the Global Financial Crisis seems irrelevant to the German government in particular, which tends to be particularly hostile towards the industry.

My firm is regulated by the SEC, FCA, and the MAS. And I would say the most reasonable is Singapore's MAS. You can have a direct conversation with them that gets answers.

Of course, this is opening up a great opportunity for my friends in Switzerland. I tell them that Brussels has gifted them an opportunity to offer the best products regardless of whether they conform to what EU bureaucrats decide is good for the people. And I think in Singapore, we have too, with a sensible regulator, the potential to offer better quality products which European regulators are denying to the investors of Continental Europe. So, European investors should actually come here to investigate a wider range of options.



European regulations are an absolute nightmare. I have seen cases where an asset manager had to fire their custodian of many years standing, who was doing a wonderful job, because they were unable to qualify for the new requirements of MiFID. So, managers had to switch, and faced a very limited choice with only a few large firms eligible. What I heard from reports and the number of complaints since that switch is that the larger providers can be a lot less competent. I understand that, as service quality does not depend on the size of the firm, but on which people serve you within a firm. And a lot of people in a large firm can be bad. In a smaller firm, you can often get good people who actually care about the service they are delivering to clients.

Francois Dotta: I agree with James, and also have in mind that all this excess of regulation will not prevent the next fraud or the next systemic risk. The result is less choice for the investors and making the manager's business more complicated, and much more expensive.

There has been a dramatic increase in costs. All the support, services, infrastructure that you need to add to your platform so that your business is fit and proper just increases your costs and shrinks the margins in asset management.

Also, a lot of managers haven't performed, so investors say, "Why should I pay 20% performance fee?" So one trend has been consolidation in the industry: you need to be bigger to succeed.

Today, if a manager doesn't have $100 million AUM, it will be very difficult to maintain the regulatory framework, so he will have to consolidate or join some platforms, but that also could not be to the taste of the institutional investors in Europe.

In my view, in the next two to five years, Asian-based managers that want to market their products in places with an excess of capital – Japan, Europe, U.S. – will need to have an onshore presence and infrastructure, which will once more increase the cost.

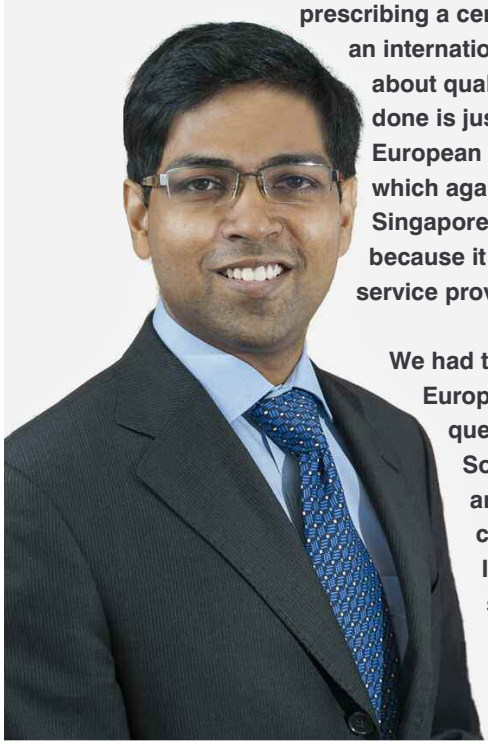


On the other side, the positive aspects for managers that are already in business is that it puts up barriers of entry. There will be less newcomers that will be able to come up with that capital base and the size to run their business. It could also be the case that we will see less scams in the industry, which typically hurt a lot of managers as well. So I do see a certain positive spillover effect whereby all those increased regulatory costs have an ancillary benefit for the industry in a way.

Roshan Padamadan: I run a small fund, and we are on a platform. So, as Francois said, we are seeing the effects of some of this regulation in the way I started the fund. We went with the platform decision because it made more sense. It would have taken too much time and effort to fully build out my own shop.

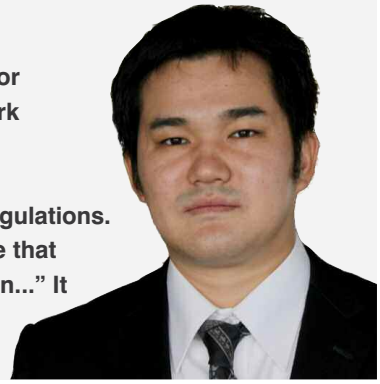
I also compared notes with a couple of fund managers who started their own firms in Singapore, and they said they spend as much as half their time looking at non-investment activities. In a small firm, the CIO and CEO tend to be the same person. I have decided that I cannot spend 50% of my time on COO or CEO kind of questions and issues because it will end up being a substantial hidden cost to my investors. So we entered the platform. It's cheaper and more convenient in terms of time and cost.

Now, in terms of limiting the global funds' marketing access, the regulators are getting what they want. It is a protectionist measure when you insist that if you want to market in Europe, you need to have a European custodian, European admin. It is not that they are doing everything better over there. Otherwise, it could have done it by prescribing a certain standard, like saying that the admin has to meet SAS 70 standard which is an internationally accepted standard for that service. If their concern would have been about quality, this could have been done through quality metrics. But what Europe has done is just blatant protectionism requiring that someone has to be based in the European Union. They could have also required the use of IFRS compliant accountants which again is a quality-based metrics. You can also do IFRS accounting sitting in Singapore. Singapore companies report in IFRS. So all of that is just pure protectionism because it is not based on any quality metric but on the geographic location of your service provider.



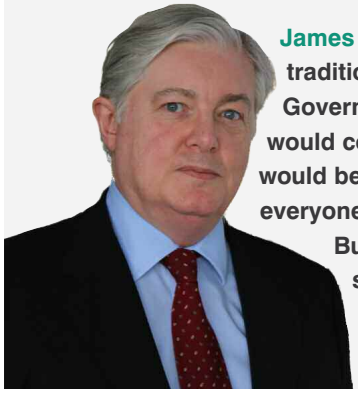
We had to give up Europe because we realized it will cost too much to set up a European onshore vehicle. When we are big enough, we will do it. So these questions become a business decision to decide where to go and what to give up. So again, I guess the regulators got what they wanted. They raised the barriers, and only people with enough capital or who already established these vehicles to cross the barriers can market internationally and so on. In Japan, it's the same. If I want to market in Japan, I know at some point I will have to set up a unit trust structure or something which fits in the Japanese way of investing. All of these are various barriers of entry. You have to take them as parts of the facts of life, and make a business decision on what you want to do.

Kensuke Suzuki: I agree with all of you. We don't have an infinite amount of time and money, so we can't comply with every single country. We did a cost and benefit research, and I'm sorry, but Germany is excluded, it would be too costly for us to communicate with the investors in Germany.



We are also aware that there are discussions about establishing an Asian Fund Passport or something similar, but that is not here yet. It would be great to see if regulators could work together and create something uniform.

The other major impediment is that there are still so many different uncertainties about regulations. So when you speak with consultants about this, you hear things like, "It might be possible that authorities might think this.....", or, "It might be possible that by year 20XX this will happen..." It is difficult to make business decisions with uncertain future changes.



James Morton: Roshan's point about protectionism is really important. We are not seeing traditional trade barriers so much as protectionism in services disguised through regulation. Governments are using regulators to cover protectionist policies. If the regulators of the world would coordinate their efforts, I believe most managers would welcome a global qualification. That would be wonderful. And why not? If we had a single standard, even if it was a high one, and everyone had to live up to that, that would make life better for consumers and practitioners alike. But instead, we are in the E.U. and regulated there, but still can't market in Germany without submitting yet more forms even though we have fully qualified under regulations required by Brussels. No wonder you see growing support for separatist parties.

Matthias Knab James, you focus on China, so let's focus for a moment also on the question why is there so much China bashing or fear about investing in China, particularly in and around the property sector? Also please update us on what you are seeing on the state or the progress around governance standards in China.

James Morton: Chinese governments aren't very fond of the Western media, and that's reciprocated for understandable reasons. And the net result is a lot of misunderstanding and mutual antipathy that you can see reflected if you read The Wall Street Journal, the New York Times or Financial Times, as many people in the financial community do. In those mainstream media you will get an extremely one-sided and highly negative view of almost everything in China. But let's address your very specific question about property.

Jim Chanos, one of the world's great short sellers, has highlighted this area, and lots of people talk about ghost cities in China, and there are some. I am not pretending that this problem does not exist. It does, you can go to Ordos and see lots of empty buildings. But the problem is exaggerated on a number of levels.

Firstly, I could have taken a television crew into China at any time in the last 20 years and found lots of unoccupied buildings. But if I had taken the same crew back to the same place three years later, in many cases those buildings would have been full.

There would have been lots of people living in them and there would have been economic activity. So this issue presents itself in a different light when you look at it as a time series, rather than one snapshot.

And we have actually been to Zhenzhou and seen some of these buildings that CBS filmed. And it's true. One of the retail centers they filmed is a disaster. But it is being renovated right now by the company that built it.

What CBS and others missed or chose to ignore is the development pattern. As people build out from the center into the suburbs, houses go in first. People buy, but don't necessarily move in right away. They wait for the infrastructure and the services; retail, transport, schools, hospitals, to go in and then they come later. So the fact that there are a lot of empty buildings doesn't mean that they are going to stay empty. Staying with Zhengzhou, the local government plan is to relocate people and businesses out of the city centre to create a proper CBRD as a provincial centre and that is driving this process of suburban development.

The second thing I would like to address is affordability. People say prices in China have gone up a lot, and they have. If you take the period 2010-2012, for example, you can show a very steep annual increase. But if you take a longer time series, then this is not the case. Also, commentators seem to ignore the other side of this equation, which is that average wages have been going up a great deal as well.

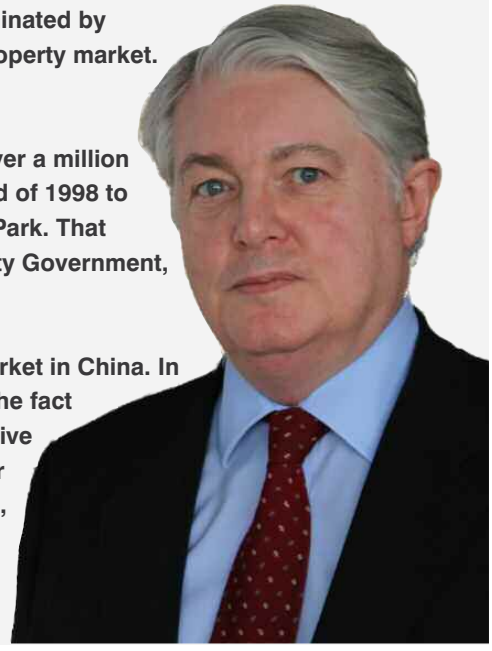
If you go back to say 2000 and take a nearly 15-year perspective, which I think is more meaningful when you are talking about property, the average cost relative to the average income for, let's say, a 90-square meter apartment, which is a sort of standard unit in a second and third tier city in China, is actually more affordable today than it was in the year 2000, but you don't read about that in the Western newspapers.

And the third thing I would like to mention is urbanization. I believe the general statistical figure is that urbanization today is about 54% in China and therefore the big period of inward migration and residential development must be over. But that's not correct, because first of all, it excludes all the people who don't have a permanent residency license in a city. So this number already is an overstatement.

Secondly, there is still inward migration into certain population centers.

And thirdly, and most important of all, the quality of housing that people expect today in China is very different from what it was even 10 years ago.

What was a perfectly acceptable apartment in 2004 is not a perfectly acceptable apartment in 2014. And we are moving out of a property market dominated by first time home buyers and into one dominated by upgraders. This is a very important distinction, and this is what will drive the property market. We are going to see lots of buildings pulled down and rebuilt.



One of my investments is with a company that is pulling down at the moment over a million square meters of pretty shoddy housing in Shenzhen that was built in the period of 1998 to 2005, which is not that long ago, but it happens to be near Huawei Technology Park. That whole area is being dramatically upgraded with the support of the Shenzhen City Government, and it will be transformed into a much higher quality community.

So this is the thing I think that most analysts are missing about the property market in China. In the meantime, because of these negative articles and negative sentiment, and the fact that this is a highly contrarian place to invest, you can find good companies at five times earnings, paying more than 6% dividend and trading at below 50% of their net asset value marked-to-market, or as Michael Metz of Oppenheimer coined it, these are wonderful Magic Sixes and sooner or later you get rewarded for owning these sorts of things, and you are paid well while you wait.

Roshan Padamadan: **I always thought the Chinese property is a well-kept secret, so James is revealing all the secrets now.**

Now, there are a lot of good plays, but you need to model the companies individually. China is a very large country, just the real estate market is worth a trillion dollars. That's like two Hong Kongs and one Singapore put together. So we are talking about a very large market, and no one single player dominating the market. The market is very fragmented, even the largest developer – China Vanke - is only 2-3% of the whole market. They all have some focus on a particular city or some provinces, and only some of the larger ones concentrate across three regions; the Bohai Rim, which is the northern area, Beijing and the surrounding areas; then there's the Yangtze River Delta, which is Shanghai and surrounding areas; and finally the Guangzhou-Shenzhen area which is the Pearl River Delta.

So these are the three major regions in China, and then there are also developers who just focus on central provinces of China or just Henan, which is one province.

Many of them have low single-digit earnings, P/E multiples, and there is nothing wrong with them. You ought to do your own research to make sure you have checked all the boxes and for corporate governance. Do you see a large ownership by the entrepreneur? What has been his track record? The entrepreneur and family and friends might have a bigger stake.

Sometimes in the West people see a high family or an entrepreneur ownership as a negative, but it may not be always the case. Sometimes it will make them very focused and it will help them take care of the company well – because if they see it as their main vehicle of wealth, they might make very good decisions in terms of not leveraging too much, and because they tend to be a bit more careful with such things. Again, for those aspects you need to understand a little bit more about the track record of that particular entrepreneur or entrepreneur family.

A lot of Chinese homes are bought with cash. The usual definition of a bubble is borrowing beyond your capacity and buying things on credit. That is not the case with Chinese property in general.



Of course, you will have cyclicality. Business cycles are there in every economy. There might be overbuilding in some places, or some cheating and fraud in some parts of the country. China is a very large country, but that doesn't mean the whole property sector is a sham. It is a rapidly urbanizing country and millions of homes are needed every year.

China also offers many different sub-sectors you can focus on, like just social low-cost housing; there are builders who focus only on that. That is another theme. There is a Hong Kong listed company which keeps getting a lot of contracts for low-cost social housing. That activity is not related to other trends, but rather to government support at the local level for those aspects, or the local governments who have budgets and targets to meet.

China is actually run at three levels. You have the central government, the provincial government, and there is the municipal government. But China is not run like an army, sometimes they don't listen to each other. Sometimes the municipal government doesn't listen to the provincial government. The provincial government sometimes ignores the central government directive.

People from outside of China may think it is a command and control system - somebody at the top says something and everybody just marches to that tune. But that is not really the case. You'll find different aspects when you start doing your research in China.

When it comes to picking names and do your fundamental research on property, you will have to figure out if this company has a clear strategy? What are they going to do? Are they focusing on a certain geography? Which customer base are they targeting?

There is no single thumb rule like, "Oh, you should be looking at the small-cap names or the middle-market names or the high-end luxury names." The companies will have to execute well in whatever sector they are in. If someone is a high-end developer and sells luxury property, he might still be successful. He just has to focus on his thing. Someone else might focus on only social housing and can also be very successful and have a really attractive stock, and so on.

Roshan Padamadan So it's all very case-by-case, there is no one single thumb rule saying that these kind of developers will not do well or will do exceptionally well. This makes China a stock picker's dream because you have no shortage of choice and you can do your work and pick your stocks.

That is how we look at Chinese property. There are plenty of opportunities if you can ignore the noise and take a three-year view. There is one final piece - you need investors who can give you patient capital, because this investment can be only made with patient capital.

James Morton This is a sector that is universally despised. But if you look at it, you will find there are a couple of hundred companies listed to choose from. Big firms are gaining share in a period of consolidation. The best ones are up over 100% this year. The worst ones are down over 50%. So you really have to select carefully.

Matthias Knab Any other comments?

Roland Schwinn I want to come back to regulations for a moment. We said earlier that smaller or mid sized managers can also opt to stay away from marketing to certain regions, thus also avoiding additional regulatory burden and costs. That is a privilege that we as exchange don't have, so we have been very busy in the last few years with implementing respective infrastructures and complying with a lot of regulations.

Roland Schwinn: Some of the work we have done was also to pro-act in advance. One service we are able to offer already now is different segregation models which I believe compared to other CCPs are pretty advanced because our individual clearing model is providing the most comfort to our customers, offering the physical segregation of funds on a physical clearing house level. This service is not only available for exchange members but all the way through to the end investor.

If a registered customer is individually segregated, the funds are ring-fenced at the clearing house level in case of a clearing member default. In such a case, the registered customer can itself act as clearing member for about one business week, and then all positions and collateral can be transferred to the next clearing member. This is a solution that we developed as a result of the experience with Lehman, but also in order to already comply with future regulations.



Roshan Padamadan: **We can all look at the VIX, or other similar metrics for measure of the market's volatility, but I think there's a lot of hidden volatility underneath that.**

The markets are actually very edgy. If a company misses any earnings estimates or something similar these days, the punishment is very swift and very brutal. Stocks have large moves, you can see 10%, 20%, or 30% moves in a day in many different markets. That shows that there is a lot of hidden volatility, investors are actually very nervous, and that doesn't come through in the metrics we see such as a VIX index. That is something to recognize, and that's why I don't care if the VIX is 12% or 15% or 18%. I am anxious anyway.

At the macro level, the three largest economic blocks – the U.S., E.U., and Japan – are all easing. The E.U. is actually starting to ease, and I would expect a full-blown QE to start. They already began in a couple of graduated ways with SME bonds, covered bonds, and so on. This is not a good sign, if you see all the larger economies engaging in a QE. We also know that China keeps doing mini stimuli and other measures to help the property sector, the banking sector, and other parts where they think support is needed.

That means we have four large economic blocks, including China, engaging in various forms of artificial support coming from their central banks and other policy makers in those regions. That also clearly demonstrates that there are a lot of risks in the system. More deleveraging is needed, but the central banks don't want to accept any kind of markets falls, so they want to support it. Somehow, it has kind of become part of an unsaid central bank's objective that they have to support the market. I mean, they will disclaim it but it seems to be the case that when there is any large market fall, they seem obliged to come in or they do come in.

The other aspect to remember at the high level is that the difference between developed markets and emerging markets is getting blurred. Who is really developed, who is really emerging? The traditional measures are all getting confused. Historically we used to add a risk premium when you went into an emerging market because there used to be a lot of policy risk, the debt was very high, you didn't know what will happen to the currency, etc. But you could say that about any of the developed economic blocks now as well. For Europe, you don't know whether they'll do QE, whether they'll weaken the currency, what is the policy risk. Is the debt situation good? I'm not so sure. Out of the EU-27, 11 of the countries are in violation of the debt-to-GDP limit of 60%, which is an integral part of the Growth and Stability Pact, one of the anchors or the pillars of the EU.



At the same time you could argue that some of the emerging markets which have low debt-to-GDP are a better place to be because at least they have got real consumer-led demand growth with growing populations. Ultimately, all money is made from people, so if you see both productivity and production increases in a country, that is usually a good place to go to. That doesn't mean that all emerging markets are better than the developed markets, but you have to handpick.

I actually like to call the U.S. my favorite emerging market because despite its high debt-to-GDP, policy deadlock, possible changes in tax code, etc., the country's population and productivity is always improving, and they keep coming up with technology and innovation. And the U.S. does have an active role in many emerging markets. That means if you are looking for emerging market exposure, some of the best ways is to buy American companies like Coca-Cola and Colgate-Palmolive. They make more money from emerging markets than developed markets.

Roshan Padamadan Again, the lines are getting blurred, and instead of being handcuffed by traditional metrics and mandates about developed versus emerging markets, and so on, I think the time has come to recognize real idiosyncratic risks for what they are, and then approach investing with a clean slate.

Francois Dotta: Roshan mentioned that real volatility, if you look at individual stocks, can be much higher than what a volatility index may tell you. So I understand that many investors are looking for protection and for strategies that are not that correlated and volatile.

I think one asset class that has made its way in the last fifteen years and achieved all that is trade finance. When you look at the real-time profile of trade finance funds, they are indeed completely uncorrelated to other asset classes, and they are also completely non-volatile, below 1%. Trade finance offers you a proxy to the real economy through international trade flows where the structural demand on the side of the recipient of capital will last for a while.



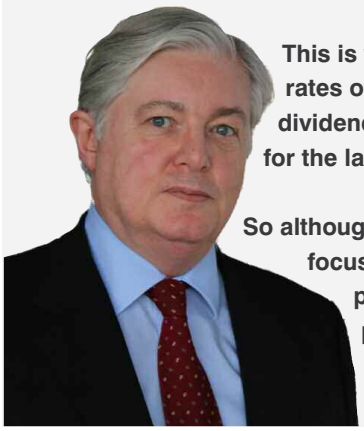
Last but not the least, it serves one of the main purposes which some of the institutional investors are looking for – it is a true income-generating strategy. What is also remarkable is that even in an environment of deteriorating yields, trade finance has been able to maintain this income-generating profile within a by-and-large very reasonable creditworthiness.

Matthias Knab You pointed out that trade finance was still working very well in a compressed or deteriorating yield environment, so it is very clear that returns from trade finance will be even better when rates go up again.

Francois Dotta That is correct, our yields are positively correlated. That means if tomorrow the base interest rates will go up, trade finance will be able to partially pass on that cost to the borrowers. In relative terms, these are our best years by and large because the deposit rate is almost at zero.

James Morton: That is a very good point. Income is probably the single biggest challenge for the investment industry today. As the world ages, including China, it needs more current income. We live in an environment of financial suppression by most of the world's governments as they benefit from zero interest rates.

In that context, when people think about Asia, they think of growth. That is why they come to Asia and invest in equities. And Asian consumption has been a fantastic theme for many years, but I think it's played out for the next couple of years anyway. We see slower growth all over Asia now, and will see slower growth compared to the last decade.



This is why we have focused on income in our firm, identifying companies that generate high rates of cash income and pay out decent ratios of that income to their shareholders by way of dividend. And what most people aren't aware of is that over half the total return at the MSCI Asia for the last 10 years has come from dividends.

So although Asia is considered a growth environment, we believe that investors are better off focusing on the income, and that is what we do. You can still find high-quality companies paying 5% or more in yield, which may not be competitive with trade finance, but it's still pretty good, and gives you on top a chance for some capital gain as well with maybe a bit more volatility.

My point is that Asia should be looked at for income opportunities as well as for growth opportunities for global investors, particularly those outside the region who need more exposure to it.

Kensuke Suzuki Before we close, please also allow me to add a final comment on Japan. While it was like we have been changing prime ministers every single year, the companies haven't been changing every year but continued as solid businesses. The microphone and camera we are using today at this Roundtable, or your cell phone, all include countless components from Japanese companies. Some companies could benefit even from construction demand in China. For example, a construction material company, Nihon Flush, has more than half of its revenue from China.

I mentioned that Japan still has over 1,500 listed companies that are valued under book and over 700 of them are traded under 10 times P/E. For the moment, that universe is still being disregarded, but there are something interesting to look at.



Roland Schwinn: I have a question our two China experts here. What is your view on the opening up process in China which seems to be driven by politics then executed by the regulators? I am thinking about schemes like the installed QDIIs and QFIIs, but also, when do you think foreign investors will be able to invest in China directly? And, conversely, when are Chinese investors able to invest into the outside world directly?

Francois Dotta Can I add another question? Do you think the Chinese will use Renminbi one day as one of the currencies they'll be using in international trade transactions?

James Morton: These are unfortunately almost impossible questions to answer, and I don't think even the leaders inside the Chinese policy making groups have decided, so we can only guess.

Generally speaking though, I believe the country is a reformist trajectory as far as financial markets are concerned. There is a desire to open them, but there is also a concern that in doing so, they will create instability and volatility, which they want to manage. The natural instinct of bureaucratic officials is to manage, and markets are difficult to manage.



So this is going to be a carefully thought-out process. For example, if you take the through train, the connect between the Shanghai and the Hong Kong stock exchanges, they will be doing it initially in a fairly small way, and will see how it works. They will be limiting it to a specific slate of stocks and limit also the amount of money which investors are allowed to trade without engaging in the QFII. I am sure that allocation will be used up relatively quickly, and then they can evaluate how it worked, and probably we will get another round with more companies and more money that will be allowed to flow across borders.

A comment made earlier that I want to pick up on is the internationalization of trade finance. The U.S. seems to be doing everything possible to encourage countries to find an alternative to the dollar, using their currency as a weapon. That is a shame but also an abuse because the guardians of the world currency should be neutral. It started against Iran, which is one thing, and now against Russia, using access to their banking system as well. It is not satisfactory to have the world's currency used this way, whatever you think about the morality.

It is clear that the world needs an alternative to the dollar, and needs it quickly. In only a few years, the Renminbi rose from about number 10 in terms of the currency used for trade finance to number two today. And we have seen the Chinese government wander around Southeast Asia handing out large trade finance lines to Indonesia, Myanmar, Laos, and Vietnam. We have seen the latest deals between Russia and China done in currencies that exclude the dollar specifically as a settlement currency.

All this is clearly part of opening up the Renminbi, and I think that is a positive step actually, and the world will be a better place for it. But as to putting a time on it, this is one of those predictions you definitely don't want to make, because you can only be wrong.

Roshan Padamadan: When it comes to the internationalization of the Renminbi, these kind of events happen once in a hundred years, that is why it is extremely difficult to say when it will happen. The pace of change will usually be underestimated at the beginning and then finally it accelerates and could conclude in just a couple of years. But those couple of years could be any time in the next 10 years.

China has not given a timetable because these things don't work on a timetable. Each step has to be accepted by the market. But you have seen China open more offshore Renminbi centers; London, Frankfurt, Luxembourg, etc., and as James mentioned, the U.S. is also helping them by making their dollar quite unattractive in many ways for some international trade participants.

Apart from using it as a currency of war, they have also made it very painful to touch U.S. dollars for anything else. At the moment, all Singapore banks send out letters to all clients asking them if they are a U.S. citizen, and so on... That is the long arm of FATCA is reaching everywhere, right? All in all, these things are increasing the cost of dealing with American citizens, Green Card holders, and also increase the cost of using the US dollar for just about anything.

You would think that these issues would drive demand to the euro or to the Japanese yen, but because of challenges in those economic blocks, which are different from the U.S. challenges, the world is still in need of a backup or a second reserve currency. There isn't any yet, but the renminbi is a candidate for that, when it is ready. It's still not convertible, as we know, but it could be the dark horse in the race, and five years from now things could be very different.



The Renminbi is de facto being used for more and more deals that China is doing. For example, China goes to Africa and says, "we will settle this purchase of this coal, iron ore or whatever else we are buying, in Renminbi." So de facto it is already being internationalized, even though it is not a convertible currency. That in itself is a very unique kind of situation.

So on the investment side, in terms of the quotas and so on, the Chinese regulators seem very wary of letting in foreigners. I think I understand, knowing history, because I also grew up in a country which was once colonized. So once you have been colonized, it's not like you are always welcoming foreign capital, because you associate capital with control. So it's not an easy decision to make whether you want to let people come in, and they may believe that the new money is not necessarily loyal to China so it might go away, so that's why you have all these restrictions. So on the current quota systems, if money comes in, you can't leave within a year, and you can't repatriate unless you meet certain conditions.

But it [the HK-Shanghai StockConnect] can help a lot more managers access China, because going through a Hong Kong broker is definitely much easier. The QFII and RQFII quotas are meant for large institutions, because you typically need to be half-a-billion dollars or more in size to get them. For a sub-quota, you need to buy in chunks of 10 million or higher from one of the Chinese brokers.

This precludes many small funds from getting a quota, because you cannot put money with a one year lockup if your fund has a liquidity of less than one year. So if you have a monthly or a quarterly liquidity fund, you will have a mismatch. Even if you think China will only be a small part of your portfolio, there is still a mismatch if you accept a longer lock-in in one of your brokerage accounts.

That means that the current quota system doesn't really work in getting large global inflows. In spite of this, the big owners of most of the big Chinese names are the Western asset managers and Western institutional investors. Over the mid and longer term though, this quota will certainly help a lot more managers access China.

Matthias Knab Just as a side note, yesterday in Europe the first UCITS fund that is actually run in Renminbi was launched.

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