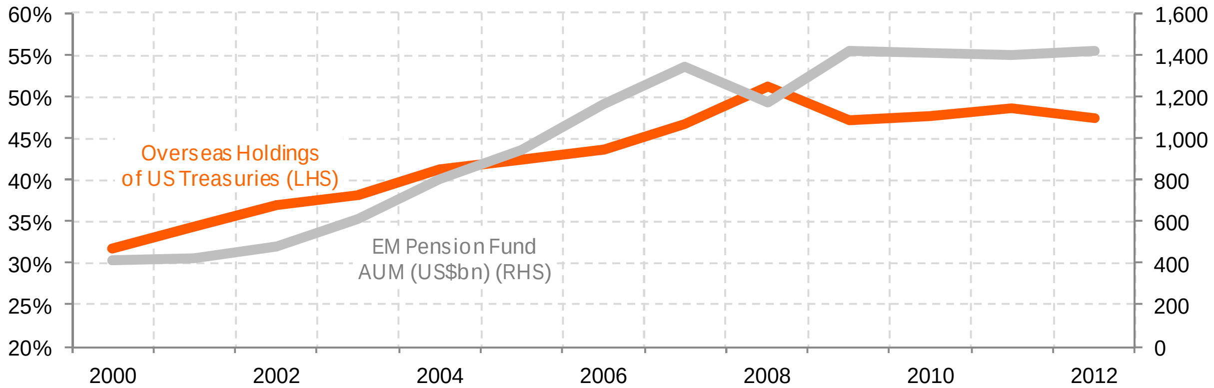
Shifting Sands of Global Government Investors

- From the mid-2000s, trading in G10 government bonds has been increasingly internationalised. Pension funds operating from new economies played a key role in this long-term growth.
- More recently, international flows have been driven by specific client segments. Examples are: US Treasuries by overseas sovereign demand and Japanese government bonds by (recent) demand from international hedge funds.
- The situation in Europe is more interesting. Increased bank holdings in the Euro zone have reduced activity from international accounts. However, in the UK and Germany reductions in domestic bank holdings have led to an increase in international activity and, more generally, increased sales to a range of domestic institutional investors.

Over the last decade or so, the secondary trading of government bonds by investment banks has increasingly become an international operation. While in 2002 banks could focus on domestic accounts, international clients now comprise about 1/3 of trading revenue for G7 governments.

The increased cross-border use of government paper by developed market investors have accounted for some of this growth as have sovereign investors. However, pension funds domiciled in Latin America, Central and Eastern Europe and Asia have played an important role, too: their assets under management (AuM) almost tripled during 2000-07 - to $1.4bn - and remained strong since.

International holdings of US Treasuries and Emerging Market Pension Fund Assets

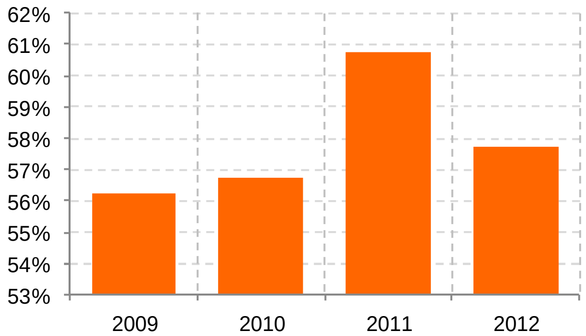


Source: Tricumen, New York Federal Reserve Bank.

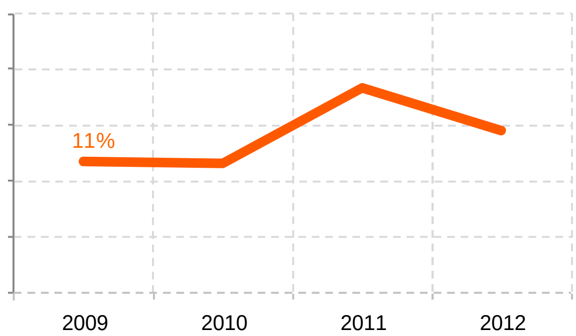
In recent years, the importance of international accounts for US Treasury, European Government and Japanese Government bond trading has waxed and waned. However, our analysis indicates that this has been down to changes in the buying behaviour of specific client industry segments rather than any long term macro change.

US Treasuries are most internationalised: 48% of average 2009-12 sales (61% in 2011) have been to overseas buyers. A big driver was the European sovereign debt crisis, as investors avoided European debt and global equities piled into US debt. This was particularly true for non-US government, state and sovereign wealth accounts, whose share of trading jumped from 11% in 2009/10.

UST trades executed with non-US accounts



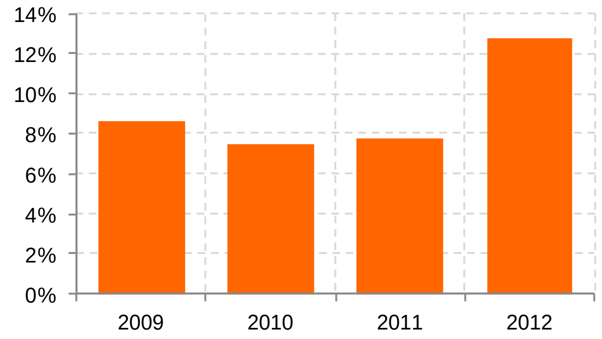
Sovereign accounts % US Treasuries trading



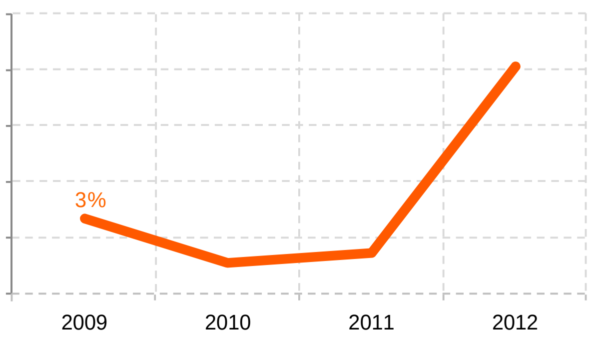
Source: Tricumen, New York Federal Reserve Bank.

Japanese government bond (JGB) trading has traditionally been a largely domestic affair, but the share of trades with international client jumped from about 8% in 2009-11 to almost 13% in 2012. There have been some changes in the domestic market – such as the decline in importance of the retail/HNWI client base and growth in importance of banks – but our research shows that that the main driver of this growth has been driven by the US and UK hedge funds: where they were once looking to short selected European government paper, their attention is now on Japan.

JGB trades executed with non-US accounts



EMEA & US hedge fund % JGB trading

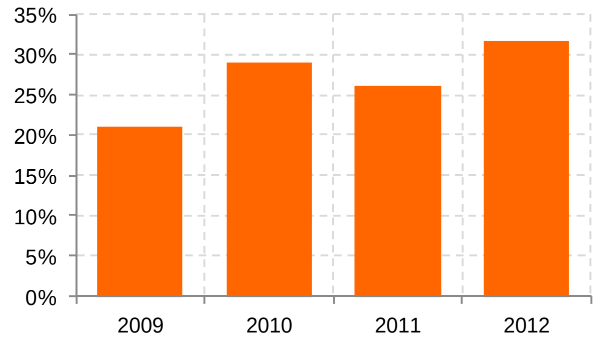


Source: Tricumen, Ministry of Finance Japan.

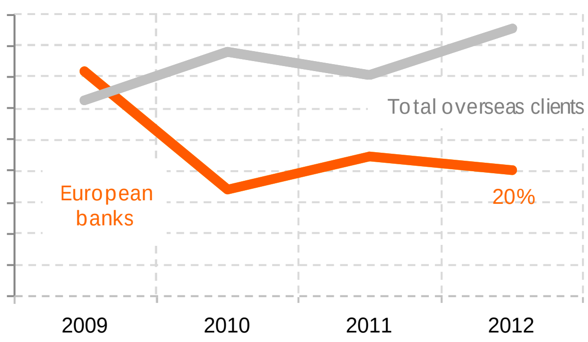
In Europe, the story is more complex. In many countries, foreign investment in government paper has declined and was replaced by ownership of this paper by banks. UK and Germany, however, have been perceived as sage heavens and have seen no decline in the secondary market activity from international accounts: in fact, their share of secondary market trading volumes has increased. This pattern is repeated for most other domestic client segments: domestic insurers and asset managers now each account for around 4% more of the secondary market volumes than in 2009.

In stark contrast to more troubled part of Europe, the only significant client segment that has declined in the UK and Germany countries is banks. Taking the UK Gilts as an example, we see that in 2009, European banks were the second-largest client segment, but by the end of 2012, their share of client trading plunged to just 20%, while the share of all overseas clients' trading jumped. At the end of 2012, non-EMEA clients accounted for 32% of all trades, up from just 21% in 2009.

Gilt trades executed with non-EMEA accounts



European banks and total overseas clients as % Gilt sovereign debt trading



Source: Tricumen, UK Debt Management Office.

In conclusion, the increasing importance of international accounts means that investment banks have to carefully balance the management of both cross-border international sales and individual domestic client segments. The pre-2008 'solution' to this typically involved hiring of ever-larger sales teams. In the ROE-constrained environment of today, this approach is unlikely to produce results. Instead, successful banks require their sales teams to be much more flexible in their product focus, and they use solid and timely market intelligence on client buying patters from integrated sales MIS.

About Tricumen

Tricumen was founded in 2008. It quickly become a strong provider of diversified market intelligence across the capital markets and has since expanded into transaction and corporate banking coverage. Tricumen's data has been used by many of the world's leading investment banks as well as strategy consulting firms, investment managers and 'blue chip' corporations.

Situated near Cambridge in the UK, Tricumen is almost exclusively staffed with senior individuals with an extensive track record of either working for or analysing banks; and boasts what we believe is the largest capital markets-focused research network of its peer group.

Caveats

This report and the information contained herein may not be reproduced or distributed in the whole or in part without the prior written consent of Tricumen Limited. Such consent is often given provided that the information released does not prejudice Tricumen Limited's business or compromise the company's ability to analyse the financial markets.

Tricumen Limited has used all reasonable care in writing, editing and presenting the information found in this report. All reasonable effort has been made to ensure the information supplied is accurate and not misleading. For the purposes of cross- market comparison, all numerical data is normalised in accordance to Tricumen Limited's proprietary product classification. Fully-researched dataset may contain margin of error of +/-10%; for modelled datasets, this margin may be wider.

The information and commentary provided in this report has been compiled for informational purposes only. We recommend that independent advice and enquiries should be sought before acting upon it. Readers should not rely on this information for legal, accounting, investment, or similar purposes. No part of this report constitutes investment advice, any form of recommendation, or a solicitation to buy or sell any instrument or to engage in any trading or investment activity or strategy. Tricumen Limited does not provide investment advice or personal recommendation nor will it be deemed to have done so.

Tricumen Limited makes no representation, guarantee or warranty as to the suitability, accuracy or completeness of the report or the information therein. Tricumen Limited assumes no responsibility for information contained in this report and disclaims all liability arising from negligence or otherwise in respect of such information.

Tricumen Limited is not liable for any damages arising in contract, tort or otherwise from the use of or inability to use this report or any material contained in it, or from any action or decision taken as a result of using the report.