EXECUTIVE SUMMARY

Investment Themes
- High quality stocks and bonds stand out as the risks of entering economic recession has emerged
- The resumption of Sino-U.S. trade talks has improved market sentiment
- Fed’s rate cut typically could extend EM equities and bond market certain support
- US treasury yields dipped in 2Q19, expect rates to stay at low levels

Asset Allocation
- Focus on assets that are expected to perform steadily in a low growth and low rate environment
- Fixed income assets are poised to benefit from low rate and easing environment, high grade bonds more stable than high yields
- Duration should be managed for USD denominated debts, EM and Euro debts are still supported
- Geopolitical risks in Middle East and Brexit could lift gold price further, and Yen is also favored

Sector Allocation
- In the U.S., healthcare, utilities and real estate related equities are favored
- For China and Hong Kong stock market, prefer consumption, infrastructure, utilities and REITs sector
- Lower U.S. rate benefits EM equities only temporarily, we focus on valuation of individual EM stock market and its economic upside from fiscal reform

At the beginning of the second quarter, market sentiments were positive amid China and U.S. were en route to reach a trade agreement, U.S. central bank stopped raising interest rates and planned to end balance sheet reduction in the year, and the rallies in many equities markets looked very likely to continue well beyond the first quarter. However a reality check came when U.S. President Donald Trump decided to increase tariffs on $200 billion (USD) of Chinese imports, which has led to suspension of the China-U.S. trade talks and markets’ appetites for risk were revised. Markets around the globe eventually corrected and investors eventually turned to the U.S. Federal Reserve to rescue via interest rate cuts. Government bonds’ yields dropped and bonds rallied dramatically. Many equities markets also did dramatically recovered at the end of the quarter, some even made new highs, as China and the U.S. acknowledged plans for their presidents to meet before the G20 meeting. Despite the recent rebounds, the spiked volatilities witnessed in the quarter reminded us to keep in mind the concerns we raised previously, that the fundamental growth and likelihood of further tightening on the risk premium for asset valuation are justified? In particular, we have more evidence that the economic cycles are moving further towards the late expansion phase. For example the global manufacturing Purchasing Managers Indices (PMIs) are tracking downhill, revealing that the global economic expansion over the last ten years is approaching the late stage.

Assuming that the trade talks will be prolonged and the U.S. Federal Reserve will reduce interest rates possibility more than once for the rest of this year, along with other major central banks loosening, we focus on assets and markets that perform well in a low growth, but low rate environment in the third quarter. Fixed income assets stand to benefit naturally from low rates. At present, across the globe from China to EU, and the U.S., economic growth has decelerated and monetary policy are expected to loosen, thus luring investors towards the quality of investment grade bonds. Investment grade is also more stable by nature relatively to high yields as risk of recessions looms. However we are now neutral in terms of duration exposures given that the long term yields will likely remain at levels of historical lows for the near future. We tend to limit the duration exposures of USD denominated debts. A dovish Fed should also restrain the strengths of the USD and thus slightly more favourable to local currencies denominated fixed income in the Emerging Markets. Expectations of additional monetary stimulus from the ECB, particularly after the new president takes office in November have also increased, and will support European fixed income despite yields already at historical lows.
A diminished rally of the USD will also improve sentiment in the Emerging Markets equities and U.S. rate cuts historically have supported them in the short run at least. Domestic factors and proactive monetary loosening by certain Emerging Markets central banks will further provide stimulus to equities rallies. However the picture will be more country focused, rather than a “regional boom” phenomenon in the past. In the U.S., equities rallies again made new highs recently amid riding on the expectations of a dovish Fed and earnings rebound later this year (and early next year), however defensive sectors such as healthcare, utilities and real estate related should be more resilient if the earnings and economics deteriorates. Similar concerns also make the outlook of European markets uncertain. Similarly, in Hong Kong equities, insurance, infrastructure, consumer and certain real estate related sectors are still attractive as the trade talk drags on and more stimulus are expected in China.

Among commodities, gold has gained momentum amid both the ECB and Fed have further boosted markets to expect further dovishness in recent weeks. Geopolitical concerns in the Middle East could further extend the rally. A dire economic outlook, on the other hand, is raising concerns on demand of crude oil, thus making it less attractive to gold. On FX, JPY is the main focus as the Brexit risk and geopolitical conflicts between Iran and the U.S. escalates, strengthening the safe haven nature of the currency. Furthermore, as the U.S. implements the rate cuts this year will narrow the interest rate differentials between USD and JPY, thus supportive for JPY.
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From optimism to despair and then back to hopes. In the U.S. markets, 2nd quarter of 2019 has turned out to be quite different than the previous quarter and relative more volatile. Markets benefited from the rallies in the first quarter and the S&P 500 Index reached new high about a month after the quarter had begun. The turning point, however, was clearly during early May when the optimism over the trade talks with China diminished significantly. The markets eventually found support amid hopes that the U.S. Federal Reserve will cut rates to counter the unclear trade outlook, and also found relief in an earning season with low growth, but better than the markets had originally expected. The markets eventually rebounded with momentum towards the end of the quarter as expectations of a meeting between the Chinese and U.S. presidents loomed along with the confidence of rate cuts by the U.S. central bank.

All about trade talks. Despite the U.S. apparently had been very close to making a trade deal with China in April, the talks collapsed during the visit by the Chinese delegates in early May, after U.S. President Donald Trump had threatened to increase tariffs on $200 billion (USD) of Chinese imports, prior to that round of discussion. In response, China imposed tariffs as high as 25% on $60 billion of U.S. goods. As a result, the S&P500 Index fell from its April / May high above the 2,900 level to the 2,700, approximately a 7% sell off. The suspension in talks and intense rhetoric exchanges between the two countries remained until the G20 meeting where both countries’ presidents met to lay grounds for further negotiations. The trade talks were also happening between the U.S. and other countries. Although the U.S. eventually delayed a decision to impose auto tariffs by up to six months, in order to allow negotiations with European countries and Japan, and removed tariffs on steel and aluminium imports from Mexico and Canada, worries over the economic future of U.S., the impact of the increased tariffs on growth and corporate earnings lingered on through the rest of the quarter.

U.S. Federal Reserve is again expected to rescue. In early May, the U.S. Federal Reserve Chairman Jerome Powell still had maintained their pledge of patience and refrained from indicating whether the direction of next rate move would be up or down, despite acknowledging the slowdown in economic growth and subdued inflation. However the policy meeting minutes of the April / May Fed meeting were interpreted as accommodative by the markets. With uncertainties over the trade issues and relationships with major partners, the U.S. president also turned to the central bank to offer monetary stimulus in order to offset any economic hardship upcoming, as a result of the rising tariffs. He has been consistently and openly voicing out his opinions on the needs of interest rate cuts and also his discomfort with the Fed chairman. Eventually in the June meeting, the Fed dropped a

United States

12-Month Performance

S&P 500 Index Data

<table>
<thead>
<tr>
<th>Data Type</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market cap (USD)</td>
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<tr>
<td>52-week Hi / Lo</td>
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<tr>
<td>3-Mth Total Return</td>
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<td>Y-T-D Total Return</td>
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<td>50 / 250D Mov.Avg.</td>
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<td>2019 Est Yield</td>
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<tr>
<td>2019 Estimated P/E</td>
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<tr>
<td>2020 Estimated P/E</td>
<td>16.0x</td>
</tr>
<tr>
<td>2019 Estimated P/B</td>
<td>3.23x</td>
</tr>
</tbody>
</table>

Source: Bloomberg L.P.
As of 06/28/2019
reference in their statement to being “patient” on borrowing costs citing “uncertainties” in the outlook that have increased the case for a cut. One member also already dissented on the votes and sought a quarter point rate cut. They also downgraded their assessment of economic activity to a “moderate” pace from “solid” at their previous meeting. Despite the median Fed “dot plot” is still calling for no rate cut, markets however were already assigning a high probabilities of about two cuts this year. Officials eventually had to made public comments repeatedly in late June to manage market expectations.

Economic slowdown looming and earnings expectations lowered.

While the markets are facing the dilemma of an uncertain future for the outlook of trade and hopes of an accommodative U.S. Fed, the U.S. economy is already showing signs of a slow pace of growth during the quarter. In particular, a few major economic indicators revealed the impact of the uncertainties on the U.S. economy are accelerating. Despite that the finalized GDP growth of the first quarter was solid (3.1%), consumer spending and business investments grew at a slower pace than in the earlier estimates. Headline durable goods sales in April and May dropped -2.8% (adjusted) and -1.3% respectively. IHS Markit also published its flash manufacturing PMI in June at 50.1, barley above 50, which is alarming and the worst since September 2009. Flash services PMI also recorded its worst reading since March 2016. In terms of corporate earnings, the first quarter earnings season had been expected to report a -2.0% year over year growth rate at the beginning of April, the results were better and corporate earnings of the S&P 500 companies managed to grow at 1.6% for the first quarter. However the second and third quarters are now predicted to only grow at 0.3% and 0.8% respectively as of June 27, 2019. Those expectations strongly contrasted the 24.9% and 28.4% growth reported in earnings during the corresponding quarters in 2018. The figures revealed a growing concerns of the markets over the future profitability.

Sector Outlooks

Healthcare / Biotechnology Relative to the other sectors or the U.S. markets in general, the S&P 500 Healthcare Sector has again lagged behind significantly for the second quarter and still on a year to date basis. The Nasdaq Biotechnology Index even suffered a negative return during the same period. The focuses on the markets so far have been on other growth related sectors (e.g. technology) and recently on the defensive sectors relatively. The potentials of the healthcare / biotechnology sector cannot be ignored, however, due to the variety of business natures within the industry. The more growth oriented biotechnology segment often has the upside potentials boosted by catalysts of new drugs approvals and breakthrough in biotechnology on an ad hoc basis. However they are more vulnerable to market sentiments and might be relatively more exposed to multiples’ retraction when the economic outlook is worsened. The political pressures on drug prices and industry practices is also another factor of uncertainty still clouding the future of the sector. The U.S. government’s plan to lower prescription drug prices recently hit two major obstacles, amid a cancellation of a proposal to reduce out-of-pocket costs for older consumers, and the new requirement for the drug companies to disclose their prices in television advertisements was thrown out by a Federal judge. The focuses apparently are shifting from the drug insurance companies to the pharmaceutical giants.
to lower drug prices overall in the U.S., however it is expected that the pharmaceutical giants will return with significant opposition efforts.

Information Technology / Telecommunication Services Despite the fact that there were fears of trade conflicts being spread to the technology front, with certain products and services banned from exporting to other countries, the technology and internet stocks in general performed well and outperformed the general market again during the second quarter. However earnings outlook have continued to lower as now the market expects its second quarter earnings to contract about 8% on a year to year basis. Earnings outlook of them will also depend on the progress of trade talks and any deterioration of trade conditions globally will likely have an impact on them. On the other hand, the communication services segment, composing of the internet / ecommerce related companies, are still expected to grow their earnings in double digit this quarter. However the political scrutiny on them will most likely become more upfront as both the U.S. government and the Federal Reserve have openly criticized the developments of crypto currency business by the largest social media. The White House also has continuously criticized social media companies for their bias stances in politics. Oversea they also face the risks of new taxes and other regulatory oversight by foreign governments. On the other hand, certain utilities type of companies within the telecommunication services sector are positioned to benefit further if the U.S. Federal Reserve continue to signal more rate cuts in the future.

Financials The financial sector within the S&P500 index has outperformed the overall index in the second quarter. Despite an inverted yield curve casting fears of an economic slowdown in the future, and of the potential impact on interest rate margins on banks, the financial sector managed to maintain an 8% year on year growth in earnings during the first quarter, among the top three sectors within the S&P 500 companies. Second quarter’s earnings have been lowered somewhat to under 5%, however it is still unclear if the changes in the interest rate yields curve would have a significant impact on the earnings of the bank during the quarter or in the upcoming quarters.

Risk considerations: 1) Further escalation of trade tensions; 2) Slowdown of economic growth; 3) Increasing oil prices; 4) Geopolitical risks in Europe and the Middle East; 5) Monetary policies of the Federal Reserve differ from market expectations, or the Fed sending unclear signals to markets; and 6) A strong USD affecting U.S. competitiveness.
EMERGING MARKETS (EM)

INVESTMENT SUMMARY
- The U.S. is set to loosen monetary policy soon.
- Emerging markets’ central banks also lean towards monetary easing.
- US-China trade talks threatened by impasse.
- Profit growth hits headwinds.
- EM equity volatility set to rise.

The U.S. is set to loosen monetary policy soon. Facing weakening economic data along with uncertainty triggered by China-U.S. trade friction, the Federal Reserve in June dropped the word “patience” it had been using since January this year; the Fed also said it will take appropriate actions to maintain the economic expansion. The market now largely expects the Fed to cut rates from July onward, up to 2-3 times this year. The USD may weaken due to rate cuts and therefore reducing the pressure on EM fund outflows—this is set to benefit EM equity market performance in the short-term.

Emerging markets’ central banks also lean towards monetary easing. During 2019, global inflation continued to moderate, but with rising protectionism damaging business confidence, number of emerging markets have already slashed rates to deal with uncertain economic conditions and to support economic growth. Among key EM countries, China, India, Russia, Malaysia and the Philippines have already cut the interest rates; more EM central banks are expected to follow suit after the Federal Reserve starts cutting rates. These measures should stimulate their respective economies and provide a boost to stock market performance.

China-U.S. trade talks threatened by impasse. Resolution of China-U.S. trade talks has hit roadblocks, as both sides have failed to make clear progress since May. The United States slapped 25% tariffs on an additional USD 200 billion dollar worth of Chinese goods, greatly increasing bilateral trade tensions. Although China and the U.S. agreed to resume trade talks after meeting at the G20 summit at the end of June, the gap between the two sides remains large, and the mood surrounding the talks has already worsened; compared to before, the chances of a resolution in short term look slim. China-U.S. trade problems may have hit a stalemate, and the tariffs from both sides are set to remain for some time. Since a significant number of EM countries rely on both China and the U.S., their economic growth will be dragged down.

Profit growth hits headwinds. EM profit outlook has still not improved as the markets have lowered projected 2019 earnings growth from 6.8% down to 5.2%. 2Q19 EM stock market remains relatively flat after significant fluctuations in Q2, with forward PE ratios holding at around the 12.9x level, which is higher than its 10-year average; at current levels, attractiveness of investments in EM stocks looks limited.
EM equity volatility set to rise. Prior to the Fed's decision to cut rates, EM stocks were favored by investors and were projected to do well. Once the Fed lowers rates, the economic environment will once again become the focal point and volatility in the stock market is expected to grow; the direction of the market going forward will hinge on progress in the China-U.S. trade negotiations.

Region Outlook

Emerging Asia Progress in China-U.S. trade talks remains bumpy as both sides have increased tariffs on imports from the other. Prospects for a successful agreement do not look promising in the short-term; this trade conflict looks set to develop into a long-term issue, and its impact on export-dependent North Asia is beginning to show, particularly on electronics industries of South Korea and Taiwan. Meanwhile, some manufacturers have already shifted part of their production to Southeast Asia and elsewhere, and these countries may receive support from foreign investments in the medium to long term. Of these countries, Vietnam’s exports rose by almost 10% in 1H19, making it a standout winner in the China-U.S. trade conflict. In India, incumbent Prime Minister Modi was re-elected, bringing expectations that economic reform policies will continue; as the country is relatively less reliant on international trade, it is projected to find favour with investors.

Latin America According to the latest data, over half of the lower house representatives in Brazil support the bill to reform pensions, and the market expects the bill to easily pass the lower house in July. Once pension reforms are successfully rolled out, it should deliver close to BRL 1,000 billion in savings to the government over the following decade and improve the government’s fiscal position. With congress passing the pension funds bill, consumer spending may decline in the short-term, and the Central Bank of Brazil is set to cut rates in 2H19 to stimulate the economy, which will boost corporate profits. Mexico agreed to strengthen border controls to avoid increased tariffs from the U.S. and became the first signatory country to the United States-Mexico-Canada Agreement (USMCA) which is expected to bring an end to trade conflicts with the US and consequently enable the Mexican market to continue to benefit from China-US trade tensions.

Emerging Europe Middle East Africa (EEMEA) The Russian stock market and crude oil prices have long been closely correlated, yet their trends are starting to diverge, with Russian equities steadily climbing even as crude oil prices slip. Russian stocks are now up almost 30% YTD, becoming the best performing major emerging market stock market. The Russian Central Bank reduced rates by 0.25% in June, and the central bank governor believes there is a chance of 1-2 more rate cuts this year. In addition to the momentum provided by rate cuts expectations, the better-than-anticipated economy and the fact that U.S. and EU have not rolled out another round of sanctions as expected is helping the Russian stock market to rise. In Turkey, the opposition party won the re-run of elections for the Mayor’s office in Istanbul, the country’s largest city. Poor economic performance was cited as a reason for the ruling party’s defeat. Markets expect President Erdogan to support the economy with fiscal measures, credit policies and interest rate cuts.
Risk Considerations:
1) Political, liquidity, and currency risks could deteriorate rapidly, 2) Fluctuation in oil / commodity / agricultural prices 3) Escalations in global trade conflicts could dampen growth, 4) Another “U-turn” on the policy stance of the U.S. Federal Reserve, weighing on EM currencies.
**EUROPE**

**INVESTMENT SUMMARY**
- The ECB mentioned resuming rate cuts and asset purchases
- Manufacturing PMI remains in contraction territory
- Market sentiment remains cautious
- European shares less attractive than at the beginning of the year

The ECB mentioned resuming rate cuts and asset purchases. During the annual European Central Bank (ECB) forum held in Portugal mid-June, ECB President Mario Draghi noted that further rate cuts and resuming asset purchases were still viable options should the economic outlook fail to improve. Such remarks have led markets to expect that the ECB will use rate cuts as the primary stimulatory measure to boost inflation. Interest rate futures prices show that the market's expected probability of an ECB rate cut by the end of the year surged from 1% at the beginning of the year to nearly 80%. The expectation for rate cuts further lowered yields of European government bonds, with German, French, Spanish and Irish 10-year government bond yields all hitting record-lows. Equity markets rose along with the bond markets. The Stoxx Europe 600 Index rebounded significantly by nearly 4% in June, achieving an aggregate total return of 17% in H119. It is unusual for equity and bond markets to rise in tandem. There are views that equity investors may be overly optimistic about future economic growth in the Eurozone, but the views held by bond and equity investors may not be as different as they appear to be, as a continued capital inflow into defensive equites and a net outflow from cyclicals shows that equity investors remain cautious. We believe future trends of the equity market are dependent on economic conditions and corporate earnings.

Manufacturing PMI remains in contraction territory. The ECB estimates that the QoQ GDP growth of the Eurozone will fall from 0.4% in the previous quarter to 0.2% in 2Q19, but economic growth shall gradually recover in 2H, with 3Q19 GDP growing 0.3% QoQ and further accelerating to 0.4% in 4Q19. Nonetheless, the minutes of the April meeting show that some officials are less confident of the Eurozone economy recovering in 2H. Despite the Eurozone composite purchasing managers index (PMI) rising to a 7-month high of 52.1 in June, it was mainly attributable to sustained growth of services PMI. This reflects that while domestic demand is still robust, the manufacturing industry has continued to contract. Currently, global trade protectionism poses a significant challenge to the Eurozone manufacturing industry, with U.S. trade policies warranting extra attention. On one hand, if the U.S. raises tariffs on Chinese exports, growth in global trade will be negatively affected, hurting the Eurozone economy. On the other hand, the issue of EU-US automobile tariffs will have a more direct impact on the Eurozone. Earlier on, President Trump postponed the decision to raise automobile tariffs till November, and Wilbur Ross, the U.S. Secretary of Commerce, recently suggested that talks on automobile tariffs between the US and the EU will be put on hold in view of the uncertainties after the EU elections. If the U.S. ultimately decides to raise tariffs on vehicles imported from Europe, the impact on the automotive industry and the related supply chain will deal a massive blow to economic growth of the Eurozone, which
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will impact the now-improving labour market. If such downside risks materialize, future economic data shall provide the rationale for the ECB to start further accommodative policies.

Market sentiment remains cautious. The expected earnings per share (EPS) of the Stoxx Europe 600 Index and the S&P 500 Index of the U.S. followed similar trends in 1Q19; both were first downgraded and then upgraded. However, they differed in that the 1Q19 EPS of the Stoxx Europe 600 Index still posted a -2% growth (as of June 25) after being upgraded, but the S&P 500 Index posted a positive growth of 1.6%. The difference in earnings growth was reflected in capital flows. As market sentiment remained cautious, the European stock markets continued to see net capital outflows YTD, at a scale greater than that of US equities.

Looking forward, the market generally estimates that the growth in corporate profits in Europe will gradually improve in the three remaining quarters this year. Such growth estimates, however, may be overly optimistic, considering the increasing possibility of slower global growth due to trade disputes, added with historical data which displays a negative correlation between European corporate earnings and EUR trends, and that the EUR’s weakness against the USD in 1H may not extend to 2H. These factors may become headwinds to corporate earnings growth.

European shares less attractive than at the beginning of the year. As for valuations, the forward PE ratio of the Stoxx Europe 600 Index is 14.1x, around the 10-year average, and does not appear to be overly cheap like in December last year. Considering that the news regarding ECB rate cut expectations have largely been priced in by markets, along with the uncertainty in the development of Sino-US trade tensions and the irresolution of issues including Brexit and Italy’s budget, the Eurozone in general will face downside risk. The risk / reward profile of European stock markets is not negative yet, but the attractiveness has undoubtedly waned compared to the beginning of the year.

Germany The German Ifo Business Climate Index fell for the third consecutive month to 94.7 in June, the lowest since 2014, and the Current Business Situation Index started to align with the Business Expectations Index, which has been at a lower level. The Bundesbank currently forecasts a contraction in the local economy in 2Q19, as the export-reliant country has been particularly impacted by heightened trade uncertainties, as well as reduced economic activity in the markets to which the country’s manufactured goods are mainly exported. In respect of the continued trade tensions and the uncertainties regarding China’s economic growth outlook, German companies have revised their earnings estimates to reflect these continued uncertainties. Downgrading of the forward EPS of DAX restarted in May. On the contrary, if China actively introduces more stimulatory measures in 2H to make its economic growth rebound, this will help bolster the earnings outlook of German companies.

UK The forward PE ratio of the FTSE 100 Index is currently around 13x, lower than its 10-year average, and represents a larger discount compared to the forward PE of the MSCI World Index, making it somewhat attractive in terms of valuation. However, when considering UK equities, the risk of a hard Brexit should also be factored in, and the leadership race for the
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Conservative Party shall be a key determinant. The leadership race has now entered the final stage, with the two candidates being former Foreign Secretary Boris Johnson, an advocate of hard Brexit, and current Foreign Secretary Jeremy Hunt, who is in favour of a soft Brexit. Although Johnson has enjoyed majority support in the first ballot, only 313 Conservative MPs had voting rights at that stage, whereas the whole Conservative Party of more than 120,000 members will have a vote in the final ballot. The final ballot can therefore be seen as a “mini-referendum” on the country’s stance on Brexit. The results due to be announced on July 22 shall signpost the future direction of Brexit.

Italy  Italy overcame economic recession in 1Q19, with GDP growing 0.1% QoQ amidst a rise in personal consumption, gross fixed capital formation and net exports. Nonetheless, the growth outlook is not optimistic as industrial production posted a -0.7% MoM growth in April and the composite PMI was below 50 in both April and May. The Italian National Institute of Statistics issued a warning late June that the 2Q19 economy stood a relatively high chance of falling into contraction once again, while the whole-year growth estimate stayed at 0.3%, with a moderate recovery expected in 2H. Apart from that, there are concerns over Italy’s disputes with the European Commission (EC) regarding budget deficits. The Italian Deputy Prime Minister Matteo Salvini announced that he would step down if tax cut measures of at least EUR 10bn were not approved, but the EC expressed its disapproval of Italy’s large-scale tax cuts and its hope that Italy could reduce debt in 2019 and 2020. It is expected that Italy and EC’s disputes over fiscal policies are unlikely to be resolved in the near-term.

Risk Considerations: 1) Escalating Sino-U.S. trade frictions 2) EU-U.S. automobile tariff talks 3) Slowdown in China’s economy and 4) Brexit talks.
Japan’s stock market performance was subpar in 2Q19. After rebounding in 1Q19, the Nikkei 225 Average Index rose only 0.46% in 2Q19, but from peak to trough it declined as much as 8.5%, a bigger drop than developed markets in the U.S. and EU. Meanwhile, the TOPIX Index and the TOPIX Second Section Index (covering mid and small caps) fell by 2.42% and 2.72% respectively. Even though Japanese equities continued to receive inflows and on a valuation basis, Japan’s stocks are attractive compared to other developed markets, US-China trade issues, the appreciating yen, a global economic slowdown and other challenges continue to dog the Japanese market.

JCB poised to keep short-term rates unchanged as expected. With a 7 to 2 vote at a Japan Central Bank meeting, the JCB elected to keep its rates and monetary policy unchanged as expected. A statement noted that with growing downside risks from the overseas economy, it was necessary to closely monitor how these risks are impacting Japanese businesses and household confidence. While the darkening outlook has prompted major central banks to signal more stimulus, JCB would also want to conserve the increasingly scarce policy tools to deal with an economy in a bind. Regarding the local economic outlook, the JCB believes exports and production may weaken due to external slowdown, but the central bank is maintaining its view the economy can continue to grow moderately this year.

Strengthening yen has impacts on the economy. The JPY trend was strong during 2Q19, rising from 112 yen to the dollar to the 107 level, with the exchange rate hitting 1 USD to 106.78 at one point, marking a six-month high; the strengthening yen is no doubt impacting export-related industries. With export data already sliding for months, the Japanese economy is facing growing pressure, and if external demand deteriorates further, Japanese businesses and consumer confidence will continue to be affected. It is therefore necessary to pay attention to any worsening in US-China trade issues; furthermore, both the ECB and the Federal Reserve are holding meetings at the end of July which could shift JPY trends.

Japanese equity fund flows will be subject to various risk factors soon. Japanese stocks have experienced inflows in excess of USD 7 billion, the highest among all developed markets this year, yet this is only one fifth of the amount recorded in the same period last year. This reflects that investors remain cautious; should there be a shift in the global markets, funds could flow away from Japanese equities.
Economic outlook for Japan remains pessimistic. Even though 1Q19 GDP growth reached 2.2%, this does not mean the Japanese economy is in a good shape as other economic data was relatively weak and the manufacturing PMI is showing contraction; meanwhile, the domestic and non-domestic New Orders Index hit lows not seen since June of 2016. Economic outlook likewise has been sliding for an extended time, dampening personal spending sentiment (including department stores and supermarket sales, among others); this is on top of an imminent imposition of a sales tax in October. Since the beginning of this year, exports are tracking external demand downward in the wake of China-U.S. trade conflicts; additionally Japanese real estate vacancies continue to rise unabated, the aging population being one reason for this. The Japanese Cabinet Office has also announced that the latest coincident index of business conditions has been revised downward to “Worsening,” indicating the Japanese economy could remain tepid for an extended time; this is a situation that must be monitored. As China-U.S. trade frictions continue, medium to long-term Japanese growth may need to depend on the tourism industry and exploit commercial opportunities brought about by the 2020 Tokyo Olympics.

Risk Considerations: 1) Global economic slowdown; 2) Risk of strengthening JPY; 3) Imminent sales tax; 4) Demand for electronic products in Asia cools off; 5) Increased fiscal spending due to aging population; 6) Japan may fail to meet JCB’s inflation targets; 7) Surge in JGB yields; 8) Worsening trade war tensions engulfs Japanese export industries; and 9) Impact of natural disasters on tourism and the economy.
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CHINA / HONG KONG

INVESTMENT SUMMARY

- Stock market was volatile in 2Q19, influenced by the news flow from trade dispute between China and the US
- Resumption of trade talk drives short-term sentiment but market still eyes on the progress
- China economic figures in recent months showed weak economic growth
- China government might introduce more stabilized measures in 2H19
- Slowing economy might cap the potential market upside

Market fluctuated and was risk-averse. Defensive plays outperformed in 2Q19. Market was volatile and HSI traded at a large range from 26,700 to 30,300 in the last quarter. Trade tension largely influenced market sentiment. In May 19, US raised import tariff from 10% to 25% on US$200bn Chinese imports, and US threatened to further impose tariff on additional US$300bn imports. The escalation of China-US trade dispute weakened market sentiment and HSI plunged from around 30,000 to around 27,000 in May. After that, market speculated the resumption of trade talk between Xi Jinping and Trump during G20 Meeting. Trade tension eased and market rebounded from low in late Jun, easing the loss in May. HSI and CSI 300 Index were largely flat in 2Q19. Market switched to defensive plays. Brokerage, internet, aviation, China telecom, Macau gaming, pharmaceutical and infrastructure sectors underperformed the market, while money inflow HK utilities, REITs and auto dealers.

The progress of trade talks would be the major uncertainty on the coming market sentiment. During G20 meeting, China and the US agreed to resume trade talks without mentioning any deadline. The US agreed to suspend to impose new tariffs on Chinese goods and China will increase to buy US agricultural products. Resumption of trade talk alleviates near-term market concerns on trade tension, driving market sentiment in the short-run. But market will continue to keep an eye on the progress of trade talk which is expected to still be a long way to reach a trade agreement. Political risk is still the major risk and uncertainty in 3Q19.

Unexcited economic figures might trigger earnings forecast downgrade. Besides trade dispute, China economic figures were in the mix bag. Industrial production and retail sales growths in Jun 2019 were better than market expectation, while import and new loan were worse than consensus. Although industrial production growth accelerated from 5% in May to 6.3% in Jun. But power production rose 2.8% yoy only, still weak. Both official and Caixin manufacturing PMI were below threshold 50 in Jun. Also, SOE profit yoy growth slowed from 15.6% in 1Q19 to 8.7% only in 5M19, implying a 6% yoy decline in May 2019. After VAT cut starting on 1 April 2019, industrial profit rose 1.1% yoy only in May. Despite a recovery from -3.7% in April, the growth remained soft. The economic growth might still face slowing pressure which might further trigger earnings forecast downgrade and add pressure on the market. Also, any potential escalation of trade dispute might further weaken China economic growth and corporate
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Earnings growth. Slowing economy might cap the potential upside of the China and HK stock markets.

Eye on economic stabilized measures in 2H19. On the back of slowing economy, China government is likely to introduce some stimulus measures to stabilize the slowing economy in 2H19 which is later than market expectation. In Jun 2019, NDRC allows local government project specific bond to be used as equity finance source for infrastructure project. This will ease the restriction on the project financing and accelerate project starts. More stabilized economic measures, including fiscal and monetary, are expected to come in 2H19, such as more tax & fee reduction, RRR cut. However, large scale of stimulus is unlikely to be introduced, given rising inflation pressure which recorded 2.7% in May, the highest level in more than 1 year. It takes times to see the effectiveness of the stabilized measures.

Risk Considerations: 1) A potential worsening of China-US trade relations as the two countries may be unable to reach a consensus on trade issues; 2) Possible continued contraction of the manufacturing industry in China which adds to the downward pressure on the economy; 3) Weak corporate earnings in 1H19 which prompts further earnings downgrades; 4) A possibly slower-than-expected pace of economic recovery as stimulating financial policies may take time to feed through.

Focus Sectors

China insurance stocks During 2Q19 CBIRC has tightened the regulation on the licenses for insurance agents. Hence, the expansion on insurance agency for the industry has delayed, resulting in a slow growth in new business value. The leading insurers focused their efforts to promote protection product at the time, which should help support their long term growth. Also, Chinese 10-year government bond yield has not declined further, that should help stabilize reserve charges and re-investment yield in bond portfolios which is good for earnings. In terms of P&C insurance, auto insurance business performed steadily, but non-auto P&C insurance products maintained high growth and became the growth driver of the P&C insurance business. The trend is expected to continue this year. According to Prime Minister Li Keqiang’s speech at the World Economic Forum, in order to deepen the reform and opening up of the financial industry, the mainland will remove the foreign shareholding restrictions on life insurance companies by 2020. In addition to lifting the shareholding restrictions, foreign insurers can also accelerate the expansion of business in different regions. We expect this round of measures to benefit those foreign life insurers which have already established a first-rate insurance agency force and are looking to expand in other provinces.

Infrastructure NDRC issued a document about the local government issuance of project specific bond and financing guidance, which allows 2019 RMB2.15tn local government project specific bond could be used as equity finance source for infrastructure development. Broker said the document has 2 breakthroughs. 1) It allows utilization of the proceeds from the project specific bond as equity capital for large infrastructure projects with some criteria. 2) It encourages financial institutions to provide supplemental financing (except bank loans) for the projects of project specific bond. More
importantly, 5M19 local government issued RMB860bn and FAI rose 3.8% YTD in April, but still lower than GDP growth rate. Broker said 2 factors will accelerate infrastructure investment growth rate in coming months. 1) May – Sep in 2018 has a low base effect and the allowance of project specific bond to be used as equity capital for large infrastructure projects. Due to Sino-US trade tension and China economic slowdown, it is expected that the government will boost infrastructure for economic growth. Looking forward, China is planning to develop maglev train, which will be another growth driver for the sector. Also, the railway and infrastructure sector trades at mid-single digit FY19E P/E. The valuation remains undemanding.

REITs Fed rate cut expectation increase, global market volatility and China economic slowdown resulted in outperformance in defensive stocks, like REITs. Thanks to the opening of High Speed Railway and Hong Kong-Zhuhai-Macau bridge, the number of HK visitors is on the increasing trend. In 2018, HK visitors increased 1.9% yoy to 66.4mn, and is expected to increase. HK-listed REIs are complied with "Real Estate Investment Trust Code", which requires REITs to 1) invest primarily in real estate that generates recurrent rental income, 2) distribute to its investors as dividends each year with not less than 90% of its annual net income after tax, and 3) comply with a maximum borrowing limit of 45% of its gross asset value. Compared with leasing landlord, the exposure on turnover clause of REITs are lower, and the malls in REITs are targeted at low-mid end levels. Asset Enhancement Initiatives and M&A are growth drivers. These years, some REITs conduct M&As in China which becomes a new growth drivers. Thanks to the "Real Estate Investment Trust Code", the gearing ratio of the sector is low. More importantly, the past 3 year correlation between Hang Seng REIT Index and the private retail properties index from Rating and Valuation Department is -0.49, which is low. This may be due to liquidity, location, management execution power and AEIs. Also, management said the land cost is high and supply is low in HK, and it is difficult for them to find target. As such, it is believe that they may conduct M&A in China or even South East Asia. This may be another growth driver. At present, Hang Seng REIT Index trades at FY19E dividend yield of ~5.0%, the valuation remains undemanding.

Hong Kong Property Increase in US rate cut expectation and the shortage of HK property market benefit 1st hand property sales. In fact, HK developers are favor for low gearing ratio and abundant saleable resources, which will help future revenue growth. On the other hand, HK developers' investment properties portfolio provides stable rental income and value-added to their projects. In these years, HK developers also disposed some low return investment properties for capital recycling and recorded disposable gain. At present, HK property stocks trade at ~40% - 50% discount to NAV and ~3.7% dividend yield. The valuation is undemanding.

China Property Management 2018 net profit rose double digit or 1x yoy growth rate, thanks to the organic growth and M&A. In fact, the average revenue of the top 100 property management companies soared from RMB294mn in 2013 to RMB742mn in 2017, representing a CAGR of 26.1%. Meanwhile, the average revenue-bearing GFA managed by the Top 100 property management companies increased from 15.1mn sq m in 2013 to 31.6mn sq m in 2017, representing a CAGR of 20.3%. In 2018, per capita disposable income was up 8.7% yoy. Scale and high quality services
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Providers will benefit from the rising of middle class and consumption upgrade. The sector has light-asset model, high organic growth, development of value-added services, parent company support, and M&A opportunities. At present, there are 70,000 players in this fragmented market, and consensus expects the top 100 companies to expand market share to 45% by 2020E, compared with 33.3% in 2017. More importantly, the contracted sales growth rate of China property developers in 2018 and 1H19 are decent, which will benefit the revenue growth rate of those property management operators with parent company support. Industrial consolidation and M&A will continue. Players in large-scale, parent company support, quality brands and net cash positions will be major beneficiaries. The sector is trading at FY19E P/E ~22x, thanks to the strong growth rate and M&A potentials. The valuation remains undemanding.

**China consumer stocks** Consumer stocks have done relatively well in share price performance in 2Q, as they are not directly affected by China-US trade tension. In particular, F&B and sportswear stocks are supported by domestic demands, so they are relatively defensive even if trade conflicts deteriorate again in 3Q. For 2019, the Chinese government will focus on tax cut and fee reduction policies, and plans to introduce measures to stimulate consumption. Thus the above consumption stocks should benefit as a result. In addition, such consumer stocks have focused on premiumization strategy in recent years, so there is room for improvement in product mix, ASP and profit margins, which will help drive profit growth. In August the above consumer stocks will announce interim results. Other the operation performance, the market will also focus on management’s sharing on the consumption outlook in 2H19.

**Utilities** HK utilities sector outperformed the market in 2Q19 as market risked off. The risk-off and low rate environment will continue to favour HK utilities sector given its defensive nature and healthy cashflow. As of 31 Jun 2019, according to Bloomberg figures, probability of US rate cut by end-2019 was 100%. HK utilities sector will become more attractive on the rising expectation of rate cut. For China utilities sector, thermal power output was marginally up 0.2% yoy only in 1H19. Strong hydropower output growth would suppress the demand for thermal power, in turn which will drag thermal coal demand. It is expected that there is downside risk in coal price this year. Potential decline in coal price will favour China independent power producers.
10-Year US Treasury Yield

Source: Bloomberg, as of 10 Jul 2019

Asia bond offers higher yield than DM bond

Source: Bloomberg, as of 10 Jul 2019

**BONDS**

As central banks turn dovish, we expect the US Treasury yields to stay low.

As expected, the Fed Reserve left federal fund rate unchanged after its policy-setting meeting in 19 June. However, it is worth noting that its policy statement dropped the word “patient” that has been used many times since the beginning of this year and said that the US economic outlook is uncertain and inflationary pressure is still muted. It will closely monitor the data and will take appropriate action to support economic expansion, implying that interest rate will be cut at least once in the second half of the year. According to the federal fund rate futures price movement as of 9 July 2019, the probability of 50bps or above rate cut was above 80%. On the other hand, Lagarde, who previously supported Draghi to launch stimulus measures, was nominated to be the next ECB president, boosting the markets’ expectation that the European Central Bank will maintain an accommodative monetary policy. Bank of England Governor Carney recently also delivered a dovish remarks, prompting investors to bet on the rate cut, while the Reserve Bank of Australia has carried out the second interest rate cut this year. As the recent decline in US Treasury yields has partly reflected the markets’ expectation of rate cut, if the Fed stance is not as dovish as expected in the future, yield may rebound but not likely to be much. Since the major central banks’ monetary policy tends to be loose, we expect the US Treasury yields to stay low in the short term.

Asian bond yield is more attractive than that of developed market bond, but high yield bond is more exposed to a lower economic growth.

As we enter the second half of 2019, uncertainties linger over US-China trade disputes, and the global economy will face downward pressure. Monetary policies of various central banks have become more accommodative, with the Reserve Bank of Australia, Reserve Bank of India and Central Bank of the Philippines having already cut rates. Markets predict that the Fed will enter a rate cut cycle in the second half of the year, while the ECB is ready to implement accommodative measures at any time. Asian bond yields are generally higher than bonds with the same ratings from developed markets. Given low yields of US Treasury and Euro government bonds providing low yields, fund may be attracted to flow towards Asian bonds.

With downward economic pressure mounting, the Chinese government announced in early June that special bonds can be used to fund certain major projects. Financial institutions were also encouraged to provide support financing to induce more local governments to issue special bonds, propelling fixed assets and infrastructure investments. After the take-over of Baoshang Bank by the China government, the PBOC began to provide credit guarantees for negotiable certificates of deposit issued by small-to-mid sized banks, reinforcing their ability to provide capital to markets while alleviating their liquidity issues. On the other hand, the Chinese regulators have recently introduced numerous measures to cool the real estate market, such as limiting availability of finance for certain mainland real estate developers by not allowing them to issue corporate bonds and asset backed securities. The
NDRC tightened the approval procedure for quota applications from real estate developers to issue offshore bonds. This helps to prevent developers from too aggressive land banking, which help stabilizing the development of the real estate market in the long term, but may increase the refinancing pressure of highly leveraged real estate developers with tight liquidity in the short term. China high yield bonds have underperformed investment grade bonds since early May. However, their yield spreads are still at long term average levels, which means China high yield bonds are still not attractive. Fundamentally, high yield bonds with lower credit quality are more exposed to a lower economic growth. With weakening market sentiment and increasing uncertainties, we remain cautious on China and Asia high yield bonds for this quarter.

Hope of Fed rate cuts induces capital flows into emerging market bonds, USD denominated bonds to benefit from consistently low US bond yields.

The Fed kept rates unchanged after its June meeting, and announced it will “take appropriate action” to support economic growth, while the ten-year US bond yield fell below 2.00%. Markets predict that the Fed will enter a rate cut cycle in the second half of the year, and global central banks have been introducing accommodative monetary policies, facilitating capital flows into emerging bond markets. In fact, despite the net capital outflow recorded by emerging market bond funds in May, capital has re-entered the emerging bond market since mid June. USD denominated emerging market bonds are expected to benefit from positive factors such as continuously low US bond yields and capital inflows.

Emerging markets local currency bonds have been more volatile. For example, Turkey was downgraded by credit rating agency Moody’s for the second time in less than a year. Moody’s downgraded Turkey’s long-term sovereign credit rating one notch to B1, making it sink deeper into “junk” territory while its rating outlook remained negative. Moody’s claimed that Turkey’s balance-of-payment was facing a crisis, and the default risk of government bonds was constantly rising. TRY denominated emerging market bonds plummeted from their peak in early May. We predict exchange rate risk will cause the performance of emerging markets local currency bonds to fluctuate greatly.

Besides mitigating the risk of exchange rate fluctuations, valuations of USD denominated emerging market bonds are also more reasonable than their developed markets counterparts, and are relatively more attractively valued. Therefore, USD denominated emerging markets bonds with better credit quality are the better choice for investors looking to balance risk and return.

ECB dovish stance supports the performance of Euro bonds.

Eurozone inflation has failed to meet ECB’s 2% target since 2013. ECB president Draghi has already declared that the inflation target will not be lowered. He also stated in June that if inflation continues to fall short of the target, ECB will implement more accommodative monetary policies, including purchase of more assets or further reducing the policy rate. In addition, the Eurozone recently posted weak economic data, such as the region’s Economic Sentiment Indicator falling to 103.3 in June, the lowest level since
August 2016, which reinforced market expectations that the ECB will introduce accommodative monetary policies.

YTD total return of the Bloomberg Barclays Euro Aggregate Bond Index has already reached 6.06%, with a credit spread of 67 basis points, which represents a reasonable valuation compared with the 2018 low of 35 basis points. With the ECB continuing to adopt dovish monetary policies, credit spread of Eurozone bonds should tighten further.

3Q 2019 Investment Outlook

INVESTMENT SUMMARY
- Sino-US trade turbulence
- Global central banks turn dovish

Sino-US trade turbulence
Recent developments in the Sino-US trade dispute have been turbulent. The US is currently imposing 25% tariff on Chinese imports worth USD 200 billion in total, while China has slapped 5 to 25% tariffs on USD 60 billion worth of imports from the US. As the world’s second largest economy, China dominates the export market of the world’s manufacturing industry. If export orders decrease as a result of tariffs, manufacturing activities are expected to slow further, weakening China’s demand for global commodities. This vicious cycle may indirectly increase the risk of global economic recession. According to the most optimistic market predictions, this round of Sino-US trade disputes may need to wait until the end of this year to be resolved, resulting in a more pessimistic outlook of the global economy. On the other hand, market concerns that the US may soon take military action against Iran. With rising geopolitical tensions in the Middle East, markets tend to be more risk-off and their attention on gold and yen are rising.

Global central banks turn dovish
In its June statement, the Fed used the words “closely monitoring” instead of “patience” while describing the economic outlook, causing markets to anticipate that the Fed may begin to cut rates. In addition, ECB President Draghi stated that accommodative policy options will be explored, which means accommodative measures may be implemented earlier than market expectations. On the other hand, although BOJ pointed out that local exports and productivity may be affected by external factors and resulting in some fatigue in the June monetary policy meeting, they still expect that the economy will continue to expand moderately this year. When other major central banks hint that they may increase stimulus, the BOJ has no intention to follow. Under the divergence of monetary policy, it might be easier to trigger the market demand of yen.

Factors such as the Sino-US trade disputes, geopolitical risks, and dovish central banks increase market demand of safe haven and will help support the performance of gold and yen in 3Q.
**INVESTMENT SUMMARY**

- Global economic slowdown
- ECB turns dovish
- US-Europe trade relations and Brexit factors
- EUR is expected to face continuous pressure

**Global economic slowdown**

Global economic slowdown, continued trade and Brexit uncertainty negative for Eurozone economic growth. The Eurozone continued to post weak economic data in recent months. Economic activity slowed significantly, particularly in the manufacturing industry. A large decrease in demand caused the Eurozone’s manufacturing PMI to fall to 47.7 in May, which was not only lower than April (47.9) but also a six-year low and the fourth consecutive month where the reading was below the expansion/contraction threshold of 50. The rate of contraction also accelerated, signaling a slowdown of economic performance in the second quarter. Despite the index rebounding to 48.9 during the period, it remained in contraction territory, while the New Orders Index has been below 50 for eight consecutive months. Rising concern of the manufacturing industry over falling demand may result in more companies cutting production and jobs. As a result, while publishing the latest economic data in May, the European Commission decreased the region’s economic growth predictions this year by 0.1% to 1.2%, and predicted GDP growth for 2020 was revised downwards from 1.6% to 1.5%. The predicted pace of economic growth for Germany, the Eurozone’s largest economy, was cut for the second time this year.

**ECB will adopt an accommodative stance**

The ECB revised all inflation and economic growth rate predictions for the next three years at its March meeting, confirming market concerns over slower economic growth in the Eurozone. A new round of targeted long term refinancing operations for commercial banks were also announced and will begin in September. Besides adjusting forward guidance on rates and claiming that there will be no rate hikes prior to mid-2020, President Draghi reiterated in mid-June that there is still considerable room for ECB’s asset purchasing programme, and further rate cuts and other measures to mitigate the side effects are all tools at their disposal. Despite Draghi’s eight-year term ending in October, markets continue to predict the ECB will adopt an accommodative stance.

**Numerous downward pressures on EU economy**

It is worth noting that while markets have nearly been completely focused on Sino-US trade disputes in recent weeks, the threat of US trade protectionism on Europe’s economy too should not be neglected. Since last June, the EU has officially imposed retaliatory tariffs on EUR 2.8 billion worth of US goods, as a response to US President Trump’s tariffs on EU-imported steel. The US and Europe also have disputes over subsidies for the aviation industry, which has been an ongoing issue at the World Trade Organisation for nearly 15 years, with both sides accusing the other of providing illegal subsidies for aircraft manufacturers. The Office of the United States Trade Representative proposed...
a list of additional tariffs on EU goods in April this year, which included large commercial aircraft, dairy products and alcoholic beverages, as retaliation for EU's subsidies for Airbus. This prompted the European Commission to release a proposed list of products worth USD 20 billion of US goods for public consultation. While the US has since delayed its plan to impose additional tariffs on Europe, tariff negotiations between the two sides will not be easy. EU officials proposed zero automobile tariffs for both the US and EU, which failed to satisfy the US. Another obstacle is that Germany and France, the two pillars of the EU, are divided on details of negotiations. France objects the inclusion of agriculture in trade negotiations, while Germany, being a major manufacturer of automobiles, is more concerned about automobile taxes. In addition, moderate forces which have long dictated European politics lost ground in recent European Parliament elections, with populist and Euro-sceptic parties gaining substantially more votes. It will be hard for a divided EU to reach an advantageous agreement with the US on trade negotiations.

Due to lackluster economic growth in the Eurozone, combined with numerous downward pressures and dovish monetary policies from the ECB, the EUR is expected to face pressure in 3Q.
AUD/USD
12-Month Performance

Source: Bloomberg L.P.
As of 06/28/2019

INVESTMENT SUMMARY
- RBA very likely to cut rates further
- China Economy slowdown unfavorable AUD

RBA very likely to cut rates further

Australia recorded only 1.8% GDP growth in 1Q19, substantially lower than 3.4% in 2Q18, growth further slowed down in 1Q19, from 2.3% in 4Q18. More importantly, the local economy has weakened in three consecutive quarters. Upon further inspection of Australia’s employment data, the unemployment rate remained unchanged at 5.2% in April and May, which has been above 5% for three months in a row. Meanwhile, the participation rate of the labour force jumped to a historical high of 66% in May, and the underemployment rate rose as well. This prompted the Reserve Bank of Australia (RBA) to cut rates in June and July, while the benchmark rate was at a new all-time low of 1%. The RBA stated that rate cuts were aimed at supporting employment growth. It was also more confident that inflation will meet its mid-term target, and also noted that while the global economic outlook remains positive, trade disputes have caused greater downward risk as international trade growth remains weak. On the other hand, RBA Governor Philip Lowe recently claimed that even with employment growth booming, there was still an abundance of spare capacity in labour markets, and full employment is yet to be achieved. He also thought that the unemployment rate needs to drop to around 4.5%, implying there may be further rate cuts to stimulate employment. He noted rate hikes had a smaller impact as in the past but remained effective, and that changing the trend of economic growth with a mere 0.25% rate cut was impractical. If the weak local employment and standstill in wage growth cannot be improved in the short term, the RBA is very likely to cut rates further in the near future. In fact, according to the latest changes in prices of interest futures, market consensus is that there’s a >60% probability of the RBA cutting rates by the end of year.

China Economy slowdown unfavorable AUD

Rate cuts by the RBA were also intended to combat the effects of trade tensions and slowdown of the Chinese economy. While US-China trade frictions have damaged the global economy, and rate cuts have become a global trend recently. Australia has felt the pressure to implement accommodative policies earlier than many other developed nations. This is primarily attributable to the fact that Australia is a major exporter of raw minerals, with products mostly exported to Asia and China, its biggest buyer. With China and the US imposing tariffs on each other, demand for China’s manufacturing industry may diminish, resulting in a further slowdown of manufacturing activity in China. This will reduce the demand for Australia’s main exports and mineral resources, affecting its economy.

Downward pressure on Australia’s economy is certainly detrimental to the AUD. On the other hand, Market consensus is that there is little possibility of achieving a decisive breakthrough with the US in the short term. As the Sino-US trade dispute looks set to become more persistent, mixed news may continue to increase the volatility of the AUD in 3Q.
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