Chapter 12

The Global Capital Market

U.K. Brexit Update 12/21 (4 min) - VIDEO
What is a Capital Market?

CAPITAL MARKETS ARE MADE UP OF DEBT AND EQUITY MARKETS.
The purpose of capital markets is to match the demand for funds with the supply of funds. These markets fuel economic growth by allocating capital that can be used to create jobs, build infrastructure and finance innovative ideas.

BUYERS

EQUITY MARKETS
Equity markets enable the issuance and trading of equity shares, such as stocks, which are ownership stakes in a company’s assets and earnings.

SELLERS

DEBT MARKETS
Debt markets enable the issuance and trading of debt, such as corporate and government bonds, which are loans for a defined period of time that pay a variable or predetermined interest rate.

Source:
Companies & Capital Markets

**Stocks (equity)** – raise money by issuing stock on public stock exchanges

**Bonds (debt)** – borrow money by floating corporate bonds

**What do companies do?**

Companies **Buy Assets:**
- Buy foreign currencies to do business
- Buy foreign stock – strategic partnership or control a foreign company
- Buy back its own stock – raise share price or prevent outside control
- Buy diversified stocks and bonds – reduce risk by diversifying

Companies **Sell Assets:**
- Sell stock in foreign exchanges to raise cash
- Sell foreign currencies – convert to home currency
- Sell a currency to use in contract to reduce currency fluctuations in another
- Sell ownership stake in another company to end strategic partnerships
- Sell stock on foreign market exchanges
Debt …

**Historic highs**
In 2020, global debt experienced the largest surge in 50 years. (debt as a percent of GDP)

Biggest debt increase in one year since World War II
### Global Equity Markets - 2020

Which countries have the largest stock exchanges?

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Total market cap (in mil. US$)</th>
<th>Total market cap (% of GDP)</th>
<th>Number of domestic companies listed</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>United States</td>
<td>40,719,661</td>
<td>194.5</td>
<td>4,266</td>
<td>2020</td>
</tr>
<tr>
<td>2</td>
<td>China</td>
<td>12,214,466</td>
<td>83.0</td>
<td>4,154</td>
<td>2020</td>
</tr>
<tr>
<td>3</td>
<td>Japan</td>
<td>6,718,220</td>
<td>122.2</td>
<td>3,754</td>
<td>2020</td>
</tr>
<tr>
<td>4</td>
<td>Hong Kong</td>
<td>6,130,420</td>
<td>1,768.8</td>
<td>2,353</td>
<td>2020</td>
</tr>
<tr>
<td>6</td>
<td>Canada</td>
<td>2,641,455</td>
<td>160.7</td>
<td>3,922</td>
<td>2020</td>
</tr>
<tr>
<td>7</td>
<td>India</td>
<td>2,595,466</td>
<td>99.0</td>
<td>5,215</td>
<td>2020</td>
</tr>
<tr>
<td>8</td>
<td>Saudi Arabia</td>
<td>2,429,102</td>
<td>347.0</td>
<td>207</td>
<td>2020</td>
</tr>
<tr>
<td>10</td>
<td>Germany</td>
<td>2,284,109</td>
<td>60.0</td>
<td>438</td>
<td>2020</td>
</tr>
</tbody>
</table>

**World Total 2020:** $93,686,226,000,000  
**Top 10 = 80.94% of World Total 2020**


**World Total 2022?**
High and Rising
The value of global equities has doubled since dipping at the start of the pandemic

World Total Dec. 2020: $93,686,226,000,000
World Total Dec. 2021: $119,717,895,834,140

Source: Bloomberg's WCAUWRLD Index
Note: Figures are through Dec. 16

Source:
https://www.bloomberg.com/opinion/articles/2021-12-20/what-eight-charts-are-telling-us-about-markets-in-2022
# Cyclically Adjusted Price/Earnings Ratios

<table>
<thead>
<tr>
<th>Nation</th>
<th>Calculated Using</th>
<th>12/31/2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>S&amp;P/TSX Composite</td>
<td>26.36</td>
</tr>
<tr>
<td>US</td>
<td>S&amp;P 500</td>
<td>39.98</td>
</tr>
<tr>
<td>UK</td>
<td>FTSE 100</td>
<td>15.64</td>
</tr>
<tr>
<td>Italy</td>
<td>FTSE MIB</td>
<td>25.94</td>
</tr>
<tr>
<td>Spain</td>
<td>IBEX 35</td>
<td>18.34</td>
</tr>
<tr>
<td>Russia</td>
<td>MOEX</td>
<td>10.53</td>
</tr>
<tr>
<td>India</td>
<td>NIFTY 50</td>
<td>34.77</td>
</tr>
<tr>
<td>Japan*</td>
<td>All public companies, (uncons.)*</td>
<td>33.22</td>
</tr>
<tr>
<td>Japan*</td>
<td>All public companies, (consol.)*</td>
<td>25.52</td>
</tr>
<tr>
<td>China</td>
<td>SSE Composite</td>
<td>18.11</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>Hang Seng</td>
<td>11.61</td>
</tr>
<tr>
<td>Australia</td>
<td>ASX All Ordinaries</td>
<td>19.93</td>
</tr>
</tbody>
</table>

Source: [https://siblisresearch.com/data/cape-ratios-by-country/](https://siblisresearch.com/data/cape-ratios-by-country/)
Global Economy – 2008 - Bottomed Out?

Cartoon of a ship sinking with the following messages:

- Attention All Passengers:
- We are very pleased to report...
- We may have bottomed out...
- Any turnaround will be rocky.
The Central Banks of the world responded to the financial crisis …

Write:

**FILM**

1. What did the central banks do? Why?
2. What happened in Japan?
What did Central Banks do???

This puts it all into perspective:

- Near 0 interest rates
- Booming stocks
- Slow income recovery
Why Buy U.S. Treasury Bonds?

VIDEO

Why China Buys U.S. Treasury Bonds
Foreign Reserve Balances - 2021

Think of reserves like a checking account …
Foreign reserves help cover for foreign expenses or impact exchange rates

Buying/selling foreign currency can impact exchange rate:
- Buying US Dollars can devalue a currency (increase reserves)
- Selling US Dollars can appreciate the local currency (decrease reserves)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country or region</th>
<th>Foreign exchange reserves (millions of US$)</th>
<th>Figures as of</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>China</td>
<td>3,426,908</td>
<td>31 December 2021</td>
</tr>
<tr>
<td>2</td>
<td>Japan</td>
<td>1,405,750</td>
<td>December 2021</td>
</tr>
<tr>
<td>3</td>
<td>Switzerland</td>
<td>1,086,197</td>
<td>October 2021</td>
</tr>
<tr>
<td>4</td>
<td>India</td>
<td>632,736</td>
<td>7 January 2022</td>
</tr>
<tr>
<td>5</td>
<td>Russia</td>
<td>630,500</td>
<td>7 January 2022</td>
</tr>
<tr>
<td>6</td>
<td>Taiwan</td>
<td>547,330</td>
<td>November 2021</td>
</tr>
<tr>
<td>7</td>
<td>Hong Kong</td>
<td>499,500</td>
<td>November 2021</td>
</tr>
<tr>
<td>8</td>
<td>South Korea</td>
<td>463,900</td>
<td>November 2021</td>
</tr>
<tr>
<td>9</td>
<td>Saudi Arabia</td>
<td>450,527</td>
<td>October 2021</td>
</tr>
<tr>
<td>10</td>
<td>Singapore</td>
<td>418,146</td>
<td>August 2021</td>
</tr>
</tbody>
</table>

Top 3
Total $5.9 trillion in Reserves

Source: https://en.wikipedia.org/wiki/List_of_countries_by_stock_market_capitalization
Assume we don’t put money into a checking account. Where can we put it?

<table>
<thead>
<tr>
<th>Rank</th>
<th>Company</th>
<th>Country</th>
<th>Total AUM, US$b</th>
<th>Balance sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>BlackRock</td>
<td>US</td>
<td>9,464</td>
<td>09/30/2021</td>
</tr>
<tr>
<td>2</td>
<td>Vanguard Group</td>
<td>US</td>
<td>8,400</td>
<td>10/31/2021</td>
</tr>
<tr>
<td>3</td>
<td>UBS Group *</td>
<td>Switzerland</td>
<td>4,432</td>
<td>09/30/2021</td>
</tr>
<tr>
<td>4</td>
<td>Fidelity Investments</td>
<td>US</td>
<td>4,230</td>
<td>09/30/2021</td>
</tr>
<tr>
<td>5</td>
<td>State Street Global Advisors</td>
<td>US</td>
<td>3,860</td>
<td>09/30/2021</td>
</tr>
<tr>
<td>6</td>
<td>Morgan Stanley</td>
<td>US</td>
<td>3,274</td>
<td>09/30/2021</td>
</tr>
<tr>
<td>7</td>
<td>JPMorgan Chase</td>
<td>US</td>
<td>2,996</td>
<td>09/30/2021</td>
</tr>
<tr>
<td>8</td>
<td>Allianz Group **</td>
<td>Germany</td>
<td>2,953</td>
<td>09/30/2021</td>
</tr>
<tr>
<td>9</td>
<td>Capital Group</td>
<td>US</td>
<td>2,600</td>
<td>09/30/2021</td>
</tr>
<tr>
<td>10</td>
<td>Goldman Sachs</td>
<td>US</td>
<td>2,372</td>
<td>09/30/2021</td>
</tr>
</tbody>
</table>

Total Assets under management - 9/30/2021

Climate Action 100+ (Responsible Investing)

Total Assets under management – $33 Trillion+

A new 5 year global initiative to ensure that companies take more action to curb emissions

Source: https://climateaction100.wordpress.com/about-us/
1. Advances in information technology

- **24-hour-day trading** – the international capital market never sleeps
- **Shocks** that occur in one financial market, **spread quickly** around the globe

2. Deregulation by governments

- Traditionally, governments limited foreign investors to purchase significant equity positions in domestic companies, and the amount of foreign investment citizens could make
- **Since the 1980s**, these **restrictions have fallen** in response to the **development of the Eurocurrency market**, and also pressure from financial services companies
- **Began in the United States**, then moved to Great Britain, Japan, and France
The Eurocurrency Market

**Eurocurrency** - any currency banked outside of its country of origin

About two-thirds of all eurocurrencies are **Eurodollars** (dollars banked outside the United States)

Other important eurocurrencies are:
- Euro-yen
- Euro-pound, and
- Euro-euro

**London** continues to be the leading center of the eurocurrency market
Why Has The Eurocurrency Market Grown?

• Many businesses need US$ (make payments in US$)
• US regulations slowed down lending US$ to non-US residents
• People outside the US who wanted to borrow US$ then had to go to the Euromarkets
Why is the Eurocurrency Market Attractive?

The eurocurrency market is attractive because it is *not regulated by the government*

- Banks can *offer higher interest rates on eurocurrency deposits* than on deposits made in the home currency
- Banks can *charge lower interest rates to eurocurrency borrowers* than to those who borrow the home currency
Why is the Eurocurrency Market Attractive?

The **spread** between the eurocurrency deposit and lending rates is less than the spread between the domestic deposit and lending rates.
London is **#1 Foreign exchange trading center in the world**, New York **#1 financial center in the world 2021**

<table>
<thead>
<tr>
<th>Centre</th>
<th>Rank</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>New York</td>
<td>1</td>
<td>762</td>
</tr>
<tr>
<td>London</td>
<td>2</td>
<td>740</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>3</td>
<td>716</td>
</tr>
<tr>
<td>Singapore</td>
<td>4</td>
<td>715</td>
</tr>
<tr>
<td>San Francisco</td>
<td>5</td>
<td>714</td>
</tr>
<tr>
<td>Shanghai</td>
<td>6</td>
<td>713</td>
</tr>
<tr>
<td>Los Angeles</td>
<td>7</td>
<td>712</td>
</tr>
<tr>
<td>Beijing</td>
<td>8</td>
<td>711</td>
</tr>
<tr>
<td>Tokyo</td>
<td>9</td>
<td>706</td>
</tr>
<tr>
<td>Paris</td>
<td>10</td>
<td>705</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Area of Competitiveness</th>
<th>Number of Mentions</th>
<th>Main Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Environment</td>
<td>201</td>
<td>• Corruption  • Rule of Law</td>
</tr>
<tr>
<td>Taxation</td>
<td>164</td>
<td>• Simplicity and fairness  • Stability &amp; transparency</td>
</tr>
<tr>
<td>Human Capital</td>
<td>146</td>
<td>• Centres becoming more competitive in attracting skilled people  • Diversity of nationalities is become more important</td>
</tr>
<tr>
<td>Reputation</td>
<td>116</td>
<td>• Security and safety are becoming more important  • Centres need to market themselves more – they are in a competitive marketplace</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>106</td>
<td>• People are becoming less patient and don’t want to wait for transportion  • ICT infrastructure is now a given – without it a centre cannot compete</td>
</tr>
<tr>
<td>Financial Sector</td>
<td>100</td>
<td>• Professional services clusters are vital  • Physical proximity still very important</td>
</tr>
</tbody>
</table>

Drawbacks Of The Eurocurrency Market

Two drawbacks:

1. Higher risk of bank failure
   (Because unregulated)

2. Foreign exchange risk
   (can lose due to currency depreciation)
The Global Bond Market

The most common kind of bond is a fixed rate bond which gives investors fixed cash payoffs.

There are two types of international bonds:

1. **Foreign bonds** - sold outside the borrower’s country and denominated in the currency of the country in which they are issued
   
   *(British bond issued in £ for U.S. company)*

2. **Eurobonds** - underwritten by a syndicate of banks and placed in countries other than the one in whose currency the bond is denominated
   
   *(British bond issued in ¥ for U.S. company)*
Why Are Eurobonds Attractive?

Three reasons:

1. **No regulatory interference** – with little regulation, the cost of issuing bonds is lower

2. **Less stringent disclosure requirements** - cheaper and quicker to offer Eurobonds

3. **More favorable taxation** - Eurobonds can be sold directly to foreign investors
TYPES OF RISKS (need to assess)

- **Exchange Rate**
  Currencies may depreciate and lower your return

- **Market Values**
  Volatility in markets

- **Political and Social**
  Impacts market attractiveness

- **Market Limitations**
  May be limits on what you can buy and to whom you can sell

- **Information**
  May be only limited information (non-transparent)

- **Legal**
  May be limited on law suits and legal remedies
How Will You Invest Internationally?

Mutual Fund Investing - FILM

Easy way to start investing internationally is by using global stock and/or bond mutual funds …

Global Financial Asset Portfolio (GFAP) for 2018

Sources: BIS, World Exchanges, FRED

As of January 2018
Both halves of this graph represent an equal amount of global wealth.

**Top half** consists of the world's eight richest billionaires.

**Bottom half** represents the poorest half of humanity – that's 3.6 billion people.

Sources: https://www.oxfam.org/
https://howmuch.net/articles/the-worlds-wealth-inequality

howmuch.net
International Investments

Write: Which specific international investments would you consider attractive? Why?

https://goo.gl/rsHrc1  Yahoo Mutual Fund Screener

Category - Select “World Stock”
“Add another filter” – “Annual Return NAV Year 5” – 20