

Fundamental Financial Factors and Non-Fund Foreign Investors Exert Strongest Influence on Emerging Markets

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New ICI Global Research Shows Regulated Funds Are Stable Source of Capital

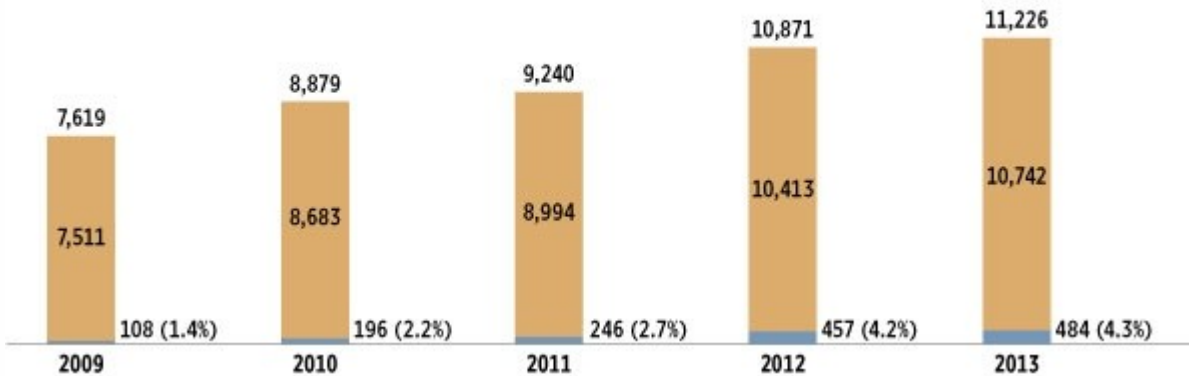
London, 6 April 2015—Amidst increasing capital inflows to emerging markets, new economic analysis finds that fundamental financial factors—such as developments in US stock and bond markets—and capital flows from a broad group of foreign investors exert much more influence over emerging markets than do flows from regulated funds. The data, drawn from the first comprehensive global analysis of regulated fund holdings and net purchases of emerging market stocks and bonds, show that regulated funds are a stable part of the foreign investor base in these markets.

The ICI Global report, “[Regulated Funds, Emerging Markets, and Financial Stability](#),” finds that regulated funds hold just 8.5 percent of the capitalisation of emerging market stock markets and 4.3 percent of outstanding emerging market debt.

Regulated Funds’ Share of Total Emerging Market Bonds Outstanding

Billions of US dollars (percentage of total); year-end, 2009–2013

Other investors
Regulated funds



Note: This figure classifies countries as emerging based on the IMF's country classification. Components may not add to the total because of rounding.

Sources: EPFR Global and International Monetary Fund (IMF)

“All foreign investors can potentially influence returns in emerging market stock and bond markets. The data clearly show that the largest influences on emerging markets are fundamental market factors and investors other than US funds,” explained Senior Economist L. Christopher Plantier, author of the paper. “The data also show that investment by regulated funds is a net positive for these markets, providing stable funding and supporting economic growth.”

Regulated Funds’ Emerging Market Investment Picture: Stable, Diverse, and Beneficial

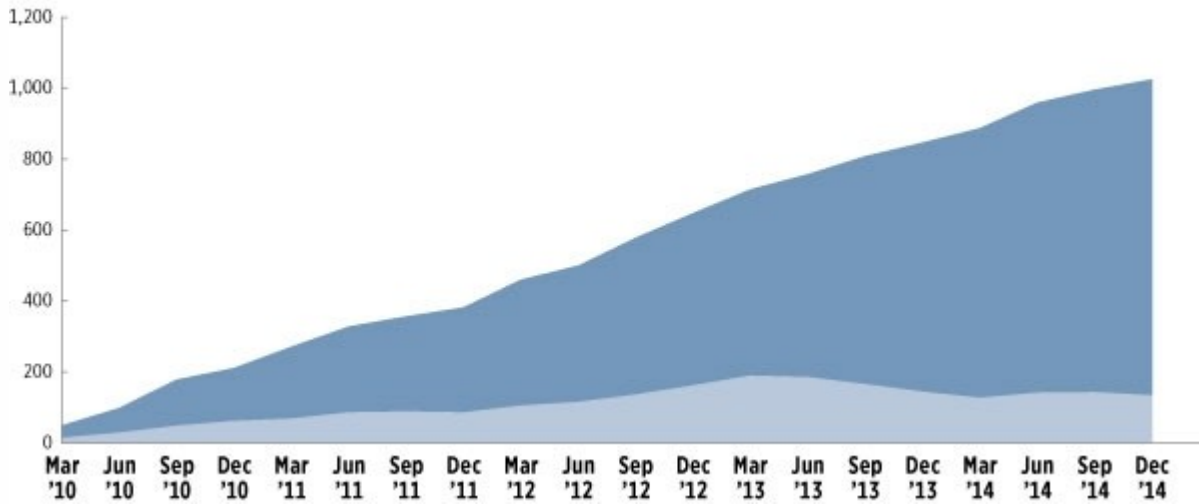
Regulated fund participation in emerging market equity and debt markets has significantly increased during the past decade due to US and European investors’ demand for diversified portfolios. Nonetheless, regulated fund holdings in emerging market stocks and bonds remain small compared to the total size of capital markets in emerging economies.

Regulated funds’ purchases of emerging market securities also constitute a small share of the total portfolio capital flowing to emerging economies from foreign investors. From 2010 to 2014, for example, emerging market economies received cumulative gross bond inflows of \$1 trillion. Less than \$140 billion of those inflows came from regulated funds.

Cumulative Net Purchases of Emerging Market Securities Are a Small Share of Total Foreign Investor Portfolio Capital Flows to Emerging Markets

*Billions of US dollars; quarterly, March 2010–December 2014**

■ Cumulative foreign investor portfolio capital flows to EM bonds
 ■ Cumulative net purchases of EM bonds



*Data for September 2014 and December 2014 are estimated.

Sources: Institute of International Finance and EPFR Global

Finally, regulated fund holdings are diversified across a wide number of emerging economies, further limiting the effects of their portfolio transactions on emerging markets. The study examines emerging markets and several somewhat further developed Asian markets, including Hong Kong, South Korea, Singapore, and Taiwan, Province of China. It finds that, as of December 2014:

- US and European regulated funds hold an estimated \$1.7 trillion in emerging market securities.
- \$1.3 trillion of the total was in equities.
- \$431 billion of the total was in bonds.
- These funds held nearly \$900 billion in Asian equity and more than \$100 billion in Asian bonds.
- The holdings are spread across more than 85 different countries.

“The dispersal of fund investment across a wide variety of markets further reduces the potential impact of US and European regulated funds on emerging economies in times of market stress. If there were investor outflows from these funds, asset managers could accommodate them by selling a small amount of securities from a wide range of emerging market countries,” explained Plantier.

New Analysis Shows Emerging Market Securities Purchases Do Not Drive Returns

In a first, the report examines both monthly and weekly regulated fund flows for a linkage between funds’ net purchases and fund returns, and finds none.

The analysis of monthly data finds that the returns on US Treasury securities and the S&P 500 index affect the returns on emerging market bonds and equities, respectively. Further and importantly, the analysis also finds that a broader measure of all foreign investor flows has far more influence on

returns than do net purchases by regulated funds. The data show regulated funds' net purchases have no effect on monthly returns of emerging market securities when all foreign investor flows are included in the analysis.

In addition, the analysis of the weekly data indicates that, while net purchases respond with a lag to returns on emerging market securities, those purchases do not have a persistent effect on future weekly returns. In addition, weekly data demonstrate that any correlation between net purchases and returns in monthly data can be explained by the gradual and lagged response of net purchases to returns.

Report Offers Insight for Markets, Regulators

“This analysis clearly tells regulators that regulated funds are not undermining financial stability in emerging markets,” said Dan Waters, ICI Global managing director. “US- and EU-domiciled regulated funds' presence in emerging market economies are in fact a source of financial stability. We encourage regulators to further examine the wealth of evidence indicating these funds act as a relatively small, stable, and diversified source of economic development and funding in capital markets around the world.”

“As the Asia-Pacific region is home to many emerging markets, this report provides valuable perspective on how regulated funds help expand, deepen, and support the region's capital growth,” noted Qiumei Yang, CEO, Asia-Pacific for ICI Global. “It adds to our understanding of the role regulated funds play, as global and regional investors increasingly adopt these funds as a long-term savings tool.”

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