

# The World's Second Largest Bond Market Is Now Open

Overview of the KraneShares Bloomberg Barclays China Bond Inclusion UCITS ETF (ticker: KBND)

# Introduction to KraneShares

## About KraneShares

Krane Funds Advisors, LLC is the investment manager for KraneShares ETFs. The firm is focused on providing investors with strategies to capture China's importance as an essential element of a well-designed investment portfolio. KraneShares ETFs represent innovative, first to market strategies that have been developed based on the firm and its partners' deep knowledge of investing. These strategies allow investors to stay current on global market trends and provide meaningful diversification.

In 2019, KraneShares established a European headquarters in London to better deliver its renowned China-focused ETFs to European investors. In addition to launching Europe-specific versions of its most popular US-listed funds, KraneShares also develops strategies tailored to meet the specific needs of its European clients.





**KraneShares**  
**Bloomberg Barclays**  
**China Bond Inclusion**  
**UCITS ETF**

### Investment Strategy:

KBND is benchmarked to the Bloomberg Barclays China Treasury and Policy Bank 9% Capped Index, which is designed to track the performance of China's onshore renminbi-denominated government and government-related bond market. The Fund seeks to invest at least 80% of its assets in a basket of fixed income securities issued by either China's Ministry of Finance itself or government-owned banks within China.

### KBND Overview:

- Invests in treasuries (i.e. government bonds) and attempts to provide attractive yields relative to other government bond markets with a monthly distribution.
- KBND offers access to the securities being included in Bloomberg Barclays broad fixed income indexes and investment opportunities within the second largest bond market in the world.
- For investors seeking diversification within their global government bond allocations, KBND offers low correlations to other major government bond markets.

### Bloomberg Barclays China Bond Inclusion Overview:

- The inclusion process began in April 2019 and is expected to conclude at the end of 2020.
- The market estimates nearly \$150 billion of fund inflows into China's \$13 trillion onshore bond market.<sup>1</sup>
- China's government bonds are a focus of the inclusion and China has already replaced South Korea as the top issuer by weight within the Bloomberg Barclays Emerging Market Local Currency Government Bond Index.

1. Financial Times, "Bloomberg adds Chinese government bonds to flagship index", 31/03/2019. Retrieved on 30/Jun/2020.

## KraneShares & Citigroup

KraneShares has partnered with Citigroup to be the distributor for KBND and will also leverage Citibank's bond connect capabilities to trade the underlying securities in KBND.

### About Citi China

Citi first established an office in China on May 15, 1902, in Shanghai. Today, Citi China is a leading international bank in China with a footprint that spans 13 cities: Beijing, Changsha, Chengdu, Chongqing, Dalian, Guangzhou, Guiyang, Hangzhou, Nanjing, Shanghai, Shenzhen, Tianjin, and Wuxi.

Citi China was the first American bank to be selected as an official Bond Connect Trading Dealer by the People's Bank of China (PBOC) upon the establishment of the Bond Connect program in 2017.



*"More overseas institutional investors are expected to be attracted to invest and participate in China's interbank bond market as China's bond market steadily opens up, especially on the back of Bond Connect. Citi is honored to be one of the first batch of Northbound Trading Dealers. Aligned with relevant policy guidelines, we will strive to make an even greater contribution to the development of China's bond market moving forward by fully showcasing and sharing Citi's experience and strengths in the domestic and international bond markets."*

*—Christine Lam, President and Chief Executive Officer, Citi China*

## Bloomberg Barclays China Bond Inclusion

- On January 31, 2019, Bloomberg announced that China's RMB-denominated government and policy bank bonds would be added to the Bloomberg Barclays Global Aggregate Index.
- Inclusion began in April of 2019 and will be complete by the end of 2020.
- Bloomberg's decision stems from years of extensive research into China's financial markets and several recent enhancements made by the PBOC, the Ministry of Finance, and the State Tax Administration including the implementation of delivery v. payment settlement and the clarification of key tax policies.
- The development represents an unequivocal endorsement of China's efforts to further open up its capital markets as well as gain the trust of the global investment community.

*“Today's announcement represents an important milestone on China's path towards more open and transparent capital markets, and underscores Bloomberg's long-term commitment to connecting investors to China. With the upcoming inclusion of China in the Global Aggregate Index, China's bond market presents a growing opportunity for global investors.”*

*—Peter T. Grauer, Bloomberg Chairman, 31 January 2019*



**Bloomberg**

## The Chinese government-related bonds being included in the Bloomberg Barclays Global Aggregate Index

- 322 onshore Chinese bonds are being added to the Bloomberg Barclays Global Aggregate Index with a total market value of \$25.42 trillion, average modified duration of 6.31 years, and an average yield of 3.07%<sup>3</sup> versus a current total market value of \$55 trillion for developed issuers within the index.<sup>1</sup>
- Currently, foreign investors only represent about 3% of the Chinese interbank bond market versus 40% in Indonesia, 10% in Japan, and 30% in the US.<sup>2</sup>

Issuer	Count	Total Market Value (MV) (US\$ trillion)	Total Amount Outstanding (US\$ trillion)	Average Modified Duration (Years)	Average Yield to Worst (%)
China Government Bond	148	12.07	12.11	8.97	2.98
China Development Bank	89	7.14	7.26	4.47	3.17
Agricultural Development Bank	46	3.72	3.86	3.84	3.16
Export-Import Bank of China	39	2.49	2.59	3.31	3.09
<b>Total/Average (non-weighted)</b>	<b>322</b>	<b>25.42</b>	<b>25.82</b>	<b>6.31</b>	<b>3.07</b>

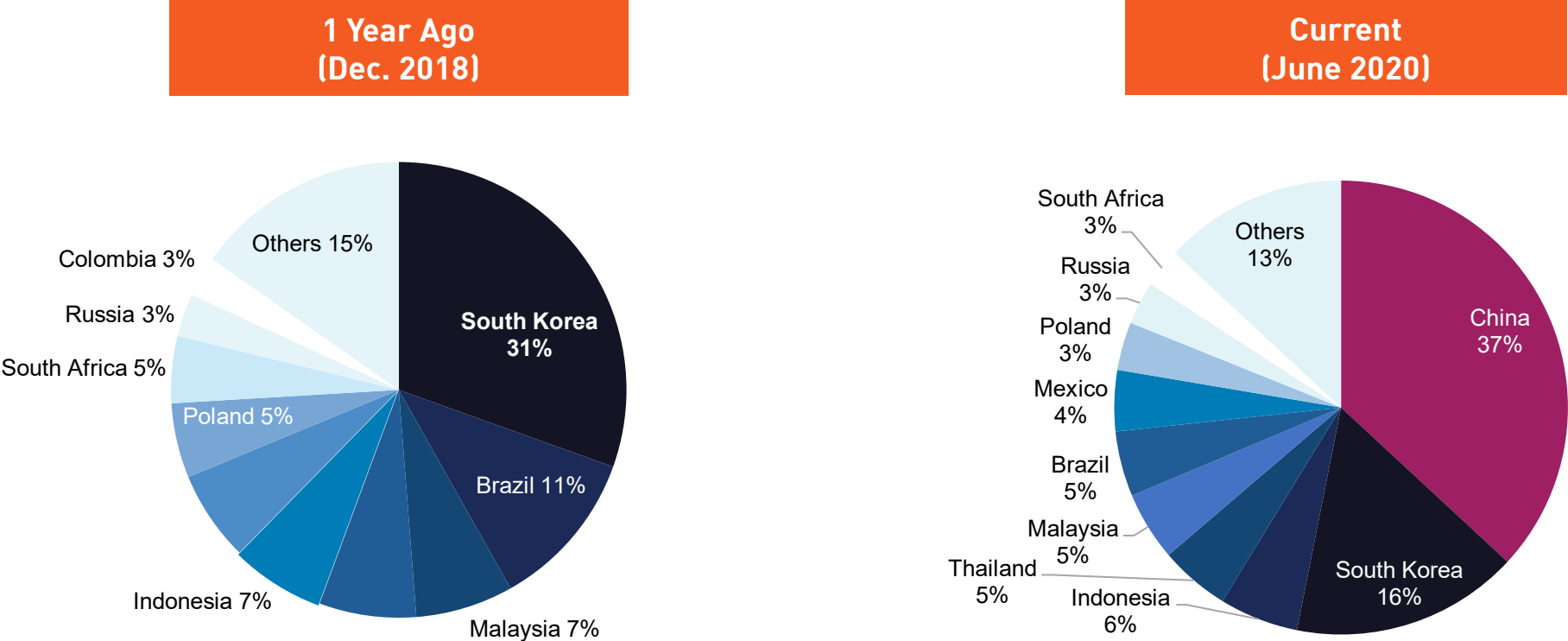
1. Data from Bloomberg as of 28/Jul/2020

2. Shu, Chang. "China's bond market is too-big-to-ignore," Bloomberg Professional Services. 18 April 2019.

The fast pace of China government bond inclusion reflects the underlying investment opportunity it offers. China went from having no representation in the EM Government Bond Index to being the top issuer in only one year.

In 2019, China replaced South Korea as the top issuer in the index by weight.

Issuer Breakdown of Bloomberg Barclays Emerging Market Local Currency Government Bond Index

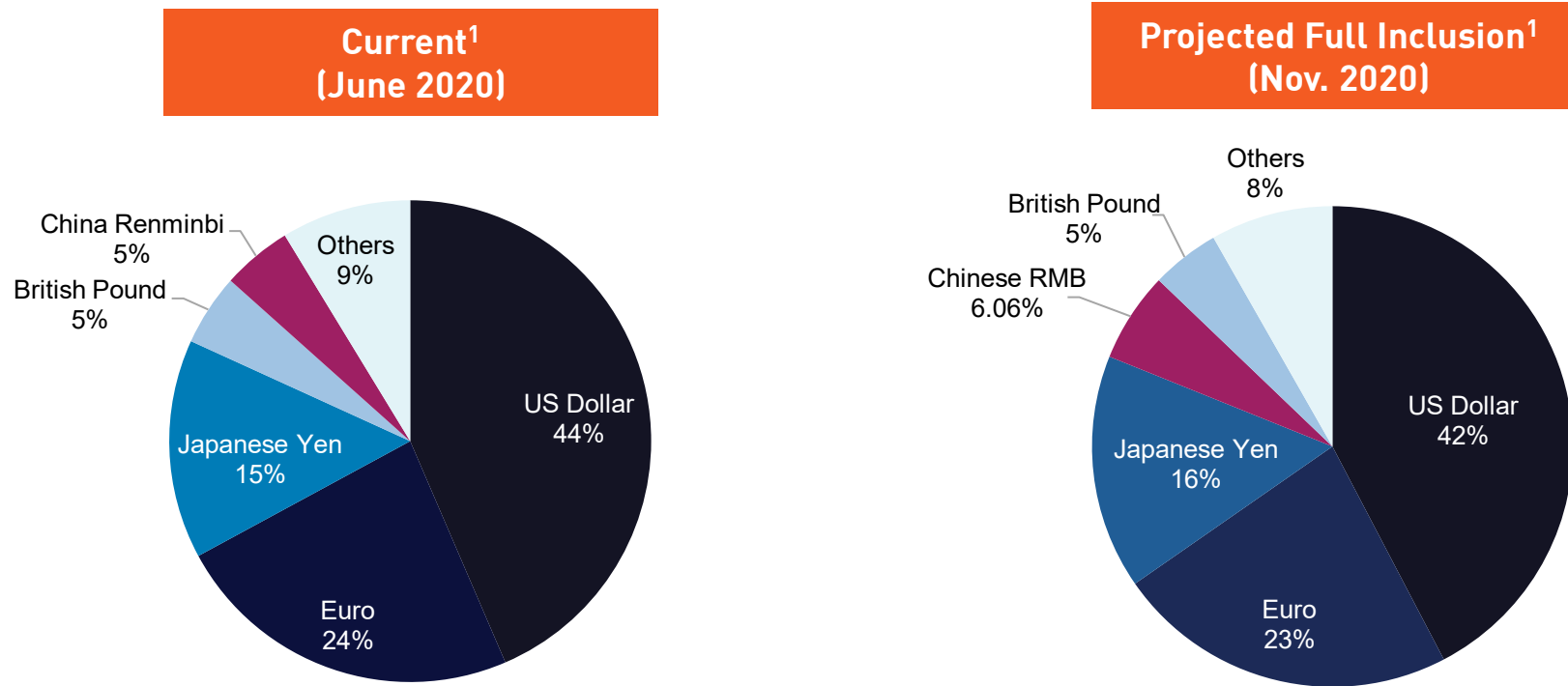


Data from Bloomberg as of 31/Jun/2020

**When Chinese bonds are fully added into the Global Aggregate Index, China's weight will increase to about 6% of the Index, and the Chinese RMB will become the fourth-largest currency component.<sup>1</sup>**

Full inclusion is likely to bring at least \$150 billion of fund inflows<sup>2</sup> into China's \$13 trillion bond market.<sup>3</sup>

### Global Aggregate Index by Currency



1. Data from Bloomberg as of 30/Jun/2020.
2. "Explainer: Why China's inclusion in global bond benchmarks matters", Reuters. 29 March 2019.
3. Financial Times, "Bloomberg adds Chinese government bonds to flagship index" 30/Jun/2020.

## A Brief History of China's Bond Market

The history of China's bond market goes back to the 19<sup>th</sup> century. However, it was not until 1951 that the Chinese developed a market for debt that resembled modern bond markets.

**1988** – A secondary market is established for the first time. Bonds begin to change hands between businesses and individuals at the Shanghai stock exchange, between banks in the inter-bank market, and between various entities in the OTC market.<sup>1</sup>

**2010** – The CIBM Direct program is established, which allows foreign investors to enter the interbank market by submitting planned investment amounts and horizons.

**2020** – Leading the world in environmentally conscious business practices, Chinese corporations issue \$22 billion in green bonds at the implore of the central government.<sup>4</sup>

**1951** – The Ministry of Finance, which is equivalent to the treasury of China, issues bonds for the first time without creating a secondary market.<sup>1</sup>

**1981** – The Ministry of Finance decides to restart government bond issuance to shore up funding gaps especially for infrastructure projects as China becomes an export powerhouse.<sup>1</sup>

**2002** – The QFII & RQFII programs are established, allowing registered foreign investors to invest in the exchange market. The program is extended to the interbank market in 2011.

**2019** – The first offshore government bonds are issued in Macau.<sup>3</sup>

**1958** – The issuance of government bonds is terminated.<sup>1</sup>

**2001** – A system for market-makers is established. This leads to a dramatic increase in liquidity.<sup>1</sup>

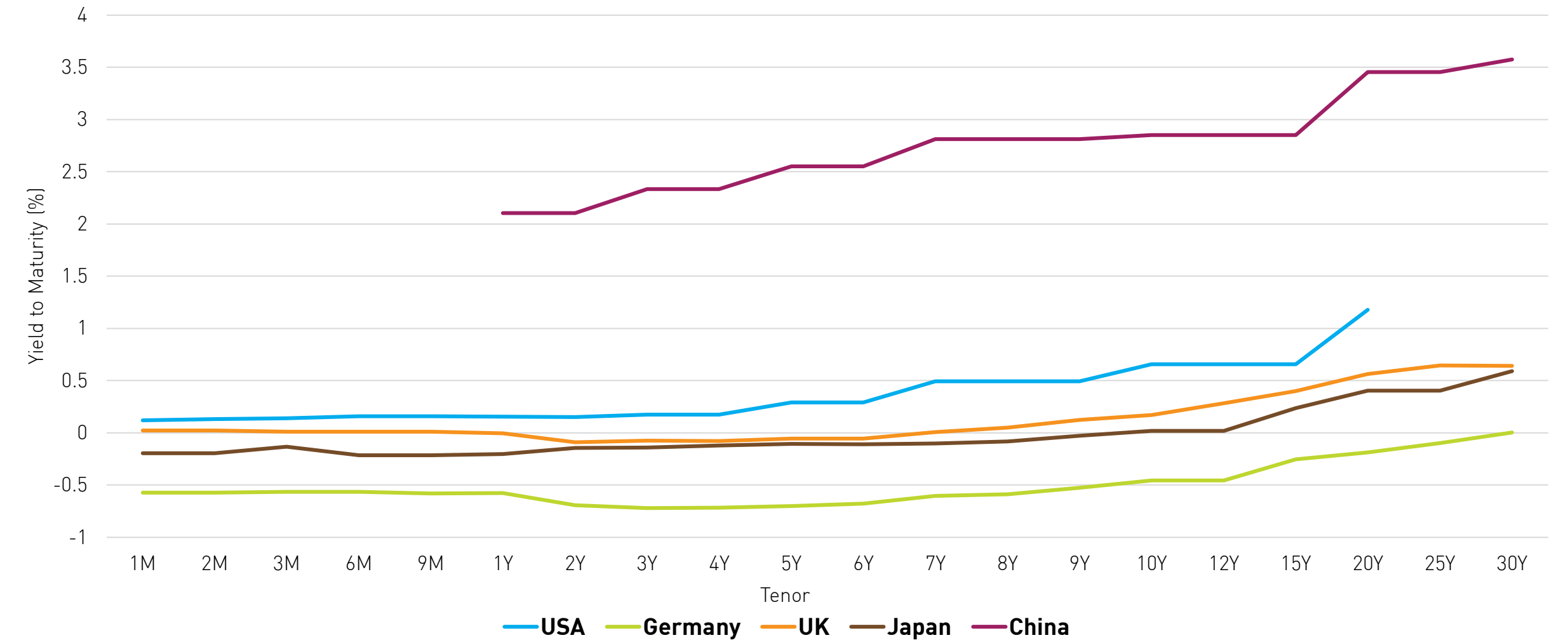
**2017** – Foreign investors with Hong Kong accounts are granted access to China's now massive bond market with few restrictions through the Bond Connect program.<sup>1</sup>



1. Bai, Jennie. "The Microstructure of China's Government Bond Market," Federal Reserve Bank of New York Staff Reports. May, 2013
2. "Bond Connect recognized globally amid 2<sup>nd</sup> anniversary," China Daily. 5 July 2019.
3. Lockett, Hudson. "China to issue first offshore government bond in Macau," Financial Times. 25 June 2019.
4. McGrath, Charles. "China leads in green bonds, others catching up," Pensions & Investments. 17 January 2020.

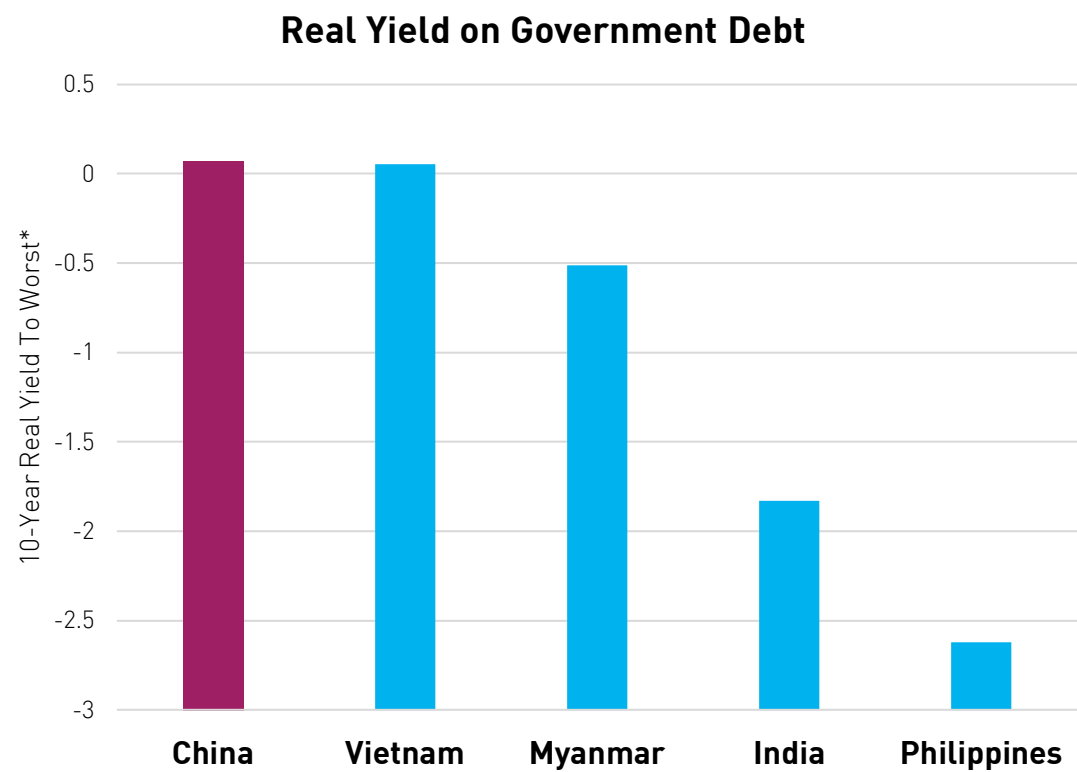
Yields on China's government bonds are higher than most developed world government debt.

### Sovereign Curves



Data from Bloomberg as of 30/Jun/2020. Curves are for illustrative purposes only. Securities may not be available at every maturity.

In real terms, yields on China’s government bonds are also attractive compared to other emerging Asian countries and China has a higher sovereign credit rating.



Country	Moody’s Sovereign Rating
China	A1
Philippines	Baa2
India	Baa3
Vietnam	Ba3
Myanmar	Unavailable

Yield data from Bloomberg as of 31/Jun/2020. Inflation Data from World Bank as of 31/Dec/2019.  
Real Yield = (Yield) – (Y2019 CPI Inflation)  
\*Yield quoted is on 10-year note where available. In cases where the issuer does not issue a 10-year note, the yield on the issued security with a maturity closest to 10 years is used.

## China's government bonds exhibit low correlations to other major government bond markets.

Over the past five years, China's government bonds have exhibited a correlation of under 15% to government bonds issued by the US, Japan, and Germany.

**Correlation Matrix**

	China Gov.	Japan Gov.	Treasuries (US)	German Bund
China Gov.	<b>1.00</b>			
Japan Gov.	0.08	<b>1.00</b>		
Treasuries (US)	0.08	0.54	<b>1.00</b>	
German Bund	0.13	0.46	0.48	<b>1.00</b>

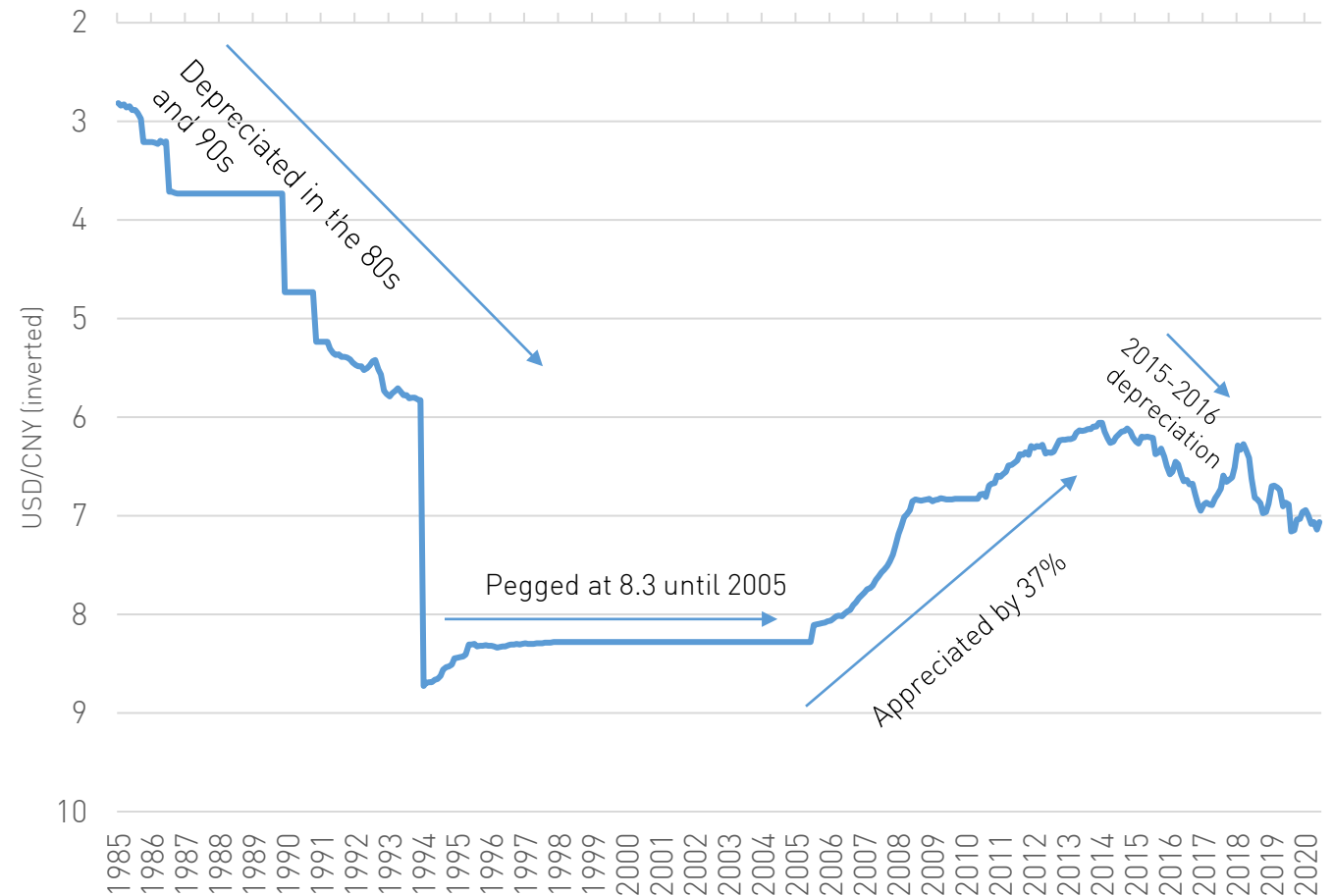
Weekly Correlation Data from 12/31/2015- 6/30/2020. Sourced from Bloomberg. China Gov. = Bloomberg Barclays China Treasury and Policy Bank 9% Capped Index, Japan Gov. = FTSE Japanese Government Bond Index, Treasuries (US) = Bloomberg Barclays US Treasury Total Return Unhedged USD, German Bund = BNP Paribas Germany Sovereign Inflation-Linked Bond Total Return Index. See page 21 for index definitions.

## Historical Evolution of CNY Dynamics & Reasons for a Stable Outlook

- The RMB steadily depreciated against the dollar for much of the 1980s and 1990s, as China gained its competitive export edge.
- In 1997, a peg to the dollar was initiated at 8.3 CNY for every dollar and lasted until 2005, resulting in appreciation that aligned with China's plan to shift the economy away from an exporting economy to a consumer led economy.
- 2015-2016 saw concerns about capital flight, an economic hard landing, banking crisis and FX reserve depletion, leading to a 7% decline. Incidentally, only a brief period of FX reserve depletion was experienced.
- The International Monetary Fund (IMF) launched a new Special Drawing Rights (SDR) basket including CNY on September 30, 2016.
- In July 2017, the Bond Connect mutual market access program was established, allowing global investors to invest directly into China's fixed income market.
- China's currency is likely to see stability going forward due to relatively stable interest rates, high foreign reserve levels, the government's desire to de-dollarize trade, and China's recent transformation into a creditor nation.

Data from Bloomberg as of 30/Jun/2019.

### USD/CNY Spot Rate

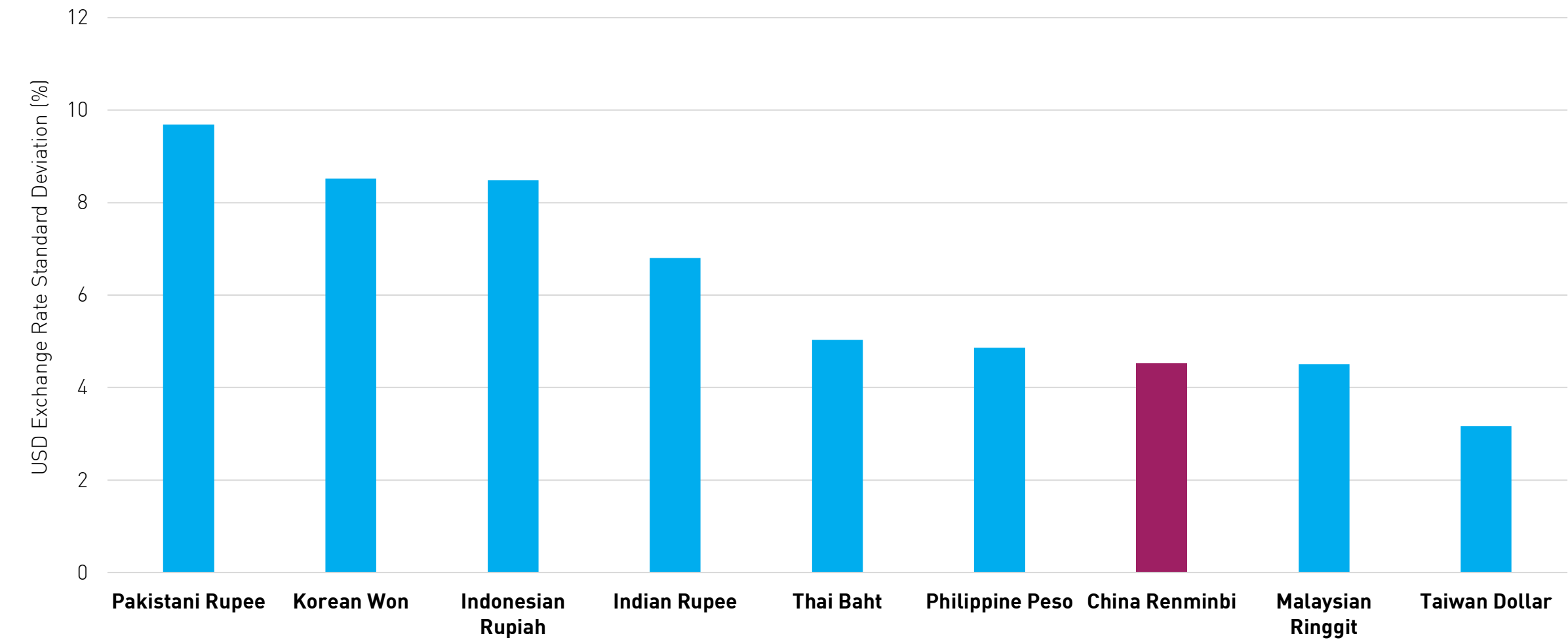


\*Spot rate refers to the immediate settlement price for a currency at a given time. Spot rates for currencies reflect the current market value of a unit of a given currency (usually in USD).

\*\*Pegged indicates that a given currency is tied to the value of another such that any fluctuations in the value of that currency parallel fluctuations in the currency to which it was pegged.

The Chinese Onshore Renminbi (CNY) had the third lowest volatility among Asian emerging market currencies in 2019.

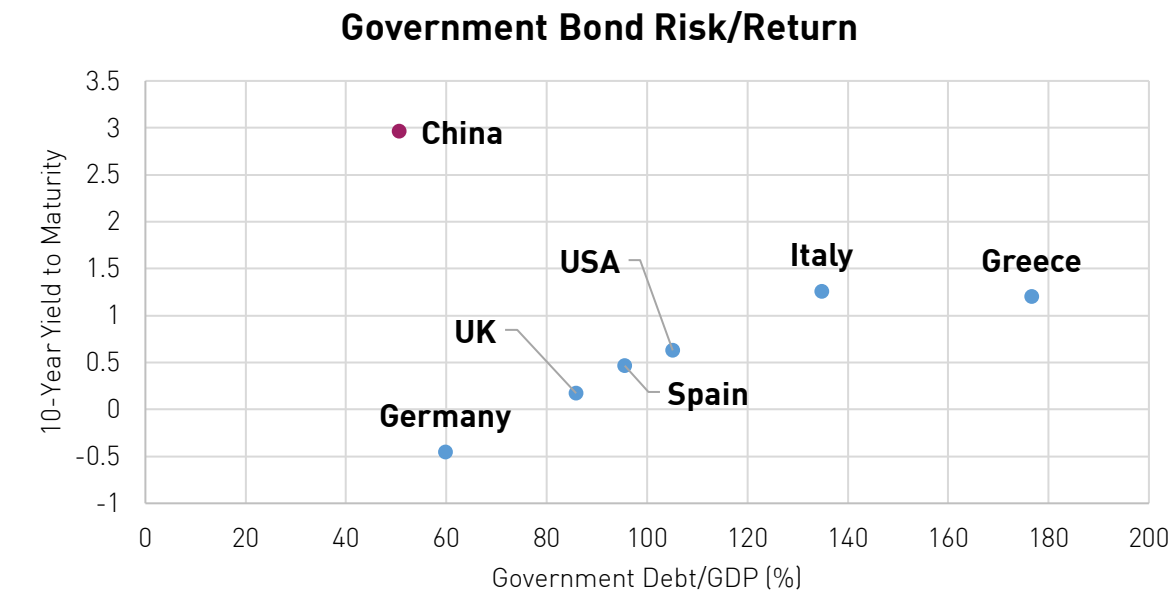
Asian Emerging Market Currencies by 2019 Volatility



Data from Bloomberg as of 31/12/2019. Past performance is no guarantee of future performance.

# Investors are well compensated for investing in China's government bonds compared to those issued by many highly indebted European governments.

- Moody's currently rates China as an A1 sovereign issuer<sup>1</sup> thanks to its steadily maintained foreign reserves, which totaled over \$3 trillion at the end of 2019.
- China has a lower sovereign debt to GDP ratio than many European countries despite offering a higher yield on its sovereign debt.
- China is the largest single holder of US treasuries and is now a net creditor to the world.



YData from Bloomberg. Yields as of 30/Jun/2020. Debt/GDP as of 12/31/2019. China Government Debt/GDP from Trading Economics as of 31/Dec/2019. UK Government Debt/GDP from Eurostat as of 12/31/2018.

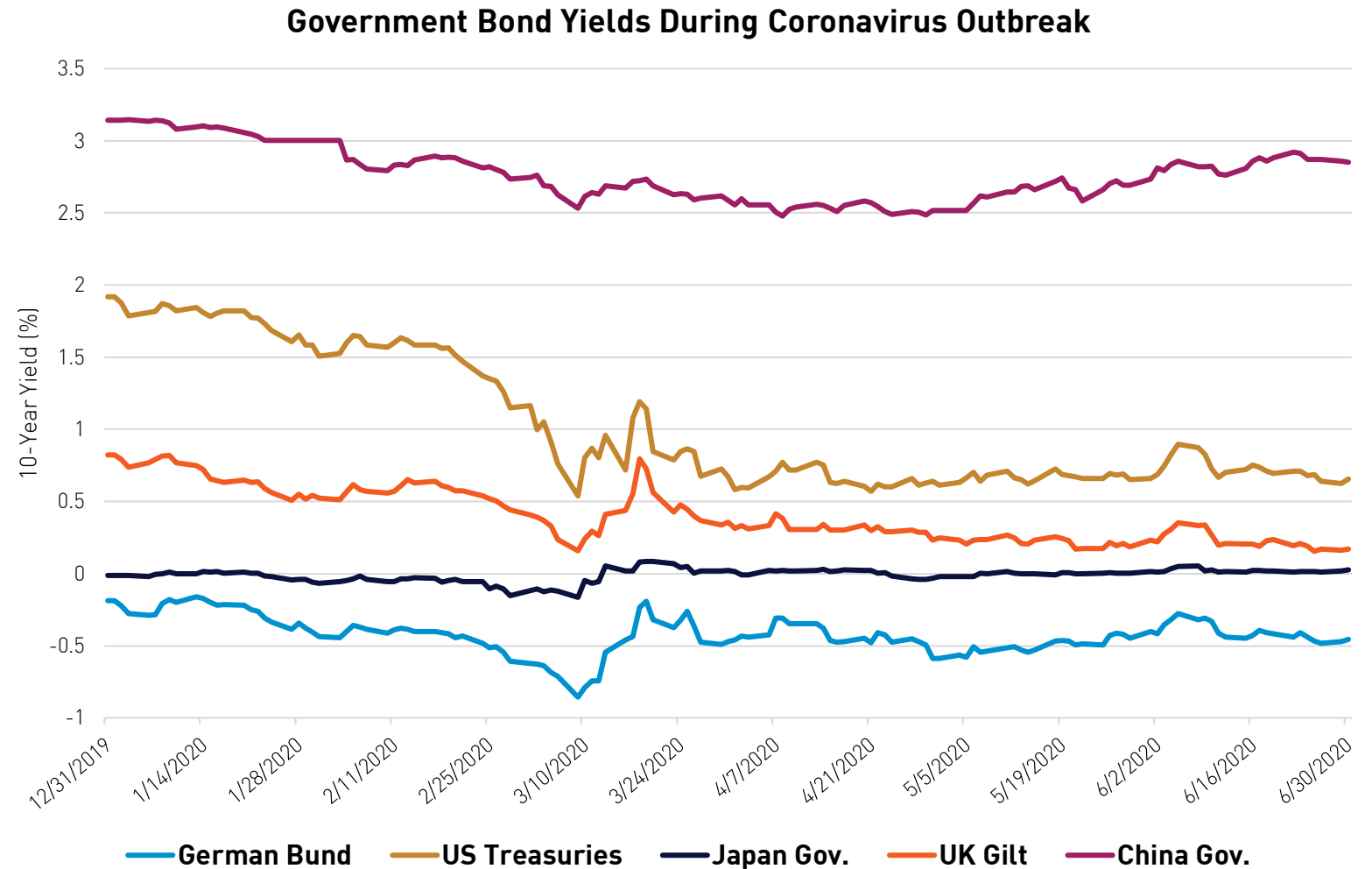
1. Moody's Investor Service  
 2. Horn, Sebastian. "How Much Money Does The World Owe China?" Harvard Business Review. February 26, 2020.



Data from Bloomberg as of 30/Jun/2020

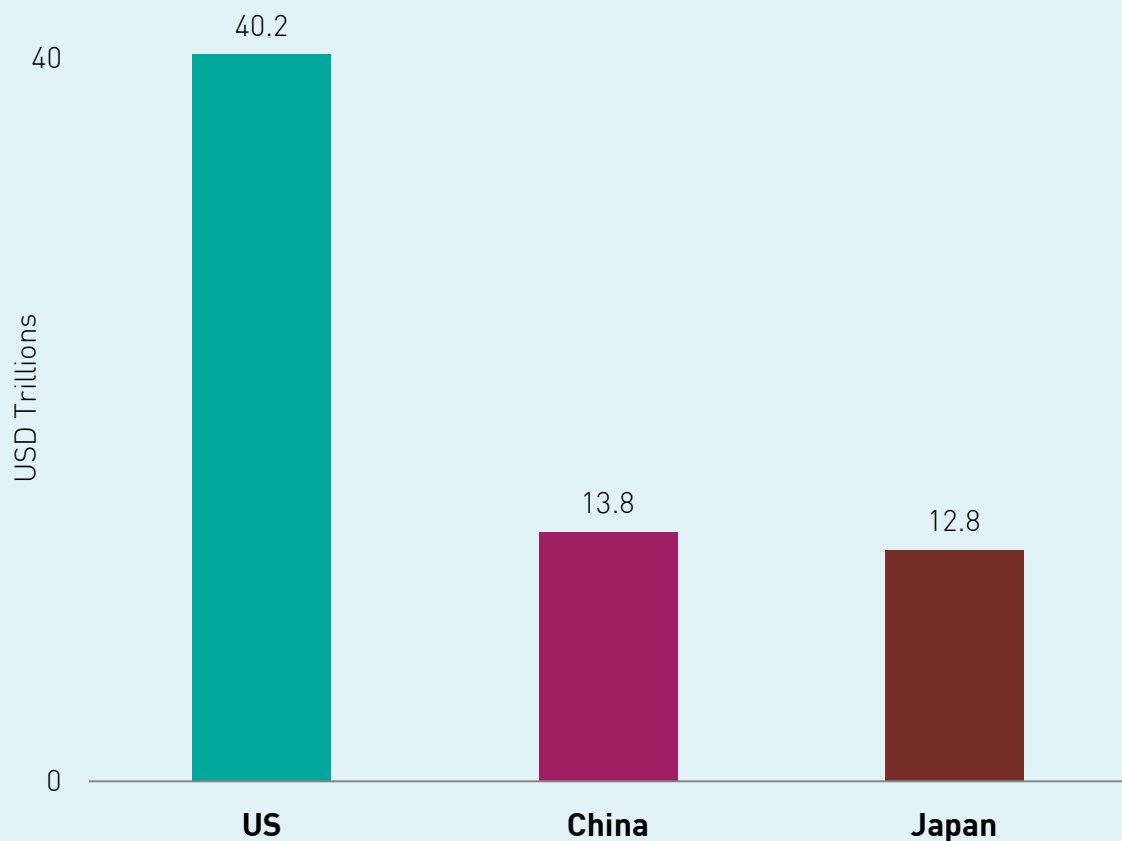
## China's government bonds have proven resilient in times of general market turmoil and bond market stress.

- The global COVID-19 pandemic in 2020 caused a selloff in equities and flight to the safety of government bonds.
- Many central banks were forced to take emergency measures to ensure liquidity in the bond market in the face of a surge in demand.
- As a result, yields on most developed world government bonds plunged to historic lows.
- Despite being the first country to experience a major outbreak of COVID-19, the yield on China's 10-year government bond never fell below 2%.
- The PBOC did not ease as aggressively as other central banks. China's financial system proved more resilient compared to others in the face of a crisis.



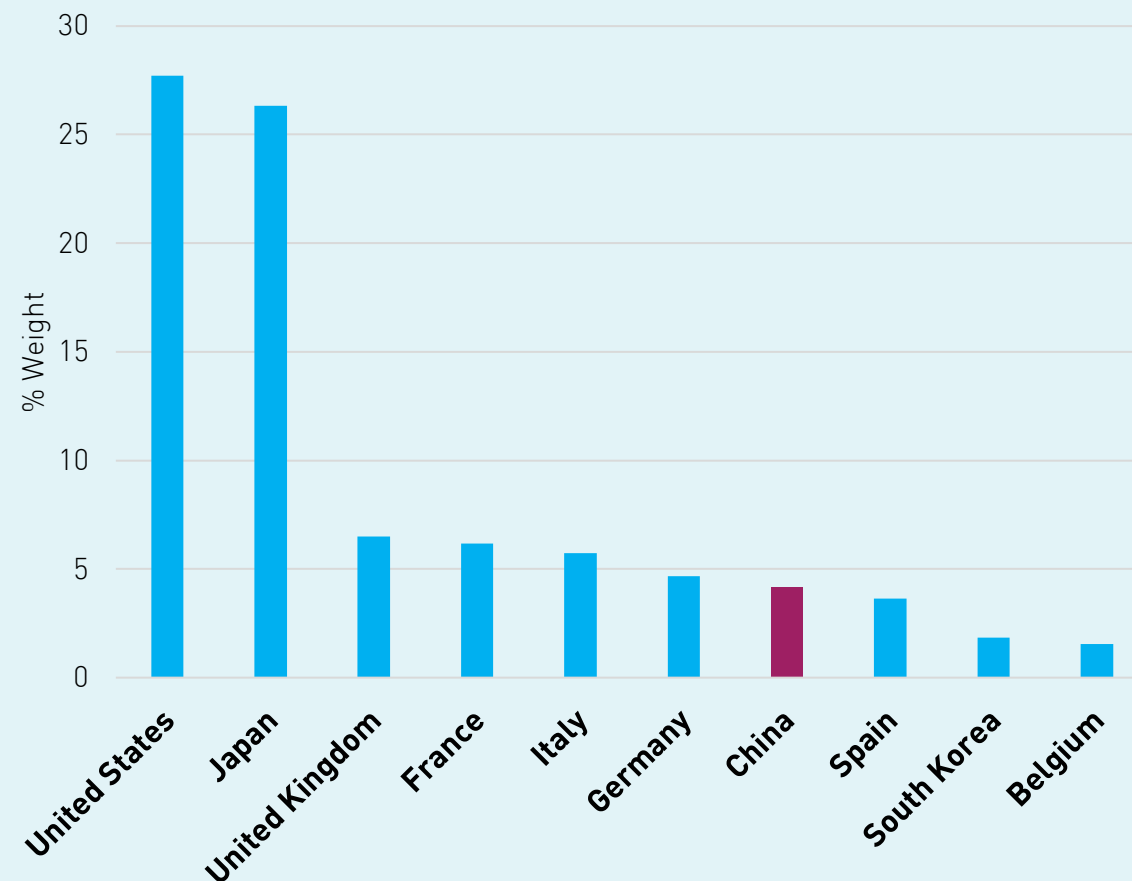
**China's Bond Market is the second largest in the world, yet its weighting in broad indexes is not reflective of the country's economic importance.**

**Top Three Bond Markets**



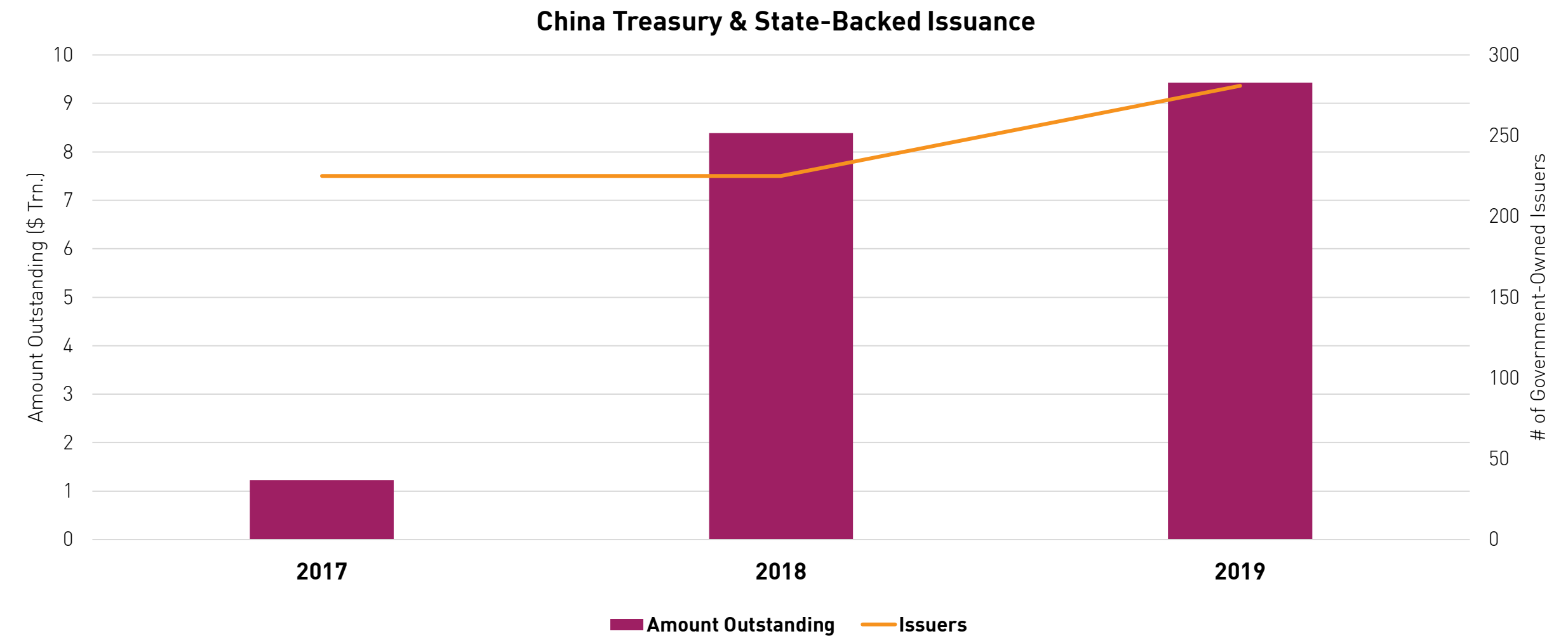
Data from the Bank for International Settlements as of 30/Sep/2019. Retrieved on 30/Jun/2020

**Top 10 Countries in the Bloomberg Barclays Global Agg Treasuries Index**

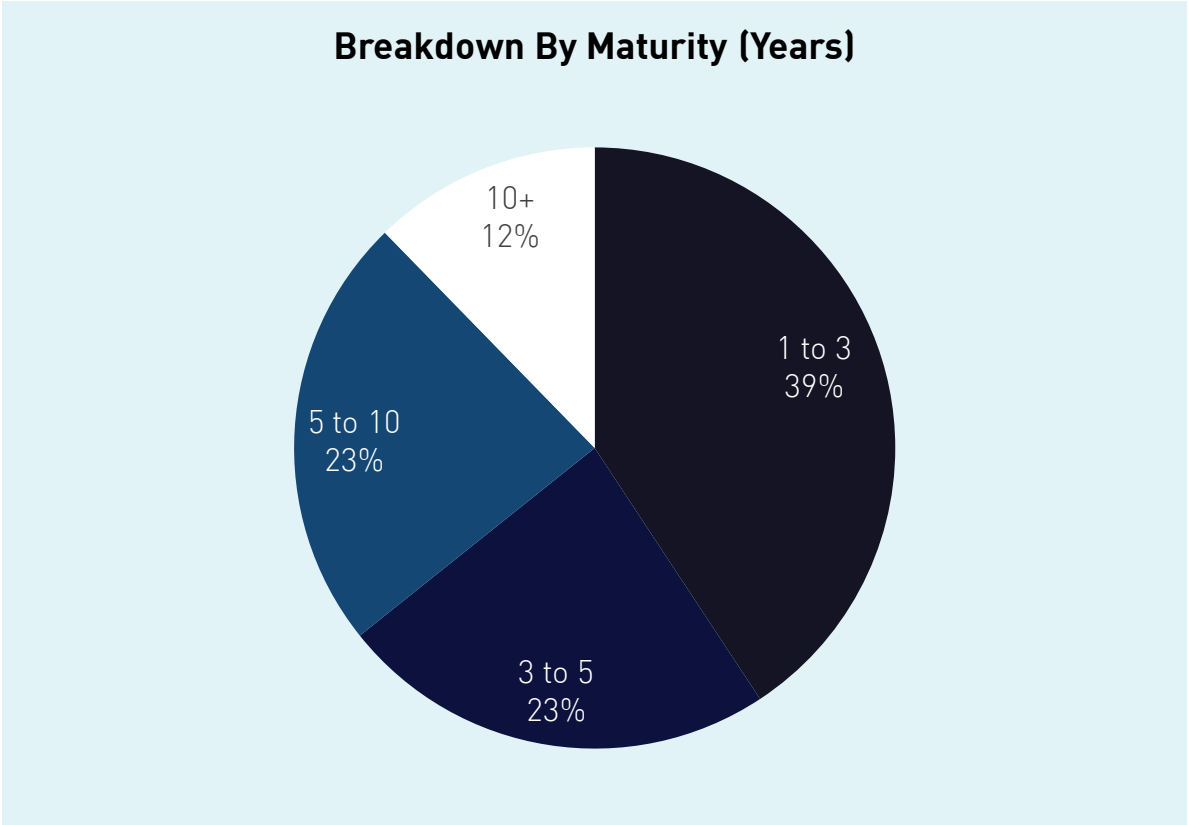
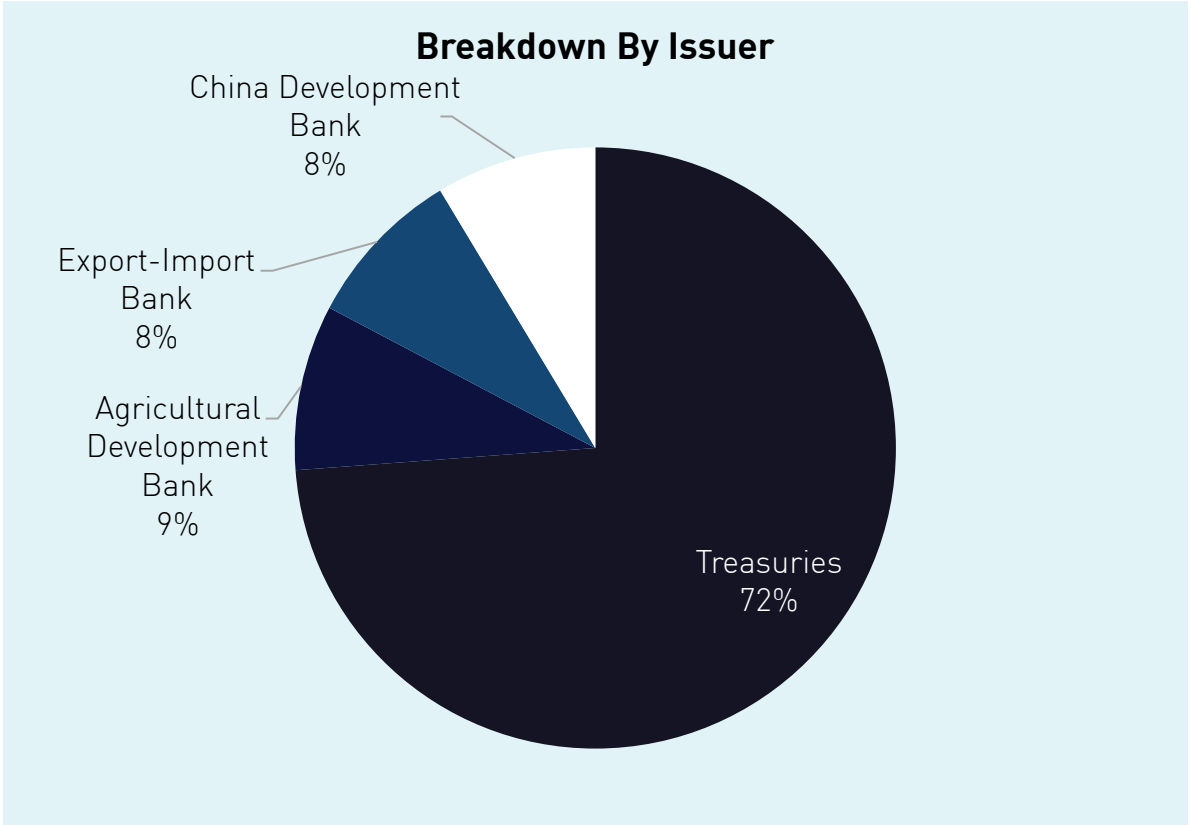


Data from Bloomberg as of 30/Jun/2020.

Issuance in China’s government bond market has increased significantly since 2017.



**KBND tracks securities of various maturities issued by both the Ministry of Finance (Treasury) as well as three key state-owned banks in China.**



## KraneShares Bloomberg Barclays China Bond Inclusion UCITS ETF (LSE: KBND)

KraneShares Bloomberg Barclays UCITS ETF is "A sub fund of KraneShares ICAV (the "ICAV"). The ICAV is authorised as a UCITS in Ireland and regulated by the Central Bank of Ireland.

For Investors in the United Kingdom (UK). Investors should read the Key Investor Information Document and Prospectus prior to investing. The Fund seeks to track the performance of an index composed of companies from developed countries.

### Investment Strategy:

KBND is benchmarked to the Bloomberg Barclays China Treasury and Policy Bank 9% Capped Index, which is designed to track the performance of China's onshore renminbi-denominated government and government-related bond market. The Fund seeks to invest at least 80% of its assets in a basket of fixed income securities issued by either China's Ministry of Finance itself or government guaranteed issuers within China.

### KBND Performance History as of 30/Jun/2020

	Cumulative %			Average Annualized %		
	3 Mo	6 Mo	Since KBND Inception 26/May/2020	1 Yr	3 Yr	5 Yr
Fund NAV	–	–	-1.32%	–	–	–
Index	-0.83%	1.03%	-0.97%	–	–	–

**Index returns are for illustrative purposes only and do not represent actual Fund performance. Index returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.**

\*Securities are investment grade insofar as they are issued by an A1 government or an entity owned by such a government. Not all securities have explicit credit ratings. Many are rated by Chinese credit rating agencies, which may use different criteria and methodology than UK entities or international credit rating agencies.

\*\*See page 21 for definitions

Exchange	London Stock Exchange
Management Fee	35bps
Listing Date	26/May/2020
Index Name	Bloomberg Barclays China Treasury and Policy Bank 9% Capped Index
Index Ticker	I34735US
ISIN Code	IE00BLM1CC35
UK Reporting Fund Status	Reporting Fund
Investment Structure	UCITS
Base Currency	USD
Underlying Securities Currency	CNY
Currency Hedge	USD
Distribution Frequency	Monthly
AUM	\$6.19mm

Fund Holdings as of 30/Jun/2020 Excluding cash. The Fund's Holdings Are Subject to Change.		% of Index
CGB 2.94	10/17/24	22.81
CGB 3.13	11/21/29	16.89
CGB 3.17	04/19/23	14.09
ADBCH 4.37	05/25/23	8.62
EXIMCH 3.37	06/03/22	8.38
SDBC 3.18	05/17/22	8.36
CGB 4.22	03/19/48	6.17
CGB 3.54	08/16/28	5.81
CGB 4	06/24/69	5.74

Credit quality of underlying securities	Investment Grade*
Maturity	8.52 Years
Modified Duration**	5.87 Years
Yield To Maturity**	2.67%
Yield To Worst**	2.68%
Average 3-Year Default Probability*	0.01%

## Term Definitions

**Yield To Maturity:** The total anticipated return on a bond if the bond is held until it matures.

**Yield To Worst:** The lowest possible return on a bond that can be received if the bond operates fully within the terms of its contract without defaulting.

**Modified Duration:** The change in the value of a bond in response to a one percentage point (100bp) change in interest rates.

**Average 3-Year Default Probability:** The average of the default probabilities (over a 3-year period) of the securities within the portfolio. Default probability is the probability that an issuer will default within a certain period (in this case 3 years) and is calculated based on each issuer's financials, economic environment, and credit rating. The metric was calculated by Bloomberg using data as of 12/31/2019.

## Index Definitions

**Bloomberg Barclays China Treasury and Policy Bank 9% Capped Index:** The Bloomberg Barclays China Treasury and Policy Bank 9% Capped Index seeks to track the performance of the Chinese onshore Renminbi-denominated government and government-related bank fixed-income market.

**FTSE Japanese Government Bond Index:** The FTSE Japanese Government Bond Index aims to reflect the performance of fixed-rate tradable bonds issued in Japanese Yen by the Japanese government. Only bonds which pay holders a fixed rate of interest are eligible for inclusion in the index. Certain additional requirements may be considered in order to determine the eligible universe of bonds, such as minimum remaining time to maturity or a minimum size of the bond issue.

**Bloomberg Barclays US Treasury Total Return Unhedged USD Index:** The Bloomberg Barclays US Treasury Total Return Unhedged USD Index measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury. Treasury bills are excluded by the maturity constraint, but are part of a separate Short Treasury Index. STRIPS are excluded from the index because their inclusion would result in double-counting.

**BNP Paribas Germany Sovereign Inflation-Linked Bond Total Return Index:** The BNP Paribas Germany Sovereign Inflation-Linked Bond Total Return Index measures the performance of German government debt securities linked to the rate of inflation.

## Important Notes

**Carefully consider the Funds' investment objectives, risk factors, charges and expenses before investing. This and additional information can be found in the Funds' full and summary prospectus, which may be obtained by visiting [www.kraneshareseu.com](http://www.kraneshareseu.com). Read the prospectus carefully before investing.**

This information is being communicated by KraneShares, which is an appointed representative of DMS Capital Solutions UK Limited, which is authorised and regulated by the Financial Conduct Authority in the United Kingdom under the reference number 503325.

UCITs shares are not redeemable with the issuing fund other than in large Creation Unit aggregations. Instead, investors must buy or sell UCITs Shares in the secondary market with the assistance of a stockbroker. In doing so, the investor may incur brokerage commissions and may pay more than net asset value (NAV) when buying and receive less than net asset value when selling. The NAV of the Fund's shares is calculated each day the national securities exchanges are open for trading as of the close of regular trading on the London Stock Exchange ("LSE"), normally 4:30 P.M. Eastern time (the "NAV Calculation Time"). Shares are bought and sold at market price not NAV. Closing price returns are based on the midpoint of the bid/ask spread at 4:30 P.M. Eastern Time (when NAV is normally determined).

Investing involves risk, including possible loss of principal. There can be no assurance that a Fund will achieve its stated objectives. The Funds are subject to political, social or economic instability within China which may cause decline in value. Fluctuations in currency of foreign countries may have an adverse effect to domestic currency values. Emerging markets involve heightened risk related to the same factors as well as increase volatility and lower trading volume.

The KraneShares Bloomberg Barclays China Bond Inclusion UCITS ETF is subject to interest rate risk, which is the chance that bonds will decline in value as interest rates rise. The components of the securities held by the Fund will be rated by Chinese credit rating agencies, which may use different criteria and methodology than U.S. entities or international credit rating agencies. The Fund may invest in unrated securities, whose prices are generally more sensitive to adverse economic changes and consequently more volatile. The Fund is subject to industry concentration risk and is non-diversified. Narrowly focused investments typically exhibit higher volatility.

Although the information provided in this document has been obtained from sources which Krane Funds Advisors, LLC believes to be reliable, it does not guarantee accuracy of such information and such information may be incomplete or condensed.

In Switzerland, the Fund has appointed as Swiss Representative Oligo Swiss Fund Services SA, Av. Villamont 17, 1005 Lausanne, Switzerland, Tel: +41 21 311 17 77, email: [info@oligofunds.ch](mailto:info@oligofunds.ch). The Fund's paying agent is Helvetische Bank AG. In respect of the Shares distributed in or from Switzerland, the place of performance and jurisdiction is Lausanne (Switzerland).

[R\_DMS]