Letter from the President

The Asian Financial Forum:

How Asia is Reshaping the Global Agenda— and Canadian Investors

by Ian C.W. Russell

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Canadian investors and the Canadian investment industry are interested in Asia, for good reason. It is a centre of growth and opportunity from which we can benefit – and learn. One of the best opportunities to learn more about economic trends in Asia is at the Asian Financial Forum in Hong Kong. Since it was launched four years ago, commemorating the tenth anniversary of the 1997 handover of Hong Kong to Mainland China, the Forum has grown in stature to become the premier financial conference in Asia – embracing themes that focus on developing trends in Asian capital markets.

This month's President's Letter offers my interpretation of some of the themes at this year's conference, contributing to your understanding of financial developments in South-East Asia, particularly in Hong Kong and Mainland China.

A 'Super-Cycle' of Asian Growth

A useful starting point would be the observations of John Peace, Chairman of Standard Chartered Bank, one of the major banks operating in Hong Kong and Asia. Mr. Peace described the current era as the third super-cycle, characterized by rapidly expanding urbanization and economic growth in the emerging economies, both in absolute and relative terms, and the rise of the middle class in the developing world. These factors fuel demand for commodities and capital goods. The policy focus has been to build a thriving export sector and transportation infrastructure in these emerging countries. However, many countries are now beginning a transition to greater reliance on domestic consumption for economic growth as a middle class emerges.

This super-cycle follows a similar pattern that occurred in the second half of the 19th Century, highlighted by rapid industrialization, innovation and a burgeoning global marketplace, a period that ended with the First World War. The second super-cycle covered the period from the end of the Second World War to the oil price hikes in the early 1970s, triggering a long period of slow growth and high inflation. The American economy dominated this period of post-war growth.

Anthony Bolton, who runs Fidelity Investments in Asia, confirmed the positive fundamentals in the global economy, expressing bullish sentiment that will remain in place through the coming year. He anticipates some weakening in market performance later this year, resulting in more tempered optimism and slowing flows into equities.

China's Next Five-Year Plan: A Broader Outlook

Cheng Siwei, Chair of the International Finance Forum in China and former Vice Chairman, Standing Committee, National People's Congress, gave his perspective on China, referring to some of the same themes. The Chinese government will soon unveil its much-anticipated 12th Five-Year Plan that will define the macro-economic objectives for the country and indicate the direction of policy initiatives. Professor Cheng expects the Five-Year Plan to focus on four objectives:

i) A shift from export-dependent growth to reliance on domestic-led consumption and investment. This will require a strengthening in the social safety net, sustained economic growth and an expanding middle class;

ii) A continued "opening up" of the economy to encourage inflows of direct and portfolio investments to fuel economic growth, and outflows of domestic savings to boost domestic investment returns. The thresholds of outgoing investment capital (QDII) and incoming capital (QFII) would steadily ratchet up. These policies would promote an expansion in the renminbi-denominated markets, such as the Hong Kong "Dim Sum" renminbi bond market, and would eventually lead over time to full convertibility of the renminbi exchange rate;

iii) A focus on environmental problems from clean energy to clean water, providing investment opportunities for the West; and

iv) A focus on education to accelerate more balanced growth and income distribution and innovation in the country.

Increased Capital Flows

Several speakers at the Asian Financial Forum predicted accelerating capital flows between the global economy, and Mainland China and other countries in South-East Asia. Financial flows will mirror increased trade in goods and services in the region. As well, capital flows into financial assets and direct investment in Asia will likely accelerate as international savings search for higher returns in the emerging economies, and local Asian capital seeks investment opportunities in global markets.

Hong Kong is well positioned at the epicenter of these capital flows for several reasons. First, these two-way flows will be anchored in a trusted legal and regulatory framework. Hong Kong benefits from an established legal system and well-regulated and efficient capital markets. The Hong Kong Stock Exchange (HKEx) has built a significant listing and trading business, notably in Mainland Chinese listed equities. Over the last two years IPOs launched on the HKEx have exceeded by a wide margin IPOs launched on the two New York stock exchanges and the London Stock Exchange. Equity offerings in the Hong Kong market have been an important source of foreign capital for Chinese companies, particularly the large national firms. Hong Kong is also building its credit markets through the issuance of government and corporate bonds. The latest development is the "Dim Sum" market in renminbi bonds. Strong issuer interest reflects the Dim Sum market as an effective source of funding for Mainland business, and investors gaining the benefit of an anticipated revaluation of the renminbi.

Hong Kong will also benefit as a centre of expertise to assess business acquisitions and joint ventures in China, and provide investment management services for both inbound and outbound capital. Chinese investment funds and wealthy Mainland investors have placed significant savings with Hong Kong-based managers (and international managers) to improve portfolio returns. Many Hong Kong-based managers are similarly attracting offshore capital to invest in public and private markets investments in China.

Chinese Corporate Expansion: A Note of Caution

The conference offered another perspective on China capital flows. The CEOs from four large Chinese corporations, the Bank of China, China Mobile, China Resources and Lenovo, discussed their strategic positioning in global markets. The panel session revealed a surprisingly cautious approach to foreign expansion, notably the Bank of China and China Mobile. This attitude may reflect the intense focus on the huge domestic market, or the gradual evolvement of these corporations into global players. Both companies indicated a cautious attitude to global expansion, with acquisitions close to home (China Mobile) and following their traditional clients abroad (Bank of China). China Resources appeared somewhat more aggressive, looking for direct resource plays and acquisitions in Africa and Asia. Lenovo was more the exception as a global firm, reflecting its roots as an integral part of IBM.

The Importance for Canadian Dealers: Attractive Investment Opportunities

Why is all this important for Canadian dealers? The accelerating outflow of Mainland Chinese savings offers Canadian financial institutions attractive opportunities in wealth management services to high net-worth clients, trading and sales in Hong Kong-listed securities as well as in Canadian and non-Asian securities. Further, Hong Kong-listed equities, and Hong Kong-based managed funds, denominated in Hong Kong dollars and eventually in renminbi, offer Canadian clients potential returns in one of the fastest growing economies in the world and across the region itself.

Investing in the emerging markets in Asia is without doubt a challenging task. The Hong Kong markets, however, provide the comfort of high listing and regulatory standards for traded investments in public markets, and investment expertise in private financial and real investments in mainland China. Relationships with Hong Kong financial institutions and Hong Kong companies therefore become important in building financial business in China and South-East Asia.

The IIAC organized an industry mission to Hong Kong in January to give firms a perspective on market trends and developments, and network opportunities to develop needed relationships with Hong Kong securities firms, money managers, financial services companies and regulators. I invite IIAC member firms to join the Canadian mission to the Asian Financial Forum in January 2012. The IIAC will encourage the Hong Kong Trade Development Council to organize a special program for Canadian dealers aimed at building an understanding of financial developments in the region and providing good opportunities for networking with the Hong Kong financial community.

The IIAC will also push for amendments to Canadian tax regulations to implement a proposed tax protocol agreement on withholding tax with the Hong Kong government, analogous to protocols already in place in the United States and numerous other countries. The exemption from withholding taxes on Canadian investments would stimulate interest in Canadian dividend-paying equities and encourage Hong Kong companies to establish subsidiary operations in the Canadian marketplace.

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