Economist Intelligence Unit

The Economist

From West to East

Gauging institutional investor attitudes to Asia

An Economist Intelligence Unit survey

Sponsored by Fidelity International

Contents

Disclaimer

Introduction

As the world emerges from the worst financial crisis for more than a generation, a shift in economic power from West to East is gathering pace. With many developed countries weighed down with debt and facing years of sluggish growth, corporations and portfolio investors are looking to the dynamic markets of emerging Asia as one of the most promising sources of long-term growth.

This focus on the fastest-growing markets of Asia is mirrored by the rapid development of financial centres in the region, such as Mumbai, Shanghai and Singapore. Global financial institutions continue to increase their presence in these centres to take advantage of strong economic fundamentals, a growing customer base, favourable demographics and deepening financial markets. Overseas investors are also expanding their allocation to Asian asset classes in the hope of better returns and improved diversification, particularly in the context of weak growth in their domestic markets.

The aim of this report, which is written by the Economist Intelligence Unit and sponsored by Fidelity International, is to assess the appetite among international investment managers to deepen their exposure to the Asia-Pacific region. The findings are based on a survey conducted in February 2010 of 109 financial services professionals from across the industry, all of whom have knowledge of their institution's overall investment strategy and exposure to assets in Asia. Investment banks formed the largest group, with 44% of respondents, while insurance companies accounted for 14%, mutual funds for 13%, and pension and retirement funds for 12%. Just over half of the respondents were based in Western Europe, and just under half were based in the Asia-Pacific region. (Respondents from North America were excluded, although respondents from institutions headquartered in this region accounted for 14% of the total.) Around 50% of respondents represented institutions with global assets in excess of US$50bn. Our thanks are due to all the respondents who took part in the survey.*

* NB: Survey percentages in this report may not add up to 100 due to rounding, or respondents being able to select multiple responses.

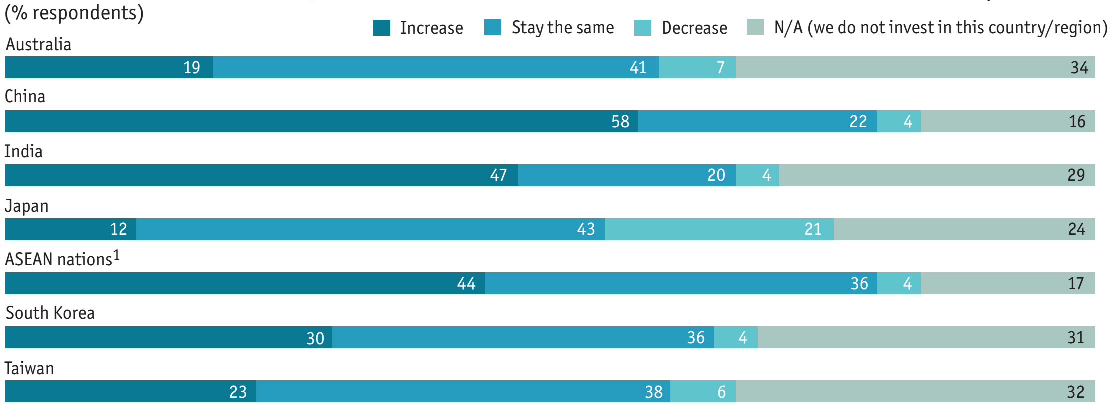
Key findings

- ## Allocations to Asia are set to increase, with major emerging markets grabbing the lion's share

The overall trend among the investors surveyed is to increase their allocation to Asian markets. Almost 90% of respondents agree that institutional investors will increase their exposure to Asia over the next three years. But beneath this impressive headline figure, there is significant variation between countries in the region, reflecting the range of market development and economic growth potential that Asia encompasses. In general, investors favour faster-growing emerging Asian markets over developed ones. China and India will attract the most significant new capital flows over the next year, with 58% of respondents planning to increase their allocation to the former, and 47% to the latter. Some 30% of respondents plan to increase allocation to South Korea, which has recovered swiftly from the economic downturn of early 2009. Developed markets attract considerably less interest, however, with only 19% planning to increase allocation to Australia and 12% to Japan (see Chart 1).

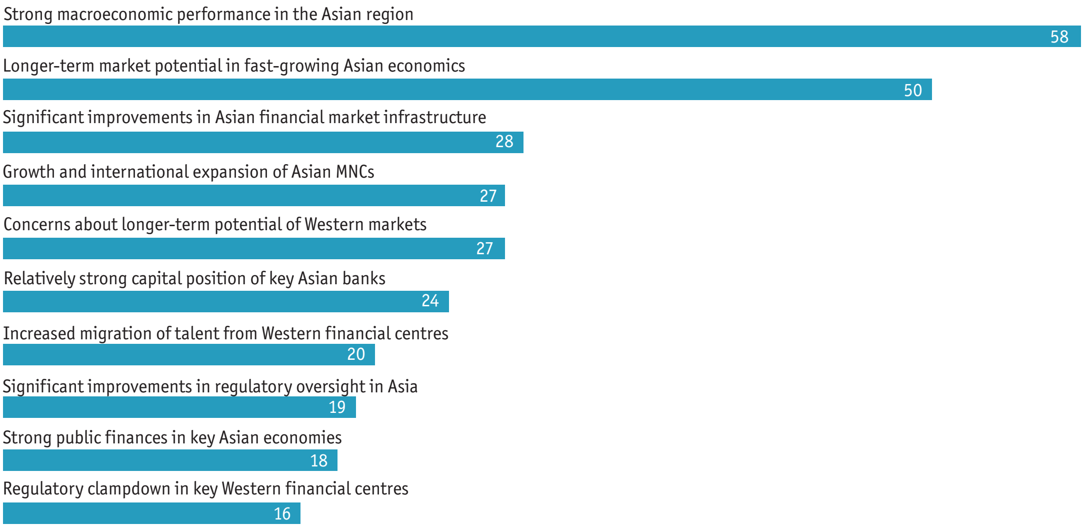
The results reflect confidence in the fundamentals of the region. Strong macroeconomic performance and the longer-term market potential of emerging countries are seen as the main factors increasing the attractiveness of key Asian financial centres (see Chart 2). Equally, few see growth in the region as a flash in the pan. Just 21% of respondents think that the Asian growth story has been overhyped, and only a similar minority thinks that the region's recovery from the recent crisis has been a product of fiscal expansion and is therefore not sustainable.

Chart 1
Over the next year, what change do you expect your institution to make to its allocation to the following countries/regions?
(% respondents)



[1] ASEAN here refers to the six largest economies of the Association of South-East Asian Nations: Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam.

Chart 2
Which of the following factors are most likely to increase the attractiveness of key Asian financial centres (excluding those in Japan and Australia) in comparison with key Western financial centres over the next three years?
(% respondents)



• Asian and longer-term investors haven't forgotten more mature markets

Despite a massive repatriation of capital over the past 18 months in response to the financial crisis, European investors are regaining their appetite for exposure to Asia. Indeed, when compared against investors from within Asia, there are only small differences in the percentages that plan to increase allocation to key markets in the region. For example, 62% of respondents from Asia-Pacific say that they plan to increase allocation to China, compared with 57% from Western Europe. In the case of South-east Asia, the proportion of investors from Europe that are likely to increase their allocation exceeds the percentage from Asia (see Chart 3). When comparing institutions according to where they are headquartered, North American investors appear even more bullish, with 11 of 15 respondents (73%) planning to increase allocation to China and India, compared to a smaller proportion of respondents from European or Asian-headquartered institutions (see Chart 4).

However, the balance shifts in the case of developed or newly-industrialised countries, such as Australia, Japan, South Korea and Taiwan. Compared to respondents from Western Europe, more investors based in the Asia-Pacific region are planning to increase allocation to these countries, possibly because of greater familiarity with and knowledge of these markets. On an institutional level this is also apparent, with Asian-headquartered institutions generally more likely to increase allocation to these countries than those in the West (markedly so in the case of Australia, which avoided a severe downturn thanks in part to strong demand for its natural resources from China).

Chart 3
Over the next year, what change do you expect your institution to make to its allocation to the following countries/regions? (Shows only those that plan to increase allocation, split by location of respondent.)
(% respondents)

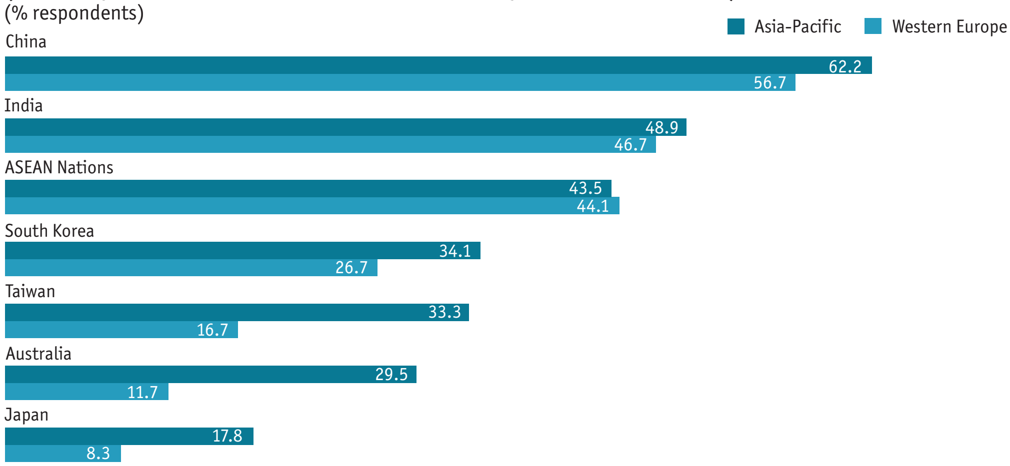
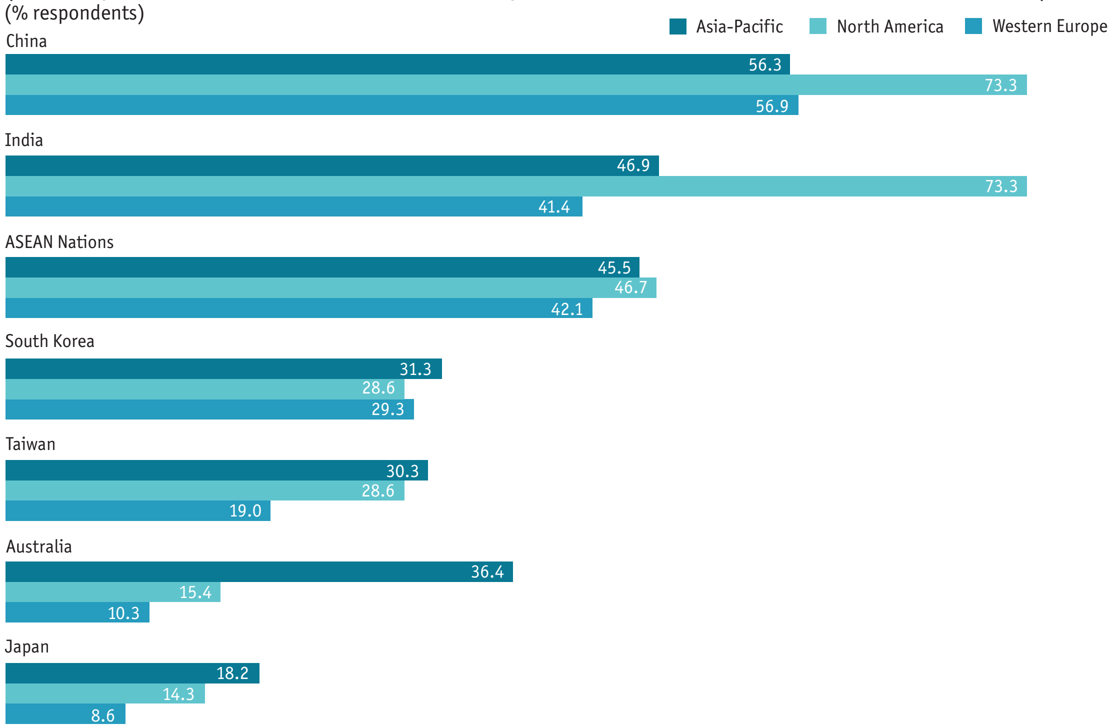


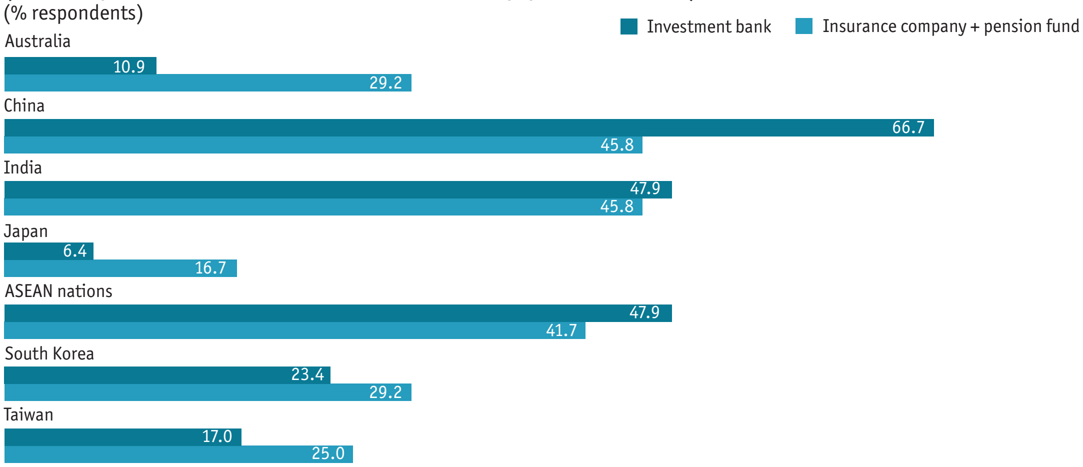
Chart 4
Over the next year, what change do you expect your institution to make to its allocation to the following countries/regions? (Shows only those that plan to increase allocation, split by region in which respondent's institution is headquartered.)
(% respondents)



Investment time horizons also make a difference. In general, longer-term investors, such as pension funds and insurance companies, are more likely to favour increasing their allocation to developed Asian markets, such as Australia and Japan, than investment banks, which might be considered to have a shorter time horizon (see Chart 5). Investment banks are more likely to favour developing markets, such as China and South-east Asian nations. This suggests that emerging markets in Asia are more likely to attract shorter-term, more speculative capital.

Nevertheless, more than 40% of longer-term investors are also expecting to increase their allocation to China, India and ASEAN nations over the next year—a greater proportion than those seeking to increase exposure to Asia's more-developed markets— suggesting a broadening tolerance of risk. This may also reflect recognition that their portfolios have been underweight in these regions. Three-quarters of insurance companies and pension funds disagreed with the statement "Our institution is over-exposed to Asia", compared to two-thirds of investment banks.

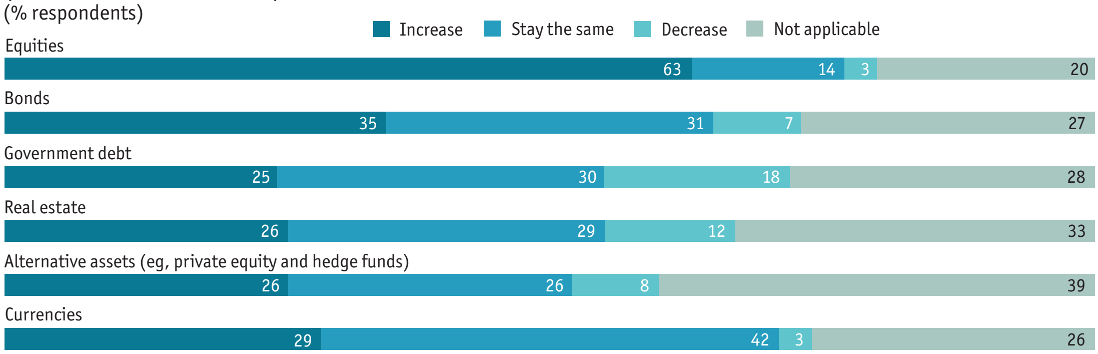
Chart 5
Over the next year, what change do you expect your institution to make to its allocation to the following countries/regions? (Shows only those planning to increase allocation, split by type of institution.)
(% respondents)



• Equities are the most attractive Asian asset class

Across Asia, stock markets have rebounded following the downturn of 2008-2009, although they remain volatile in some countries. Between lows in March 2009 and the end of the year, the Shanghai Composite Index rose by 58% and the Bombay Stock Exchange Sensex index rose by 114%. International portfolio investors, keen to gain exposure to fast-growing Asian companies, growing domestic consumption and a strong pipeline of new equity issuance, have been allocating increasing amounts of capital to the region. Among respondents to our survey, equities are the asset class that is attracting the most significant interest, by some margin. More than 60% of respondents say that they plan to increase allocation to equities in the region, compared with just 35% who plan to gain greater exposure to bonds and 26% to real estate (see Chart 6).

Chart 6
Over the next year, what changes does your institution plan to make to its allocation to the following asset classes in Asia (excluding Australia and Japan)?
(% respondents)

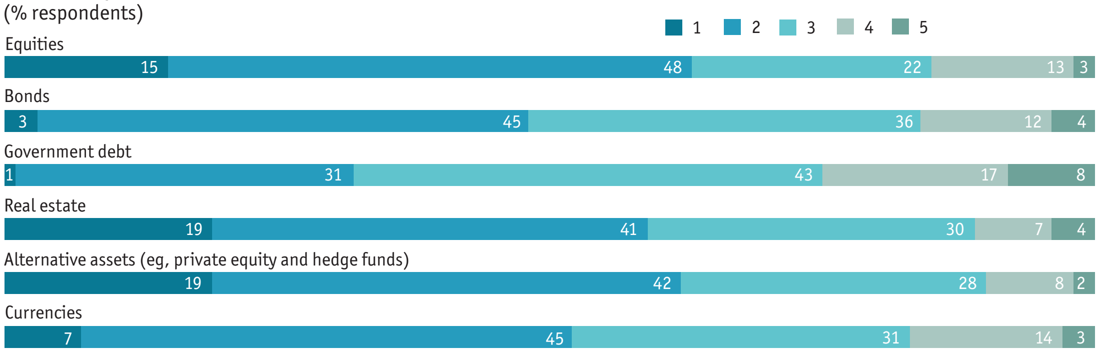


• Investing in Asia is seen as risky, but balanced by potential rewards

The strong performance in financial markets across much of Asia during 2009 highlights the significant returns that can be made by international investors with an allocation to the region. But these gains come with substantial risks. Despite strong macroeconomic fundamentals, a recovery in exports and rising consumption levels, a tightening of fiscal and monetary policy could act as a brake on corporate earnings growth. This could push down equity prices, particularly in countries such as China where policymakers have injected massive liquidity into the market. The risk of overheating also looms, with 54% of respondents agreeing that Asia is more prone to asset price bubbles than the West.

In general, the majority of respondents say that investing in asset classes in Asia such as equities, real estate, alternative assets and currencies, is riskier than similar investments in Western markets. The exceptions are bonds and government debt, where the majority believes that the risks are equivalent or lower (see Chart 7).

Chart 7
How does the risk associated with investing in the following asset classes in Asia (excluding Australia and Japan) compare with similar investments in Western markets? Please rate on a scale of 1 to 5 where 1 is significantly higher risk in Asia and 5 is significantly lower risk in Asia.
(% respondents)



However, respondents also believe that the rewards more than compensate for the risks. Asked about the potential returns from investing in Asian asset classes, the majority believes that they are greater than with equivalent investments in Western markets, with government debt the only exception to this view (see Chart 8). In addition, for most asset classes, the proportion that believes the rewards are greater than in Western markets exceeds the percentage that thinks the risks are greater (see Chart 9). For example, 78% of respondents think that the returns from investing in equities are greater than an equivalent investment in the West, while 63% think that the risks are greater.

Chart 8
How do the potential returns associated with investing in the following asset classes in Asia (excluding Australia and Japan) compare with similar investments in Western markets? Please rate on a scale of 1 to 5 where 1 is significantly higher potential return in Asia and 5 is significantly lower potential return in Asia.
(% respondents)

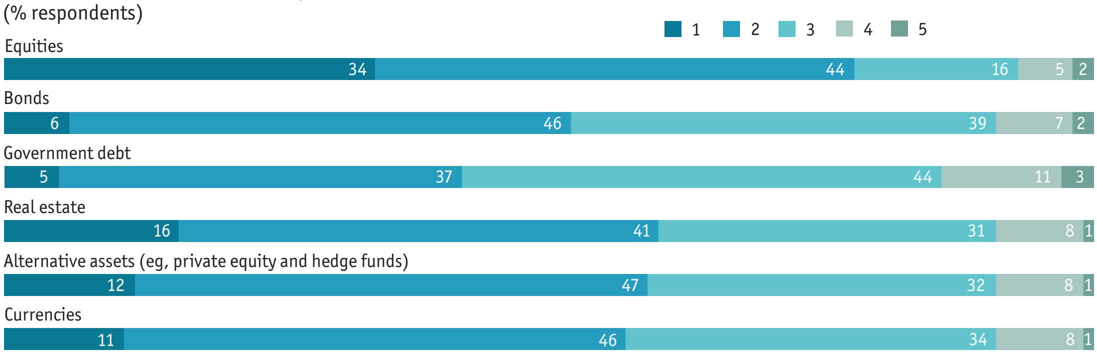
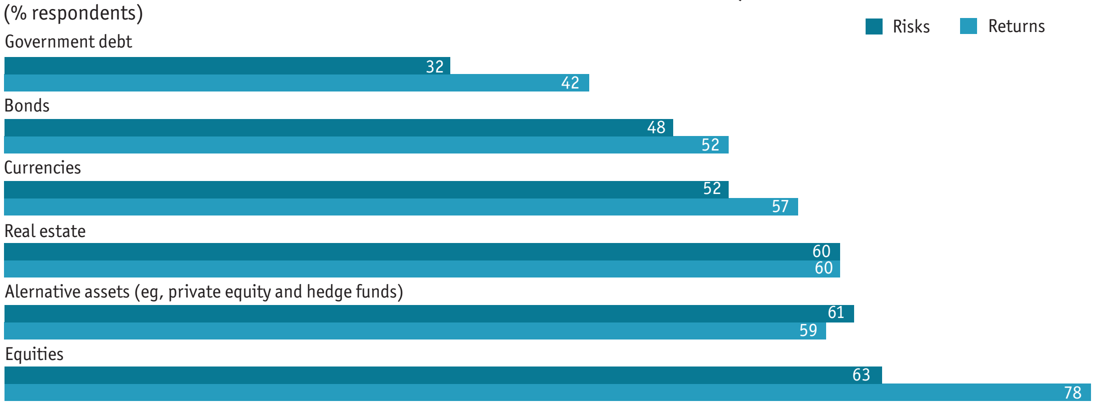


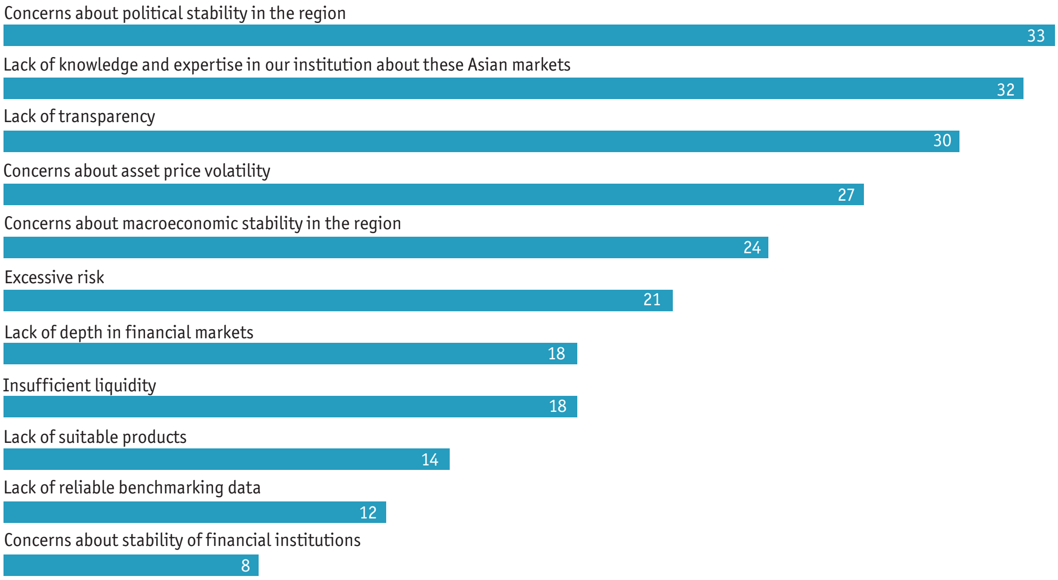
Chart 9
How do the risks/potential returns associated with investing in the following asset classes in Asia (excluding Australia and Japan) compare with similar investments in Western markets? (Shows only respondents who believe that the risks and/or potential returns are greater than with equivalent investments in Western markets.)
(% respondents)



• Uncertainty about institutional expertise in Asia does not necessarily equal caution

Attracted by the high potential returns, institutional investors have been increasing allocation to Asian assets, but some admit that their institution lacks knowledge of markets in the region. Indeed, this is seen as the second most significant reason preventing institutions from investing in Asia (see Chart 10). But a lack of understanding does not automatically lead to a cautious approach. Among those respondents who cite a lack of knowledge and expertise about Asian markets as a barrier to further investment, 46% say that they are increasing allocation to China, and 31% to India. This is lower than the percentage of total respondents increasing such investments, but it still suggests that some institutions could be raising their exposure to Asian markets without having the appropriate knowledge and expertise in place.

Chart 10
Which of the following factors are most likely to prevent your institution from increasing its allocation to investments in Asia (excluding Australia and Japan)?
(% respondents)



• Asian financial centres are unlikely to overtake New York or London in the foreseeable future

Over the past decade, Asian financial centres have been strengthening their position as both global and regional hubs for the financial services industry. Today, five of the world's top ten financial centres are located in Asia. At the same time, the financial crisis has had a severe impact on the standing of New York and London. In October 2009, a poll of Bloomberg subscribers found that London had fallen behind

Singapore as the city that was most likely to be the best financial hub in two years' time.[2] Eversheds, a law firm, found in a December 2009 survey that Shanghai could overtake London within ten years.[3]

Confidence is undoubtedly growing in Asian financial centres and, as they mature, they will attract increasing amounts of talent, infrastructure, resources and business. But it is too early to call time on the incumbents, according to our survey respondents. Just 24% think that Asian financial centres, such as Hong Kong and Shanghai, will supersede their Western counterparts, such as London and New York, in size and importance within a decade. Even among respondents based in Asia-Pacific, who might be expected to be most confident of a change in the guard, just 39% agree with that statement.

• Asia's institutional investors are a match for those in the West

The steady deepening of capital markets across Asia and the emergence of financial centres with significant international clout have been accompanied by an ongoing improvement in the local

Chart 11
Over the past three years, what changes have there been to the performance of Asian financial centres (excluding those in Japan and Australia) across the following criteria?
(% respondents)

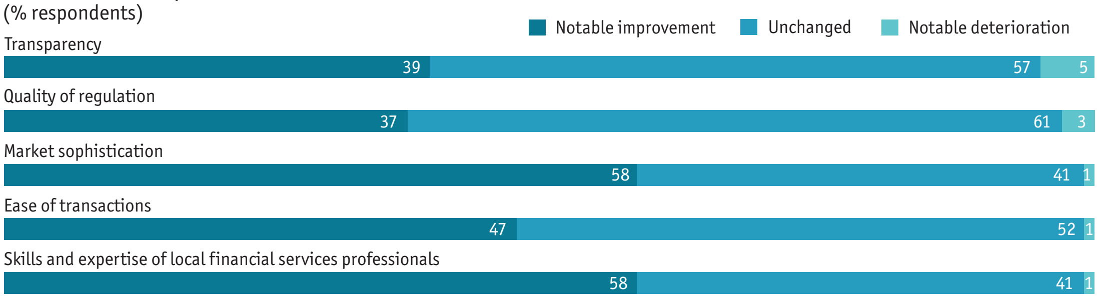
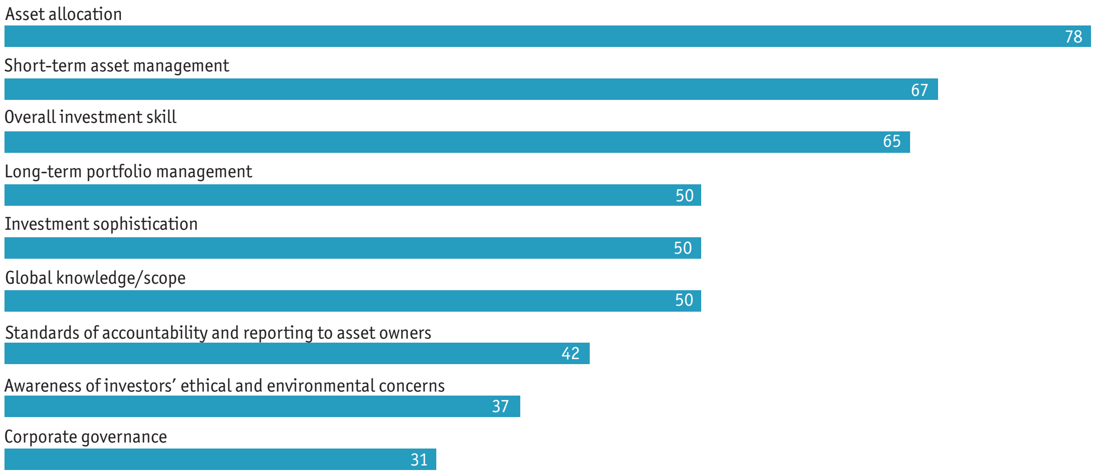


Chart 12
In each of the following areas please rate the skills and expertise of Asian institutional investment firms (excluding those in Japan and Australia) in comparison with their counterparts in the West. (Shows only respondents who believe that the skills and expertise of Asian institutional investment firms are equivalent to or better than those of Western counterparts.)
(% respondents)



[2] Bloomberg survey, available at http://www.bloomberg.com/apps/news?pid=20601087&sid=aEC0OYmvvcZM

[3] *Boom or Gloom*, Eversheds, available at http://press.eversheds.com/imagelibrary/downloadMedia.asp?MediaDetailsID=286

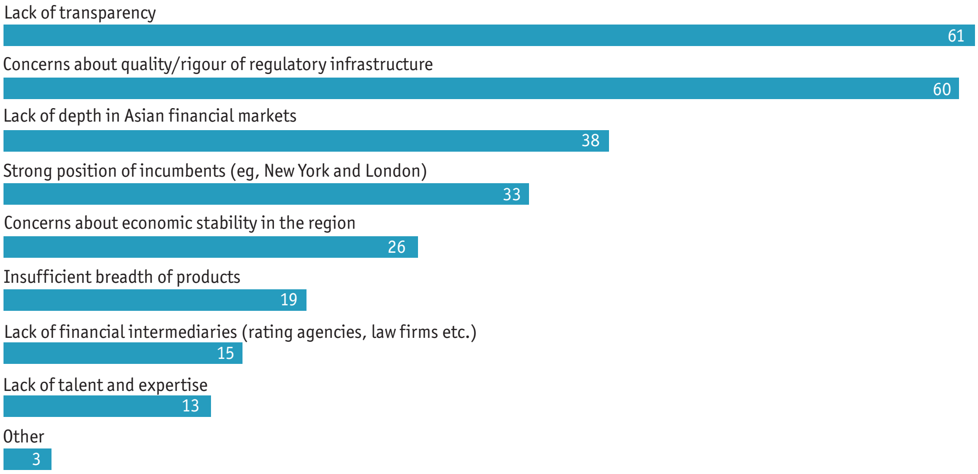
skills base. More than half of respondents believe that the skills and expertise of financial services professionals in the region have improved over the past three years (see Chart 11), and just 13% see a lack of skills and expertise as a barrier to the development of Asian financial centres. The skills of those at local institutions are considered to be better than or equivalent to those of their Western counterparts across most activities, including asset allocation, short-term asset management and overall investment skill. The only exceptions are accountability and reporting; awareness of ethical and environmental concerns; and corporate governance, where less than half of respondents see local expertise as being better than or equivalent to the West (see Chart 12).

• Concerns linger about transparency and the quality of regulation in Asia

Despite recognising that there are significant opportunities in Asia, international portfolio investors continue to worry about a lack of transparency in the region. Clearly, there is huge variation between countries, from the relatively high levels of transparency and disclosure in Hong Kong, to the more restrictive and opaque nature of investing in China. Overall, however, respondents see transparency as the main barrier to the development of financial centres in the region (see Chart 13).

The quality and rigour of regulatory infrastructure in Asia follow close behind in their list of concerns. An important challenge for investors in the region is a lack of standardisation of regulatory practices across markets, while corporate governance and accountability to investors can lack stringency. As financial markets develop, however, securities regulation is likely to show greater maturity, although again, there will be wide variation across the region. More than one-third of respondents think that the quality of regulation has improved over the past three years, while just 3% say that there has been a deterioration.

Chart 13
What do you consider to be the biggest barriers to the development of financial centres in Asia (excluding those in Japan and Australia)?
(% respondents)



Conclusion

The stabilisation of financial markets around the world is leading to a resumption of international capital flows. With developed markets in the West facing the prospect of weak corporate earnings over the medium term, the dynamism and growth potential of emerging Asia looks increasingly attractive to international portfolio investors. Financial centres in the region are growing in importance, with new contenders, such as Shanghai and Mumbai, joining the more established hubs of Singapore and Hong Kong.

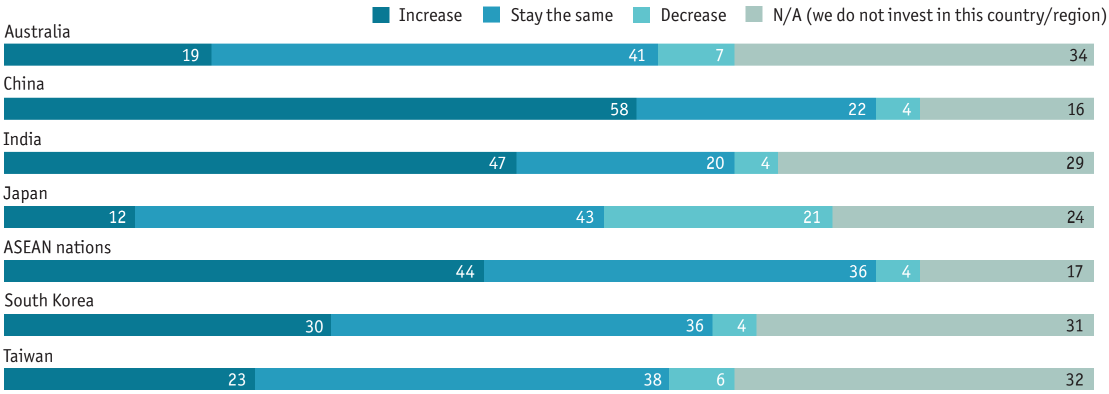
But this shift in economic weight is still in its early stages. Few expect Asian financial centres to steal the crown from New York or London within the next decade and assets under management, while growing rapidly, still represent a small percentage of the global total. Moreover, while Asian financial markets are maturing quickly, there is still progress to be made on corporate governance, transparency and regulation.

Appendix: Survey results

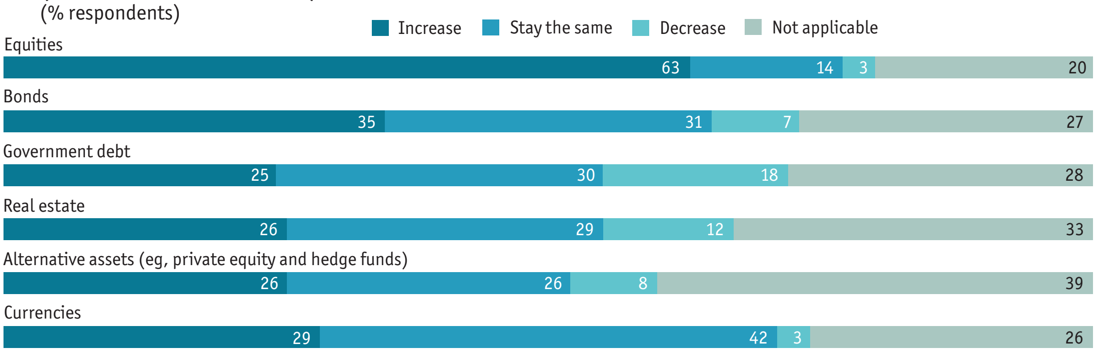
Screener question:

Are you generally familiar with your institution's overall investment strategy and exposure to assets in Asia?
(% respondents)

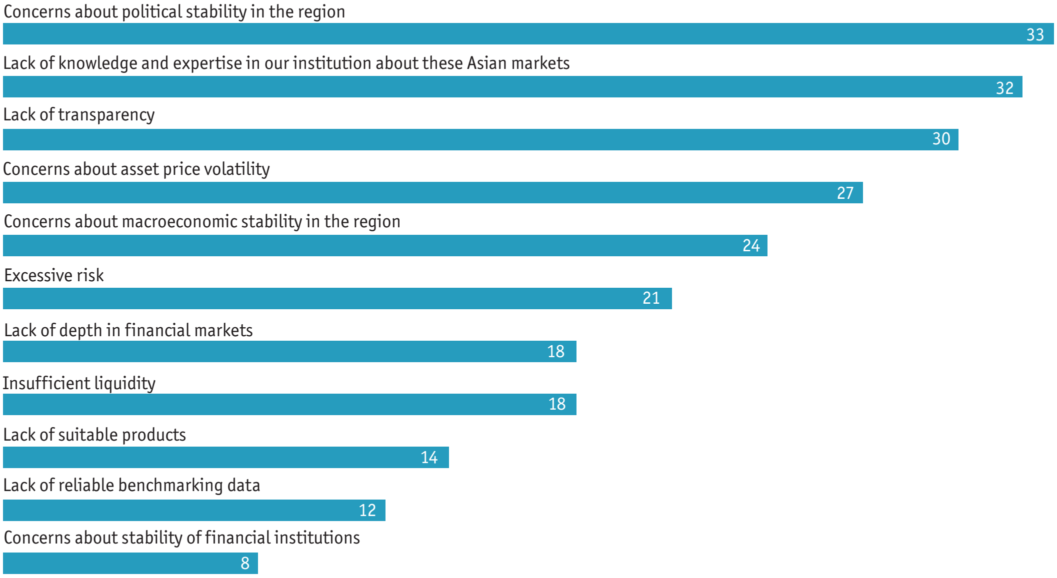
1. Over the next year, what change do you expect your institution to make to its allocation to the following countries/regions?
(% respondents)



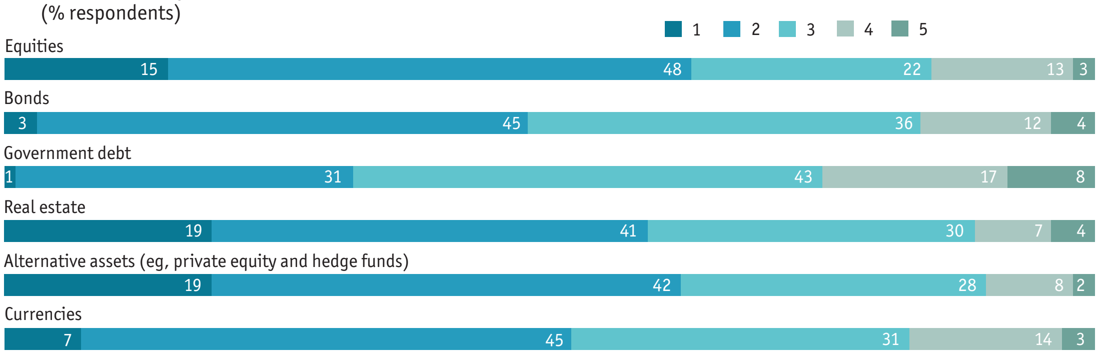
2. Over the next year, what changes does your institution plan to make to its allocation to the following asset classes in Asia (excluding Australia and Japan)?
(% respondents)



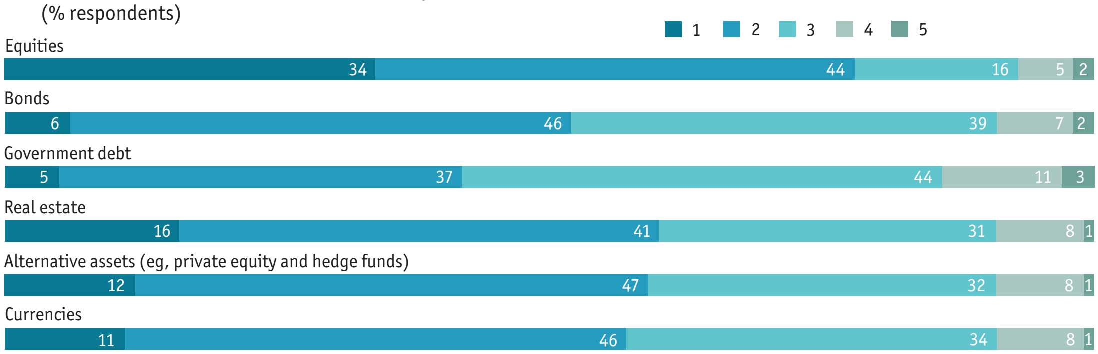
3. Which of the following factors are most likely to prevent your institution from increasing its allocation to investments in Asia (excluding Australia and Japan)? Select up to three.
(% respondents)



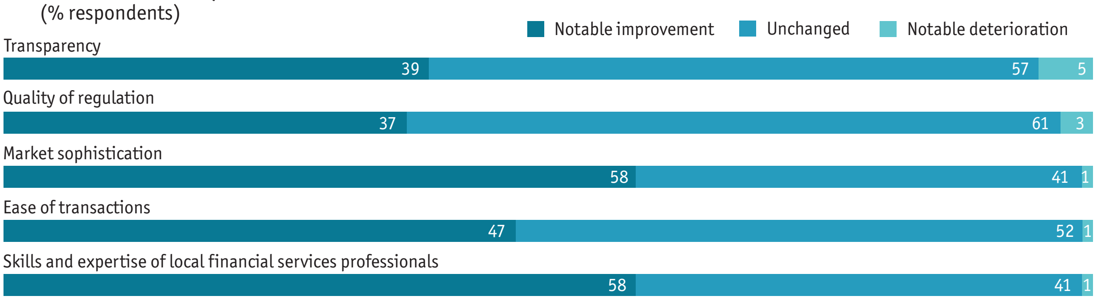
4. How does the risk associated with investing in the following asset classes in Asia (excluding Australia and Japan) compare with similar investments in Western markets? Please rate on a scale of 1 to 5 where 1 is significantly higher risk in Asia and 5 is significantly lower risk in Asia.
(% respondents)



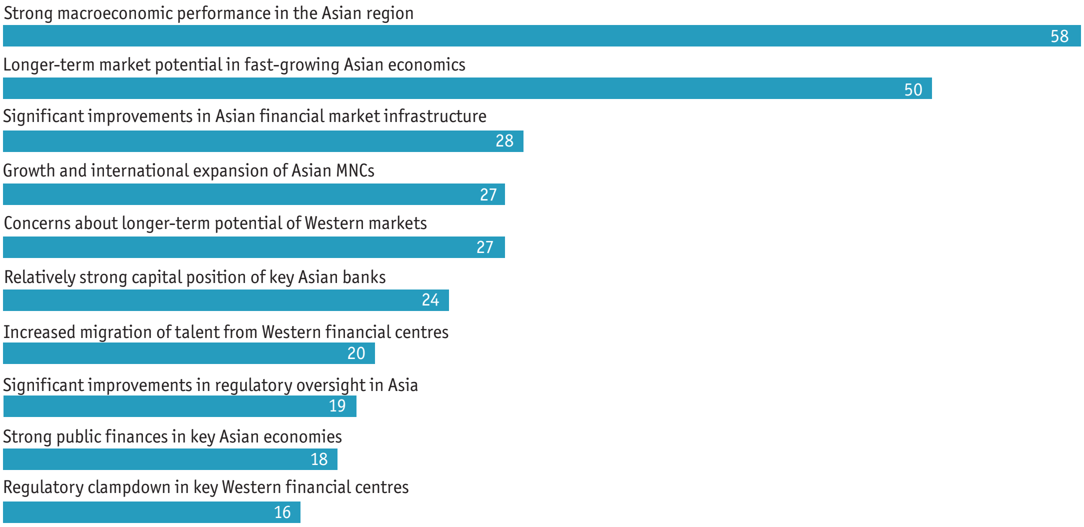
5. How do the potential returns associated with investing in the following asset classes in Asia (excluding Australia and Japan) compare with similar investments in Western markets? Please rate on a scale of 1 to 5 where 1 is significantly higher potential return in Asia and 5 is significantly lower potential return in Asia.
(% respondents)



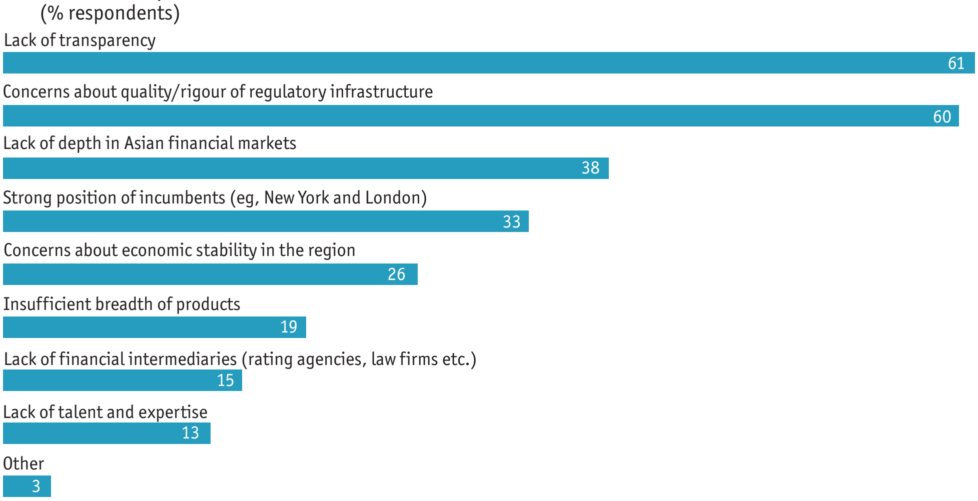
6. Over the past three years, what changes have there been to the performance of Asian financial centres (excluding those in Japan and Australia) across the following criteria?
(% respondents)



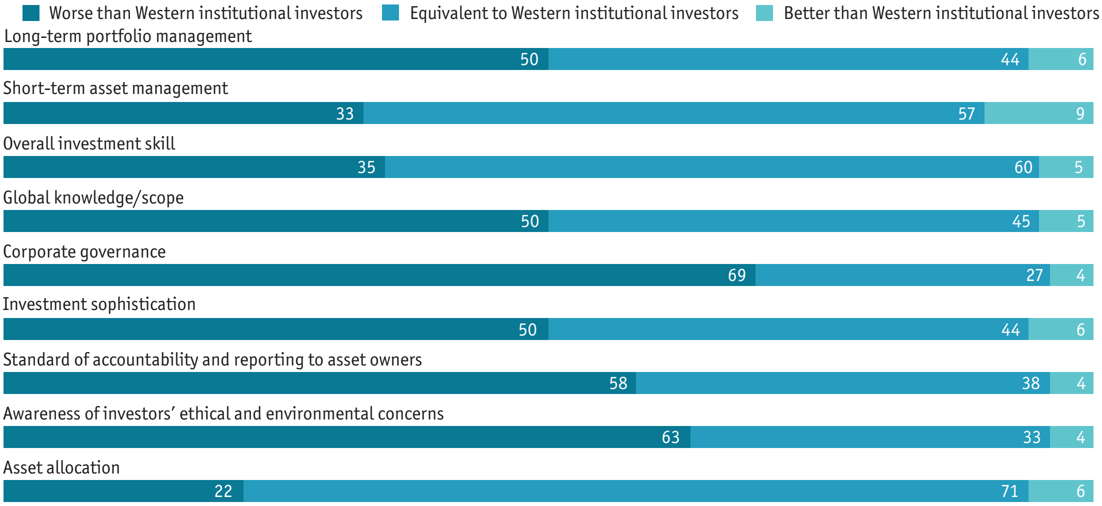
7. Which of the following factors are most likely to increase the attractiveness of key Asian financial centres (excluding those in Japan and Australia) in comparison with key Western financial centres over the next three years? Select up to three.
(% respondents)



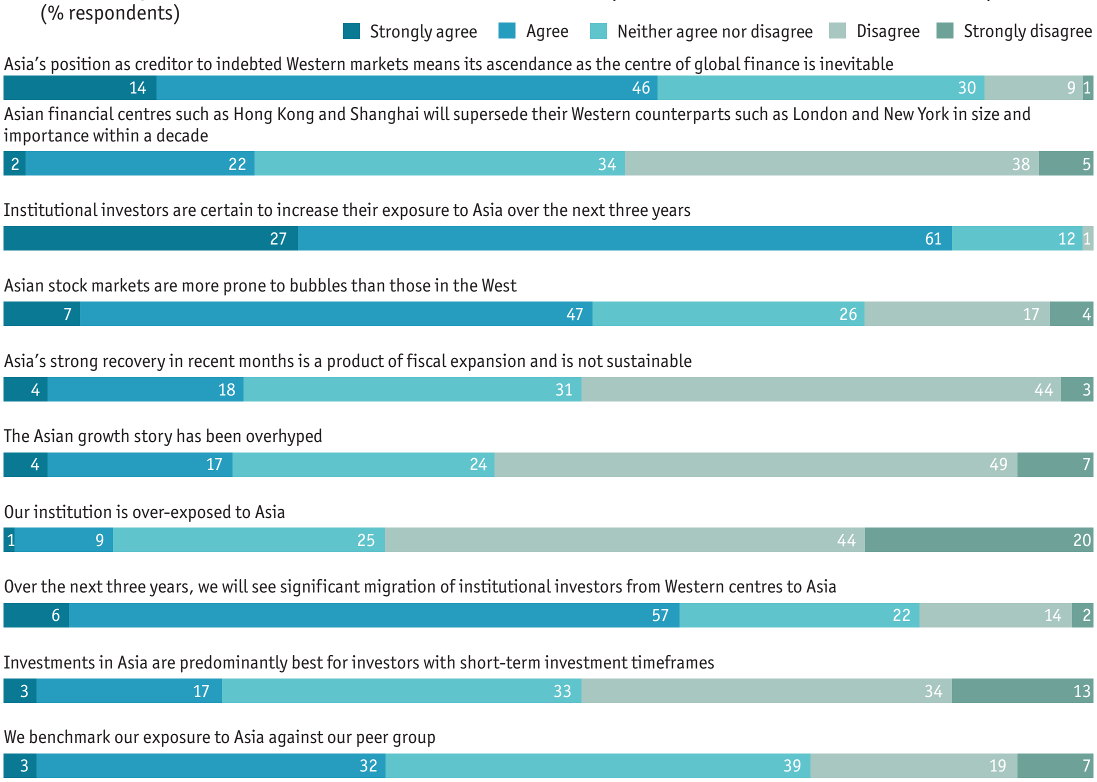
8. What do you consider to be the biggest barriers to the development of financial centres in Asia (excluding those in Japan and Australia)? Select up to three.
(% respondents)



9. In each of the following areas please rate the skills and expertise of Asian institutional investment firms (excluding those in Japan and Australia) in comparison with their counterparts in the West.
(% respondents)

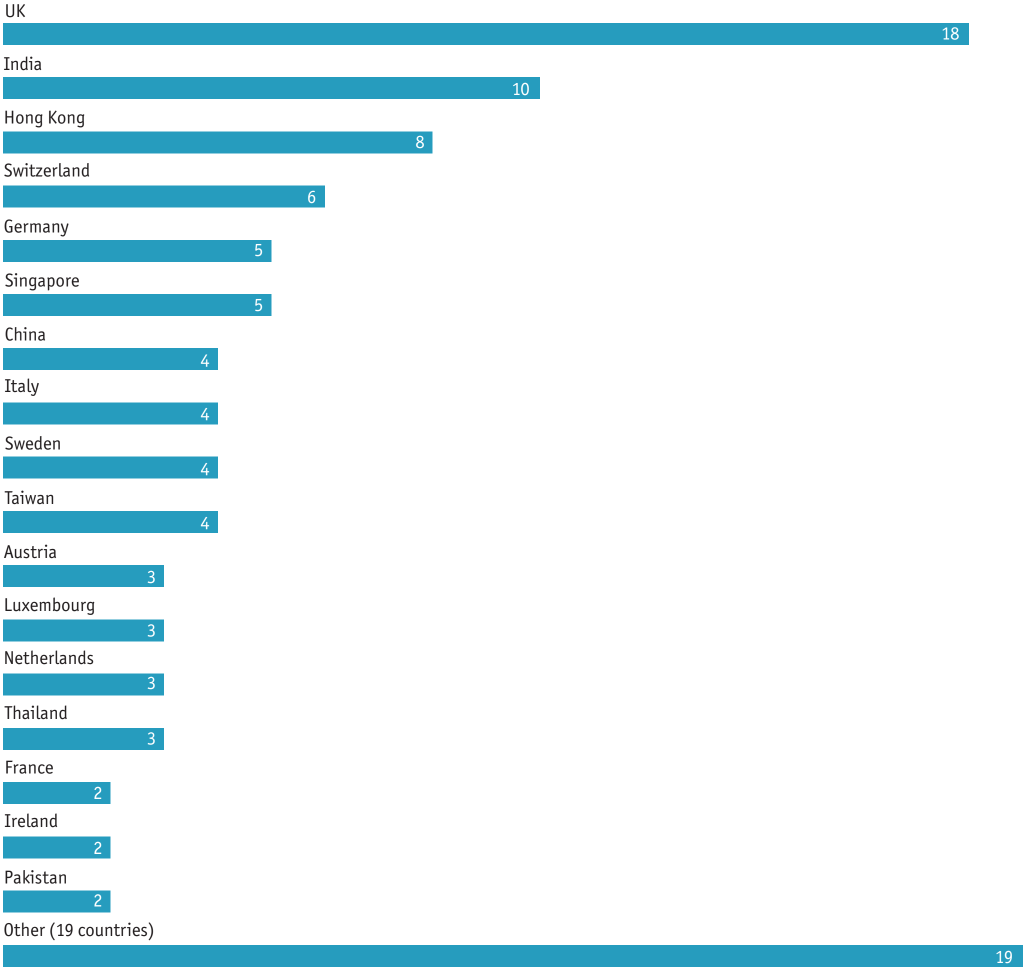


10. Please rate you level of agreement with the following statements (where "Asia" excludes Japan and Australia).
(% respondents)

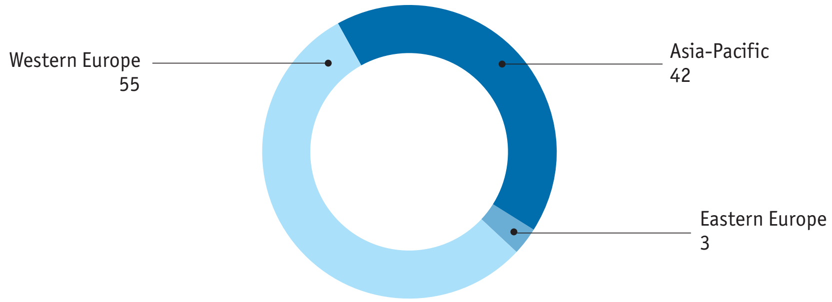


Demographic questions:

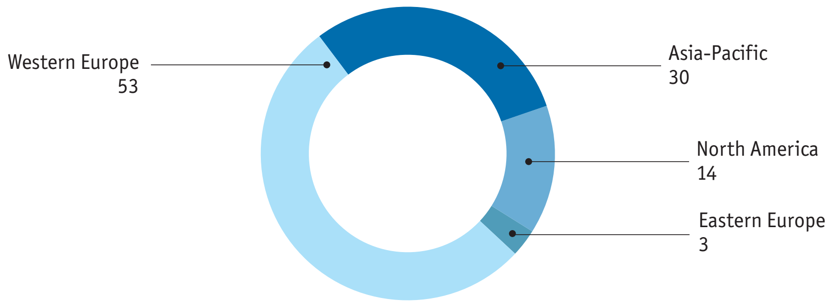
In which country are you personally located?
(% respondents)



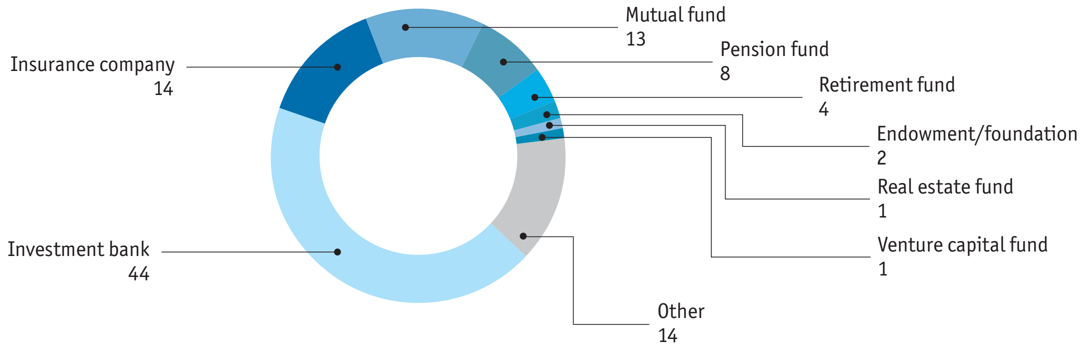
In which region are you personally based?
(% respondents)



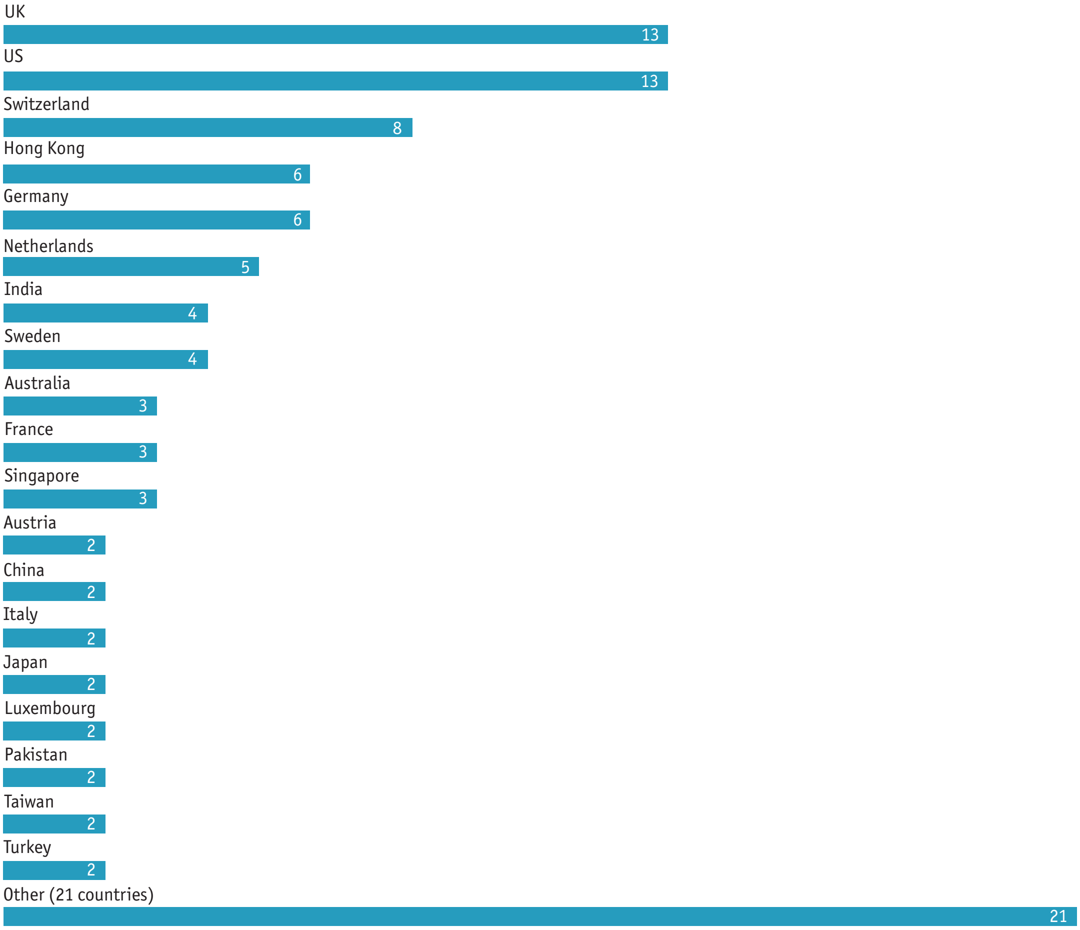
In which region is your organisation headquartered?
(% respondents)



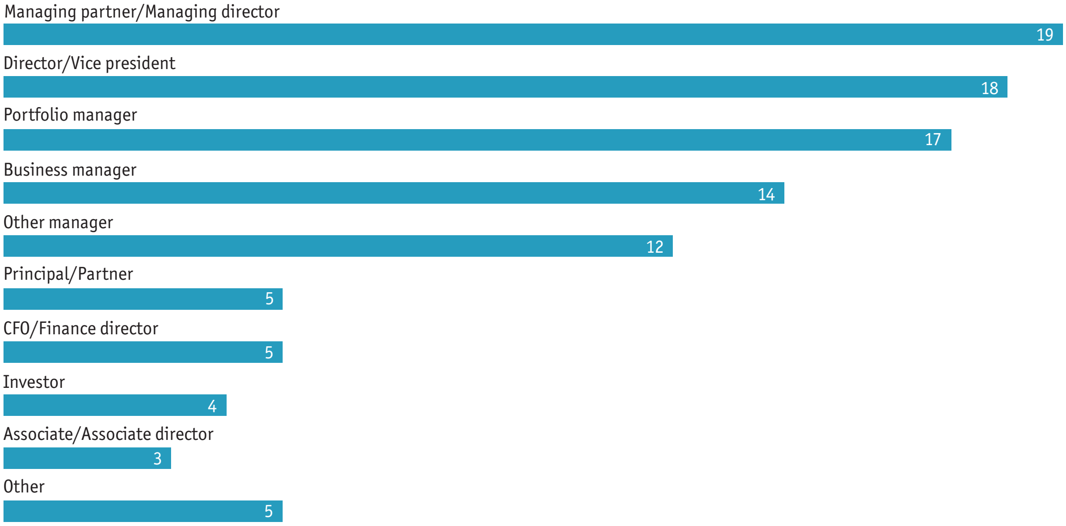
What type of financial institution do you work for?
(% respondents)



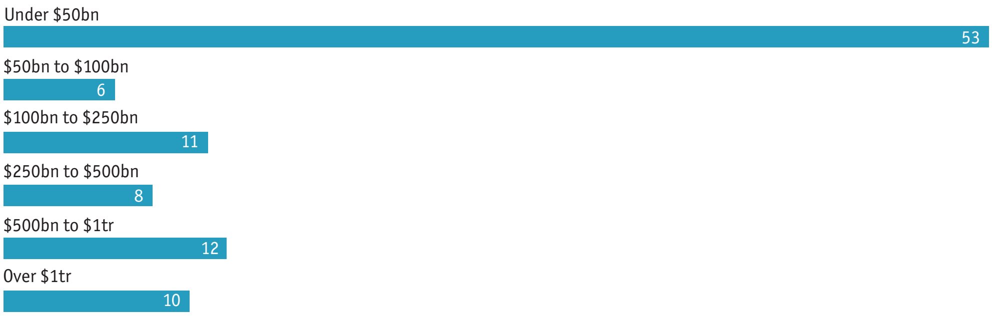
In which country is your organisation headquartered?
(% respondents)



Which of the following best describes your job title?
(% respondents)



What are your organisation's total global assets in US dollars?
(% respondents)



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