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Investment Consulting

How has China changed the Investments of Swiss Pension Funds?

PPCmetrics AG
Oliver Kunkel, MSc., Managing Director

Berne, September 22, 2021

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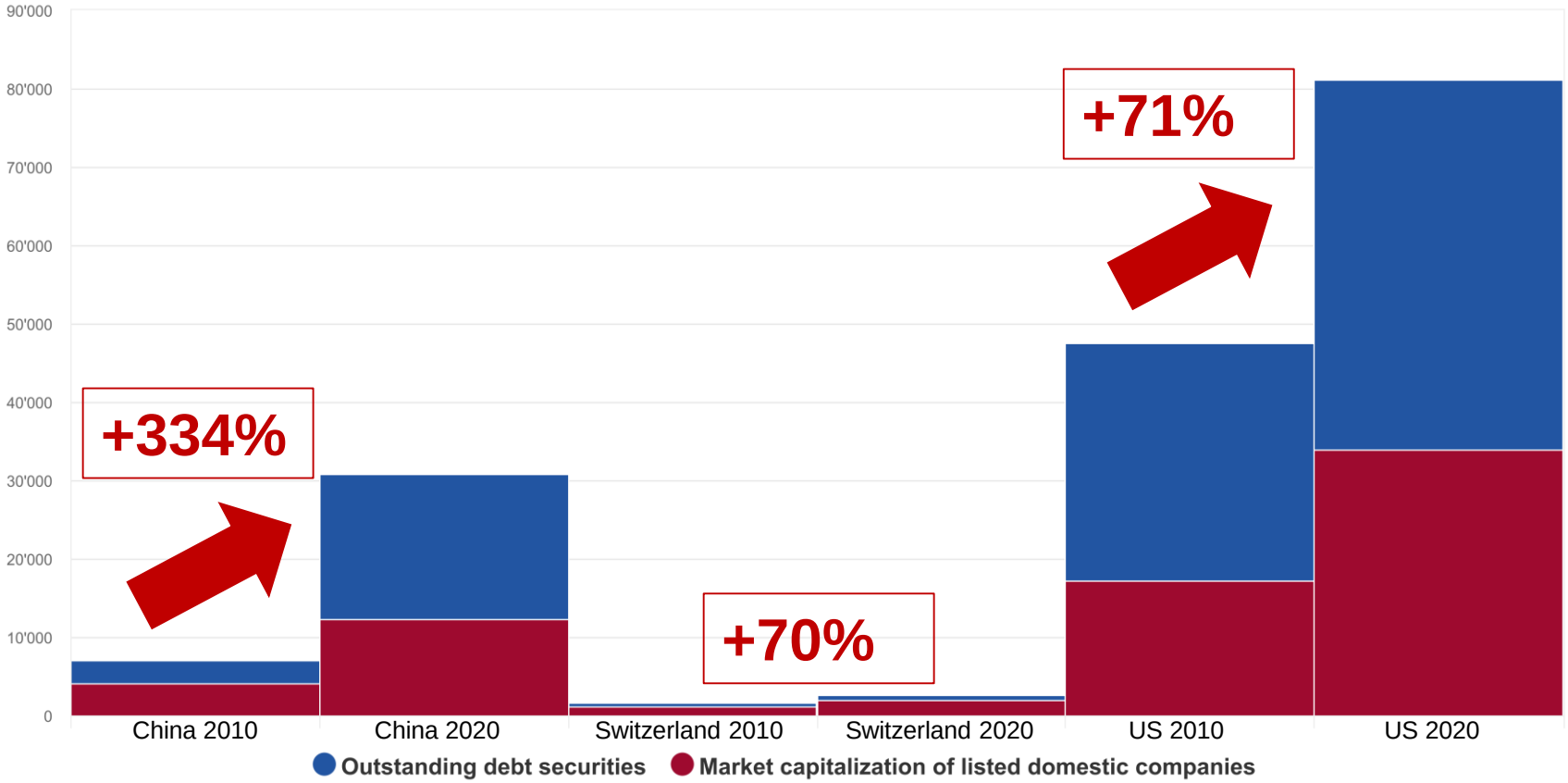
China has a considerable market size

Bond and equity market capitalization 2010 vs. 2020 (in USD billions)



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Source: World Bank, Bank for International Settlements

How China is represented in indices

Index	MSCI Emerging Markets	Bloomberg Barclays Global Aggregate	FTSE Russell WGBI	J.P. Morgan GBI-EM Global Diversified	J.P. Morgan EMBI Global Diversified
New Securities	China A-Shares	Chinese government and policy bank securities in **local currency**	Chinese government bonds in **local currency**	Chinese government bonds in **local currency**	Chinese government and government related bonds in **hard currency**
Transition Start	Mai 2018	April 2019	October 2021	February 2020	1999
Transition End	August 2020	November 2020	October 2024	November 2020	-

Source: Bloomberg, FTSE, J.P. Morgan, MSCI

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Why so late?

- Difficulties with **market access**
- Difficulties with **currency hedging**
- **Lower liquidity** compared to other markets
- **Uncertainties** regarding **lock-up periods**, **repatriation limits** («capital control»), **settlement** and **taxation**

Press Announcement

Share

Bloomberg to Add China to the Bloomberg Barclays Global Aggregate Indices

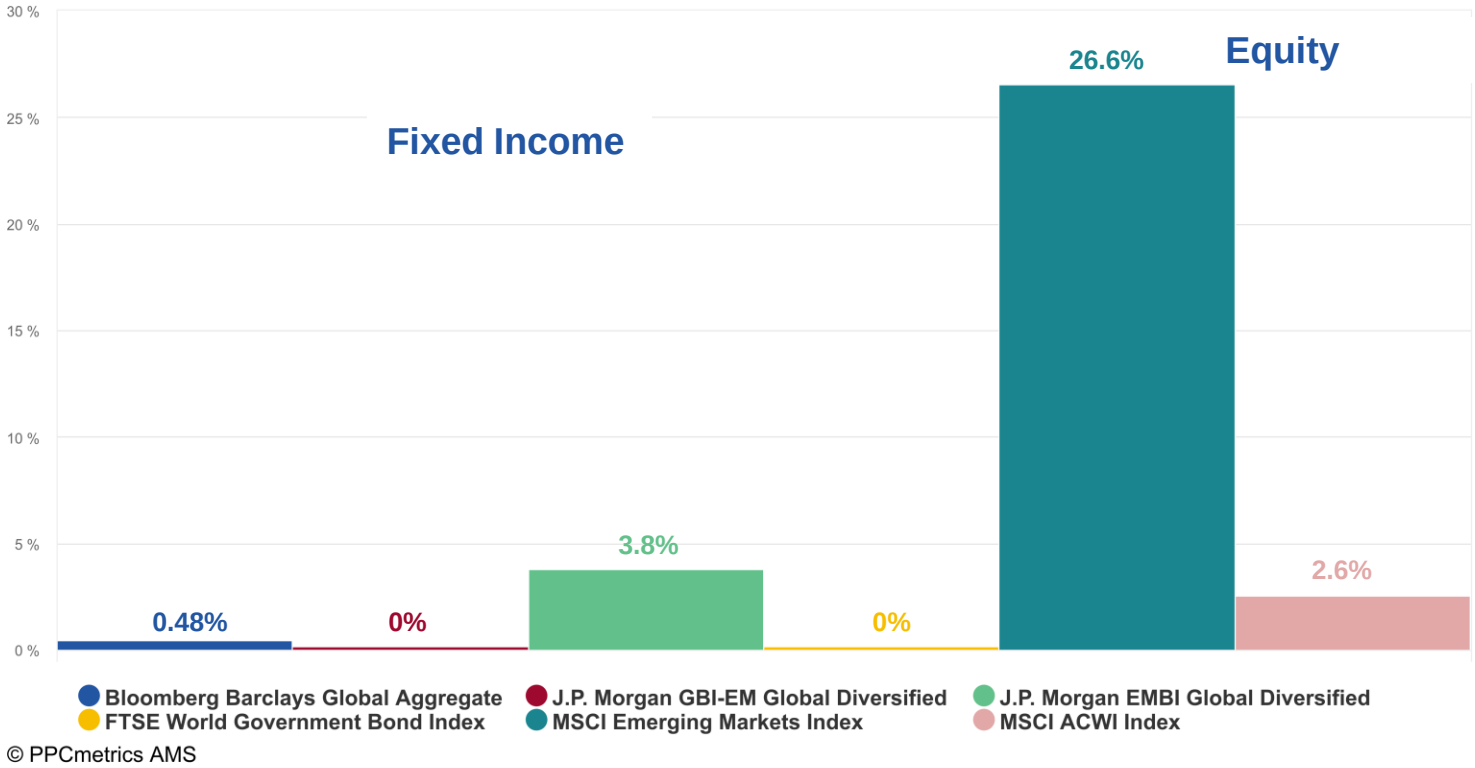
March 23, 2018

Momentum was gained with Bloomberg's inclusion of Chinese RMB-denominated bonds to its flagship benchmark «Bloomberg Barclays Global Aggregate Index», starting in April 2019.

Source: Bloomberg

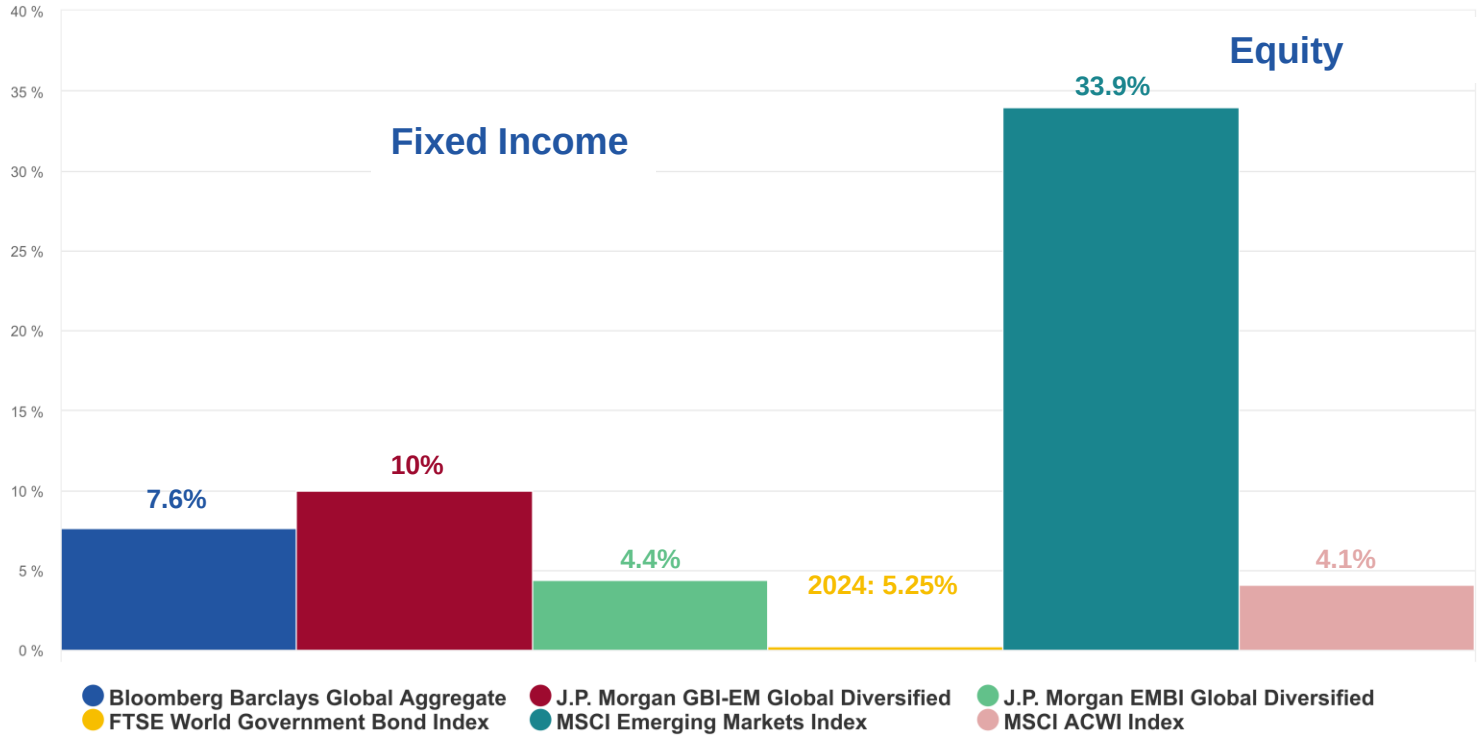
Strategic Issues

Weight of China (2015)



Source: Bloomberg, FTSE, J.P. Morgan, Data as of 31.12.2015; Data publicly available

Weight of China (2020)



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For the FTSE WGBI, it is expected that China will account for a share of 5.25% (market participants' assessment) after the end of the inclusion phase.

Source: Bloomberg, FTSE, J.P. Morgan, Data as of 31.08.2021, Data publicly available

Weight of China in Portfolios: 2015 vs. 2020

Asset Class	Benchmark	%
Fixed Income CHF	SBI Domestic AAA - BBB	25%
Fixed Income FC	Barclays Global Aggregate	15%
Fixed Income EM LC	J.P. Morgan GBI-EM Global Diversified	2.5%
Fixed Income EM HC	J.P. Morgan EMBI Global Diversified	2.5%
Swiss Equities	SPI Index	10%
Equities DM	MSCI World ex CH	18%
Equities EM	MSCI Emerging Markets	2%
Real Estate	KGAST Immo Index	20%
Alternatives	Customized Benchmark	3%
Liquidity	FTSE 3-months Eurodeposit	2%
		100%

Asset allocation approximately based on the latest BFS Pensionskassenstudie (2019)

Exposure China

	2015 (31.12.2015)	2021 (31.08.2021)
Bonds	**0.17%**	**1.50%**
Equities	**0.53%**	**0.68%**
Total	**0.70%**	**2.18%**

Source: Bloomberg, FTSE, J.P. Morgan, Data as of 31.08.2021, Data publicly available

Conclusion 1 – Strategic Risk

- Pension funds have **undoubtedly been impacted** by the rapidly developing Chinese market.
- The **China exposure** has due to the index changes been primarily through **government and government-related bonds**.
- **Corporate bonds** can only be included via off-benchmark securities within broader portfolios or dedicated China investment programs.
- Due to the recent dynamic in representing China in benchmarks, clients should review and evaluate the role of Emerging Markets and China and **identify possible overlaps**.

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Review the weight of China

Tactical Allocation
(Benchmark Securities)

Asia

- Government LC
- Government HC

China

- HC/LC Government
- HC/LC Government Related

Further Expansion of Universe
(Off-Benchmark Securities / Satellites)

Asia

- LC Corporates
- HC Corporates

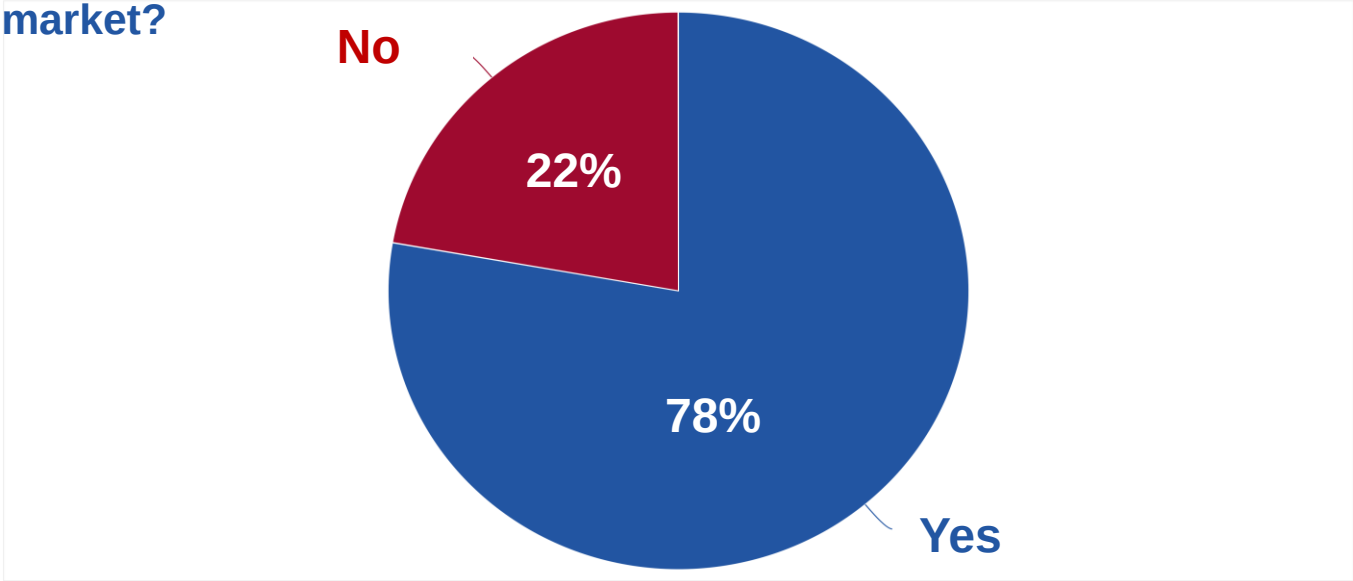
China

- LC Corporates
- HC Corporates

Implementation Issues

Implementation Issues: Direct Market Access

Do you have access to the onshore CNY denominated Chinese bond market?



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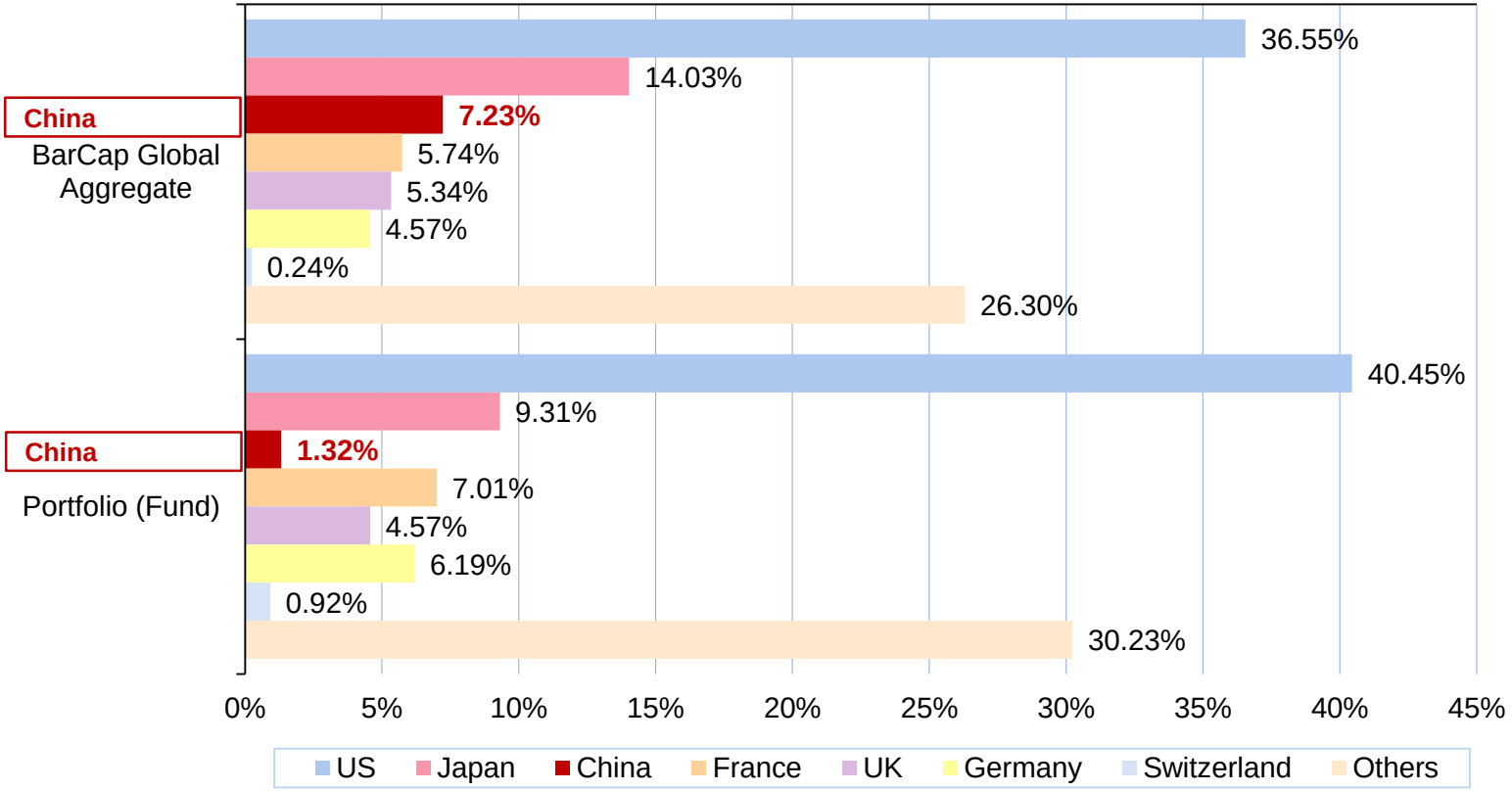
Not all depositaries currently safeguarding assets for Swiss pension funds have on-shore access to the Chinese bond market.

Source: PPCmetrics AMS Market Screen 2021

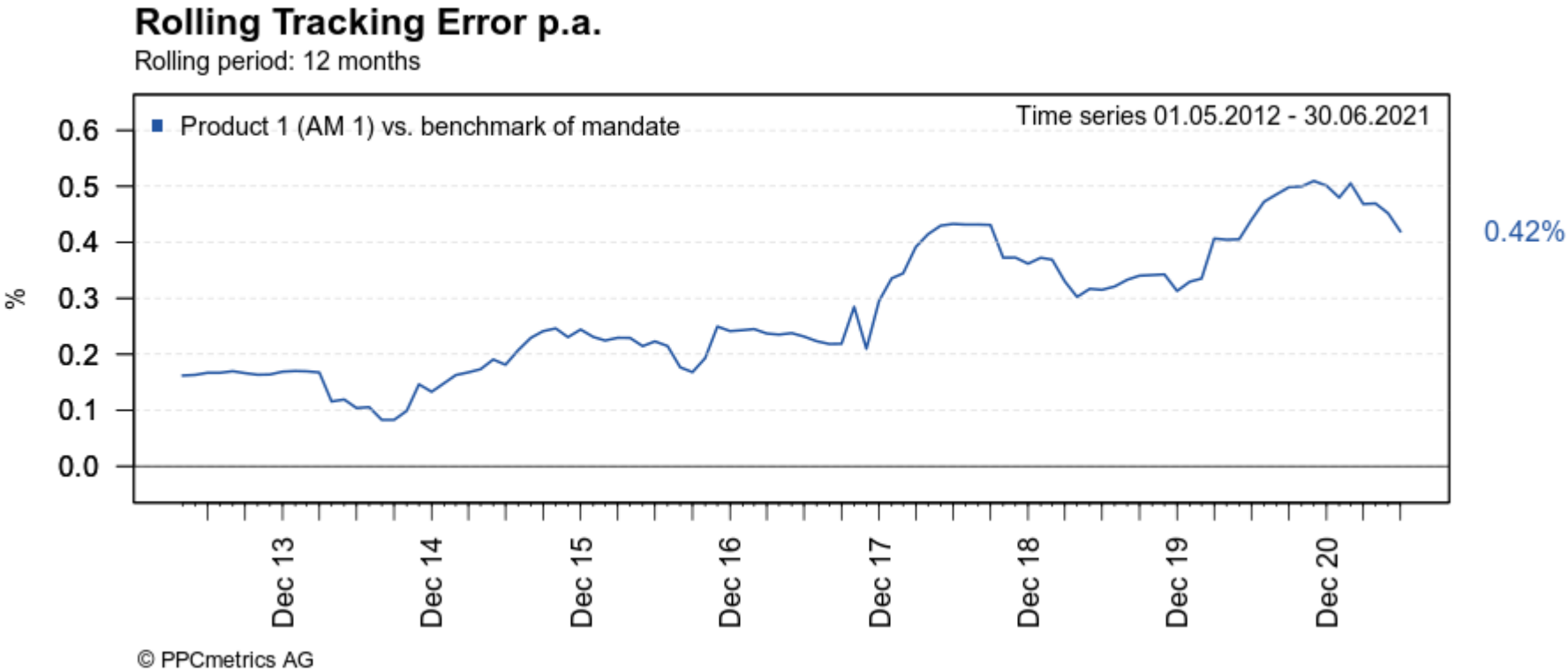
Not all funds were following the index (1)

Benchmark vs. Portfolio (passive Fund)



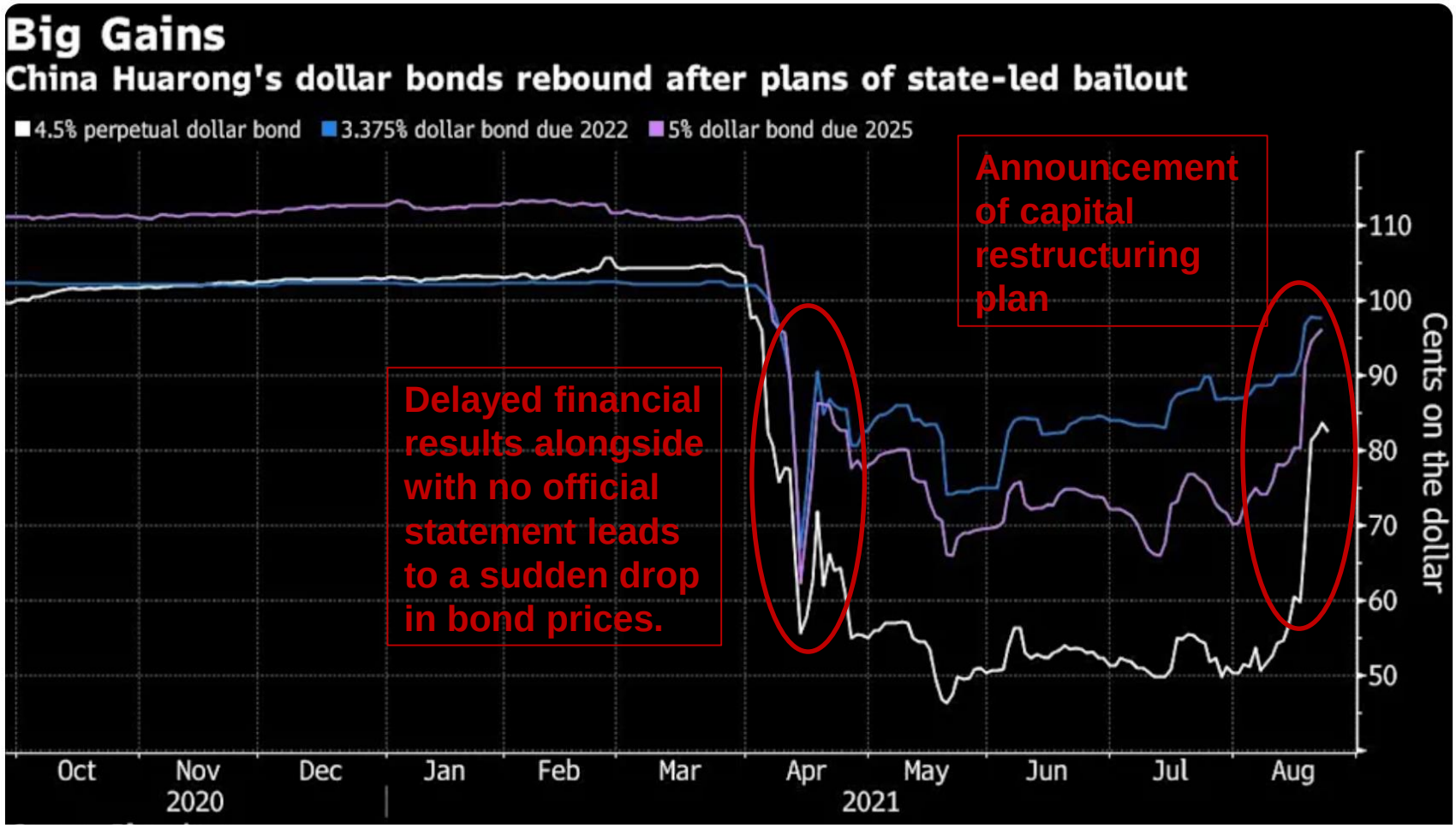
Source: Manager Reporting, Bloomberg, Data as of 31.03.2021

Not all funds were following the index (2)



The replication accuracy (tracking error) significantly deteriated since the introduction of China to the benchmark.

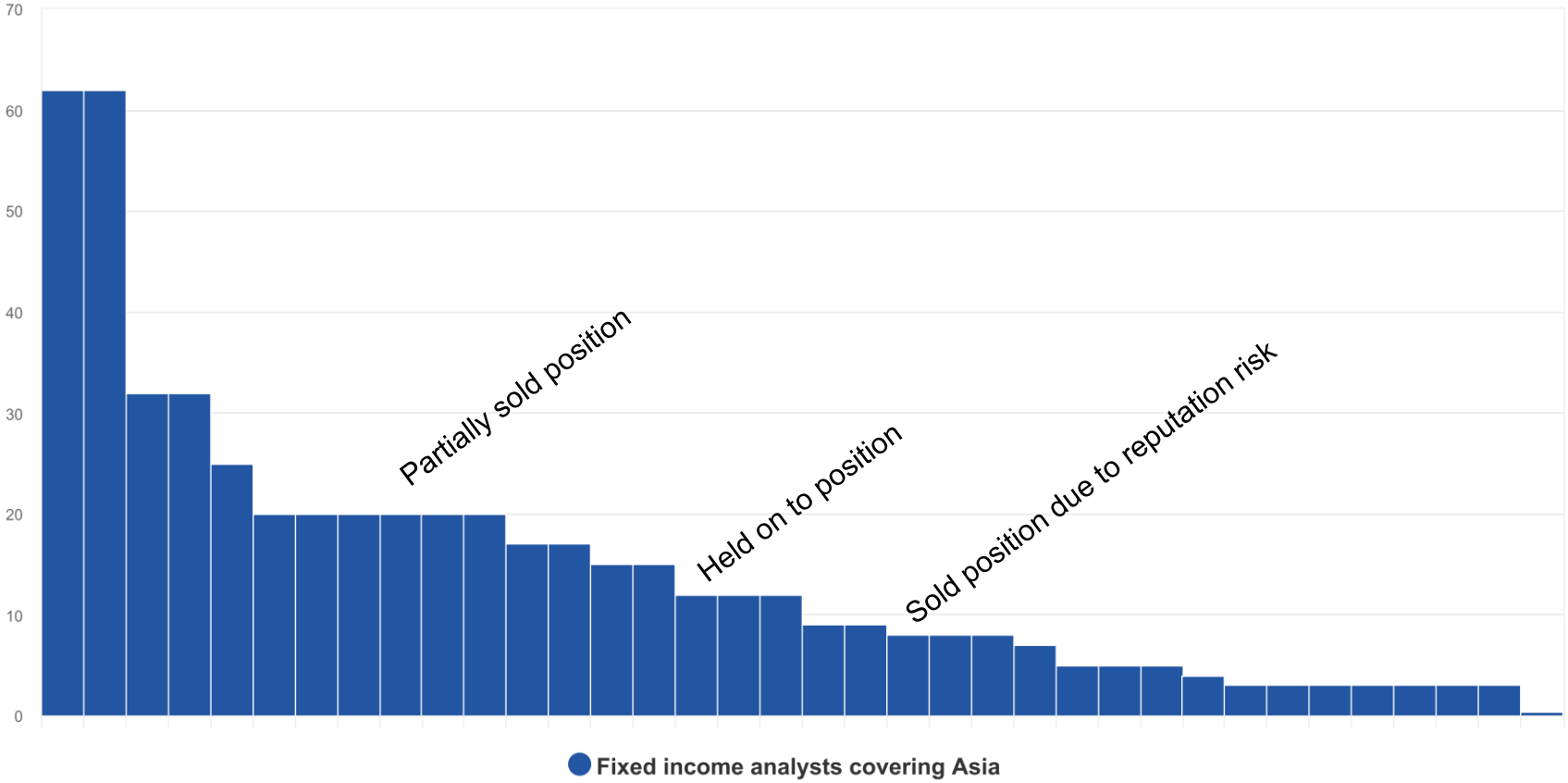
Example Huarong



Source: Yahoo Finance

Examples of manager reaction

Market Screen Asia Bonds



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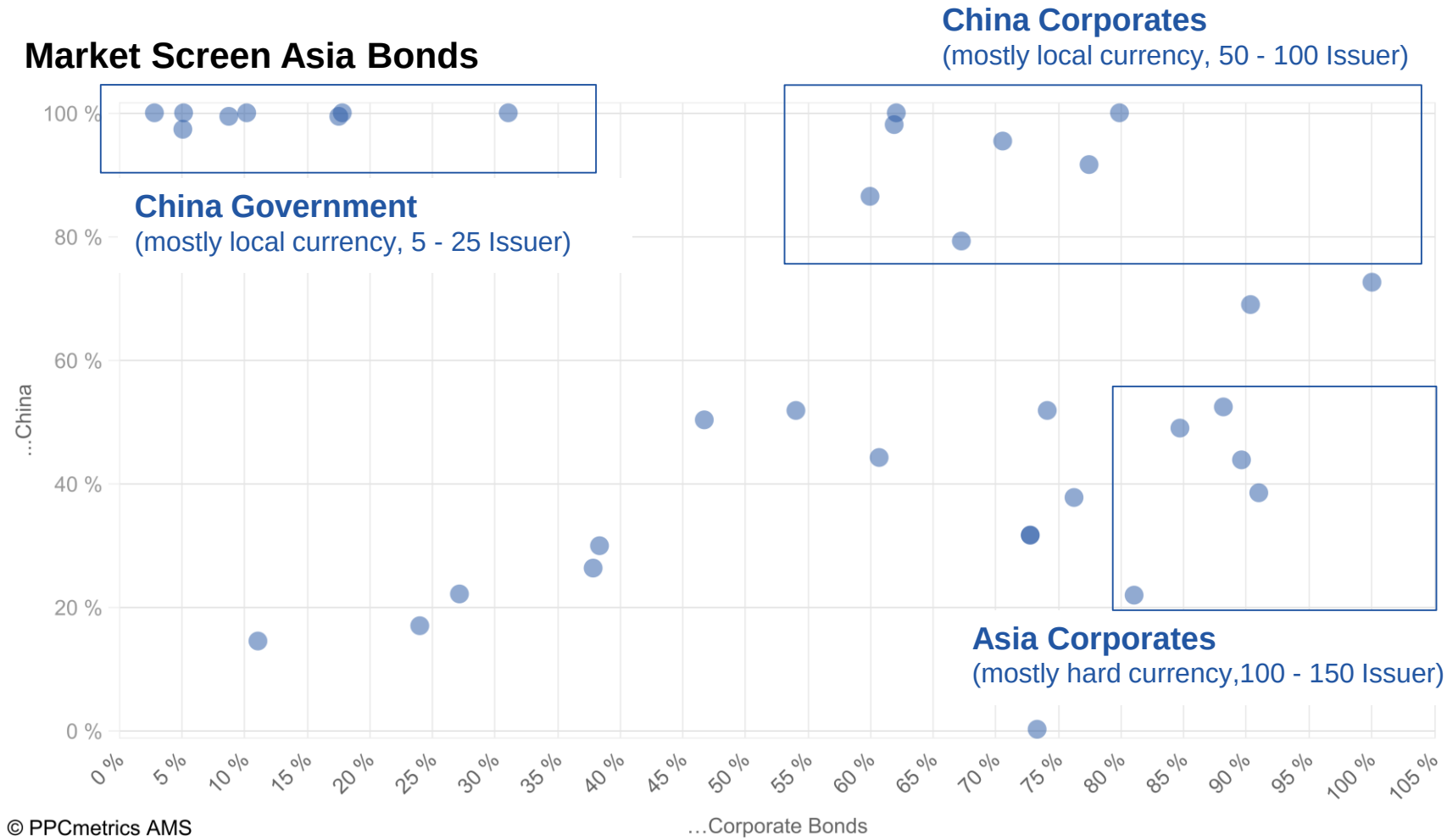
Source: PPCmetrics Market Screen, Total AuM of the companies CHF 28’000 billion.

Few clients individually filled the “China GAP”



Source: PPCmetrics Market Screen, Total AuM of the companies CHF 28’000 billion.

Conclusion 2 – Implementation Risk

- Not all depositaries and / or managers are able to invest in the Chinese market (especially on-shore securities).
- Clients should monitor possible structural deviations of the investments vs. benchmarks and identify possible measures.
  - Change to a portfolio / manager with broad market access.
  - Review and change of mandate structure (include satellites for China)

Summary

Summary

- Pension funds have undoubtedly been impacted by the rapidly developing Chinese market. It is critical to identify potential risks:
- **Strategy Risk:**
  - Due to the recent dynamic in representing China in benchmarks, clients should evaluate the role of Emerging Markets and China and identify possible overlaps.
  - The China exposure has been primarily through government and government-related bonds. Corporate bonds can only be included via off-benchmark securities within broader portfolios or dedicated China investment programs.
- **Tactical / Operational Risk:**
  - Since not all managers are able to invest in the Chinese market, clients should monitor possible structural deviations of the investments vs. benchmarks.
  - Clients should monitor possible structural deviations of the investments vs. benchmarks and identify possible measures, such as changing to a portfolio / manager with broad market access and / or review and change of the mandate structure (include satellites for China).

Thank you!

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MSc

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Function

Managing Director (2019)

Division Manager Asset Manager Selection & Controlling

Education

Master of Science in Economics (financial market theory, real estate finance), Universities of Maastricht and St. Gallen

Work Experience

PPCmetrics AG: Senior Investment Consultant (2006)

PPCmetrics AG: Investment Consultant (2002)

University of Maastricht, Finance Department: lecturer and research associate

Global Property Research, Amsterdam: research stay

Teaching

Lucerne University of Applied Sciences

University of Zurich (Center for Urban & Real Estate Management CUREM)

Fachschule für Personalvorsorge (Pension Fund Management)

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