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Capital markets union push comes amid European investment crunch

Jim Brunsden in Brussels

When Jonathan Hill was nominated last year as a European commissioner, he was given responsibility for one of the EU’s core missions: build a capital markets union to make it easier for businesses to access funding.

Capital markets union, or CMU, is a catch-all term that takes in the many measures the commission will take over the next five years to clear obstacles between companies and potential investors.

These range from tackling legal issues that deter funds from investing across borders to cutting the number of documents a company must produce when issuing shares. Lord Hill will unveil details of CMU on Wednesday.
The drive comes as Europe remains gripped by an investment crunch, with businesses, especially small and medium-sized ones, struggling to find the finance they need to grow.

The philosophy behind the CMU is that the EU can make a contribution to solving this by getting its common market to work better. The idea is that this will, in turn, support Europe’s economic recovery.

The initiative is also a response to the post-crisis world where banks’ appetite to lend has shrunk as they respond to tougher regulations and seek to get bad debts off their balance sheets.

It is also another swing at a longstanding goal. The commission embarked on its first push to merge national financial markets in 1999. That was meant to be achieved by 2005 but was still far from a reality when the financial crisis struck and priorities radically changed.

This time around, the commission is seeking to address several problems:

**Businesses’ access to bank financing has diminished**

![Provision of credit by euro area banks](chart)

European companies, especially small and medium-sized ones, are struggling to get the financing they need from their banks. According to the latest data from the commission, only 64 per cent of companies secure the full amount of loans they request.

Success rates also vary wildly across countries, with the highest percentages of outright rejection of loan applications being reported by small and medium-sized enterprises in the Netherlands (23 per cent) and Greece (21 per cent).

Overall bank lending has declined precipitously since the financial crisis, and according to European Central Bank data are only just beginning to slowly recover.
Market financing options for companies are too limited

If there is one statistic that has been repeated more than any other by policymakers pushing CMU, it is that EU businesses get about 80 per cent of their debt-based financing from banks, and 20 per cent from the market. In the US, the reverse applies.

The chart above shows a snapshot of this financing mix in December 2014, with outstanding bank debt to companies of more than €4tn and outstanding corporate bonds of about €1tn.

The commission believes there is scope for the EU debt market to grow — it is less than a third of the size of that of the US. The commission is of the opinion that there is room for growth in equity financing too.

The securitisation market is nearly dead

Asset-backed securities (ABS) were labelled “toxic sludge” for their prime role in the financial crisis.
But over the past 18 months the asset class has become a focus for policymakers as they seek to widen the financing options available to businesses.

The logic is that the securities allow banks to shift loans off their balance sheets, bringing in other investors and giving them the chance to lend more.

The EU plans centre on reviving an ABS market that is “simple, transparent and standardised” and so free of pre-crisis excesses.

But the data suggest that bringing back the market is going to take some serious work.

Figures from the Association for Financial Markets in Europe show that €217bn of asset-backed debt was issued in Europe in 2014, compared with €819bn in 2008.

The comparison with the US does not make pleasant reading once again. More than €1tn of ABS were issued in the US last year.

**High unemployment and low growth**

The EU is trying to find levers to pull to stimulate the economy amid persistently high unemployment and sluggish growth.
The EU and eurozone economies grew 0.4 per cent during the second quarter, compared with the previous three months. In France, the euro area’s second-largest economy, there was no growth at all.

Six years since the financial crisis, and five since the start of the eurozone sovereign debt crisis, the euro area has an unemployment rate of close to 11 per cent, double that of the US.

This average conceals far higher rates in individual countries, notably Greece (25 per cent) and Spain (22 per cent). For younger people the figures are dramatically worse.

Although the CMU is a wide-ranging assortment of measures, the direction of thinking is clear: the EU must consider any measure — large or small — that can help inject some dynamism into its economy.

**Key points of CMU**

- **Securitisation**: resurrecting the market for bundled loans — labelled “toxic sludge” during the financial crisis — so banks can use balance sheets to lend more.

- **Investment**: clearing obstacles to investors, including a patchwork of insolvency and securities regimes that increase uncertainty and risk.

- **Business**: cutting red tape for companies seeking to access market finance, including through streamlined prospectus requirements.

- **Tax**: yet another push on Brussels’ 14-year effort to agree common EU rules on how businesses should calculate their taxable profits.

- **Review**: revisiting the more than 20 pieces of EU financial legislation passed since 2009 to check for “unintended consequences”.

Questions:

1. What are the responsibilities of Jonathan Hill as a European Commissioner?

2. What is the philosophy behind capital markets union (CMU)?

3. Why is CMU considered as a response to post crisis world?

4. Why were the plans about merging national markets?

5. Are small and medium enterprises getting bank financing easily? In which countries this issue is more severe?

6. How is Europe different in terms of debt financing from US?

7. What is the view of the European Commission about Europe’s bond and equity market?

8. What is happening in Europe to Asset-Backed-Securities?

9. How is economic growth and unemployment in Europe?

10. What are the key points of CMU? Which one(s) do you find more important? Why?
How Foreign Should Investors Get?

Some advisers say U.S. investors should have up to half of their stockholdings overseas

By Chana R. Schoenberger

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In their stock portfolios, Americans often have stuck close to home. Now, as they increasingly cross borders to buy shares, how far should they take it?

The answer might startle some U.S. investors, who typically hold perhaps 20%, at most, of their holdings in non-U.S. stocks. A number of advisers are recommending much higher percentages—with some making the case that half or more of an investor’s stockholdings should be overseas.
Asset manager BlackRock Inc., for instance, recommends investors keep between 30% and 50% of their stock portfolios in overseas shares.

“The problem is, most U.S. investors don’t have anywhere close to that much allocated” to international stocks, says Russ Koesterich, BlackRock’s global investment strategist.

Foreign holdings often come with risks, some of them severe. Still, with U.S. stocks at relatively high valuations, the gains available in a heavily American portfolio might be limited, some analysts say.

*Pushed overseas*

“If you look at the U.S., fundamentals are deteriorating in terms of the stock market,” says David Larrabee, a director at the CFA Institute, an association of investment professionals. He says that while there is no one-size-fits-all portfolio, in general investors shouldn’t have more than half of their stock investments in U.S. shares.

A strong dollar is compressing exports, rising labor costs are likely to hurt corporate profits, and interest rates are set to rise, he says. Plus, stock valuations in the U.S. are at their highest levels in at least six years by several measures, he says.

Those valuations have helped push many investors toward international stocks. In 2014, a net $115 billion flowed into foreign-stock funds and ETFs, according to data from Thomson Reuters Corp.’s Lipper unit. This year, through July, investors have poured $134 billion into the category.

Some investors are looking for monetary policy abroad to give overseas stocks a boost the way low interest rates have contributed to the run-up in U.S. stocks in the past several years, says Gary Chropuvka, head of customized beta strategies for Goldman Sachs Asset Management’s quantitative investment strategy team, which manages $60 billion.

Having seen how well U.S. stocks did as the Federal Reserve’s monetary-policy moves spurred economic expansion, “people are more and more convinced that there are a lot of similar opportunities to the U.S.” overseas, particularly in developed Europe and Japan, Mr. Chropuvka says. Efforts by the central banks of the European Union and Japan to boost their economies seem poised to succeed, along with a push in Japan for greater productivity and more effective corporate governance, he says.

Goldman recommends that the average investor keep about half of a stock portfolio in international shares. Within that allocation, it recommends putting about 5% to 15% of the portfolio in international small-cap and emerging-market stocks. “Those are mostly underrepresented in most U.S. investors’ portfolios,” says Mr. Chropuvka.
Weighing the risks

Of course, there are risks overseas. Mr. Chropuvka notes the continued possibility of destabilization in Europe because of the turmoil in Greece, uncertainties about Japan’s economy and the threat of China’s economic slowdown depressing global demand.

David Wessels, an adjunct professor of finance at the Wharton School in Philadelphia, points to two concerns in particular: the risk that political upheaval in one country will provoke a withdrawal of international investors from shares in several countries, even though there may be little connection between the risks in the various markets; and the uncertainty surrounding monetary policy in the EU and Japan.

Still, Prof. Wessels says, the diversification foreign stocks provide is important. Adding them to a portfolio won’t necessarily lessen its volatility the way some other assets would, he says, because so many U.S. companies do significant business overseas that movements in the U.S. stock market tend to correspond closely to those in most major international markets. But, he says, “there are millions of people outside the United States entering their respective economies each and every year, and American companies have only so much exposure to these new consumers.” Buying foreign stocks allows investors to take fuller advantage of that trend, he says.

“Even just allocating to each of the G-20 economies would provide meaningful exposure to markets outside the United States,” he says.

Questions:

1. How much foreign stock does a typical investor hold?
2. What is Blakcrock’s view about foreign stock holdings?
3. What does David Larrabee of CFA Institute think that investors should not have more than 50% of their stocks in US shares?
4. How much money was invested in foreign stocks according to Reuters?
5. What is the view of Gary Chropuka of Goldman Sachs on US and foreign stocks?
6. According to Gary Chopuka, how does monetary policy affect stock market?
7. What is Goldman’s view about percentage of portfolios in foreign stocks?
8. What are the risks of investing overseas?
9. What are the risks David Wessel point out?
10. Why diversification with foreign stocks will not reduce volatility of portfolio according to Wessel?