

# Finding Quality Income

An Overview of Opportunities Within  
China's Interbank Bond Market



## Introduction to KraneShares

### About KraneShares

Krane Funds Advisors, LLC is the investment manager for KraneShares ETFs. Our suite of China focused ETFs provides investors with solutions to capture China's importance as an essential element of a well-designed investment portfolio. We strive to provide innovative, first to market strategies that have been developed based on our strong partnerships and our deep knowledge of investing. We help investors stay up to date on global market trends and aim to provide meaningful diversification. Krane Funds Advisors, LLC is majority owned by China International Capital Corporation (CICC).



 KCNY

## KraneShares E Fund China Commercial Paper ETF

### Investment Strategy:

The KraneShares E Fund China Commercial Paper ETF (NYSE: KCNY) seeks to track the CSI Diversified High Grade Commercial Paper Index. The Fund seeks to invest at least 80% of its total assets in a diversified basket of investment-grade<sup>1</sup> commercial paper denominated in on-shore renminbi issued by sovereign, quasi-sovereign and corporate issuers in the People's Republic of China and traded in the inter-bank bond market. Commercial paper in the Fund is investment-grade and has a remaining term to final maturity of no more than one year and no less than one month.

### KCNY features:

- Invests in money market securities (i.e. commercial paper) and attempts to preserve principal investment while providing attractive monthly distributions
- The average maturity of the securities held by the fund is less than six months
- Invests into commercial paper that has received an investment grade credit rating<sup>1</sup>

### China commercial paper may be appropriate for investors who...

- Require an allocation to investment products that only invest in short-term securities
- Have an investment goal with a short time horizon
- Seek a daily liquidity requirement

<sup>1</sup> Investment grade commercial paper is commercial paper that is issued by an issuer whose long-term bonds are rated AAA or equivalent by one or more Chinese credit rating agencies; or commercial paper that is issued by an issuer whose long-term bonds are rated AA+ or equivalent by one or more Chinese credit rating agencies and commercial paper is rated A-1 or equivalent by one or more Chinese credit rating agencies.

## E Fund Asset Management is the co-advisor to the KraneShares E Fund China Commercial Paper ETF (ticker: KCNY)

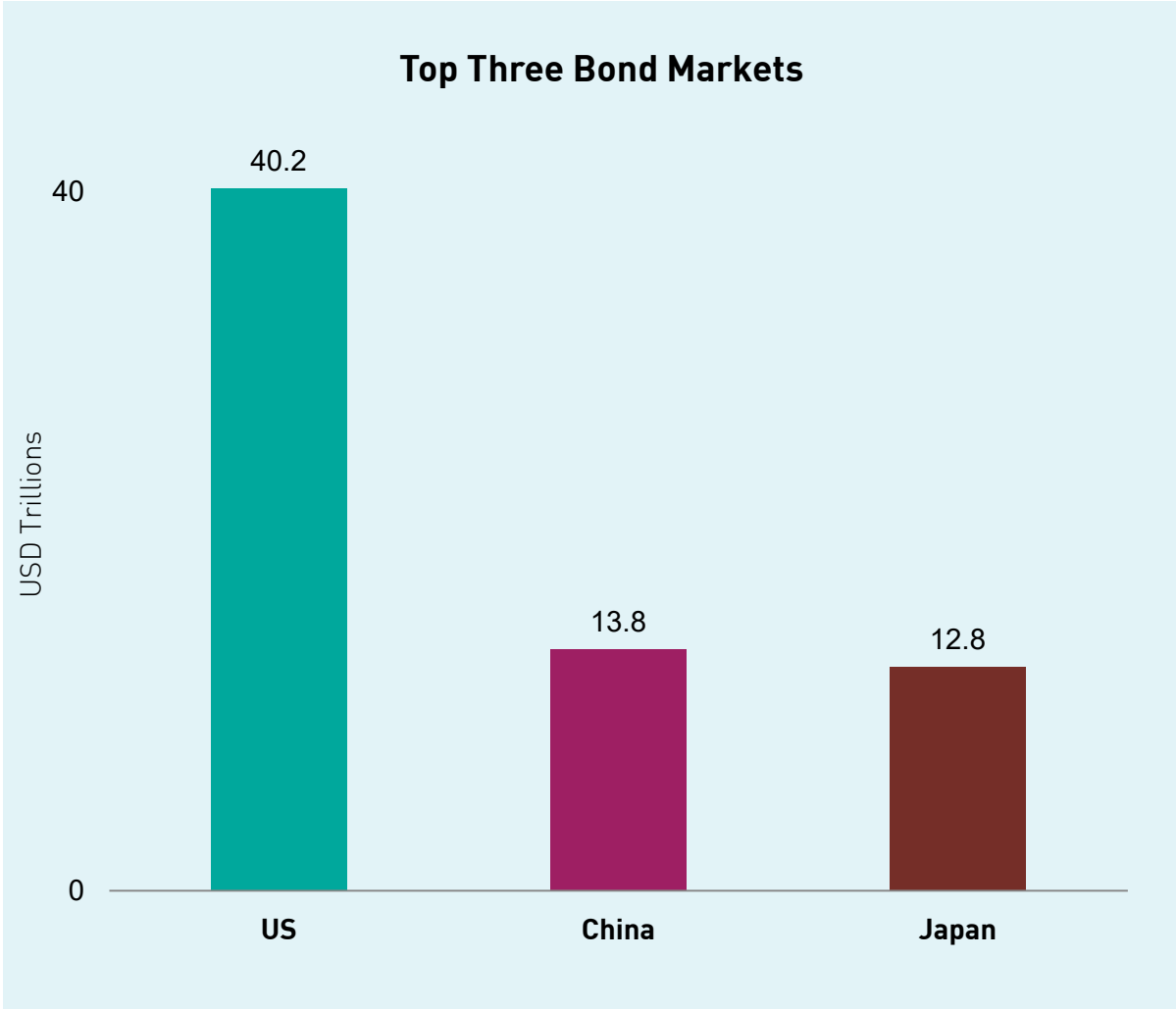


**\$200b AUM**

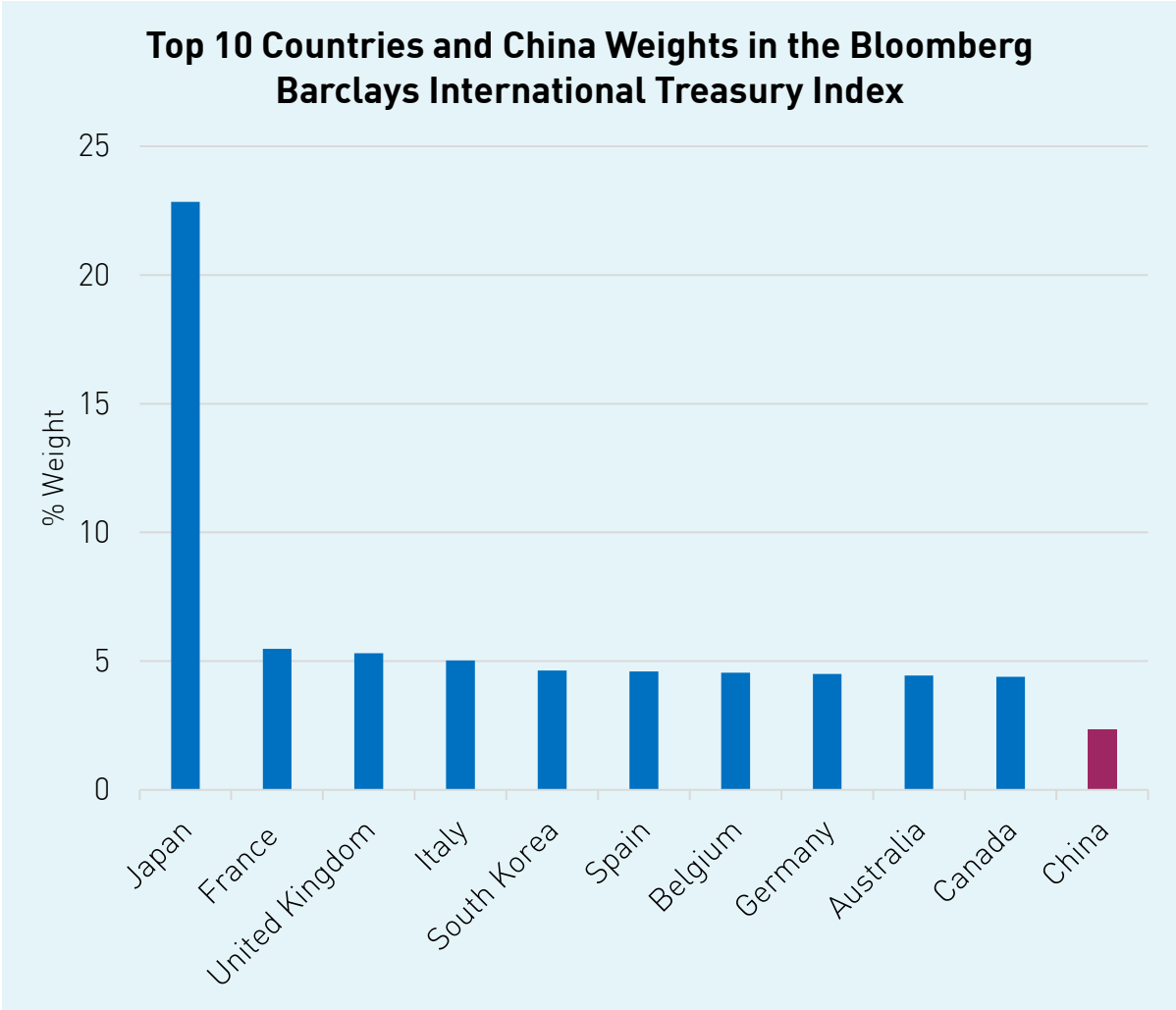
### E Fund Quick Facts

- **Located:** Headquartered in Guangzhou with offices in Beijing, Shanghai and Hong Kong
- **Established in 2001**, was among the 1st Chinese asset management companies approved to do business in Mainland China
- **\$200b** in assets under management; one of the top three asset managers by assets in Mainland China
- Serves more than **67 million investors**

**China's Interbank Bond Market is the second largest in the world, yet it has little foreign ownership.**



Data from the Bank for International Settlements as of 6/30/2019. Retrieved on 12/31/2019



Data from Bloomberg as of 12/31/2019.

**On April 1, 2019, Bloomberg Barclays began including RMB-denominated bonds issued by the Chinese government and policy banks into their Global Aggregate Index, which is tracked by \$2.5 trillion in assets,<sup>1</sup> as well as their Global Treasury and Emerging Markets Local Currency Government Bond Indexes.**

- 364 onshore Chinese bonds are being added to the Bloomberg Barclays Global Aggregate Index
- New regulations have provided global investors with the fundamental rules of engagement and foundation for enhanced market access and participation through CIBM Direct and Bond Connect.
- Currently, foreign investors only represent about 3% of the Chinese interbank bond market<sup>2</sup>

**Chinese Treasury and Policy Bank Debt Being Included in the Bloomberg Barclays Global Aggregate Index<sup>3</sup>**

Issuer	Count	Market Value (MV) (US\$ bn)	Amt Out (US\$ bn)	Duration	Yield to Worst
China Government Bond	159	10,400.5	9,992.7	1,551.0	3.00
China Development Bank	102	6,558.2	6,272.4	978.0	3.37
Agricultural Development Bank	58	3,321.5	3,192.5	495.3	3.33
Export-Import Bank of China	45	2,002.0	1,926.4	298.6	3.31
<b>Total</b>	<b>364</b>	<b>22,282.1</b>	<b>21,384.0</b>	<b>3,323.0</b>	<b>3.19</b>

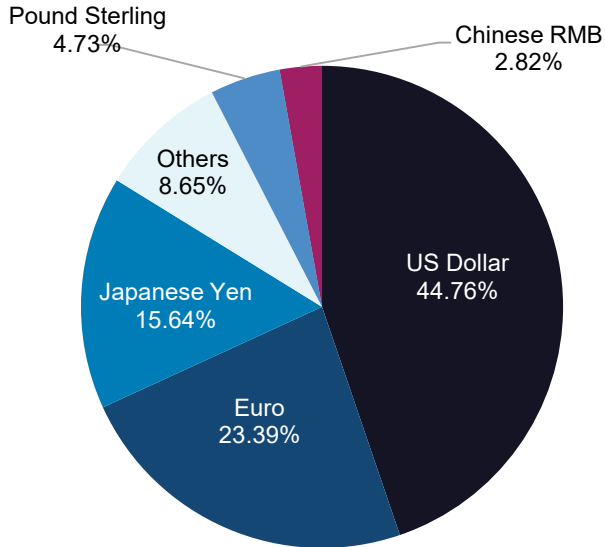
1. "Explainer: Why China's inclusion in global bond benchmarks matters", Reuters. March 29, 2019.
2. Shu, Chang. "China's bond market is too-big-to-ignore," Bloomberg Professional Services. April 18, 2019.
3. "Index Announcement: Details on the Upcoming China Inclusion to Bloomberg Barclays Indices," Bloomberg Professional Services. February 18, 2019.

**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>.

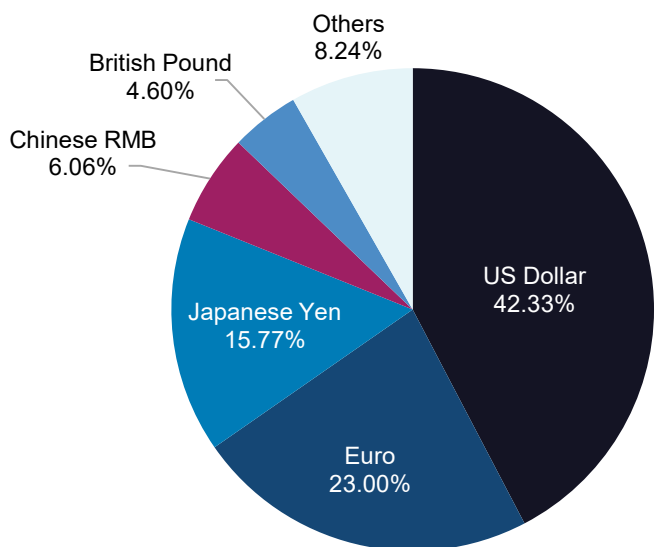
**Current  
(Dec. 2019)**

**Currency Breakdown of the Global Aggregate Index<sup>1</sup>**



**Projected Full Inclusion  
(Nov. 2020)**

**Currency Breakdown of the Global Aggregate Index<sup>1</sup>**



1. Data from Bloomberg as of 12/31/2019.
2. "Explainer: Why China's inclusion in global bond benchmarks matters", Reuters. March 29, 2019.
3. Financial Times, "Bloomberg adds Chinese government bonds to flagship index", 3/31/2019.
4. Data from the Bank for International Settlements as of 12/31/2018. Retrieved 12/31/2019.

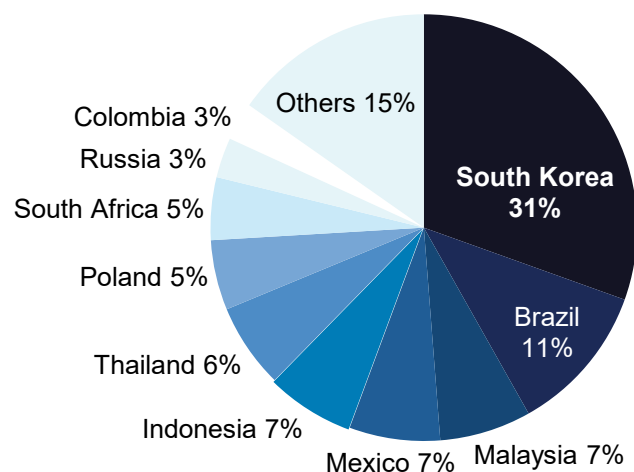
# Illustrating the fast pace of bond inclusion, in just one year China went from having no representation in the Bloomberg Barclays Emerging Market Local Currency Government Bond Index to being the index's top constituent.

In 2018, China replaced South Korea as the top constituent in the index by weight.

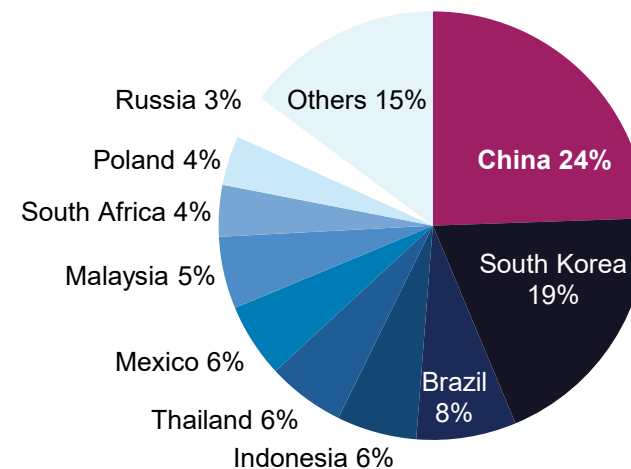
**1 Year Ago  
(Dec. 2018)**

**Current  
(Dec. 2019)**

**Issuer Breakdown of Emerging Markets Government Bond Index**



**Issuer Breakdown of Emerging Markets Government Bond Index**



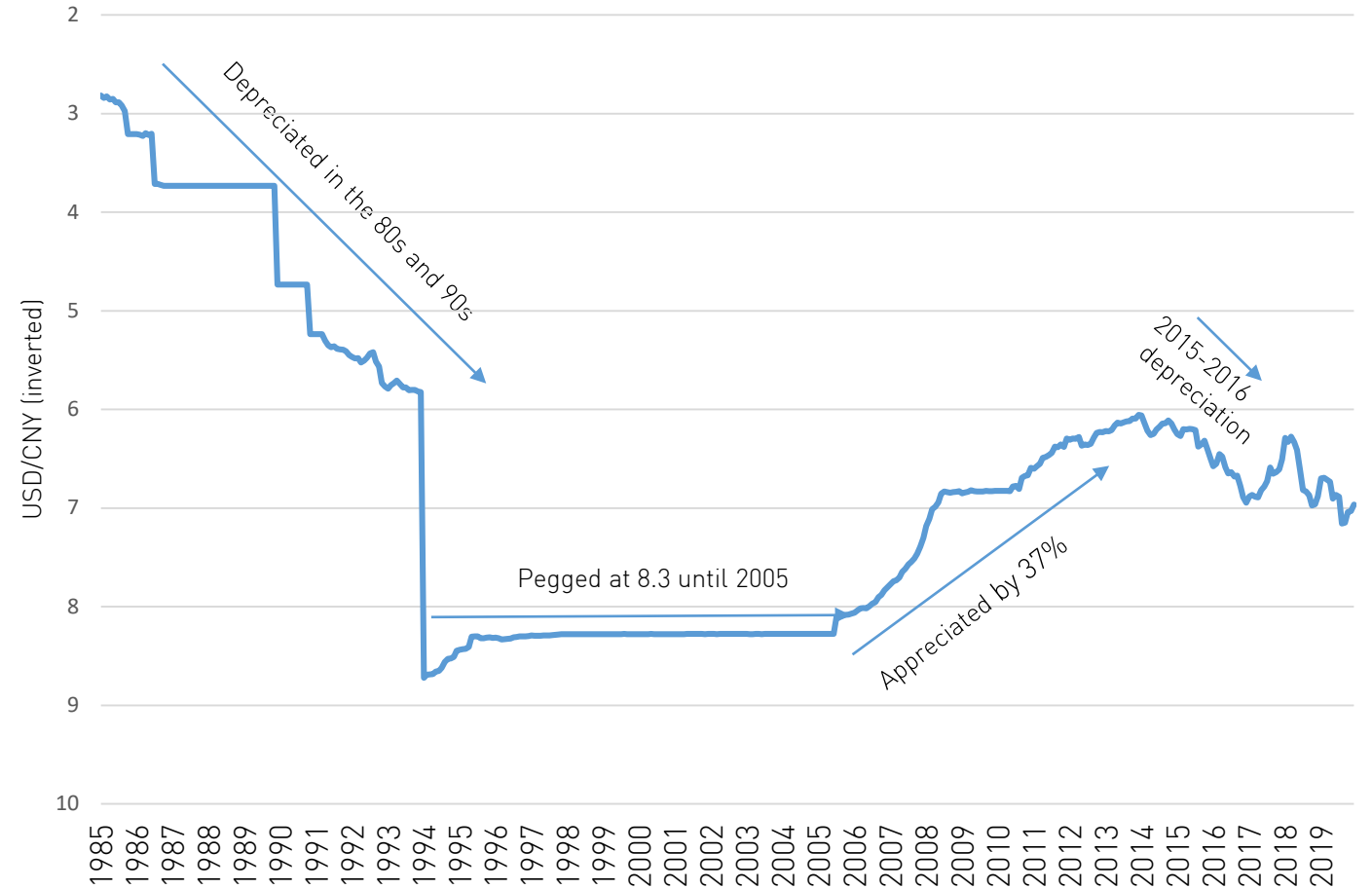


## Historical evolution of CNY dynamics & reasons for a stable outlook

- 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 this peg stayed in place until July, but none of the other concerns fully materialized. 2005.
- Once the peg was removed in 2005, the CNY appreciated by 37% to reach a high of 6 RMB per dollar, which remains the recent high to this day.
- The appreciation that occurred after de-pegging aligned with China's plan to shift the economy away from an exporting economy to a consumer led economy.
- August of 2015 began an CNY depreciation cycle that lasted 1.5 years, with 2015 ending down 4.5% for the currency.
- 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.
- July 2017, Bond Connect established for global investors to invest into China's fixed income market directly.
- In September 2018, China implemented a new settlement system for Bond Connect to further open Chinese markets to international investors.
- China's currency is likely to remain stable 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 12/31/2019.

### USD/CNY Spot Rate

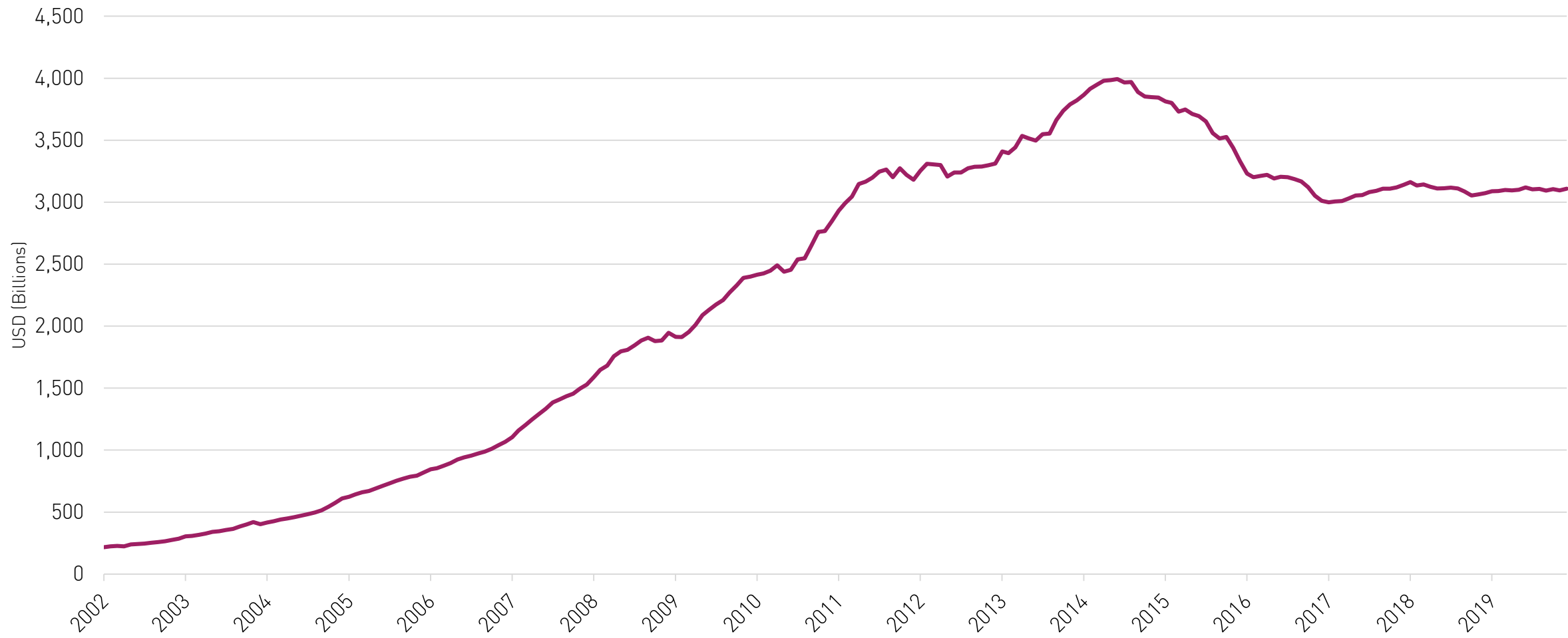


\*Spot rate refers to the immediate settlement price for a currency at a given time. Spot rates for currencies reflect the current market value of a unit of a given currency (usually in USD).

\*\*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.

# China maintains over \$3 trillion in Foreign Exchange Reserves.

### China Monthly Foreign Exchange Reserves



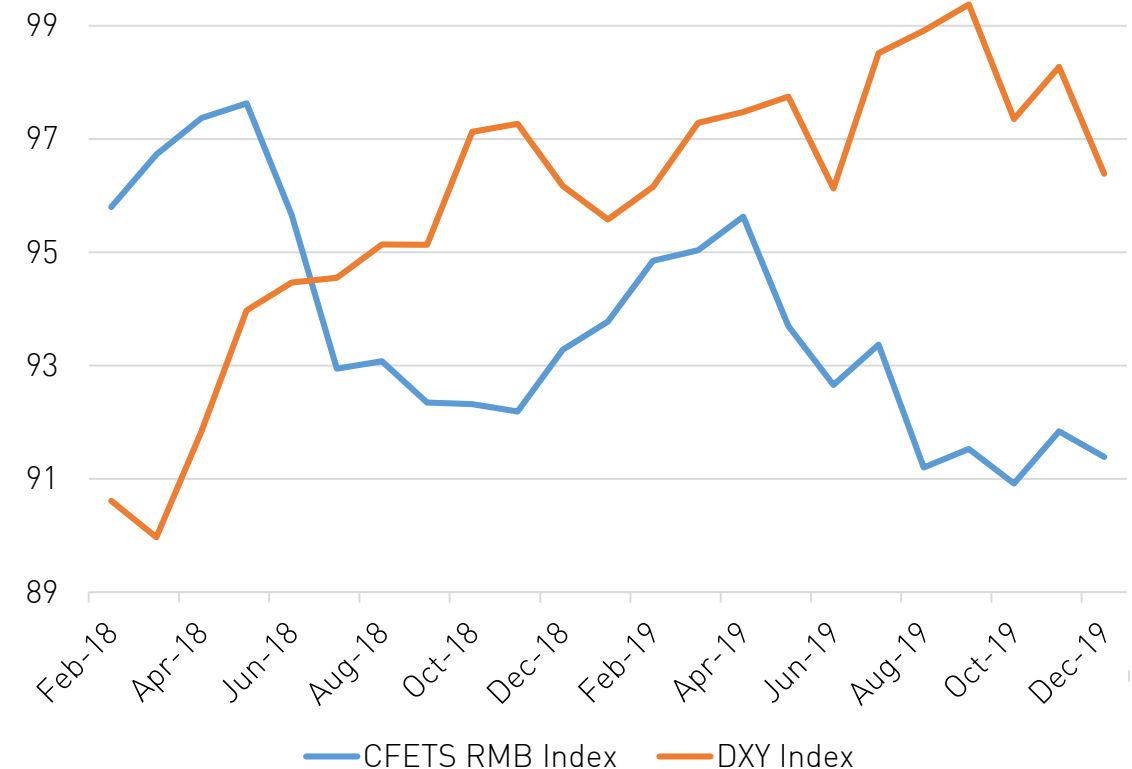
Data from Bloomberg as of 12/31/2019.

## PBoC's new CFETS Basket approach has created stability.

China Foreign Exchange Trade System (CFETS) was created by People's Bank of China (PBoC) to manage the RMB risk. In December of 2015, CFETS adopted a 13-currency basket for managing the RMB. The basket was expanded to 24 currencies at the end 2016. Since the basket approach was implemented, the RMB basket index has been stable relative to the US dollar.

	Currency	2016	2017
US Dollar	USD	26.40%	22.40%
Euro	EUR	21.40%	16.30%
Japanese Yen	JPY	14.70%	11.50%
Australian Dollar	AUD	6.30%	4.40%
Hong Kong Dollar	HKD	6.60%	4.30%
Malaysian Ringgit	MYR	4.70%	3.80%
British Pound	GBP	3.90%	3.20%
Singapore Dollar	SGD	3.80%	3.20%
Thai Baht	THB	3.30%	2.90%
Russian Rubble	RUB	4.40%	2.60%
Canadian Dollar	CAD	2.50%	2.20%
Swiss Franc	CHF	1.50%	1.70%
New Zealand Dollar	NZD	0.70%	0.40%
South Korean Won	KRW		10.80%
Saudi Riy-al	SAR		2.00%
United Arab Emirates Dirham	AED		1.90%
South African Rand	ZAR		1.80%
Mexican Peso	MXN		1.70%
Turkish Lira	TRY		0.80%
Polish Zloty	PLN		0.70%
Swedish Krona	SEK		0.50%
Danish Krone	DKK		0.40%
Hungarian Forint	HUF		0.30%
Norwegian Krone	NOK		0.30%

RMB (CFETS Basket) vs. US Dollar (DXY Index)\*

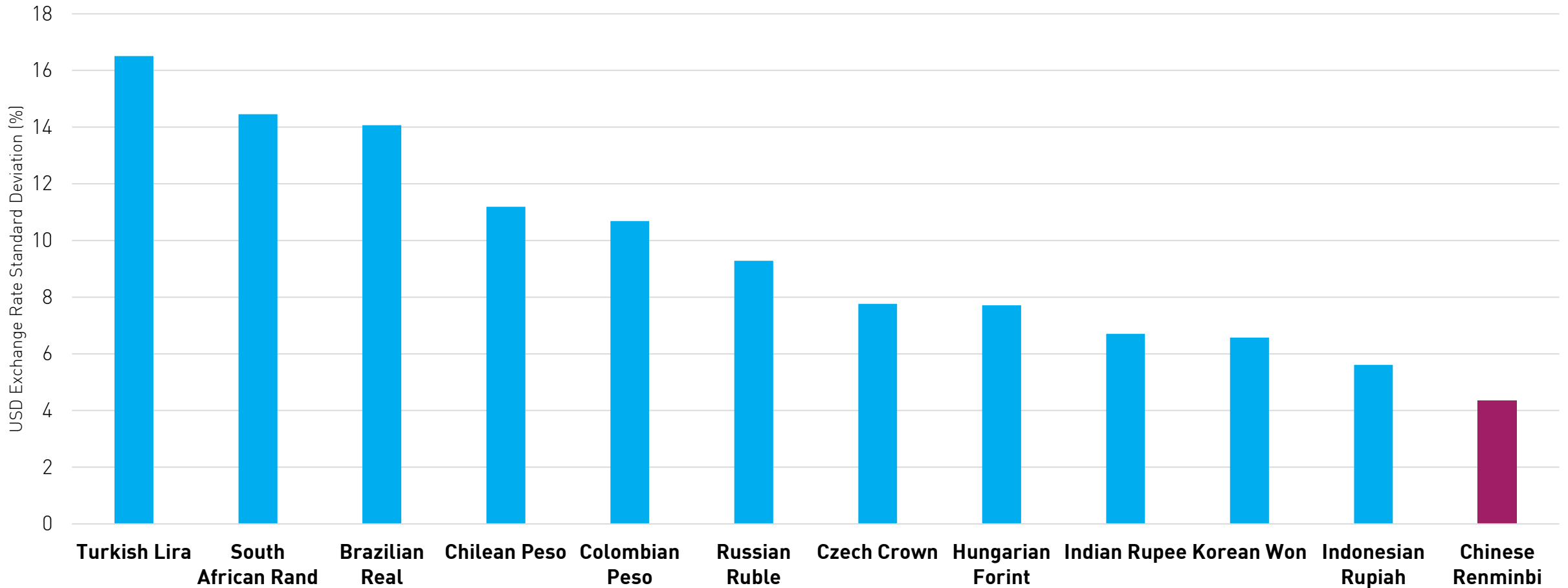


\*See page 16 for index definitions.

Unmanaged index returns do not reflect any fees, expenses, or sales charges. Past performance is no guarantee of future results.

## Chinese Onshore Renminbi (CNY) had lower volatility than many emerging market currencies over the past year.

Emerging Market Currencies by 2019 Volatility

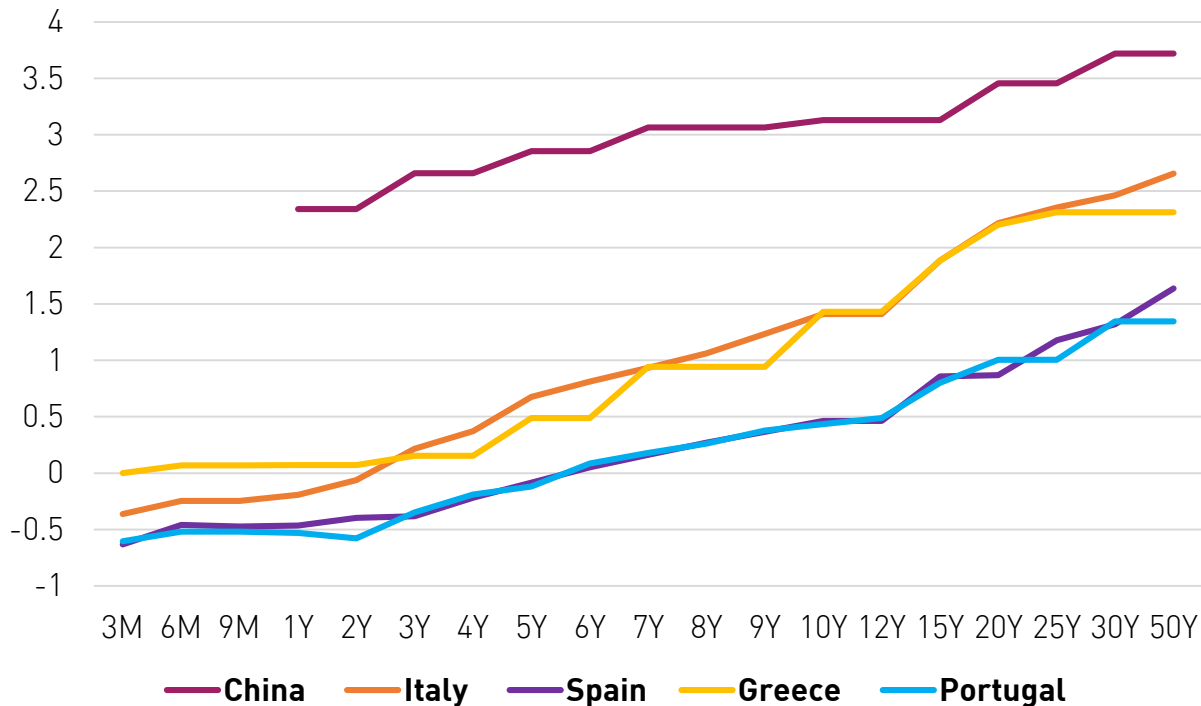


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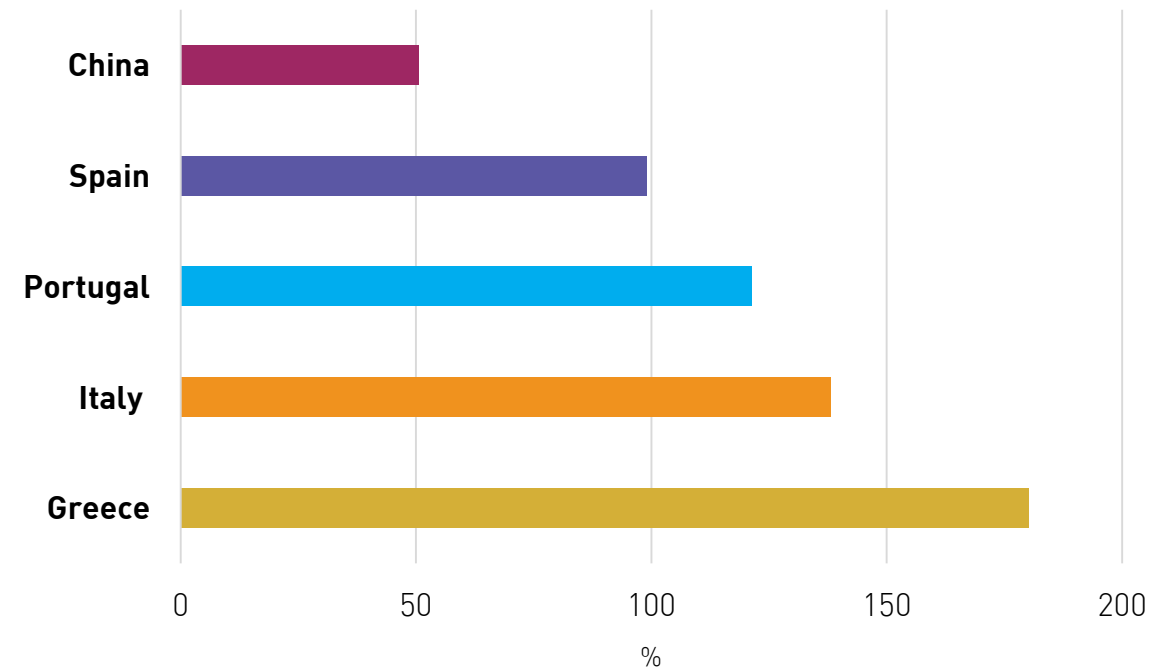
## Investors are paid a premium for investing in China's government bonds.

- China's government bonds offer higher yields than many far riskier global assets such as Southern European government debt.
- China's GDP growth rate of 6.2% in 2018 was higher than those of Spain (2.6%), Portugal (2.1%), Italy (1.9%), and Greece (0.9%)<sup>1</sup> and China's debt-to-GDP ratio is significantly lower than all four of those countries. Therefore, debt issued by these governments carries significantly more risk than that issued by China.
- Nonetheless, investors are better compensated for investing in China's government debt.

**Yield on Government Debt\***



**Government Debt to GDP\***



Data from Bloomberg as of 12/31/2019.

1. Data from The World Bank. Retrieved 12/31/2019.

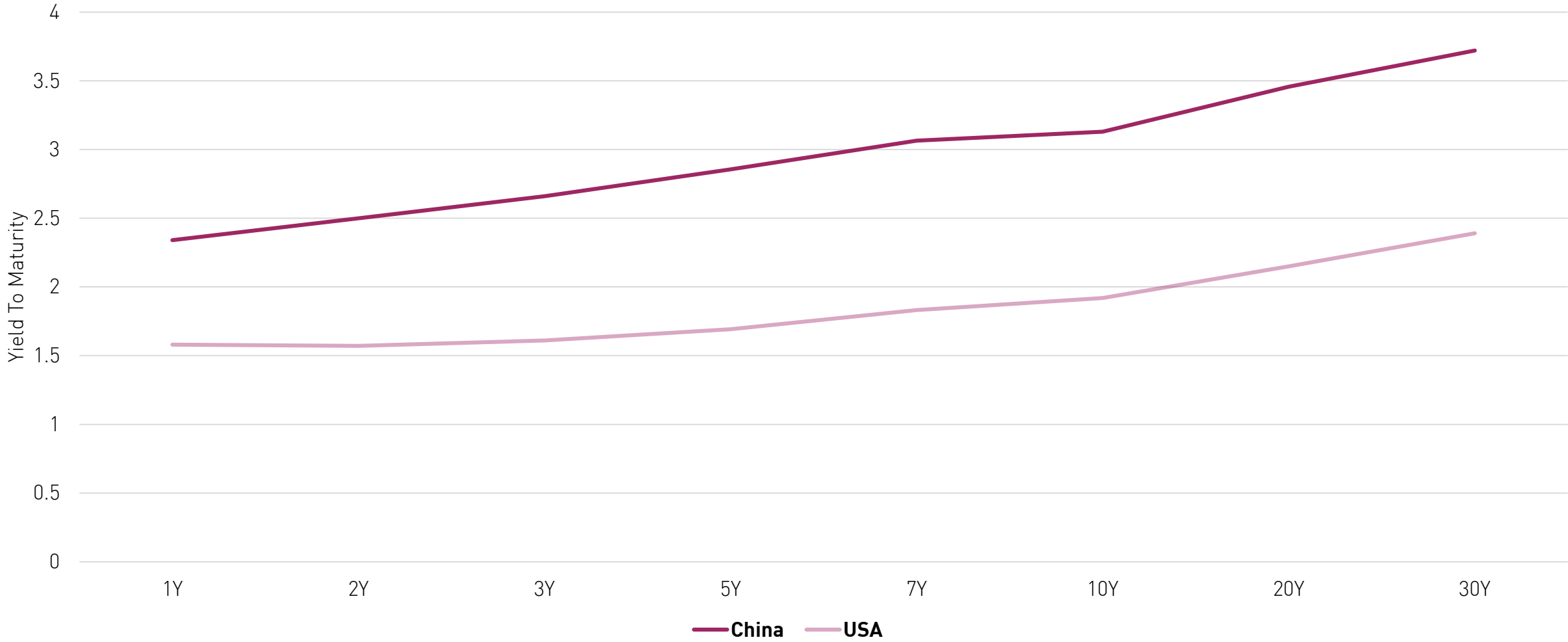
\*Instruments may not be available at every maturity

Data from Bloomberg as of 6/30/2019. Retrieved 12/31/2019.

\*China Debt to GDP from Trading Economics as of 12/31/2018.

# Yields on China's sovereign debt are higher than yields on US treasuries

US vs. China Sovereign Yield Curve\*



Source: Bloomberg, as of 12/31/2019. A yield curve is a line that plots a set point in time of bonds having equal credit quality but differing maturity dates.

\*Instruments may not actually be available at every maturity

## KraneShares E Fund China Commercial Paper ETF (NYSE: KCFNY)

### Investment Strategy

The KraneShares E Fund China Commercial Paper ETF (NYSE: KCFNY) seeks to track the CSI Diversified High Grade Commercial Paper Index. The Fund seeks to invest at least 80% of its total assets in a diversified basket of investment-grade<sup>1</sup> commercial paper denominated in on-shore renminbi issued by sovereign, quasi-sovereign and corporate issuers in the People's Republic of China and traded in the inter-bank bond market. Commercial paper in the Fund is investment-grade and has a remaining term to final maturity of no more than one year and no less than one month.

### KCFNY Performance History as of 12/31/2019

	Cumulative %			Average Annualized %			
	3 Mo	6 Mo	Since Inception 7/31/2013	1 Yr	3 Yr	5 Yr	Since Inception 7/31/2013
Fund NAV	3.14%	-0.09%	3.41%	1.40%	3.48%	0.82%	0.66%
Closing Price	2.71%	-0.49%	2.77%	1.14%	3.55%	0.64%	0.54%
Index	3.29%	0.04%	6.93%	1.75%	3.79%	1.50%	1.33%

\* Contractual net fee waivers are in effect until August 1, 2020

**The performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when sold or redeemed, may be worth more or less than their original cost and current performance may be lower or higher than the performance quoted. For performance data current to the most recent month end, please visit [www.kraneshares.com](http://www.kraneshares.com)**

**Index returns are for illustrative purposes only. Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index.**

## Key Fund Information

Ticker	KCFNY	
Primary Exchange	NYSE	
Index Name	CSI Diversified High Grade Commercial Paper Index	
Total Annual Fund Operating Expense	Gross: 0.71%	Net: 0.59%*
Inception Date	12/02/2014	
Distribution Frequency	Monthly	

Credit quality of underlying securities	Investment Grade <sup>1</sup>
Maturity	0.22 yrs.
30-day SEC Yield <sup>2</sup>	2.11%
30-day SEC Unsubsidized Yield <sup>2</sup>	1.99%

Top 10 Holdings as of 12/31/2019 (Holdings subject to Change) (Excl cash & cash equivalents)	
%	
9.06	AHPUBG 3.55 01/21/20
6.14	JACOP 2.35 05/11/20
5.33	QDCCIZ 3 04/07/20
5.32	SINFER 2.95 04/13/20
5.32	SHGANG 3.21 05/19/20
5.27	SHELEC 2.33 04/17/20
5.26	XIAINT 2 ½ 05/15/20
4.52	TJNCON 3.3 01/09/20
4.50	LUANMI 3.49 03/20/20
4.47	BJURBA 3 ½ 03/06/20

- For purposes of the Underlying Index, investment grade commercial paper is commercial paper that is issued by an issuer whose long-term bonds are rated AAA or equivalent by one or more Chinese credit rating agencies; or commercial paper that is issued by an issuer whose long-term bonds are rated AA+ or equivalent by one or more Chinese credit rating agencies and commercial paper is rated A-1 or equivalent by one or more Chinese credit rating agencies.
- 30-day SEC yield is based on the dividends and interest earned during the most recent 30-day period covered by the fund's filings with the SEC after the deduction of the fund's fees and expenses. The unsubsidized version does not adjust for any fee waivers or reimbursements in effect.

## KraneShares E Fund China Commercial Paper ETF (ticker: KCNY) Monthly Distributions

2018 Distributions			
Ex-Date	Record Date	Payable Date	Amount
12/26/2018	12/27/2018	12/28/2018	\$0.70
11/28/2018	11/29/2018	11/30/2018	\$0.12
10/29/2018	10/30/2018	10/31/2018	\$0.12
9/26/2018	9/27/2018	9/28/2018	\$0.12
8/29/2018	8/30/2018	8/31/2018	\$0.12
7/30/2018	7/27/2018	7/31/2018	\$0.12
6/28/2018	6/27/2018	6/29/2018	\$0.13
5/30/2018	5/29/2018	5/31/2018	\$0.13
4/27/2018	4/26/2018	4/30/2018	\$ 0.11

2019 Distributions			
Ex-Date	Record Date	Payable Date	Amount
12/27/2019	12/30/2019	12/31/2019	\$0.07
11/26/2019	11/27/2019	11/29/2019	\$0.07
10/29/2019	10/30/2019	10/31/2019	\$0.06
9/26/2019	9/27/2019	9/30/2019	\$0.08
8/28/2019	8/29/2019	8/30/2019	\$0.10
7/29/2019	7/30/2019	7/31/2019	\$0.10
6/26/2019	6/27/2019	6/28/2019	\$0.10
5/29/2019	5/30/2019	5/31/2019	\$0.10
4/26/2019	4/29/2019	4/30/2019	\$0.10
3/27/2019	3/28/2019	3/29/2019	\$0.12
2/26/2019	2/27/2019	2/28/2019	\$0.12
1/29/2019	1/30/2019	1/31/2019	\$0.12



**RMB Basket Index (CEFTS):** This index tracks the performance of CNY (RMB, Chinese Yuan) against the 13 currencies accepted by the China Foreign Exchange Trade System (CEFTS) for its currency basket. The currencies were selected based on international trade-weights with adjustments of re-export trade factors. The purpose of this index is to help guide market participants to refer not only to the CNY/USD exchange rate, but also to the effective exchange rate based on the aforementioned basket of currencies.

**Bloomberg Dollar Index (DXY):** This index tracks the performance of a basket of leading global currencies versus the US Dollar. The currency basket is updated annually based on their importance in terms of trade and liquidity.

## 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.kraneshares.com](http://www.kraneshares.com). Read the prospectus carefully before investing.**

ETF shares are not redeemable with the issuing fund other than in large Creation Unit aggregations. Instead, investors must buy or sell ETF 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 when buying and receive less than net asset value (NAV) 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 New York Stock Exchange ("NYSE"), normally 4:00 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 4:00 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 a decline in value. Fluctuations in currency of foreign countries may have an adverse effect on domestic currency values. Emerging markets involve heightened risk related to the same factors as well as increased volatility and lower trading volume.

The KraneShares E Fund China Commercial Paper 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 high yield and 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.

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