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Keynote – The Changing World: Asia
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Introduction

Good afternoon.

I would like to add my warm welcome to the World Federation of Exchanges to Singapore.

It is a great pleasure for me to deliver some opening remarks and to join my colleagues–Boon Chye, Deborah and of course, Sri from CNBC on this panel.

I would like to discuss the role exchanges can play in enhancing the prospects for Asia. I will touch on three topics:

(1) The central role exchanges and clearing houses play in our financial system,
(2) How recent developments have impacted that role, and
(3) Asia's growth prospects, and how exchanges can help.

I hope the comments raise useful issues for our later panel.

A virtuous cycle: Exchanges promoting fund raising, liquidity and efficiency

The first key role exchanges play is in primary fund raising. Exchanges bridge entrepreneurs and companies who have need of capital, and can generate good returns on that capital, with savers who have excess capital, and are in search for returns. This intermediation can take place bilaterally, but exchanges can give companies access to a larger and more diverse pool of investors. The larger pool also helps to match savers and investors of the same duration and risk appetite, overall encouraging more risk-taking.

Number two, importantly exchanges are also secondary markets, where those who need liquidity can sell their claims to others with less urgent need for liquidity. The greater the number and diversity of investors who come to transact, the greater the likelihood of a match of buyer and seller, and therefore the more liquid is the market. The more liquid the market, the more "safe" and attractive the securities traded, and the lower the cost of capital for issuers.

Thirdly, the prices of securities traded on exchanges became important signals for the allocation of capital in the economy. The prices signal investors to funnel capital to higher expected return activities (lower valuations) and away from less productive ones. This helps drive efficiency and growth in the economy.

ESG is an area where markets are aiding the allocation of capital. Companies adopting better corporate governance, are enjoying better stock prices, lower cost of capital and improved flows. Investors are concerned now about the role environmental, climate and social factors are driving regulations and returns. The markets are rewarding companies with sustainable business practices. Companies are now putting these issues at the core of their investment calculus.

What we have is a virtuous cycle, where exchanges promote primary fund raising, creating range of securities, and attracting a wide range of investors to come and transact. This creates liquidity in the market, attracting more investors and lowering the cost of capital. As more investors transact prices become more efficient and drive more productive capital allocation, which promotes economic vitality.

What promotes this virtuous cycle?

First, the greater the number of investors, and the more diverse they are, the greater the likelihood of matching savers with investors. The greater range also enhances secondary liquidity is enhanced. The more informed and professional the investors, the more likely pricing and capital allocation will be efficient.

Secondly, the greater the breadth of companies and securities listed the greater the likely match to any investor, and the more investors can be attracted. Also breadth allows investors to diversify, and lower the risk premium required and lowers the funding cost.

Thirdly, the more transparent the financial information, and the greater the credibility exchanges have in regulating, and ensuring the quality of, the companies and securities listed, the greater the ease for investors in making investment decisions. Regulatory quality enhances secondary liquidity and primary fund raising.

Finally there is an important symbiosis between exchanges and the vitality of the economies they serve. The stronger the economy the stronger the exchange and vice versa. Stronger economies with better growth will have fixed income securities with higher yields and better safety. The same can be said for equity returns and volatility. Furthermore economies with strong vitality and innovation can manage the process of creative destruction well. Likewise their exchanges can remain vital, because as some companies come to the tail of their lifecycle, new companies will be emerging and issuing securities that investors can find attractive.

Changing landscape and tensions

Much has changed since exchanges met in coffeehouses. Technology and the internationalization of capital flows has meant that physical location is no longer a limitation on access to capital on investment opportunities in. Most developments have enhanced the virtuous cycle. Let me comment on a few recent trends:

1. Central bank actions

For a decade, financial market prices have been heavily influenced by central bank action in lowering interest rates and directly purchasing sovereign and corporate securities. This has raised valuations and reduced the cost of capital. While this has led to significant new corporate credit being issued it has not led to an explosion of new equity issuance. In some countries central bank purchases have reduced the float available to others and reduced liquidity in those markets. Prices anchored by central banks have meant that market participants have not been the only drivers of pricing and capital allocation.

2. Declining liquidity

There is a general agreement that liquidity in markets have declined significantly, with many potential causes.

a. *Electronic trading and the fragmentation of liquidity*

Electronic exchanges have made it easy to separate trading from physical location- a definite advantage. However because it is easy to set up new venues and marketplaces, we can ask whether liquidity been splintered and lowered in any one marketplace?

b. *The concentration of funds in a small group of large institutions*

In addition to central banks, assets have also become more concentrated in fewer large institutions. Inflows have gone into large passive funds, dominant hedge funds and cost-efficient asset management companies, and away from smaller players. Savings in some countries have also concentrated in large pension funds, super-annuation funds and sovereign wealth funds. But with more concentration, there is less diversification of investment styles, time horizon and risk tolerance. Could this result in less liquidity and less efficient market pricing?

c. *Banking regulation post GFC and the loss of market makers*

Post GFC, banking regulations have limited their market risk-taking, raising the capital required to back risk weighted assets. Banks have cut back their market making activities and risk-taking. Estimates show that brokers provide only 10-20% of the market liquidity they did 10 years ago. We see this in the small volume available to trade during market stress and in the flash crashes in liquid markets like equities and FX. Diminishing liquidity reduces price efficiency and ultimately primary fund raising capacity.

d. *Performance of active equity funds and rise of passive investing*

Finally the rise of passively managed funds and ETFs may have reached the point where it impacts pricing efficiency. Few active managers are now available to rebalance from overvalued to undervalued securities, or to act on long-term value. We see some concentration of securities holdings across passively managed funds, which can add to price momentum and flows in the near-term, but could lead to lack of liquidity and greater volatility at turning points.

3. The rise in private investing and the decline in public listings

The third major trend lies in the increasing preference for private capital versus public listing. A Milken Institute study showed that from 2000-2018, PE backed firms rose from fewer than 2,000 to nearly 8,000 in the US,. In the same period listed companies fell from 7,000 to ~4,000.[1] While IPOs used to be seen as the hallmark of corporate success, companies are preferring to stay private for longer. Some of this is because there are advantages in private markets such as greater alignment of interest from concentrated control shareholders. Without having to react to short term price movements, managements can focus on longer-term strategies. Information has also become more transparent and competition more fierce in private markets.

However as recent IPOs have shown, private market pricing may be no more rational and disciplined than public markets. In fact with fewer and less diverse investors, pricing is less transparent and potentially less efficient. There is less liquidity overall, and in time the impact on overall fund raising and efficiency of capital allocation is up for debate.

A changing – and growing – Asia

What does this mean for Asia?

GIC has been committed to Asia's growth story and we continue to take a constructive view on its long-term future.

Emerging Asia Ex-Japan has seen its share of global GDP rise from 10% to 36% in the span of 40 years. It's growth rate continues to outstrip other regions, and accounted for half of global growth last year. We expect this trend to continue. Whilst China has been an important driver, India, Indonesia and Vietnam amongst others, are also set to grow strongly in the next few years. Asia is not a homogeneous region. Different per-capita GDP levels, different governments and regulatory regimes means that investing in the region requires some navigation. Nevertheless we see some broad common themes.

1. **The Asian Financial Crisis of 1997-98 had taught the region invaluable lessons**, and has led to more disciplined monetary and fiscal policies, improved regulation, and a shift towards more flexible exchange rates. Beyond exporting to developed markets, Asian economies are now also relying more on regional sources of growth where there has been supply-chain, trade, and financial market integration.

2. **Asia in general retains a positive attitude towards globalization and openness**

   The region's growth path has been characterized by the continual lowering of trade and investment barriers. With opening up, countries, especially emerging ones, have benefited from technological catch-up. Strong intra-regional trade means that there are large markets for companies to tap.

3. **Asia continues to see improvement in its institutions**

   These progressive reforms are increasingly being recognized, and this has been reflected in improvements in ease of business environment rankings for many countries in the region.

4. **Finally Asia has a dynamic working population**

   We see the region's people and businesses as not only being driven, but adaptable to change. Education levels have risen markedly, and many countries are still enjoying a demographic dividend. There is a growing middle class that form a large consumer market, and business models are rapidly being innovated to serve it.

[1] Companies Rush to Go Private (2018). Milken Institute

The region's equity, bond, and foreign exchange markets have grown in response to the rapid rise. Today, Asia's equity markets make up nearly 40% of global market capitalization, though significantly less of the popular global indices. The development of local currency bond markets have also improved funding stability. Asian economies are prodigious savers, and have transitioned from being recipients of global investor flows, to originators of those flows within Asia and to other regions.

Conclusion

Not everything is rosy at the moment. The global economy has been in a long expansion, and perhaps we are closer to the end of the expansion. Trade frictions have already taken its toll on global manufacturing. Political and geopolitical risk, as well as potential further trade and investment restrictions, are clear and present dangers for global and Asian growth.

But global environment aside, what can we still do to enhance this virtuous cycle between exchanges and economies?

1. We can further encourage a diverse mix of investors to come to our markets, by encouraging transparent pricing, reducing technological and regulatory barriers, and attracting international investors. We can try to develop an even more professionalized investment industry, comprising insurance, asset management and wealth management. This will instill greater valuation discipline, reduce speculation and enhance market stability to encourage further investment flows and capital formation.
2. We can encourage efforts to offer a range of securities to domestic investors to allow them to diversify and create a safe liquid portfolio. Emerging market exchanges may find it difficult to offer that range without creating simple clear listing processes. Even so there may be limited diversification, and so cross-border cooperation to allow for cross-listing and trading can help domestic investors easily access a diversified range of securities to invest in, and thus drive further inflows.
3. Asian exchanges need to continue to improve the quality of financial information and corporate governance of companies; which will in turn remove uncertainties for investors.
4. Finally the greater the clarity and transparency of monetary, fiscal and exchange rate policy, the greater the vitality of the Asian economies, and the more they support the work of exchanges in fund raising, providing secondary liquidity and pricing efficiency.

These efforts will bear fruit in the tough environment, and when that environment turns better.