HSBC Global Asset Management

China inclusion: a significant investment development

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Senior investment professionals will tell you that when they look back on their career there are a small number of moments which actually led to really significant changes in the investment landscape or the shape of the marketplace. Sometimes you can look back and say that happened and there are things that were forced upon you. So an example would be perhaps the global financial crisis or the introduction of major regulatory changes such as MiFID II. Others are perhaps more positive. We look back on the introduction of securitised mortgages and securitised lending as really exploding that marketplace, or perhaps the broader availability through regulation of hedge funds. Indeed, this is a moment which our Head of Fixed Income Products said to me the other today, “This is the biggest change I have seen in my career for 25 years.” And that change is the inclusion of Chinese domestic bonds in the major indices for Global Aggregate Bonds introduced by Bloomberg BGA.

So maybe it's worth reminding ourselves of some of the facts around this inclusion. I mean, the starting point is that China is already the third largest bond market in the world, just behind the U.S. and Japan with over $12 trillion already in the mark, and it's worth thinking that for many investors, investing into Chinese bonds has been an option to play, so some have been actively involved and many have chosen to just invest by using emerging market debt funds. In terms of the scale of this development, actually this is only the beginning, because there are only 364 bonds that will be included at this stage and they will be exclusively government bonds and policy bonds issued by a very small handful of organisations. That's the China Development Bank, the Agricultural Development Bank, and the Export-Import Bank.

So as I've already mentioned, a number of investors have been making active decisions to allocate to Chinese bonds already, and in fact these people have had great success from doing so, because there a very clear diversification benefits from allocating to Chinese bonds. I mean, correlations are very low and, in fact, in certain circumstances have been negative against U.S. bonds, and in addition to that, they've seen superior returns, both in terms of absolute returns, but also in terms of risk-adjusted returns. So as an investment decision in itself, investing in Chinese bonds has proved highly beneficial, and we would argue that whether you want to follow the benchmark or not, it certainly seems to be a very sensible thing to do – getting higher yields, better diversification, and better risk-adjusted returns.

So that I guess leaves the final question, which is so how do I invest in these securities? It's interesting I think to reflect, first of all, on what's happened with the inclusion of Chinese A-shares into the equivalent equity indices, where the market has seen commitments, both to active funds, but also to passive funds, But looking on the bond side of things, I think the key question is when do I commit you've got to determine when is my entry point going to be; I probably need to do something. Now, if it's a question of I just want to get exposure to the asset class then probably the best answer is going to be to use an index fund, The other option is to say, well, I'm perhaps a little bit more concerned about risk management, or I want to include that corporate bond diaspora now, in which case you should look for an active fund. Unsurprisingly, HSBC has a range of funds already available. We are one of the leaders in Asian and Chinese fixed income investing, so I would urge you to make contact with your HSBC representatives to understand the range of products we have, and if you'd like further information on the technical details of this index inclusion then, again, we have more material to support your decision-making.