

FIXED INCOME 101 | CHINA

The Rise of China's Corporate Bond Market

CONTRIBUTORS

Michele Leung

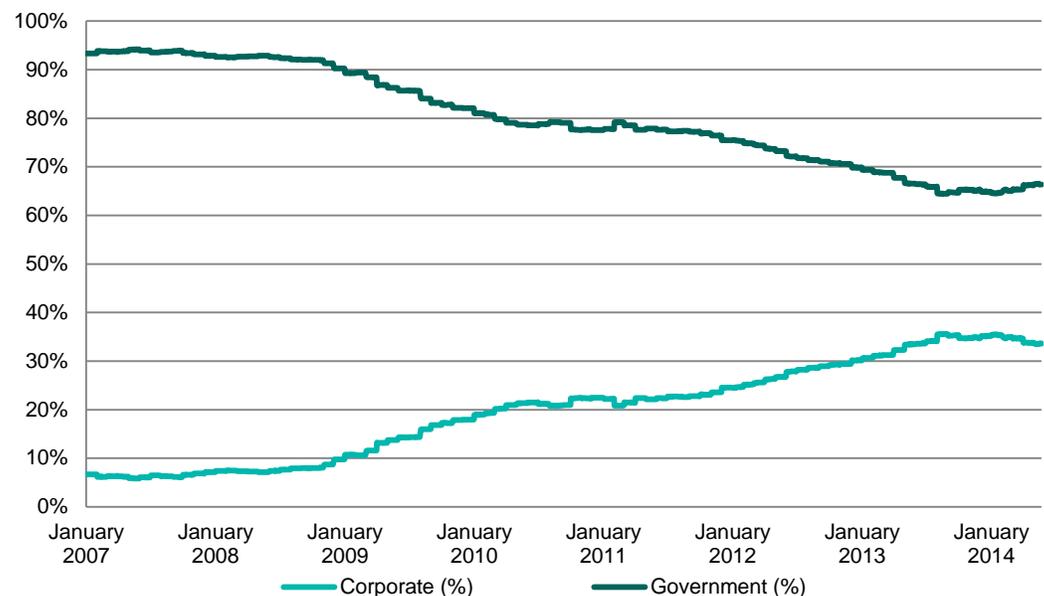
Associate Director, Fixed Income
Indices

michele.leung@spdji.com

The S&P China Corporate Bond Index currently represents 70% of the total local-currency-denominated corporate bond markets tracked by the S&P Pan Asia Corporate Bond Index. Its size easily makes it the largest corporate market among the 10 countries that comprise the regional index, followed by the S&P Korea Corporate Bond Index, which accounts for 15%.

The size of the corporate bond market in China, as measured by the S&P China Corporate Bond Index, currently stands at CNY 7.58 trillion, representing an expansion by more than 14 times since December 2009. The corporate bond sector has also gained an increasing market share of the overall Chinese bond market; it rose from less than 10% to 33% over the period studied, as noted in Exhibit 1.

Exhibit 1: Corporate vs. Government Bond Markets in China



The total size of the corporate bond market in China, as tracked by the S&P China Corporate Bond Index, currently stands at CNY 7.58 trillion.

Source: S&P Dow Jones Indices. Data as of June 11, 2014. Charts are provided for illustrative purposes. Past performance is no guarantee of future results. This chart may reflect hypothetical historical performance. Please see the Performance Disclosures at the end of this document for more information regarding the inherent limitations associated with back-tested performance. The "Corporate (%)" represents the market cap of the S&P China Corporate Bond Index/S&P China Bond Index. The "Government (%)" represents the market cap of the S&P China Government Bond Index/S&P China Bond Index.

While the spread of the S&P China Corporate Bond Index over the S&P China Sovereign Bond Index was historically within the range of 1% to 3%, it widened in the past two years to nearly 4%, and it only came down in early 2014 after the risk of some corporate bond defaults was resolved.

Exhibit 2: The Spread of the S&P China Corporate Bond Index Over the S&P China Sovereign Bond Index

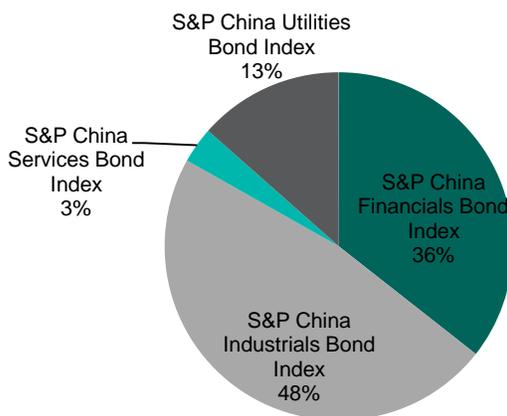
Over 90% of Chinese corporate bonds are issued by state-owned enterprises, whereas private corporate bonds only account for a small fraction of the market.



Source: S&P Dow Jones Indices. Data as of June 11, 2014. Charts are provided for illustrative purposes. Past performance is no guarantee of future results. This chart may reflect hypothetical historical performance. Please see the Performance Disclosures at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

In fact, over 90% of Chinese corporate bonds are issued by state-owned enterprises (SOE),¹ whereas private corporate bonds only account for a small fraction of the market. Within the corporate bond market, the industrial bond is the largest sector (see Exhibit 3). Represented by the S&P China Industrials Bond Index, it is also the fastest-growing segment and has expanded by over 24 times in the period studied. The major issuers of these bonds are China Railway and China National Petroleum Corp.

Exhibit 3: Sector Breakdown of the S&P China Corporate Bond Index



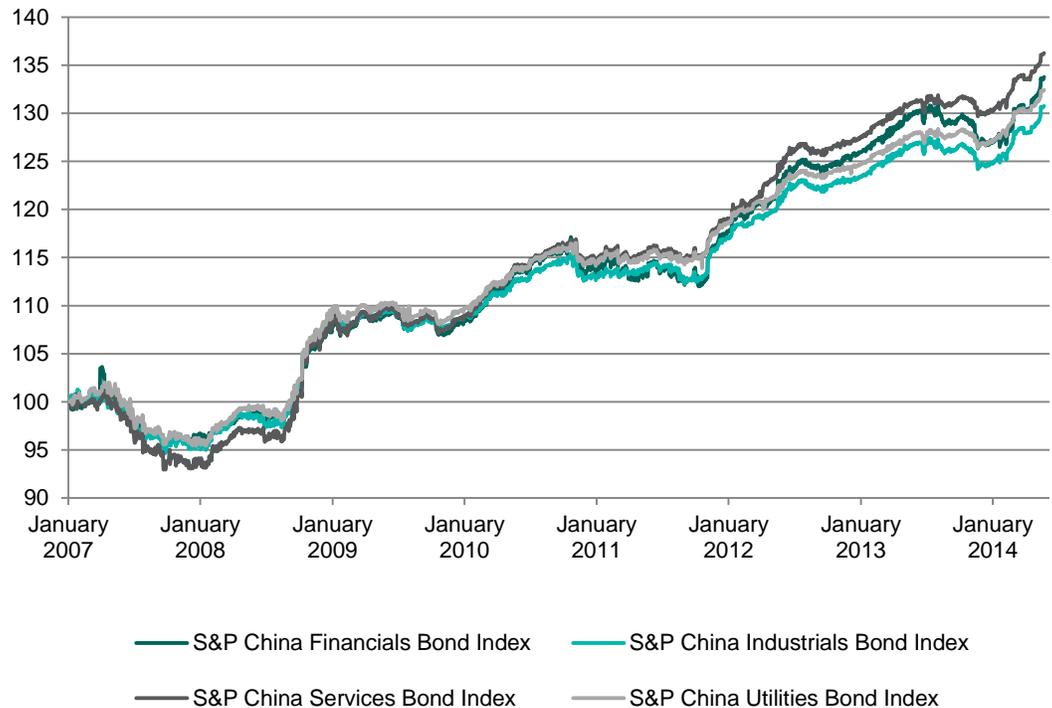
Source: S&P Dow Jones Indices. Data as of June 11, 2014. Charts are provided for illustrative purposes. Past performance is no guarantee of future results. This chart may reflect hypothetical historical performance. Please see the Performance Disclosures at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

¹ Bank of America Merrill Lynch, *More on China's on-shore corporate bond market*, Asia Credit Strategy, March 28, 2014

In terms of total return performance, the S&P China Corporate Bond Index has risen 5.7% YTD and 32% since the index's first value date on Dec. 29, 2006. Among all the sector-level indices, the S&P China Services Bond Index is the outperformer, growing 36% over the same period.

Exhibit 4: Total Return Performance

In terms of total return performance, the S&P China Corporate Bond Index has risen 32% since the index first value date on Dec. 29, 2006.

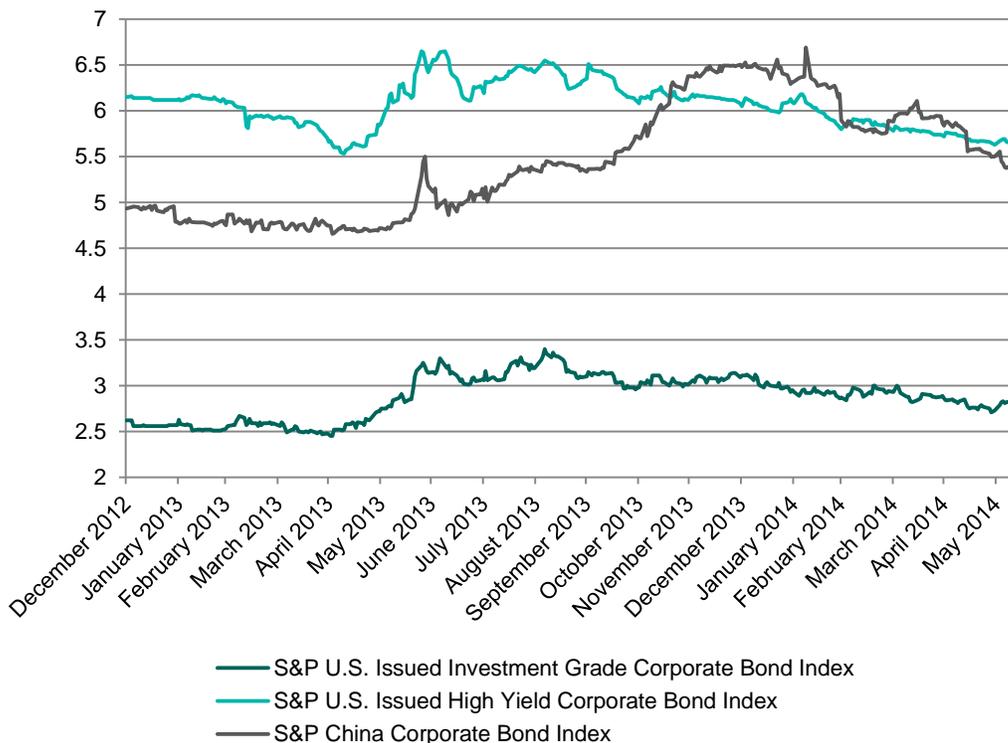


Source: S&P Dow Jones Indices. Data as of June 11, 2014. Charts are provided for illustrative purposes. Past Performance is no guarantee of future results. This chart may reflect hypothetical historical performance. Please see the Performance Disclosures at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

As of June 11, 2014, the modified duration of the S&P China Corporate Bond Index is 3.46, with a weighted yield-to-maturity of 5.38%. Among all sector-level indices, the S&P China Financials Bond Index has both the highest yield-to-maturity and modified duration, which are 5.74% and 4.43, respectively.

Exhibit 5 compares the yields of the S&P China Corporate Bond Index with the S&P U.S. Issued Investment Grade Corporate Bond Index and the S&P U.S. Issued High Yield Corporate Bond Index. As a reference, the S&P U.S. Issued Investment Grade Corporate Bond Index and S&P U.S. Issued High Yield Corporate Bond Index have modified durations of 6.61 and 4.92, respectively.

Exhibit 5: Yield-to-Maturity Comparison for the S&P China Corporate Bond Index



Source: S&P Dow Jones Indices. Data as of June 11, 2014. Charts are provided for illustrative purposes. Past performance is no guarantee of future results. This chart may reflect hypothetical historical performance. Please see the Performance Disclosures at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

As China continues to implement new policies to strengthen its economy and improve governance, the growth in the corporate bond market is expected to remain solid. The S&P China Corporate Bond Index seeks to provide global investors with the key market characteristics of the rapidly expanding corporate bond sector, while also improving transparency in the local-currency bond market.

Like What You Read? Sign up to receive complimentary updates on a broad range of index-related topics and events.



PERFORMANCE DISCLOSURES

The S&P Pan Asia Bond Index, the S&P China Corporate Bond Index, the S&P China Financials Bond Index, the S&P China Industrials Bond Index, the S&P China Services Bond Index, the S&P China Utilities Bond Index, the S&P China Sovereign Bond Index, and the S&P Korea Corporate Bond Index (the "Index") were launched on March 12, 2014. All information presented prior to the launch date is back-tested. Back-tested performance is not actual performance, but is hypothetical. The back-test calculations are based on the same methodology that was in effect when the index was officially launched. Complete index methodology details are available at www.spdji.com. It is not possible to invest directly in an index.

S&P Dow Jones Indices defines various dates to assist our clients in providing transparency on their products. The First Value Date is the first day for which there is a calculated value (either live or back-tested) for a given index. The Base Date is the date at which the Index is set at a fixed value for calculation purposes. The Launch Date designates the date upon which the values of an index are first considered live: index values provided for any date or time period prior to the index's Launch Date are considered back-tested. S&P Dow Jones Indices defines the Launch Date as the date by which the values of an index are known to have been released to the public, for example via the company's public website or its data feed to external parties. For Dow Jones-branded indices introduced prior to May 31, 2013, the Launch Date (which prior to May 31, 2013, was termed "Date of introduction") is set at a date upon which no further changes were permitted to be made to the index methodology, but that may have been prior to the Index's public release date.

Past performance of the Index is not an indication of future results. Prospective application of the methodology used to construct the Index may not result in performance commensurate with the back-test returns shown. The back-test period does not necessarily correspond to the entire available history of the Index. Please refer to the methodology paper for the Index, available at www.spdji.com for more details about the index, including the manner in which it is rebalanced, the timing of such rebalancing, criteria for additions and deletions, as well as all index calculations.

Another limitation of using back-tested information is that the back-tested calculation is generally prepared with the benefit of hindsight. Back-tested information reflects the application of the index methodology and selection of index constituents in hindsight. No hypothetical record can completely account for the impact of financial risk in actual trading. For example, there are numerous factors related to the equities, fixed income, or commodities markets in general which cannot be, and have not been accounted for in the preparation of the index information set forth, all of which can affect actual performance.

The Index returns shown do not represent the results of actual trading of investable assets/securities. S&P Dow Jones Indices LLC maintains the Index and calculates the Index levels and performance shown or discussed, but does not manage actual assets. Index returns do not reflect payment of any sales charges or fees an investor may pay to purchase the securities underlying the Index or investment funds that are intended to track the performance of the Index. The imposition of these fees and charges would cause actual and back-tested performance of the securities/fund to be lower than the Index performance shown. As a simple example, if an index returned 10% on a US \$100,000 investment for a 12-month period (or US \$10,000) and an actual asset-based fee of 1.5% was imposed at the end of the period on the investment plus accrued interest (or US \$1,650), the net return would be 8.35% (or US \$8,350) for the year. Over a three year period, an annual 1.5% fee taken at year end with an assumed 10% return per year would result in a cumulative gross return of 33.10%, a total fee of US \$5,375, and a cumulative net return of 27.2% (or US \$27,200).

GENERAL DISCLAIMER

© S&P Dow Jones Indices LLC, a part of McGraw Hill Financial 2014. All rights reserved. Standard & Poor's and S&P are registered trademarks of Standard & Poor's Financial Services LLC ("S&P") a part of McGraw Hill Financial. Dow Jones is a registered trademark of Dow Jones Trademark Holdings LLC ("Dow Jones"). Trademarks have been licensed to S&P Dow Jones Indices LLC. Redistribution, reproduction and/or photocopying in whole or in part are prohibited without written permission. This document does not constitute an offer of services in jurisdictions where S&P Dow Jones Indices LLC, Dow Jones, S&P or their respective affiliates (collectively "S&P Dow Jones Indices") do not have the necessary licenses. All information provided by S&P Dow Jones Indices is impersonal and not tailored to the needs of any person, entity or group of persons. S&P Dow Jones Indices receives compensation in connection with licensing its indices to third parties. Past performance of an index is not a guarantee of future results.

It is not possible to invest directly in an index. Exposure to an asset class represented by an index is available through investable instruments based on that index. S&P Dow Jones Indices does not sponsor, endorse, sell, promote or manage any investment fund or other investment vehicle that is offered by third parties and that seeks to provide an investment return based on the performance of any index. S&P Dow Jones Indices makes no assurance that investment products based on the index will accurately track index performance or provide positive investment returns. S&P Dow Jones Indices LLC is not an investment advisor, and S&P Dow Jones Indices makes no representation regarding the advisability of investing in any such investment fund or other investment vehicle. A decision to invest in any such investment fund or other investment vehicle should not be made in reliance on any of the statements set forth in this document. Prospective investors are advised to make an investment in any such fund or other vehicle only after carefully considering the risks associated with investing in such funds, as detailed in an offering memorandum or similar document that is prepared by or on behalf of the issuer of the investment fund or other investment vehicle. S&P Dow Jones Indices LLC is not a tax advisor. A tax advisor should be consulted to evaluate the impact of any tax-exempt securities on portfolios and the tax consequences of making any particular investment decision. Inclusion of a security within an index is not a recommendation by S&P Dow Jones Indices to buy, sell, or hold such security, nor is it considered to be investment advice.

These materials have been prepared solely for informational purposes based upon information generally available to the public from sources believed to be reliable. No content contained in these materials (including index data, ratings, credit-related analyses and data, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse-engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P Dow Jones Indices. The Content shall not be used for any unlawful or unauthorized purposes. S&P Dow Jones Indices and its third-party data providers and licensors (collectively "S&P Dow Jones Indices Parties") do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Dow Jones Indices Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content. THE CONTENT IS PROVIDED ON AN "AS IS" BASIS. S&P DOW JONES INDICES PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Dow Jones Indices Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the Content even if advised of the possibility of such damages.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P Ratings Services reserves the right to assign, withdraw or suspend such acknowledgement at any time and in its sole discretion. S&P Dow Jones Indices, including S&P Ratings Services disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgement as well as any liability for any damage alleged to have been suffered on account thereof.

Affiliates of S&P Dow Jones Indices LLC may receive compensation for its ratings and certain credit-related analyses, normally from issuers or underwriters of securities or from obligors. Such affiliates of S&P Dow Jones Indices LLC reserve the right to disseminate its opinions and analyses. Public ratings and analyses from S&P Ratings Services are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P Rating Services publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

S&P Dow Jones Indices keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P Dow Jones Indices may have information that is not available to other business units. S&P Dow Jones Indices has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

In addition, S&P Dow Jones Indices provides a wide range of services to, or relating to, many organizations, including issuers of securities, investment advisers, broker-dealers, investment banks, other financial institutions and financial intermediaries, and accordingly may receive fees or other economic benefits from those organizations, including organizations whose securities or services they may recommend, rate, include in model portfolios, evaluate or otherwise address