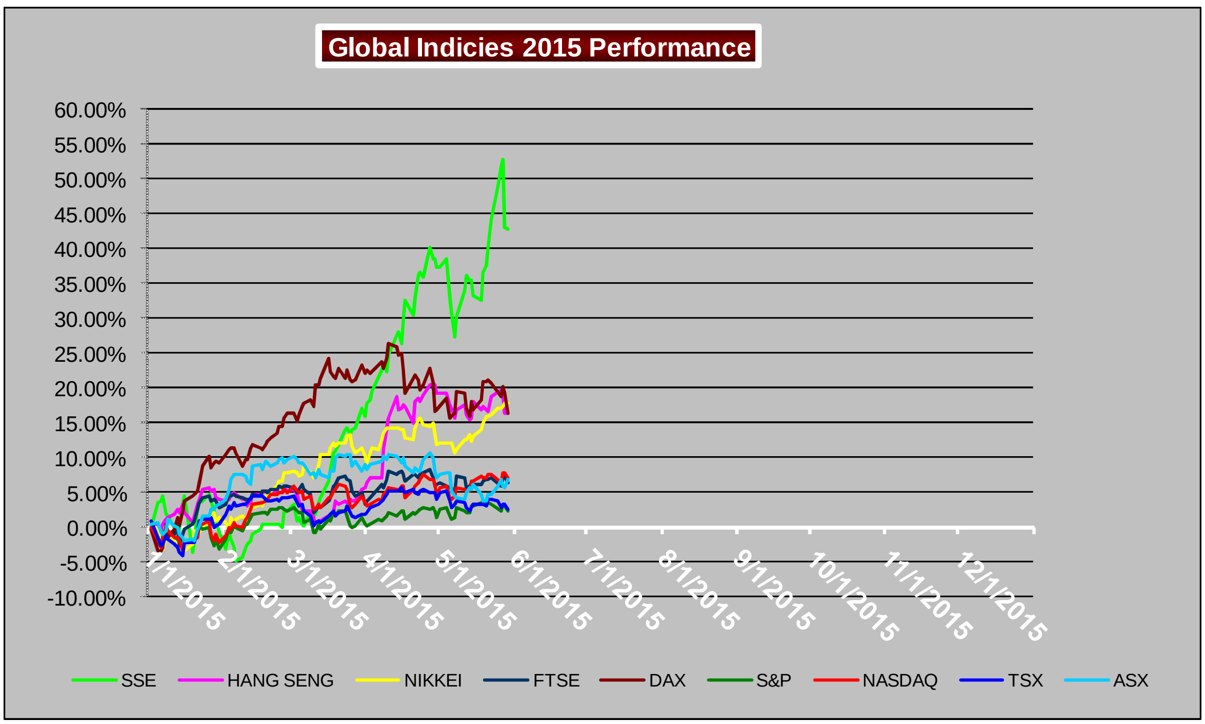
GDB June 2015 Newsletter

Monthly Market Summary:

2015 May Market Activity		
SSE COMPOSITE	*4,611.74*	+170.09 (+3.83%)
HANG SENG	*27,424.19*	-708.81 (-2.52%)
NIKKEI 225	*20,563.15*	+1,043.14 (+5.34%)
FTSE 100	*6,984.40*	+23.80 (+0.34%)
DAX	*11,413.82*	-40.56 (-0.35%)
DOW	*18,010.68*	+170.16 (+0.95%)
S&P 500	*2,107.39*	+21.88 (+1.05%)
NASDAQ COMPOSITE	*5,070.03*	+128.61 (+2.60%)
ASX 200	*5,777.20*	-12.80 (-0.22%)
TSX COMPOSITE	15,014.10	-210.40 (-1.38%)



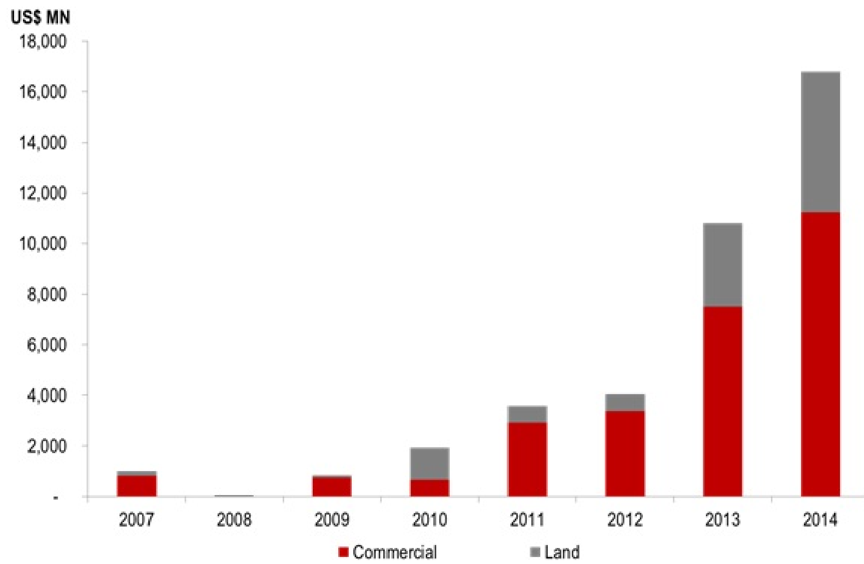
Investment Themes:

The Chinese capital market has undergone some major policy transformations in the last year. In November of 2014, the Chinese government introduced the China-Hong Kong Connect program to open up capital flows bilaterally between China and Hong Kong. In the second quarter of this year, a new pilot scheme in six cities will deregulate capital control further by allowing individuals more access to the international financial markets.

A second iteration of the Qualified Domestic Individual Investor program, QDII2 is expected to unveil in six Chinese cities: Shanghai, Tianjin, Chongqing, Wuhan, Shenzhen and Wenzhou sometimes in the coming quarters. Under the existing QDII program, which began in 2006, individual investors are able to access the international capital markets only through funds offered by QDII approved Chinese commercial banks, fund managers, or securities firms. While QDII is limited to institutional investors and has a limited quota of USD 84.13 billion (as of March), QDII2 opens the door for qualified individual investors with financial assets of at least 1 million RMB (USD 160,000) to invest directly in overseas stocks, bonds, mutual funds, insurance, derivatives and real estates. The upper bound of outbound investment is limited to 50 percent of the individual's net asset. QDII2 when launched will not only serve as a risk diversification for high net worth Chinese investors, but also provide them exposure to a wider range of developed financial products which are not available in China.

Mainland investors have long been faced with the limited options to channel their investments. Up until now, the two main sources of investments in China are real estate and domestic stocks. With the lack of investment alternatives, and the significant wealth creation in China, the formation of asset bubble such as the astonishing 150% rise in the Shanghai A-shares over the past 12 months poses as significant risks. QDII2 will serve as an opportunity to further open up the capital account to circumvent overheating in the local markets. In fact, using past data from Chinese overseas commercial and land acquisition as a predictor for QDII2's demand, the program will be unquestionably successful in funneling domestic capital into the overseas markets, but this time into much more liquid financial products in the form of stock and bonds.

Figure 1 – China Outbound Investment Volumes 2007-2014



QDII2 is also part of China's plan to ease the pressure and the cost of dealing with the country's enormous foreign exchange reserve. When the central bank purchases foreign exchange, it has to put an equivalent amount of RMB into circulation and then carry out open market operations to hedge against excessive amounts of currency build up in the market. Encouraging the private sector to hold and invest with foreign exchange, which QDII2 will do, will help alleviate such problems.

QDII2 is another giant leap forward towards financial liberalization in China. The arrangement will inject significant outflow of capital onto the global equities and fixed income markets. According to economist's forecast at China International Capital Corp, if QDII2 were to expand nationwide beyond the trial cities, it would theoretically free up about RMB 41 trillion (USD 6.7 trillion) in domestic wealth for overseas investments (almost half of the total NYSE market cap of USD 16.6 trillion). QDII2's impact will be felt through financial markets in New York, London, Frankfurt, and beyond and create demand for financial assets abroad. Domestic and overseas financial intermediaries, asset managers, and insurance companies are also the likely beneficiaries from this outward movement in investment activities.