AllianceBernstein®

AB Investor Intentions Survey

ARE GLOBAL INVESTORS READY FOR CHINA?

GLOBAL INVESTORS TAKE THE SLOW BOAT TO CHINA

China Is About to Become a Capital-Market Powerhouse, but Not All Investors Are Ready

A significant proportion of global investors have yet to position themselves to take advantage of the opportunities likely to flow from China's entry into global capital markets, an exclusive survey conducted by AllianceBernstein (AB) shows.

Despite China's rise to become the world's second largest economy (and the largest on a purchasing power parity basis[1]), during the last 10 years or so, its weight in international investment portfolios remains extremely small. China onshore stocks and bonds account for around less than 2% of most foreign investors' portfolios.

But this will soon change, with major consequences for global investors and financial markets. We decided to conduct a survey to assess the level of understanding in the market of, and the level of preparedness for, what's about to happen.

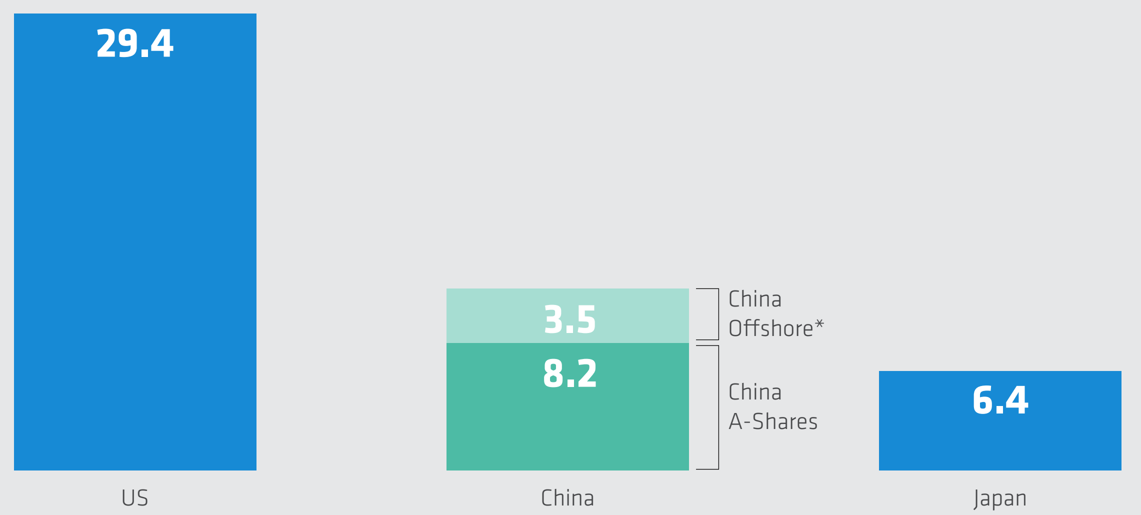
The survey—*Are Global Investors Ready for China?*—polled a range of institutions in the US, Asia and EMEA (Europe, Middle East and Africa) and showed that many institutions, with US retirement plans prominent among them, have yet to engage meaningfully with China's investment potential.

AMONG THE SURVEY'S KEY FINDINGS

1. **More than 80% of respondents have no specific plan regarding investment in China, and more than a third would delegate decisions about China to their external portfolio managers**
2. **Despite China's potentially significant weight in global indices, most investors do not seem ready to make stand-alone allocations to the country**
3. **A third of bond investors among respondents said that inclusion of Chinese government bonds in major global and/or emerging-market (EM) indices would automatically make the bonds part of their universe**
4. **Half of them said, however, that they would need more information about the market to assess the impact on their investment guidelines**
5. **95% of equity investors among respondents have China exposure, but mostly (78%) through a global or EM strategy**
6. **More than 80% of equity investors prefer actively managed strategies, with an even balance between those who favored a segregated mandate and those who preferred mutual funds**

1 International Monetary Fund, October 2017

DISPLAY 1: CHINA EQUITY, THE WORLD'S SECOND LARGEST STOCK MARKET, IS NOW ACCESSIBLE TO ANY OFFSHORE INVESTORS
Equity Market Capitalization (USD Trillions)



As of March 31, 2018
*China Offshore includes the Hong Kong–listed stocks (H-shares, red-chips and P-chips) and the China stocks that have American depositary receipts (ADRs) listed on the New York Stock Exchange (NYSE), NYSE American or Nasdaq, excluding OTC stocks.
Source: Bloomberg, Hong Kong Stock Exchange (Main Board and GEM), NYSE, Shanghai Stock Exchange, Shenzhen Stock Exchange and Tokyo Stock Exchange, Goldman Sachs

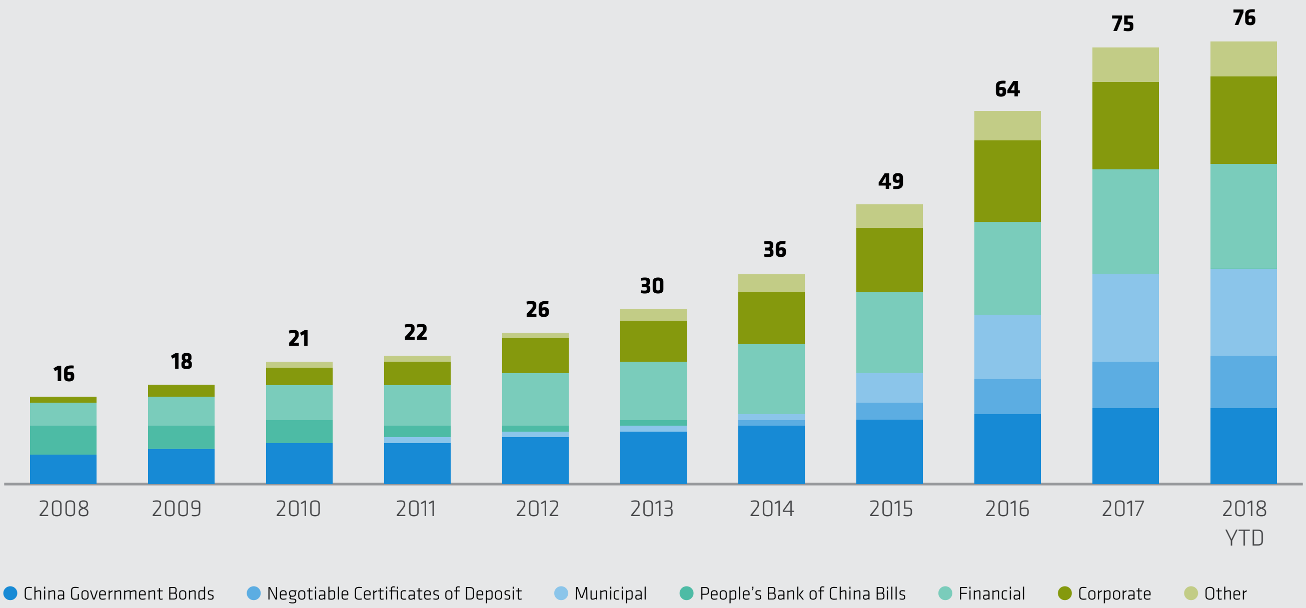
There have been times over the last few years when China's economic challenges and policy shifts appeared to weigh on its efforts to open its economy and financial markets to offshore investors.

The country has faced external challenges, too: the survey, for example, was conducted during the first quarter of 2018, when the possibility of a trade war between the US and China dominated headlines.

Even then, however, a steady flow of news stories continued about China's progress in opening its capital markets and financial-services sector to overseas interests, and this continued progress, in our view, underlines the relevance and timeliness of this survey.

DISPLAY 2: CHINA ONSHORE BOND MARKET IS SHOWING STRONG GROWTH

Annual Market Trend (RMB Trillions)



As of March 2018
Source: Wind and AB

BACKGROUND TO THE SURVEY

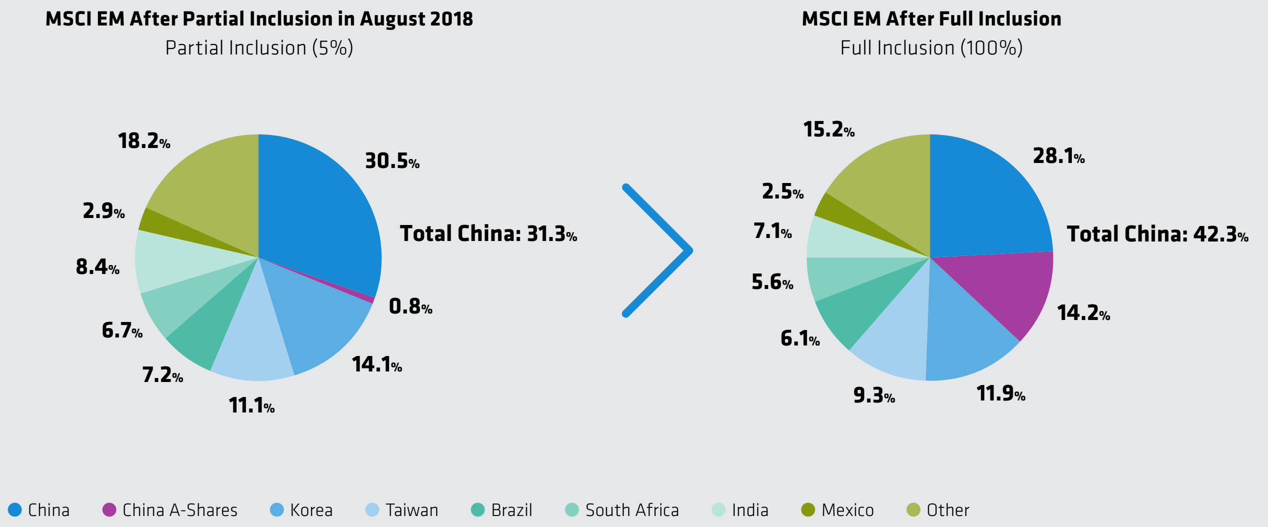
In attempting to understand China's potential impact on global investment markets, we think it's important to consider its liberalization program in the context of the size of its onshore equity and bond markets, as well as how China's inclusion in global indices will trigger large-scale portfolio reallocations.

Among the key financial market reforms China has made during the last few years are the launch of Stock Connect in 2014 and Bond Connect in mid-2017, schemes that enable foreign investors and investors from mainland China to trade in each other's equity and fixed-income markets.

The moves have significantly improved offshore investors' access to, respectively, China's A-shares market, the world's second largest stock market with a market capitalization of US$8 trillion (*Display 1, page 2*), and its huge US$11 trillion onshore bond market (*Display 2*).

DISPLAY 3: MSCI IS ADDING CHINA A-SHARES TO MSCI EMERGING MARKETS INDEX

Road Map for Index Inclusion



As of February 9, 2018

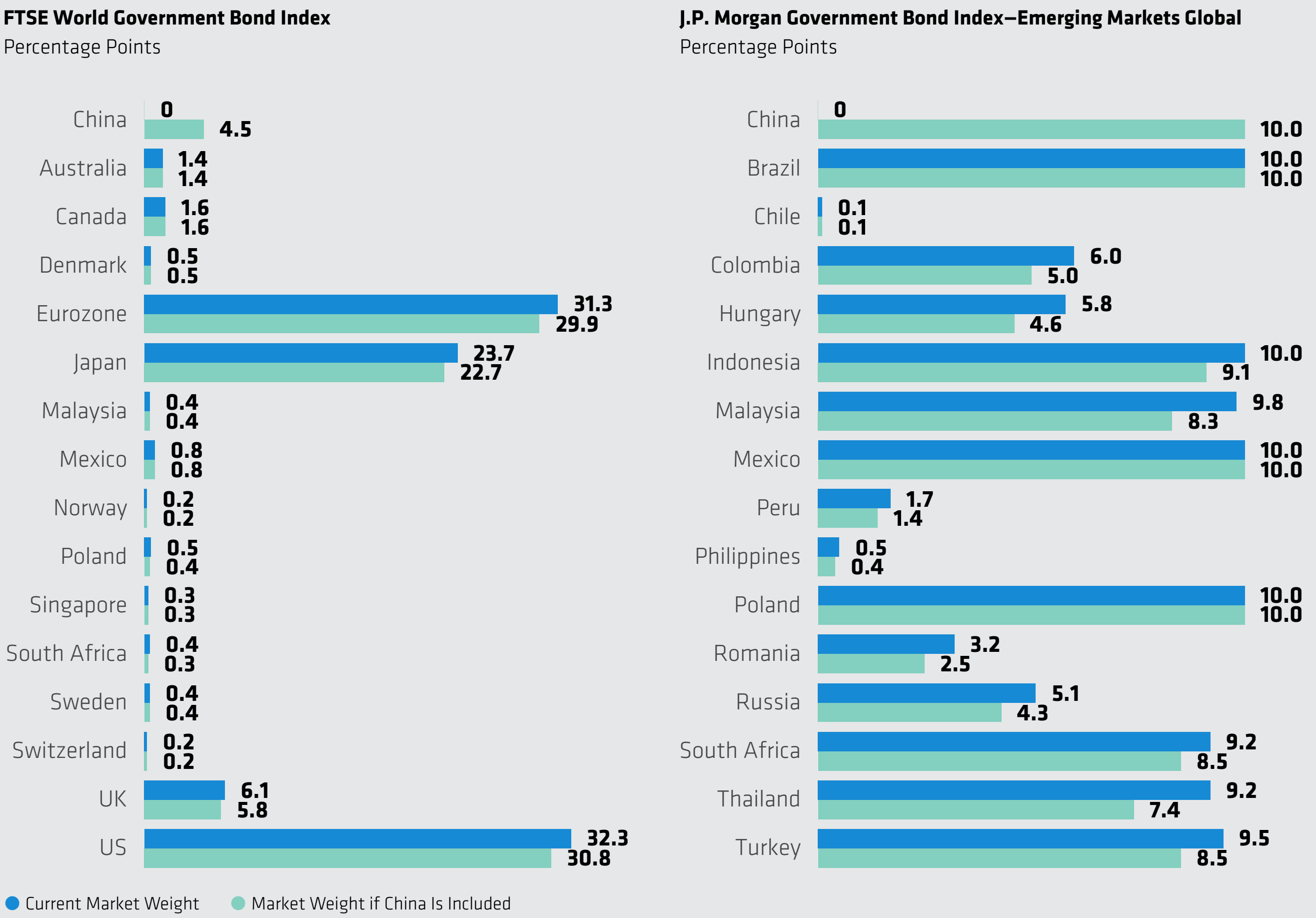
The percentage number refers to the Inclusion Factor applied to the free float–adjusted market capitalization of China A-share constituents in the estimated MSCI Emerging Markets Index. Numbers may not sum due to rounding.

Source : MSCI, J.P. Morgan and AB

MSCI's inclusion in August 2018 of A-shares in its Emerging Markets Index will result in a new class of investors—those who follow the MSCI index—accessing China's onshore stock markets.

While the A-shares' presence in the index will be small initially, it could grow to the point where China accounts for nearly 43% of the index (*Display 3*).

DISPLAY 4: CHINA INCLUSION TO FTSE WORLD GOVERNMENT BOND AND J.P. MORGAN GBI–EM GLOBAL BOND INDICES



Left chart as of March 7, 2017; right chart as of March 15, 2016
FTSE World Government Bond and J.P. Morgan GBI-EM Global indices' estimated weights are based on a FTSE publication and a J.P. Morgan publication.
Source: Citigroup, J.P. Morgan, Thomson Reuters, *The Wall Street Journal* and AB

Similarly, we expect that China onshore bonds will be included in the FTSE and J.P. Morgan main bond indices within the next few years, forcing global investors who follow these benchmarks to reallocate potentially billions of dollars to the Chinese markets (*Display 4*).

In March 2018, Bloomberg Barclays announced that Chinese government bonds would become eligible for inclusion in the Bloomberg Barclays Global Aggregate Index, subject to conditions, from April 2019.

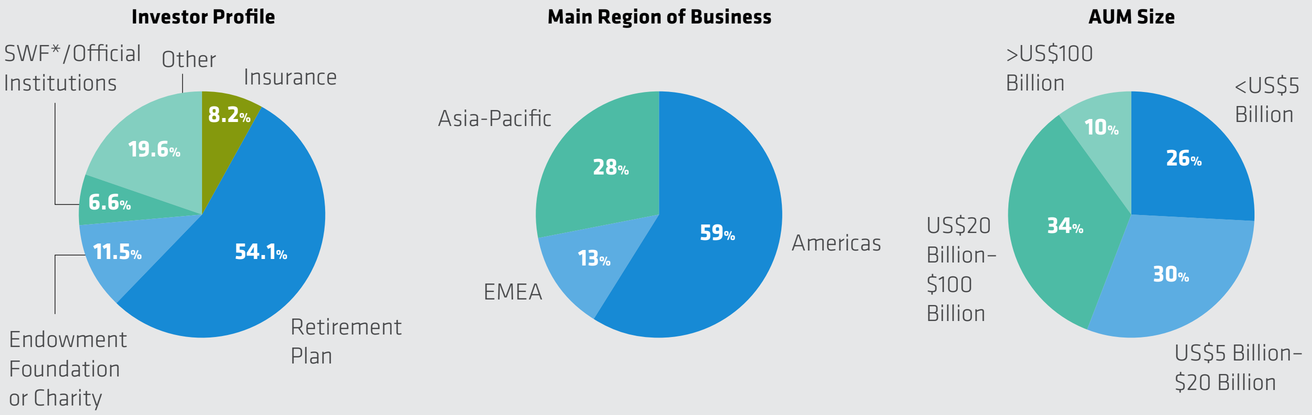
We estimate that, assuming an index weight of 5.9%, this could translate into a US$100 billion inflow to the onshore bond market during late 2018 and 2019—a strong tailwind for the China fixed-income market.

The high probability of these events taking place, together with their sheer scale, means that few (if any) investors are likely to escape the effects of China's emergence as a global investment market.

These are the reasons for the importance we attach to this survey as a gauge of how ready investors may or may not be for this once-in-a-lifetime event, and as a wake-up call to investors everywhere to investigate and prepare now for the opportunities that China's financial markets will create.

SURVEY RESULTS

DISPLAY 5: INVESTOR PROFILE
Who Participated in the Survey?



As of March 31, 2018
*Sovereign wealth fund
Source: AB

+ 68 institutional investors from across the Americas, EMEA and Asia including pension funds, insurance companies, endowments and foundations

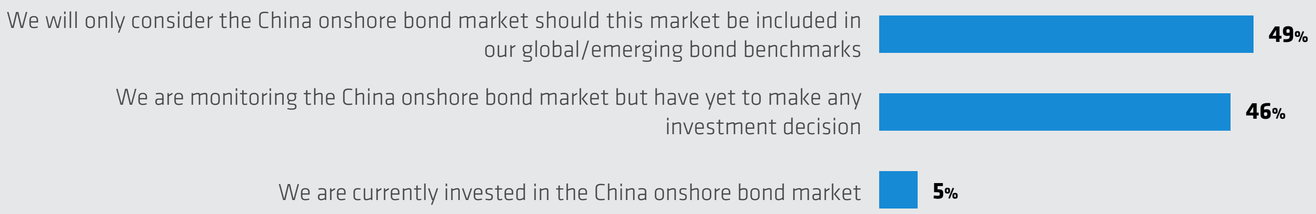
DISPLAY 6: MOST RESPONDENTS DO NOT HAVE A SPECIFIC INVESTMENT PLAN FOR CHINA
How Would You Best Describe the Importance of China for Your 2018 Investment Plans?

As of March 31, 2018
Source: AB

+ More than 80% of respondents do not have a specific plan regarding investment in China. While a few indicate an interest in learning more about the development of the Chinese capital markets, more than a third are happy to delegate any investment decision about China to their external portfolio managers
+ Despite China's potentially significant weight in global and emerging equity and bond indices, most investors do not seem ready to carve out a stand-alone allocation to Chinese securities the way they may have done with, for example, Japanese equities

CHINA ONSHORE BOND MARKET

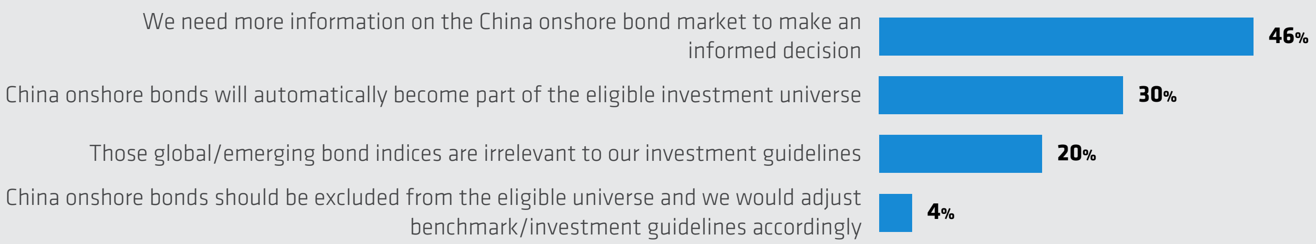
DISPLAY 7: 50% ARE WAITING FOR CHINA ONSHORE BONDS TO JOIN MAJOR INDICES
Which of the Following Best Describes Your Current Involvement with the China Onshore Bond Market?



As of March 31, 2018
Source: AB

+ Even though China onshore bond yields have been significantly higher than yields in the US, Europe or Japan, the onshore market remains largely untapped by global investors outside China
+ While market access has become simpler through, for example, specific quotas (Qualified Foreign Institutional Investor and Renminbi Qualified Foreign Institutional Investor) and the launch of the direct access scheme for foreign institutional investors, half of respondents are waiting for the market to be included in the major global and emerging bond indices

DISPLAY 8: 50% NEED MORE INFORMATION TO MAKE AN INVESTMENT ALLOCATION DECISION
How Likely Will Your Investment Guidelines Be Impacted if/When the China Onshore Bond Market Is Included in the Major Global/Emerging Bond Indices?



As of March 31, 2018
Source: AB

+ Bloomberg announced on March 23, 2018, that, subject to conditions, Chinese government bonds would become eligible for the Bloomberg Barclays Global Aggregate Index starting in April 2019. According to one-third of the respondents, that would automatically make those bonds part of their investment universe
+ But almost half of the respondents said they needed more information about the market to assess the impact on their investment guidelines

CHINA EQUITY MARKET

DISPLAY 9: MOST HAVE CHINA EXPOSURE VIA GLOBAL AND EMERGING-MARKET ALLOCATIONS

Which of the Following Statements Best Describes Your Current Involvement with the Chinese Equity Market?

As of March 31, 2018
Source: AB

- Investors are more familiar with Chinese companies listed in Hong Kong or New York (accessible since the early 1990s) than those listed onshore (accessible to only a few investors until recently). 97% of respondents are already exposed to China equities, but mainly offshore equities through a global or EM strategy (78%)
- Very few have a dedicated allocation to China equities (now). Among those who separately allocate to China, most adopt a comprehensive approach to both China offshore equities (mainly H-shares and American deposit receipts) and China onshore equities (A-shares)

DISPLAY 10: MOST ARE NOT READY TO CONSIDER CHINA AS A SEPARATE ASSET ALLOCATION

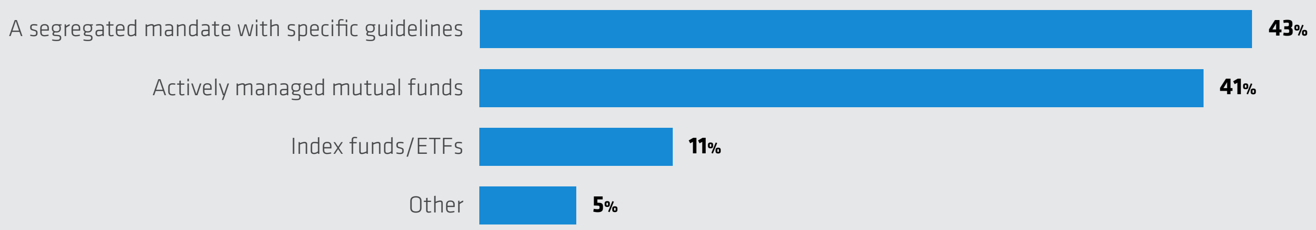
With China Equities Potentially Representing Close to 50% of the MSCI Emerging Markets Equity Index, Which of the Following Statements Best Describes Your Allocation Considerations in the Medium Term (One to Three Years)?

As of March 31, 2018
With Stock Connect offering a more flexible access framework to China A-shares, MSCI will include A-shares in the MSCI Emerging Markets Index using a two-step inclusion process in May and August 2018. With a partial inclusion at first, A-shares will account for a small portion of the index (0.7%), but continued alignment of the A-shares market with international-market accessibility standards and proven resilience of Stock Connect could lead to further inclusion in the coming years.
Source: AB

- 100% of respondents would allocate to China equities in the foreseeable future, on the assumption that the asset class can represent up to 50% of the MSCI Emerging Markets Index. Most, however, would still prefer to manage their exposure via a global or EM strategy. Global investors are not ready to consider China worthy of a dedicated allocation. Only 20% would consider this option over the medium term

DISPLAY 11: CONSENSUS—ACTIVE INVESTMENT IS THE BEST APPROACH TO CHINA EQUITIES

If You Plan to Have a Stand-Alone Allocation to China Equities, Which Approach Are You More Likely to Select?



As of March 31, 2018
Source: AB

+ China equities remain one of the few asset classes for which active strategies are vastly preferred
+ More than 80% of the respondents prefer actively managed strategies with an even split between segregated mandate and mutual funds. Only 11% of the respondents would invest in China equities via an index fund or an ETF
+ 5% of the respondents do not have an opinion

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