

Emerging Market Strategies

Game Theory

- **Relation Based System**
- **Rule Based System**



Cosimo d' Medici

Medici



Hokkien Chinese
Temple Singapore

South East Asia
Overseas Chinese



New York Diamond District

Jewish Diamond Merchants
of New York

Game Theory Models

- **Each System is mix of relation based and rule based system**
- **US one end of spectrum**
- **Most Emerging Markets at other End**
- **Direct correlation between level of legal risk and level of relationship based system**

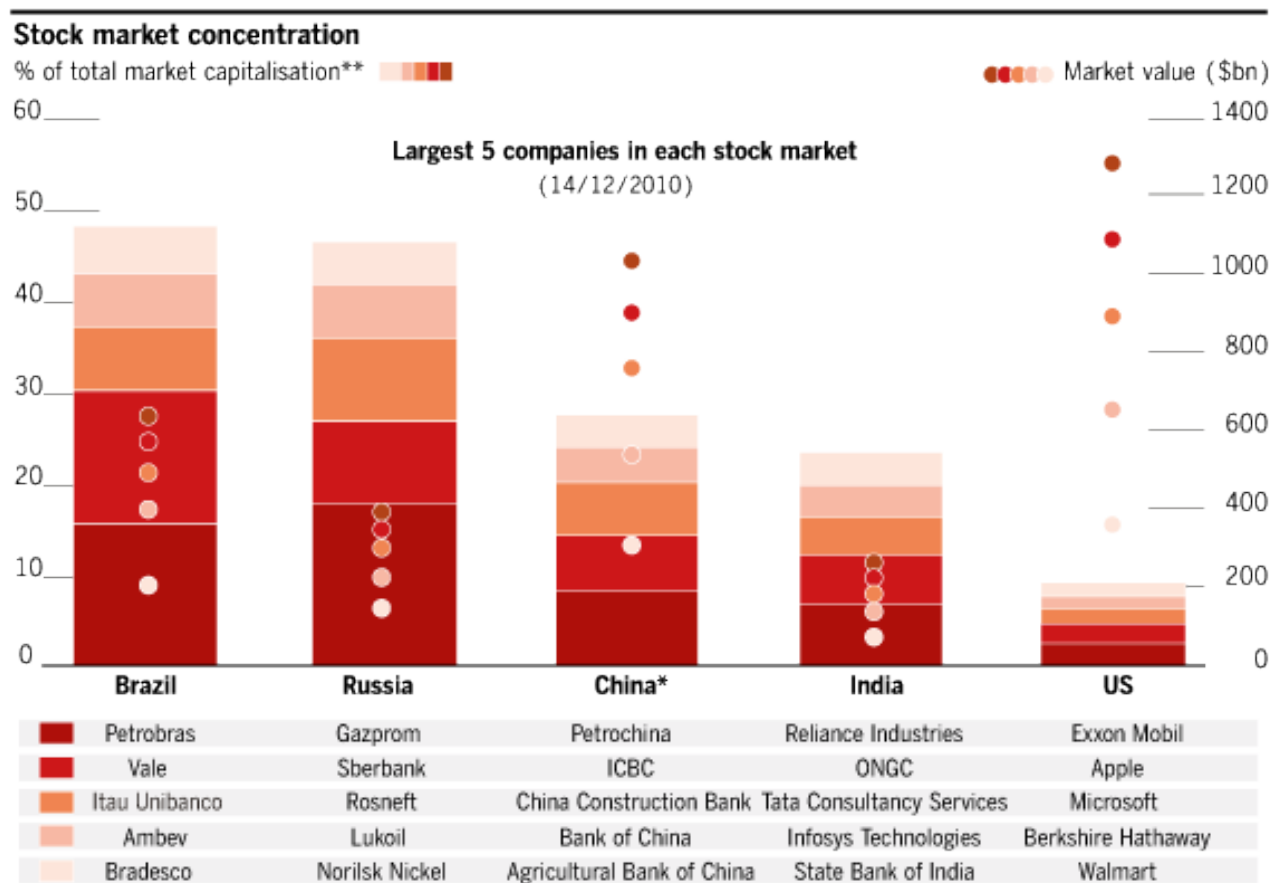
Hallmarks Relationship System

- Family Businesses

Hallmarks Relationship System

- State Owned Companies

Market Concentration State & Family Owned Businesses



Source: Thomson Reuters Datastream

*Hong Kong and Shanghai markets combined

**Datastream total market indices

Hallmarks Relationship System

- Crony Capitalism and Corruption

Hallmarks Relationship System

- Underground Economies

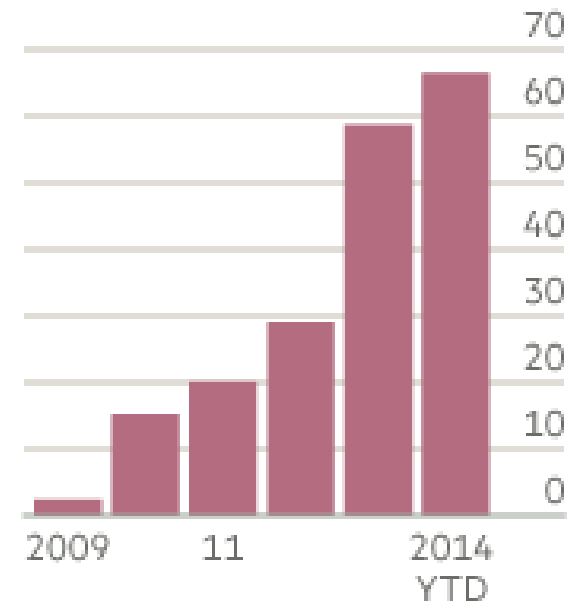
Information

- Family Owned Corporations
- State Owned Corporations
- Connections
- Underground Economies

China

- Misallocation of Capital
- Debt
- Booms Followed by Long Busts

China global debt sales soar
Total raised \$bn



Source: Dealogic

FT

Local Government Debt



Roads to Nowhere and Empty Cities



Jiaozhou Bay Bridge

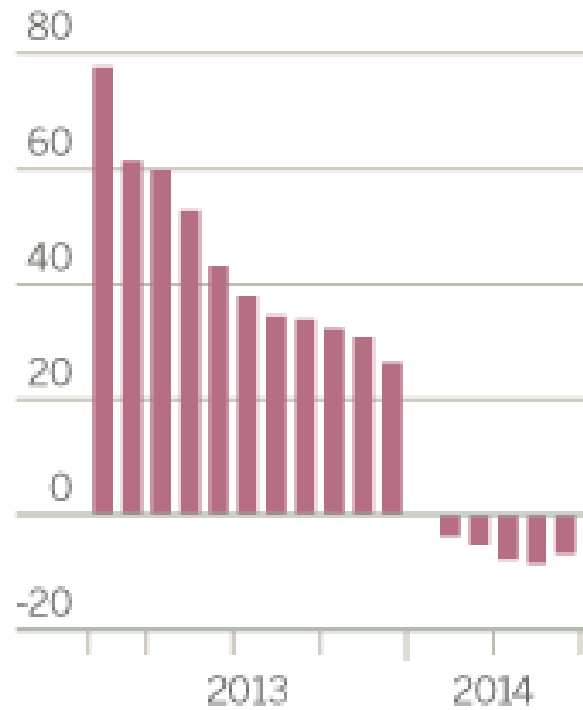
Ordos, Inner Mongolia



Chinese Real Estate

Value of real estate sales

YTD (annual % change)



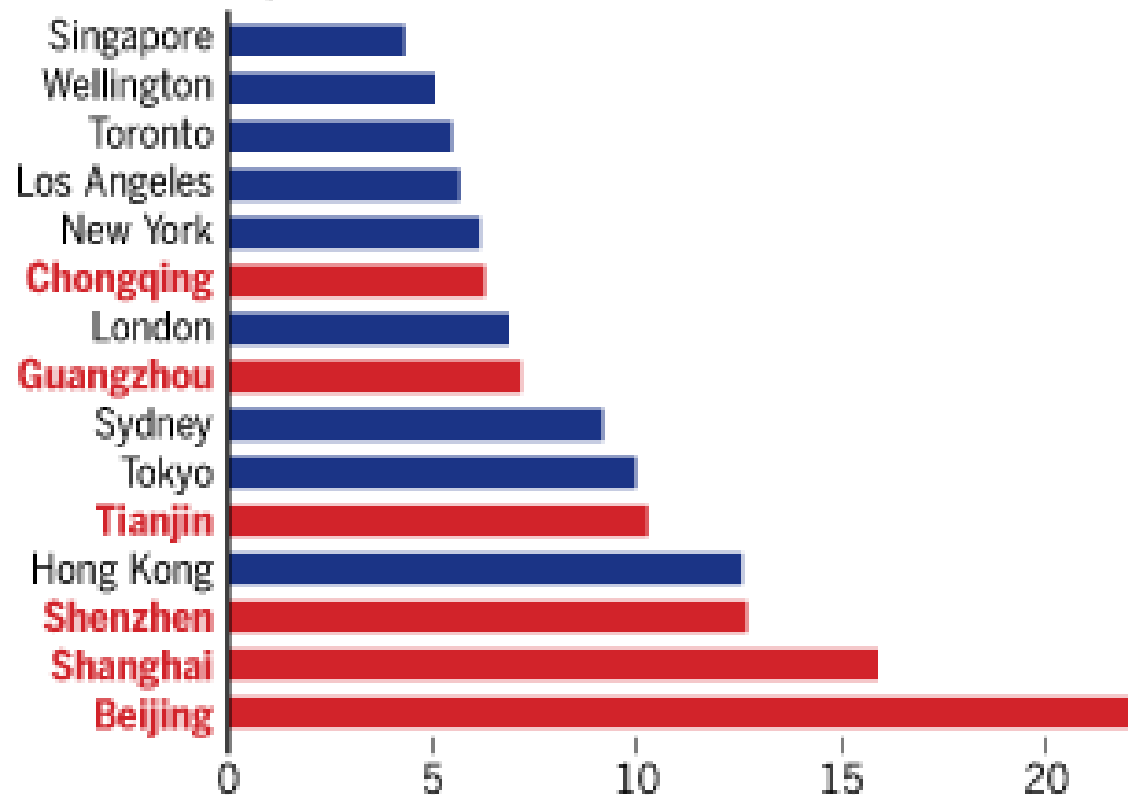
Source: Haver Analytics

FT

Bubble with Chinese Characteristics?

Chinese cities become the least affordable in the world ...

Ratio of house price to annual household income, selected cities 2011



Source: Thomson Reuters Datastream

Downside

Slippery Slope

Average percentage change in prices of new homes in 70 Chinese cities

From previous year



From previous month



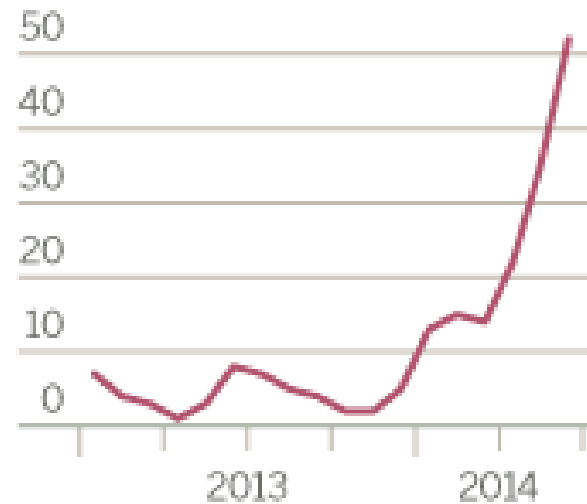
Source: WSJ calculations from National Bureau of Statistics data

The Wall Street Journal

Decline has metastasize

Cities registering a month-on-month decline in residential property prices

Number from 70-city composite



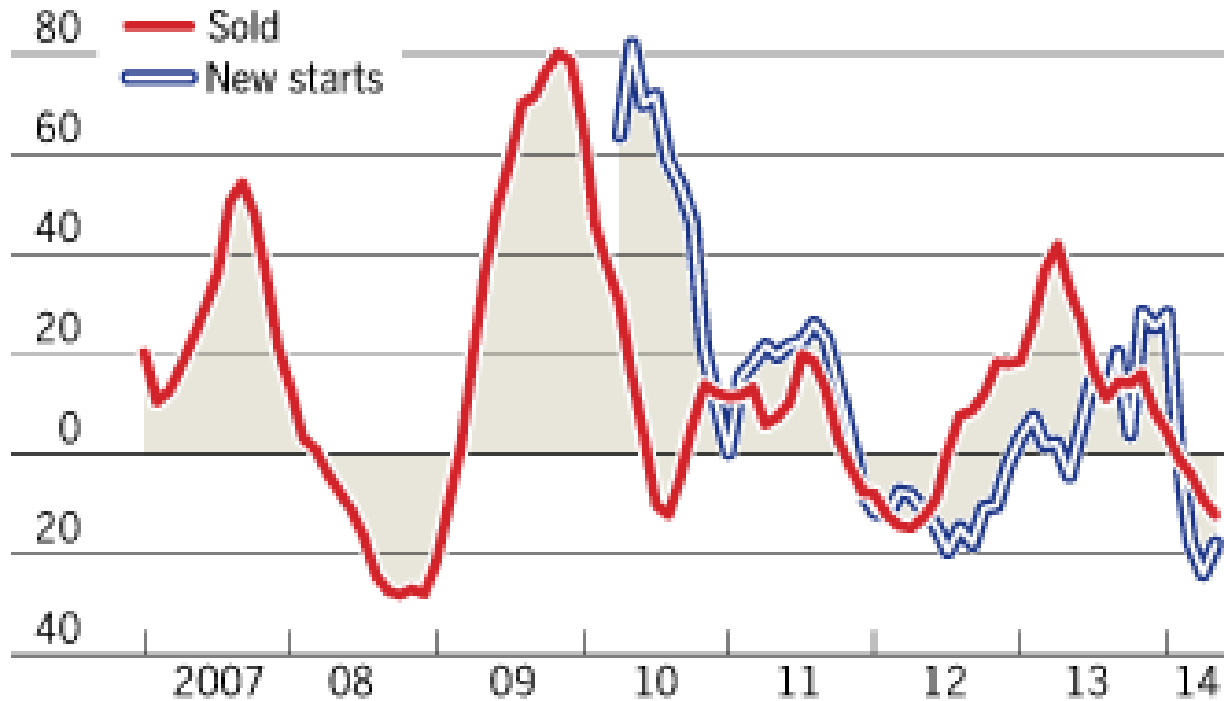
Source: Haver Analytics

FT

Slowdown in Construction

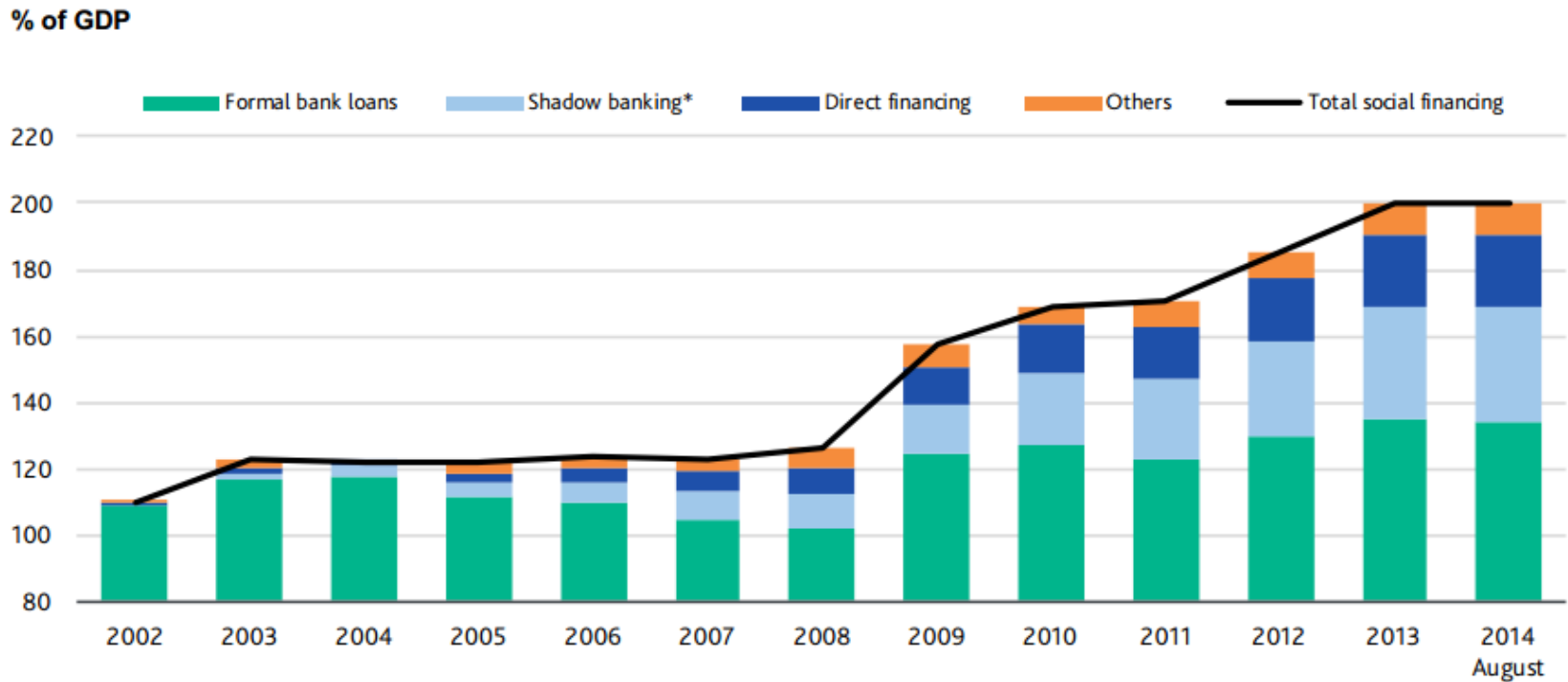
... but property construction is falling sharply

Year-on-year (%)



Source: Standard Chartered

Growth of Shadow Banking

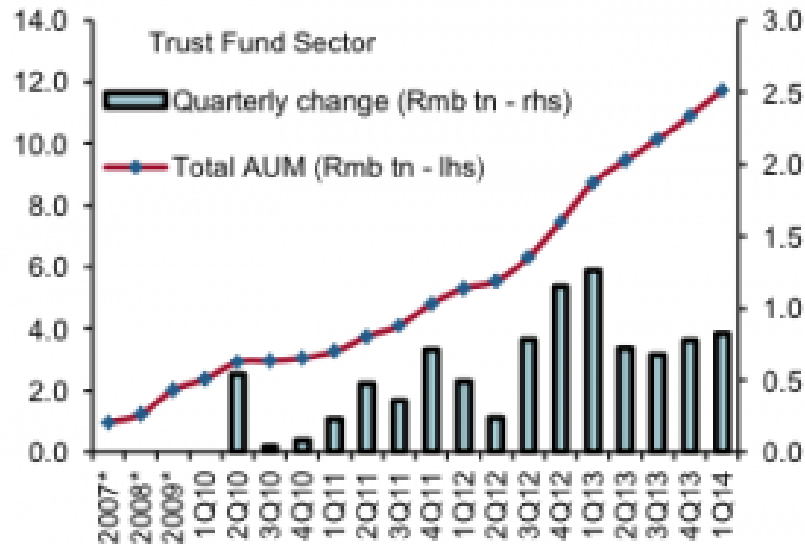


Source: Moody's Investors Service and PBOC

*Shadow banking components in the TSF include Entrusted loan, Trust loan and Bill acceptance

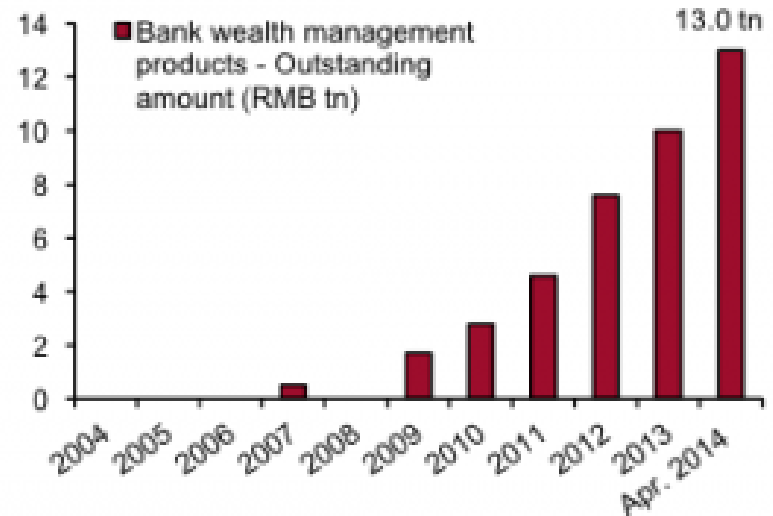
Shadow Banking is Getting Larger

Exhibit 3: The trust fund sector is getting ever bigger...



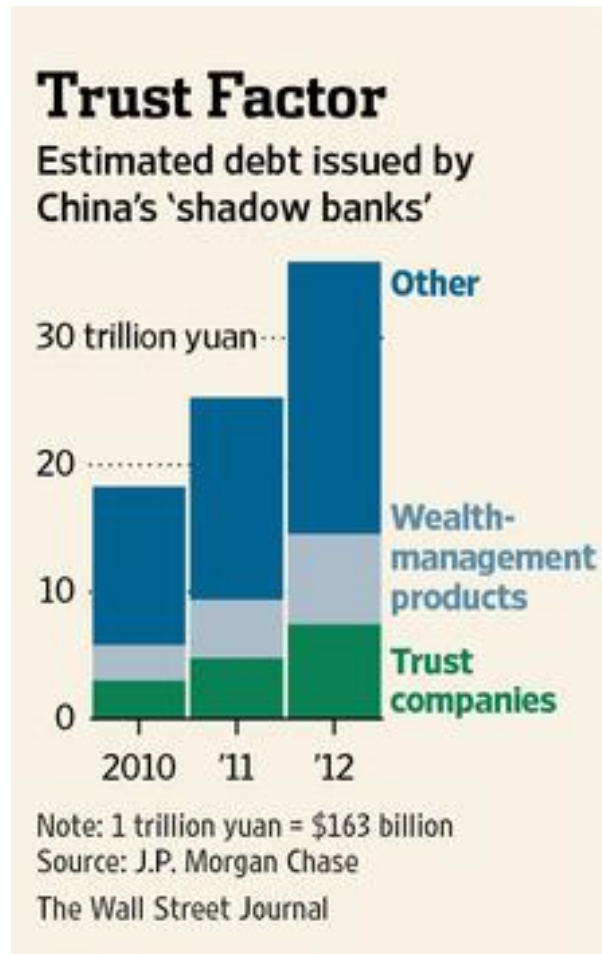
Source: China Trustee Association, Credit Suisse

Exhibit 4: ...the size of bank wealth management products is getting ever larger



Source: CBRC, Credit Suisse

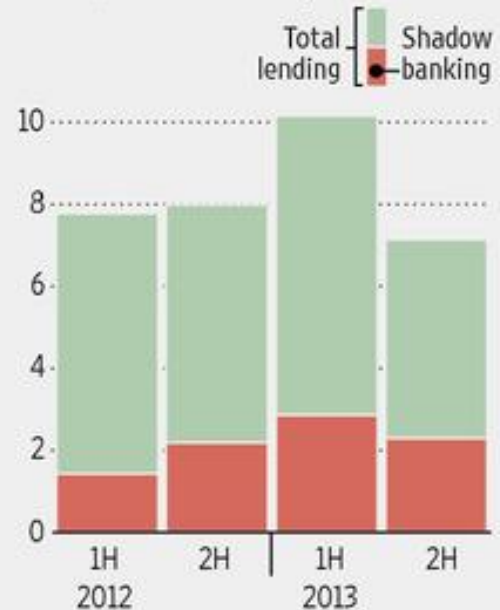
Shadow Banking Growth



Shadow Banking Size

Credit Tightens

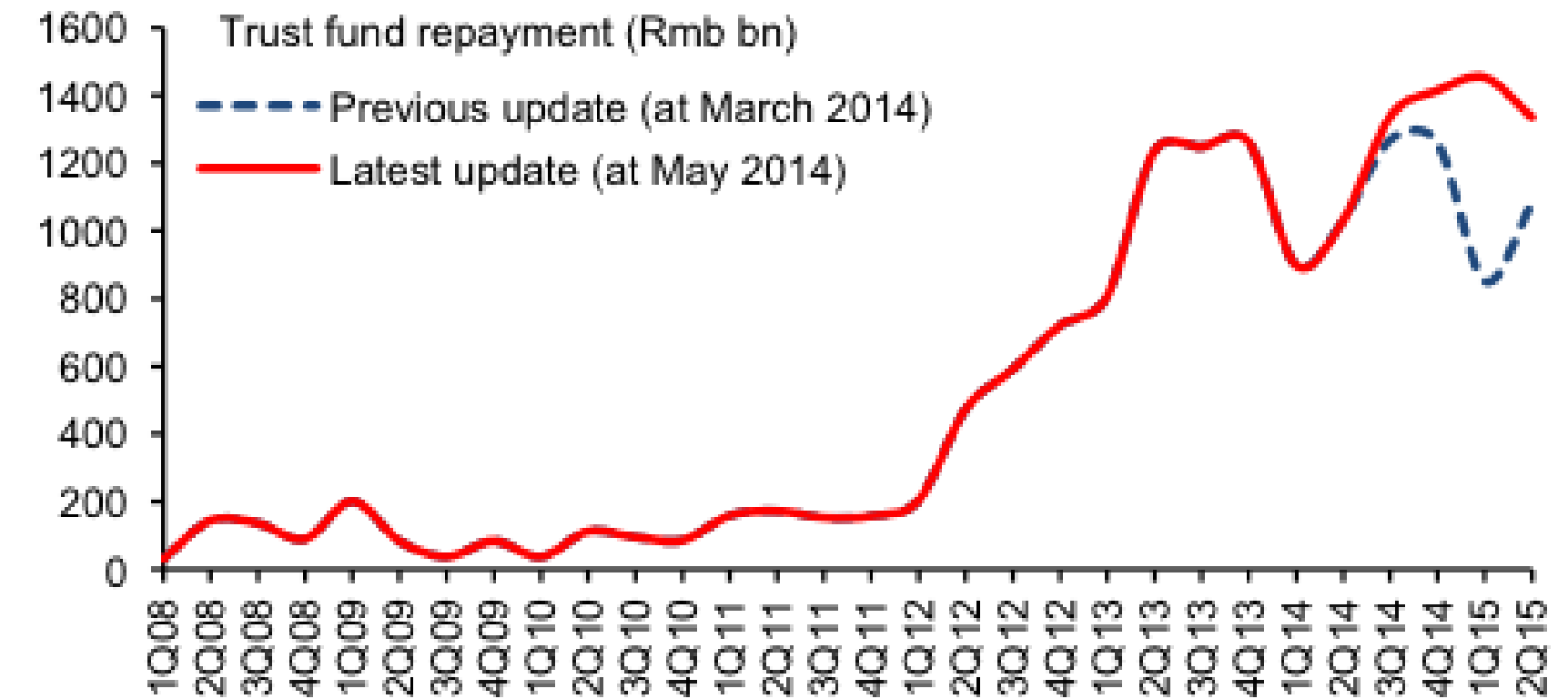
Chinese lending slowed in the second half of the year. New credit, in trillions of yuan:



Note: 1 trillion yuan = \$165 billion
Source: People's Bank of China

Extend and Pretend

Exhibit 1: Roll-over and bailout has pushed back the repayment peak

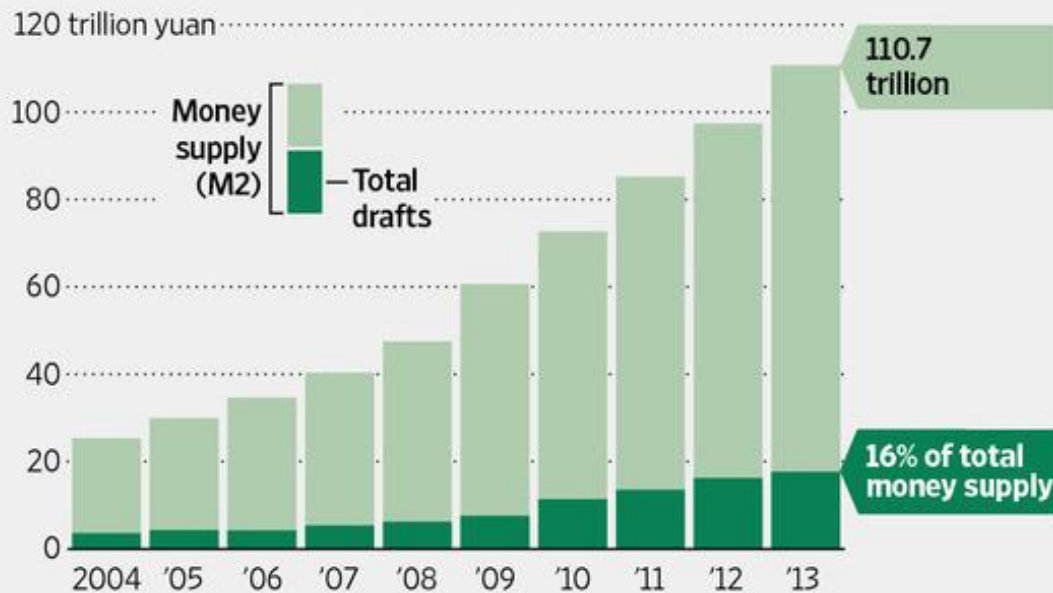


Source: Wind, Credit Suisse estimates

Shadow Banking Money Substitute

Virtual Currency

Acceptance drafts, a kind of guaranteed IOU, are playing a bigger role in China.



Notes: Total acceptance drafts include those issued by both banks and large companies; 100 trillion yuan = \$16.12 trillion

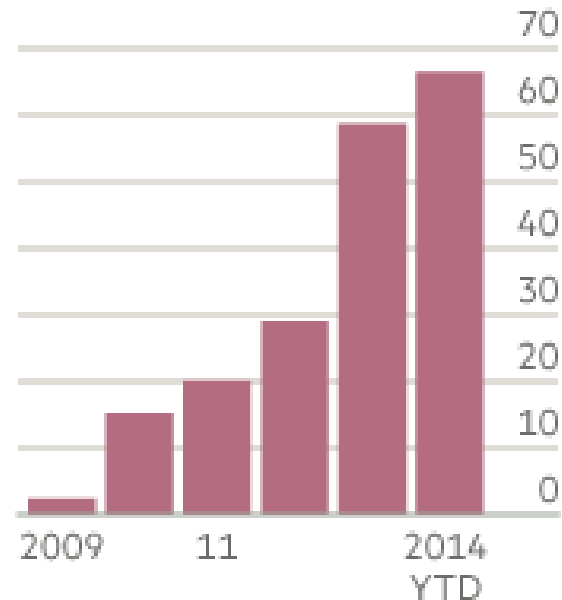
Source: People's Bank of China
The Wall Street Journal

Li Keqiang Index



China Taps International Markets

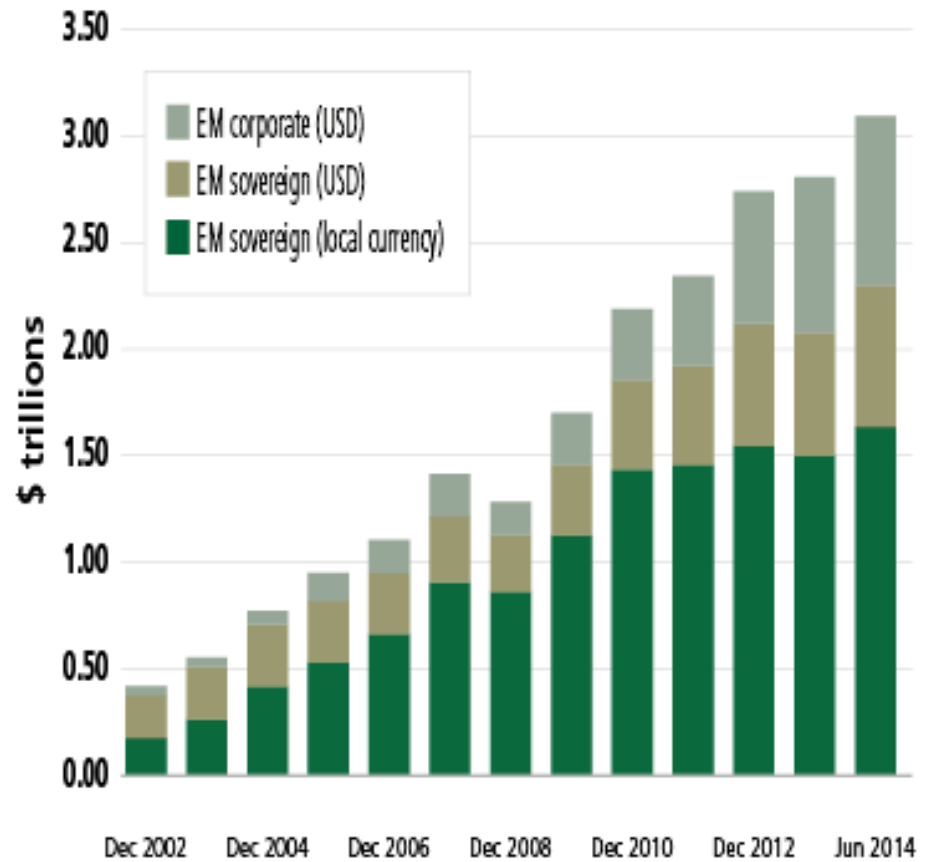
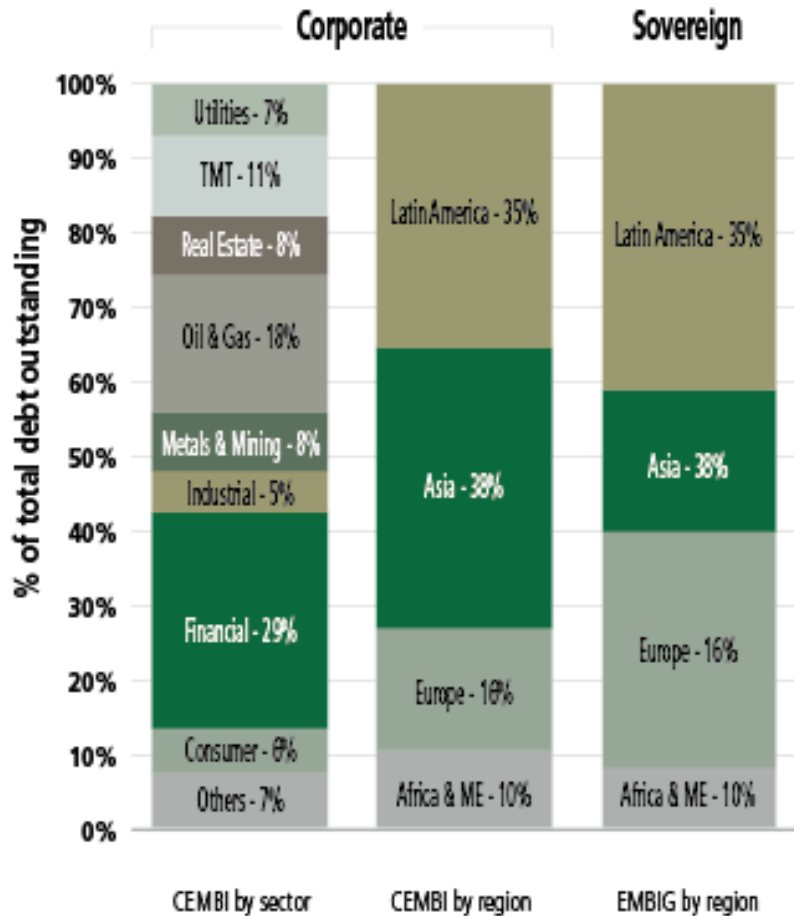
China global debt
sales soar
Total raised \$bn



Source: Dealogic

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EM Dollar Debt



EM Currency Decline



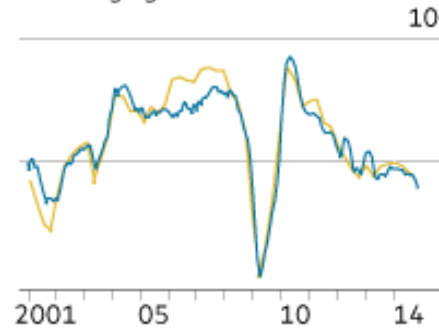
Emerging Market Slowdown

Slowing growth

Annual % change

Emerging markets GDP —

CE emerging markets GDP tracker —



Regional industrial production

Volumes, three-month average
(annual % change)



Source: Capital Economics

Theory and Practice

- Direct Investors
 - Market and Product define the strategy
- Indirect Investors
 - Booms and Busts – Momentum and foreign investors
- Analysis
 - Asymmetries of information

Japan Slows

Japanese GDP growth

Annualised quarterly change (%)



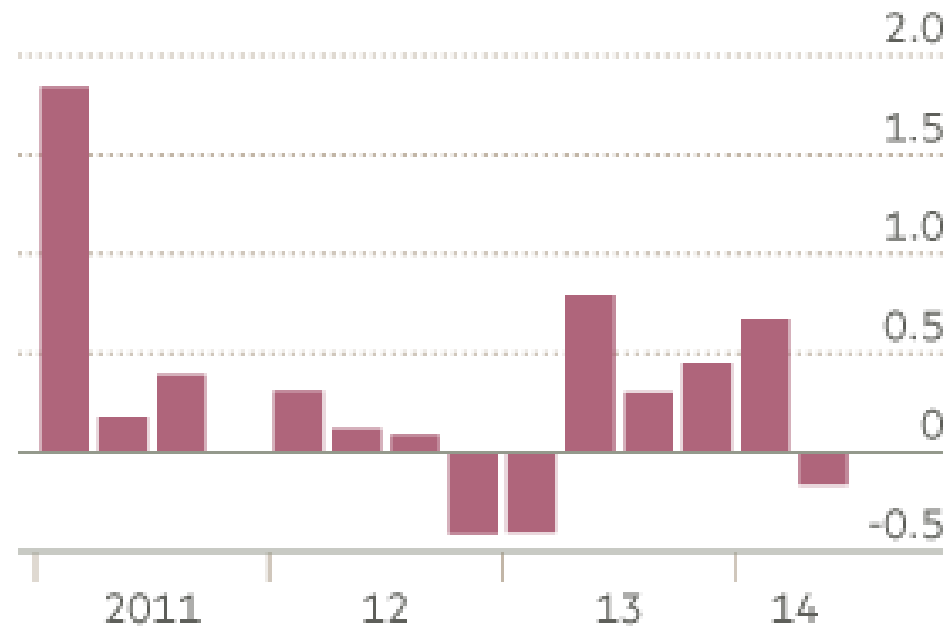
Source: Thomson Reuters Datastream

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Germany Slows

German GDP growth

% change from previous quarter



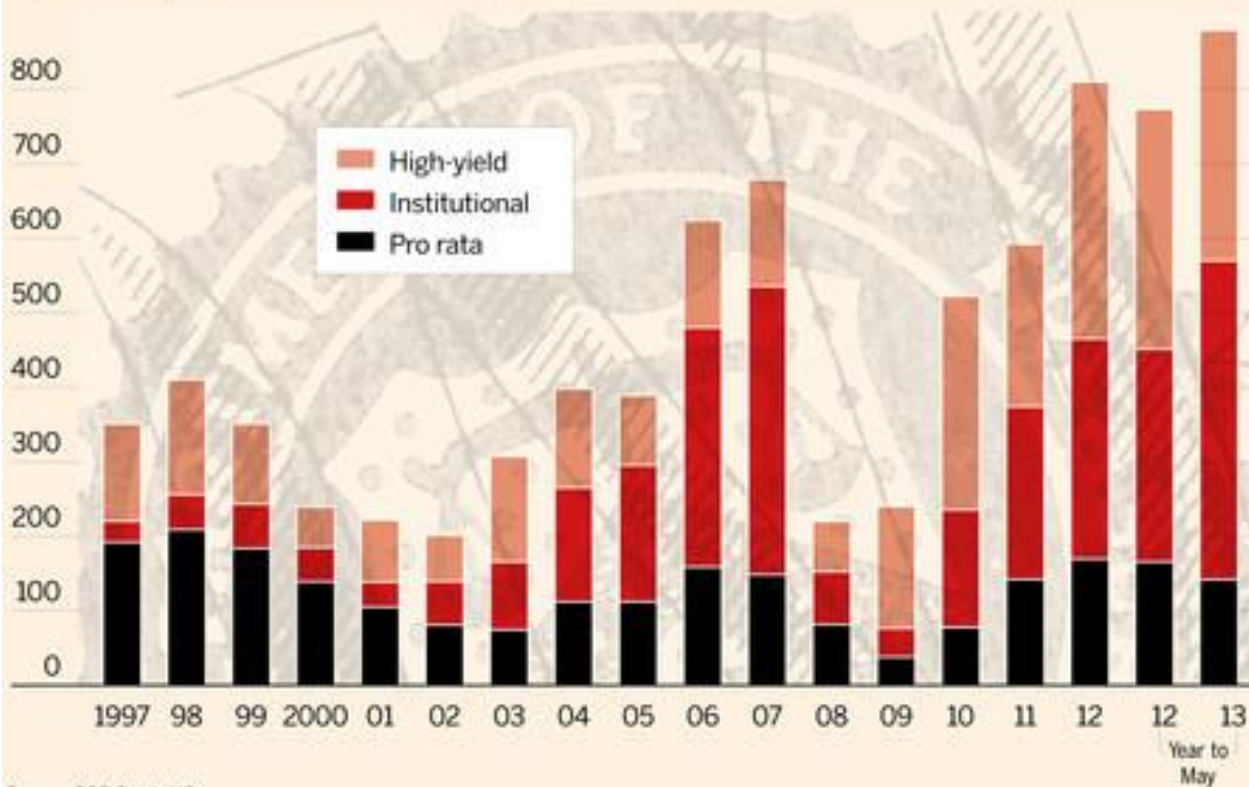
Source: Thomson Reuters Datastream

FT

US Debt Market

More loans to the indebted ...

US leveraged finance volume \$bn



Sales of leveraged loans and high-yield bonds - two types of credit issued to already indebted companies - have jumped as investors seek out greater returns from riskier assets

US Debt Market

... as demand for junk surges

US triple C issuance \$bn



Issuance of junk bonds rated 'triple C' by credit rating agencies - the lowest possible designation and a category that indicates substantial risks for investors - have surged as investors seek out the highest-yielding of high-yield bonds

Source: S&P Capital IQ

US Debt Market

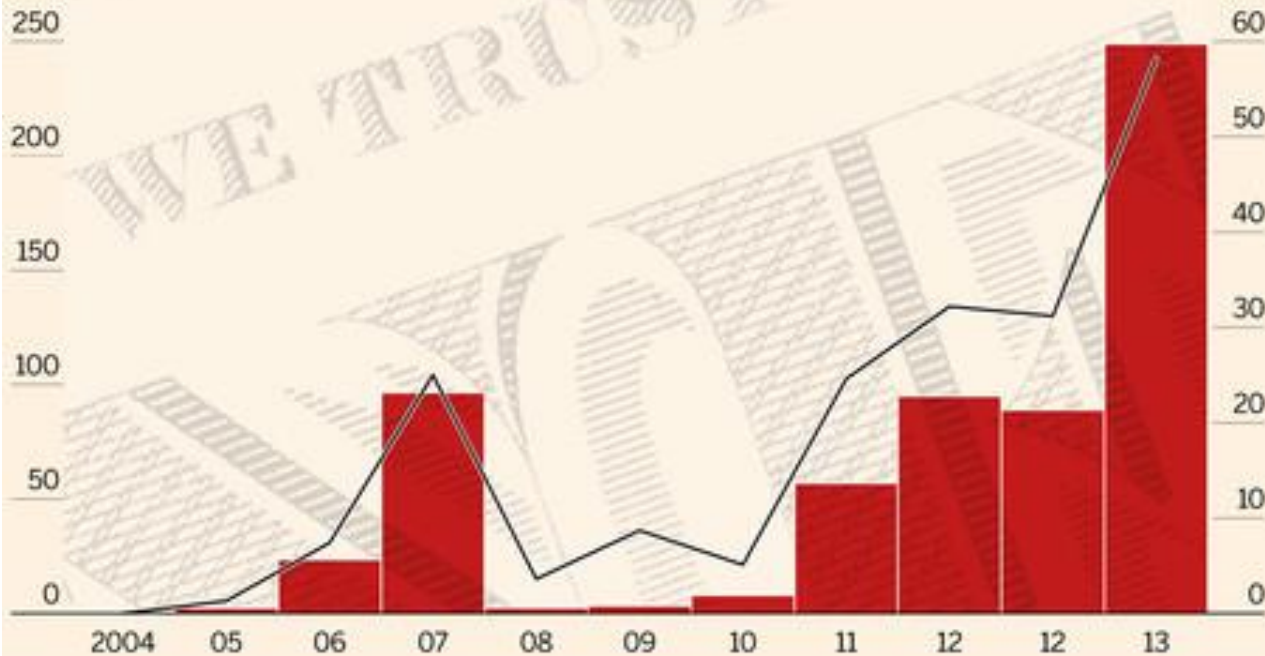
... and so does the cov-lite ...

US new-issue first-lien covenant-lite loan

Volume (\$bn)



— % of all new loans to companies



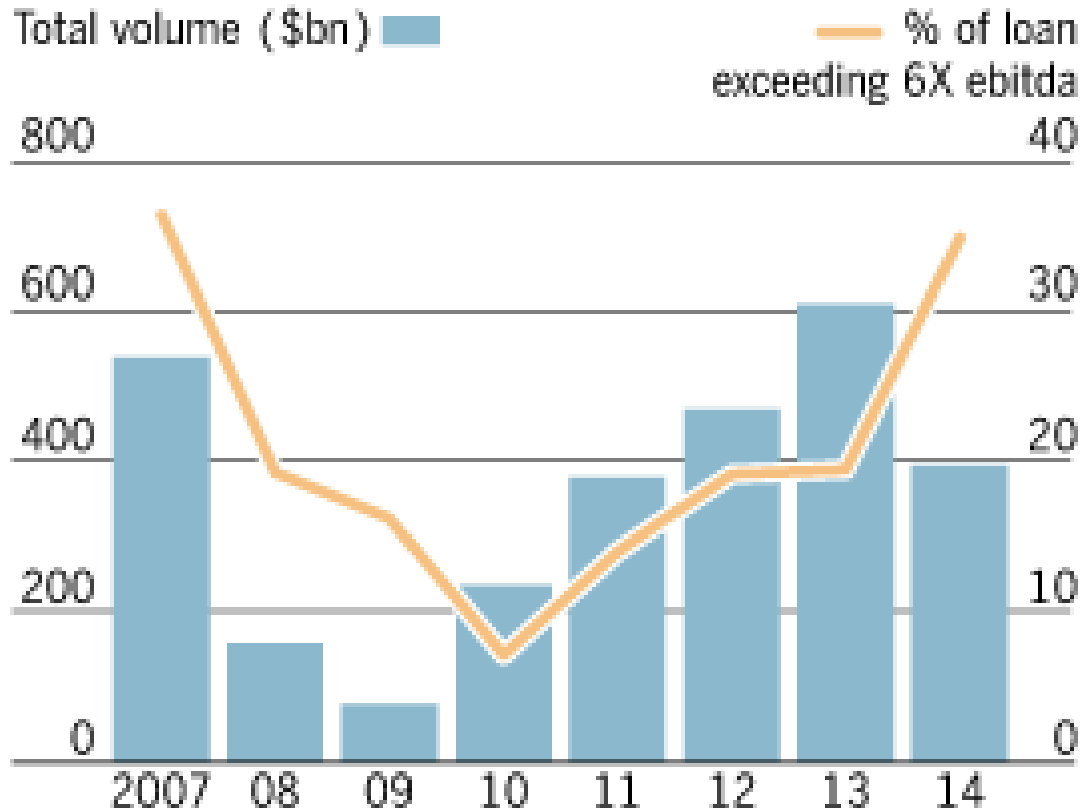
Loans that come with fewer protections for lenders, known as 'covenant-lite', surged to a record in 2013 and now account for almost 60 per cent of all new loans made to companies

Source: S&P Capital IQ

Up to May

US Debt

US leveraged - loan volumes



Source: S&P Capital IQ LCD

Growth through Stimulus?

- Tharman Shanmugaratnam, chairman of the IMF's International Monetary and Financial Committee, said: "We're clearly in recovery, globally as well as in most parts of the world."