EXECUTIVE SUMMARY

Investment Analysis

<table>
<thead>
<tr>
<th>Asset</th>
<th>Market</th>
<th>Analysis#</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>DM Sovereign Debt</td>
<td></td>
<td>●</td>
</tr>
<tr>
<td>European and US IG Corp</td>
<td></td>
<td>●●</td>
</tr>
<tr>
<td>Asia IG Corp</td>
<td></td>
<td>●●●</td>
</tr>
<tr>
<td>European and US High Yield</td>
<td></td>
<td>●●</td>
</tr>
<tr>
<td>Asia High Yield</td>
<td></td>
<td>●●</td>
</tr>
<tr>
<td>Latin America &amp; EMEA</td>
<td></td>
<td>●</td>
</tr>
<tr>
<td>Equities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>US</td>
<td></td>
<td>●●●</td>
</tr>
<tr>
<td>Europe</td>
<td></td>
<td>●●</td>
</tr>
<tr>
<td>Latin America &amp; EMEA</td>
<td></td>
<td>●●</td>
</tr>
<tr>
<td>China A Shares</td>
<td></td>
<td>●●</td>
</tr>
<tr>
<td>HK Listed Chinese Enterprises</td>
<td></td>
<td>○○</td>
</tr>
<tr>
<td>HK Listed Local/Foreign Corp</td>
<td></td>
<td>○○</td>
</tr>
</tbody>
</table>

As of 30 Jun 2021. The views expressed were held at the time of preparation and are subject to change. Source: Hang Seng Investment Services Limited

# Symbol representation:
●●● : The particular asset / market potentially may perform well relative to the relevant major global benchmark(s).
●● : The particular asset class potentially may perform in line relative to the relevant major global benchmark(s).
● : The particular asset class may not perform well or in line relative to the relevant major global benchmark(s).

Global equities had a very strong quarterly performance in 2Q, amid the economic recoveries and rising inflationary expectations, which had resulted in continuous rotation from bonds to stocks. In June, the FOMC statement issued by the US Fed appeared hawkish and the latest “Dot Plot” revealed that the Fed members expect interest rate hikes of 50 basis points as early as 2023. As a result, there has been speculations of Fed “tapering” announcement any time soon. Looking forward to second half of the year, amid the possibility of a tapering announcement, some investors are likely to turn more cautious towards risky assets. Based on historical performances, long term US rates rose and bond prices fell when tapering was announced by the Fed Chairman in May of 2013. And US equities had some levels of corrections, however emerging markets had experienced capital outflows with assets falling for a prolonged period of time. If the tapering was implemented without the solid economic recovery as a pre-condition, it would remain the biggest risk to global markets, in our view. From a tactical perspective, a diversified approach to global equities, among the traditional and new economies sectors with both growth and value stocks, should make up the core of the portfolio. On the other hand, offshore China equities and onshore A shares could stand out going forward. Both US and European equities, valuation wise, are now at elevated levels amid continuous monetary easing over the years. In contrast, Chinese monetary policies have been taking a more neutral stance since earlier

Highlights

- We remain optimistic on equities in 2H2021, but note that investors are likely to become more cautious amid concerns on Fed’s tapering plan, unless Fed can continue to keep a very dovish tone on job market and economic impacts from Covid.
- US and European equities could benefit further from reopening, strong corporate earnings performance, and ample liquidities. However, while we are now standing at record high levels of equities prices, the stock markets may turn more volatile when growth and recovery story start to show signs of cooling down in coming months.
- China A shares and Hong Kong equities underperformed regional and global equities markets in the recent months. We expect sentiment to improve gradually in 2H, and China and Hong Kong equities could stand out on Central Government’s pro-growth reiteration, and likely relaxation of current travel restrictions between Mainland and Hong Kong.
- Volatility of the US dollar investment grade bond market is expected to stabilize after the inflationary outlook can become more clear in the US around 4Q this year. In the meantime, we think the risk reward for the onshore RMB government bonds looks more attractive.
- On commodity currencies, there is an obvious divergence between the monetary policies of the Australian and New Zealand central banks. NZD is expected to outperform AUD before the Australian central bank considers to adjust their yield curve control and other quantitative easing policies.
3Q 2021 Investment Outlook  13 July 2021

Among global equities markets, US equities are still expected to benefit from further reopening of local business and economies, strong growth of corporate earnings and large amount of fiscal stimulus. And tech stocks again appear to be favored by investors amid the resilient fundamentals of the mega tech corporations, including the strong balance sheet, cash flows and earnings growth, while also benefiting from the numerous emerging disruptive themes. There are also many US companies with strong franchises and bright outlooks, across sectors from both the old and new economies, which could see their earnings growth raised up again. European equities are expected to benefit from the fact that the pandemic is put under control, and the gradual reopening of the economies within the region. As the pandemic is contained, rising consumer confidence will benefit the related sectors in both Europe and the US as consumer spending spikes in the short term. Majority of the European large corporations are exporters and those with strong branding, sales network and are capable of passing down the costs to consumers will be relatively favored. However, it is important to point out that markets in both US and Europe have been trading close to their peaks recently and technically are subject to corrections if new breakthroughs cannot be achieved in the near term.

For the domestic A shares and Hong Kong markets, sentiments are expected to improve if the travel restrictions between Mainland and Hong Kong can be gradually relaxed. Moreover, when the anti-monopoly investigation fades, investors will refocus on the underlying growth potential of the Chinese tech sector and major tech leading companies. After the price correction in recent months, the valuation of China technology sector has come down a lot and appears to be attractive again, in our view.

For fixed income, we remain underweight bonds amid the continuous upward pressures on long term U.S. interest rates as the economy recovers further. We expect that the volatility of the US dollar investment grade bond market will gradually stabilize after the inflationary outlook becomes more clear in 4Q. On the other hand, the onshore RMB government bonds has performed well with good stability. Current rate differentials between the Chinese government bonds and the US Treasuries are still at an attractive high level.

In the FX markets, the European Central Bank are behind the US Federal Reserve relatively in terms of monetary tightening, but as long as the latter has not confirmed their tapering plans, the downward pressures on the Euro would remain subdued. And the recent strength of the greenback is expected to be constrained amid the lack of rate spread advantage. On commodity currencies, there is an obvious divergence between the monetary policies of the Australian and New Zealand central banks. NZD is expected to outperform AUD before the Australian central bank considers to adjust their yield curve control and other quantitative easing policies.
3Q 2021 Investment Outlook

13 July 2021

2021 Forecasts

Equities

US
Emerging Markets (EM)
Europe
China / Hong Kong

Global Bond Market

Currencies

EUR/USD, GBP/USD
USD/CAD
AUD/USD, NZD/USD
# 2021 Forecasts

## Equity Indices

<table>
<thead>
<tr>
<th>Region</th>
<th>Index</th>
<th>2021 Full Year Forecast*</th>
<th>Vs Full Year Forecast Last Issue</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>S&amp;P 500</td>
<td>4,400</td>
<td></td>
</tr>
<tr>
<td></td>
<td>NASDAQ</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td>Europe</td>
<td>Stoxx Europe 600</td>
<td>480</td>
<td></td>
</tr>
<tr>
<td>EM</td>
<td>MSCI Emerging Markets</td>
<td>1,400</td>
<td></td>
</tr>
<tr>
<td>HK</td>
<td>Hang Seng Index</td>
<td>30,000</td>
<td></td>
</tr>
<tr>
<td>Mainland</td>
<td>HS China Enterprise Index</td>
<td>11,500</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Hang Seng TECH Index</td>
<td>8,800</td>
<td></td>
</tr>
<tr>
<td></td>
<td>CSI 300 Index</td>
<td>5,500</td>
<td></td>
</tr>
</tbody>
</table>

## Rates

<table>
<thead>
<tr>
<th>Region</th>
<th>Bond</th>
<th>Rate</th>
<th>Vs Full Year Forecast Last Issue</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>US 10 Year Treasury</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>German 10-Year Government Bond</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>China 10-Year Government Bond</td>
<td>3.5%</td>
<td></td>
</tr>
</tbody>
</table>

## Currency

<table>
<thead>
<tr>
<th>Currency</th>
<th>Rate</th>
<th>Vs Full Year Forecast Last Issue</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUD</td>
<td>0.79</td>
<td></td>
</tr>
<tr>
<td>CAD</td>
<td>1.20</td>
<td></td>
</tr>
<tr>
<td>EUR</td>
<td>1.26</td>
<td></td>
</tr>
<tr>
<td>GBP</td>
<td>1.44</td>
<td></td>
</tr>
<tr>
<td>JPY</td>
<td>108</td>
<td></td>
</tr>
<tr>
<td>NZD</td>
<td>0.75</td>
<td></td>
</tr>
</tbody>
</table>

## Commodities

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Rate</th>
<th>Vs Full Year Forecast Last Issue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gold (USD/oz)</td>
<td>1,900</td>
<td></td>
</tr>
<tr>
<td>WTI Crude (USD/barrel)</td>
<td>70</td>
<td></td>
</tr>
</tbody>
</table>

*Full Year Forecast is the high-end estimate from current quarter till the end of the year.
**INVESTMENT SUMMARY**
- Entering the second half strong
- The Fed's address in the June FOMC meeting surprised the market.
- Inflation fears shadow reopening
- Corporate earnings will be in focus.
- Fiscal stimulus and vaccines will be the market catalysts
- Growth in US remains intact

**Entering the second half strong.** The U.S. economy turned more optimistic in the second quarter, as broader vaccination in the US helps reopening of domestic economy. MSCI World Index was up 11.8% and the S&P 500 was up 15.2% during the first half of the year, led by the cyclical values and small-caps. But sector rotations continue, and money flowed from reflation trades back to growth stocks in late June. US equities are expected to enter the second half strong. The key drivers include: vaccination rollouts, the easing of stringency measures, robust monetary and fiscal stimulus, reopening of economies, higher consumer confidence and stronger corporate earnings.

**The Fed's address in the June FOMC meeting surprised the market.** The Fed policymakers indicated an improved economic growth outlook in the US, as 2021 GDP growth has been raised to 7% from 6.5% in its March forecast. Despite higher inflation forecasts for 2021, the Fed’s overall inflation forecasts remain largely unchanged over the next two years with core PCE inflation projected to edge down back in 2.1% in 4Q 2022 and 4Q 2023. This suggested the Fed has remained confident that the current upswing in inflation will prove transitory rather than structural. While no details about the timeline or structure of tapering was provided after the June FOMC meeting, investors are still concerned about inflation risk, which might trigger the Fed to tighten its monetary policy earlier than expected. Investors will pay close attentions to the Fed’s open comments about stepping up of tapering discussions, before Powell provides more guidance on the tapering strategy at the Fed’s Jackson Hole symposium on 26-28 August.

**Inflation fears shadow reopening.** After more than a year in which inflation remains subdued, April and May CPI and PPI data exploded higher. The recovery from the pandemic is gaining further pace, with growth in the US accelerating as economies reopen. But it also raises worries about rising inflation. While the US Fed sees higher inflation as temporary, it also appears increasingly concerned about higher-than-expected inflation risks, which might trigger investors’ speculation of the Fed’s tapering. We believe equities tend to perform better than bonds during periods of reflation. Mild inflation traditionally supports cyclical plays, while lower long-term treasuries yields support growth plays.

**Corporate earnings report in focus.** Investors would eye on earnings report for the second quarter. According to Refinitiv’s latest consensus estimates dated on 2nd July, 2021, average earnings growth rate for the S&P 500 constituent companies for 2Q 2021 is expected to be 65.4% year-on-year. If the energy sector is excluded, the growth rate declines to 52.3%. Ten of the 11 sectors in the index expect to see an improvement in earnings relative to 2Q 2020. The industrials and consumer discretionary sectors have the highest earnings growth rates for the quarter, while the utilities sector has the weakest anticipated growth compared to 2Q 2020.

**Infrastructure plan remains to be the catalysts.** Biden’s main campaign theme was to “build back better,” and Congress has now turned its focus to infrastructure. The latest news said that a bipartisan group of negotiators is still working to turn a US$1.2-trillion, eight-year framework into legislation, and the bipartisan deal might possibly pass the Senate on the week of 19 July. Some critics said even without a bipartisan deal, Democrats could still get a bill passed on a smaller size and scope with their slim congressional majority through the reconciliation process. We view any infrastructure spending package would still serve as catalysts, and could help cyclical plays to maintain their leadership into the second half.
3Q 2021 Investment Outlook  13 July 2021

Growth in US remains intact: Overall, US equities should remain positive on the back of strong earnings growth, reopening of economy and fiscal stimulus. While S&P 500 Index, trading at 2021 and 2022 PE multiples of 22.8x and 20.4x respectively, appears to be a bit over-stretched. We do not iron out the possibility of the three US major indices to breakout for another record high this year, but much more volatility will be expected in the market.

Sector Outlook

Technology: Our sector preference for technology related companies becomes more positive in the third quarter, driven by the three key themes in technology: positive earnings outlook, pick-up in technology spending, and sufficient liquidity environment that traditionally benefit growth companies with strong fundamentals. We expect technology-related sectors with resilient earnings to hold up well. We favour technology sector's long term structural growth prospect, including the development of AI, 5G, healthcare and new technological applications, as they helped many companies to increase productivity. Increasing demand is expected to find in semiconductors and software. However, short-term risk on the supply chain issues, especially on sourcing semiconductors, might create affect the revenue of some companies. We still favour the mega-cap tech companies, which are backed by fundamentals in strong balance sheet and earnings, as well as disruptive change in new products and ideas.

Consumer: The US consumer discretionary sector is typically sensitive to swings in the economy. The massive stimulus efforts and stay-at-home orders spurred a surge in spending on home improvement and e-commerce sales early in the crisis and the related stocks led the equity market rally. Now, with vaccine distribution expected to be substantially completed soon, even the most beaten-up stocks in the sector, like those in the apparel and hotel industries have recovered and in many cases extended well beyond pre-crisis price levels. But the cruise industry is the exception. The longer-term trend toward e-commerce and electric vehicles is likely to continue to support the fundamentals of these growth industries, but investor enthusiasm may have pushed valuations too high. Inflation and the likely accompanying rise in interest rates might impact some companies. Those companies that have established brand names, sales network and ability to pass rising price pressures to end-consumers have an edge.

Financials: The US financials sector includes banks, savings and loans, insurers, investment banking, brokerages, mortgage finance companies and mortgage real estate investment trusts. Banks are pro-cyclical and are traditionally benefit from its positive sensitivity to interest rates, steepening yield curve, and pick-up in economic activities. The Fed announced that all 23 large banks passing the supervisory stress test on 24th Jun should serve as tailwind for financials, as banks’ high loan loss reserves are now being released due to low default rates amid strong economic growth, which overall supports earnings growth. Thus, share buyback and raised dividend pay-out will be banks’ short term catalysts. The recent flattening yield curve environment, however, might affect banks’ net interest margins in the short-run. In the second half of year, investors in financials will pay close attention to consumer-banking and loan growth among the banks which are supposed to turn more positive while the economic activities become more expansionary.

Industrials: The US industrials sector, includes aerospace and defense, building products, electrical components and equipment, construction machinery, and transportation. Share in industrials have picked up in the first half being a beneficiary of early economic recovery. It is still considered an outperforming sector as industrials is historically pro-cyclical. Transportation and air freight have benefited from a return in demand as economies reopen. Additionally, Biden’s new infrastructure plan should call for an increase in infrastructure and clean-energy investment, and thus will likely support the machinery and building materials industries. The aerospace and defense industry, however, continues to face significant headwinds amid expected lower demand and uncertainty surrounding the political appetite for defense spending.

Risk considerations: 1) Inflation and tax concerns as key sources of volatility; 2) surge in inflation could cause interest rates to rise too quickly, and trigger the Fed to tighten monetary policy; 3) slump in oil prices; 4) geopolitical tensions with China 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) the Coronavirus outbreak remains around the globe; 7) vaccine deployment not able to contain the virus; 8) pullback risk from the largest mega cap stocks that could lead to a broader market decline.
EMERGING MARKETS (EM)

INVESTMENT SUMMARY
- Emerging Markets varied in terms of performances during the second quarter
- The strengthened USD became the headwinds of emerging markets during the second quarter
- Reactions by central banks towards inflation in emerging markets

Emerging Markets varied in terms of performances during the second quarter. MSCI Emerging Markets Index returned moderately during the second quarter of this year, however the differences among each market were quite large. By regions, Latin American and Eastern European emerging markets were the best performing markets as the MSCI Latin American Index and MSCI Eastern Europe Index both recorded double digit quarterly returns. Among them, Poland, Czech Republic and Hungary outperformed as their economies improved. Brazilian currency and equities also performed well, and the Brazilian stock market became the best performing one during the quarter. Meanwhile, Russian and the Saudi Arabian markets benefited from higher oil prices. On the other hand, the MSCI Asia ex Japan Index's performance was disappointing with the index only rising slightly for the quarter. Despite, performances in stocks markets of India, South Korea and Taiwan begin not bad, along with the positive returns in the mainland and Hong Kong markets, however markets such as Thailand and Singapore were disappointing.

The strengthened USD became the headwinds of emerging markets during the second quarter. In June, the FOMC statement issued by the U.S. Federal Reserve appeared hawkish with the economic and economic forecasts being raised, and the latest "Dot Plot" revealed that the Fed members had expected interest rate hikes of 50 basis points by the end of 2023. Although Chairman Powell reiterated the fact that the "Dot Plot" was not a roadmap, however the market interpreted that as rising inflationary expectation by the Fed. As a result, there has been speculations of "tapering" by the end of this year with the possibility of earlier than expected interest rate hikes. In turn, the DXY has been pushed above 92 for a short period of time, however it is worth noting that the latest unemployment rate of June has risen slightly, and as the Fed makes reference to both the performances of the labour market and inflations, despite a continuously improving domestic employment, its vulnerabilities still exist. Therefore, it has not reached the critical point at which the Fed has urgency to raise rates, despite a strong economic recovery. With the DXY hovering around the level of 92, it appears that the market has digested the news of the Fed could be raising rate higher than expected, and with the U.S. treasuries yields not rising like it did earlier this year, it does not increase the rate differential of the USD over others. Without any new stimulus, the upward forces behind the USD might be constrained. Thus the impact of USD strengthening on the emerging markets will also somewhat diminish. However long term U.S. rates rose and bond prices fell when tapering was announced by the Fed Chairman in May of 2013. And U.S. equities had some levels of corrections, however emerging markets had experienced capital outflows with assets falling for a prolonged period of time. It is expected that until the Fed formally announces its plan to reduce asset purchases, the emerging markets still will be sensitive to the latest shifts of monetary policies.

Reactions by central banks towards inflation in emerging markets. Since April, U.S. consumer price index already spiked up. A number of Fed members reiterated that price increase was only temporary and it is still quite some time before achieving the dual goal of full employment and inflation stability. Thus the quantitative easing policies should remain. They also expressed that due to the impact of various factors, such as the low base effect of last year and the supply chain disruption, prices of commodities have spiked up and inflation will remain at higher levels in the coming months. As a result, it might take some time before it is revealed that inflation is sustainable or not. On the other hand, central banks of the emerging markets reacted to inflation in an opposite manner. As one of the largest emerging markets, the central bank of Brazil has started raising interest rates since March and other central banks also followed in the last quarter. For example, the Mexican central bank surprised the market with a 0.25% interest rate hike in late June after the inflation there had started rising at a sustained rate of 6% year over year since April. According to the rate futures in June, the expectation is that the central bank might be determined to raise rate again as early as August and it might reach the level of 6% in the 1Q of 2022. The central bank in Russia also surprised the market with a 50 basis point hike each time in April and June. However, it is worth noting that equities in the above markets performed quite well in the second quarter, reflecting that as long
3Q 2021 Investment Outlook 13 July 2021

as the pace of economic recovery has not slowed down and the inflation is not uncontrollable, interest rate hikes could still be favourable factors for the stock markets of emerging countries.

Regional Outlook

North Asia and the Pacific region: As we enter the third quarter, most of the North Asian countries should be able to leap forward beyond the pandemic, and as the global demand continue to be strong stimulating the exports of the region, the manufacturing has strongly rebounded. With the Regional Comprehensive Economic Partnership (RCEP) agreement begin implemented, the dynamics of investment and trading within Asia will be reenergized. 6Supply chain changes and ecommerce bring new opportunities making Asian exporters even more prosperous. The rating agency Standard and Poor thus has revised the forecasts of economic growth of the full year of Taiwan to 5.6% from 4.2% previously, while maintaining the forecast of 2.7% growth for next year. Amid the strong demands of electronic devices and shortage of chip globally, such developments will benefit the manufacturing industry with higher output in Taiwan. And South Korea will also benefit from the rising of the semi-conductor industry through the rest of this year, as revealed by the 39.7% year over year growth in exports in June. In Japan, the economic growth in the third quarter is not expected to expand much despite the upcoming Olympics because the oversea tourists are still practically banned from participating and spending in the country. The effect of the prolonged pandemic measures has hindered the economic outlook in Japan, resulting in probably more time before a solid economic recovery is in sight.

ASEAN and South Asia: Despite the severity of the pandemic in the South East Asian areas, equities markets there overall have performed quite well in the first half of the year. Among them, Vietnam stood out with over 28% return in the half year period, partially due to the Sino-U.S. trade tensions, which has resulted in Vietnam becoming the new destination of manufacturing facilities. The Vietnamese government also lowered the earnings tax rate and even has offered large corporations with tax holidays as they are lured to invest there. In India, with over 3 billion confirmed cases, the medical system there once collapsed and the economic consequences included large unemployment and income reductions. Although Indians are gradually being vaccinated and parts of the regions are ready for reopening, there have been warnings from experts on pre-mature reopening and the possible outcomes of another wave of pandemic there, which would probably lead to disruption of the economic recovery inevitably. In Thailand, tourism in Phuket has been reopened. At the same time, a full reopening is being prepared for October with the fully vaccinated oversea visitors allowed without quarantine upon arrivals, in order to stimulate the Thai to recover faster. However, there are still concerns over Prime Minister Prayut’s plan to save the tourism industry and the economy going forward. And for the Philippines, amid the impact of the pandemic on its economy, the World Bank has previously pointed out that the forecast of its economic growth is lowered to 4.7% from the forecast of 5.5% in March in the World Economic Outlook Report published in June. The Pilipino economy has already contracted 9.6% last year, an historical low, the condition there needs more attention. In Indonesia, the central bank has kept its reference rate at the historic low of 3.5% and has been hinting that it will be kept at that level until the end of this year. Meanwhile, the monetary policy will continue to be easing to encourage lending to corporations and the GDP growth is expected to range from 4.1% to 5.1. In contrast to other emerging countries which have started raising interest rates, inflationary pressure is not yet evident in Indonesia.

Latin America: Benefiting from the pandemic being partially under control and the roll out of the vaccination plan, the service Purchasing Manager Index (PMI) rose for the second month in a row in June from the 9 months’ low in April. In addition, the Brazilian central bank has raised rates multiple times with its benchmark rate already at 4.25% targeting to tame the inflation there. However, it is worth noting that the Brazilian equities market has accumulated quite a lot of gains, and the risk factors facing it include the movements of the USD, domestic politics in Brazil and the variant virus in South America.

Risk Considerations: 1) Geo-Political, liquidity, and currency risks could increase 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 US Federal Reserve, weighing on EM currencies; 5) The coronavirus variant spread around the globe.
EUROPE INVESTMENT SUMMARY

- The European equities markets performed better than the U.S. and the emerging markets in the 1H.
- Lifting of dividends restrictions and long term rates risings might be the catalysts of European bank stocks.
- Physical consumer services industry will benefit from loosening of travel restrictions.
- The variant virus might delay the economic reopening again.

The European equities markets performed better than the U.S. and the emerging markets in the 1H. When 2021 began, global demand recovered strongly pulling up the rate of acceleration of inflation, “Reflation Trade” became the focus of the market for the first half of the year, lifting up the Europe stock indexes with heavy weightings of cyclicals and value stocks to multiple new highs. Up to the end of June, the Euro Stoxx 600 Index recorded a year to date total return of 15.8% in local currency, performing better than the S&P 500 Index of 15.2% in the U.S. and the MSCI Emerging Market Index of 7%. Looking forward to the second half of the year, global economic recovery is expected to accelerate amid the rising rate of vaccination. Thus “Reflation Trade” might still be the most important investment theme of the year. With the U.S. rate of vaccination faster than others, the economic recovery there is also leading, however it might be peaking. In contrast, the reopening of the economies in the Euro zone lagged the U.S. and the economic pace of recovery could speed up further there. Such difference could attract fund flows into the European equities markets, albeit the performance in the second half of the year there is still expected to moderate compared to the first half.

Lifting of dividends restrictions and long term rates risings might be the catalysts of European bank stocks. The consumer price index (CPI) of the Euro zone rose 2% yoy in May, the first time since November of 2018 reaching the target of the central bank, however still much lower than the 5% increase in the U.S. Inflationary pressure in the Euro zone is clearly much lower than that in the U.S. allowing more flexibility for the European Central Bank to maintain monetary easing. With highly accommodative monetary support and the implementation of the Europe Recovery Fund will both be critical to the strong economic recovery of the Euro zone in the future. It is worth noting that the European Central Bank Chief Largarde has stated that if there is no material worsening of the economic and financial conditions, the European banking industry will be allowed to pay dividends and conduct shares buybacks again in September. This will lift up the dividend yields of the European bank stocks, which are attractive to income oriented investors to a certain extent. In addition, the U.S. Fed announced their “Dot Plot” in June revealing that the members expected interest rate increase of 0.5% in 2023, which might reflect that there is a number of the Fed members convinced that the inflationary target will be achieved between 2022 and 2023. Thus the market expects the U.S. Fed might announce the plan to withdraw from quantitative easing in the second half of this year, which in turn might push up long term U.S. rates. Based on past data, European bank stocks usually perform better than the overall market during a rising rate environment.

Physical consumer services industry will benefit from loosening of travel restrictions. According to data from Bloomberg, up to the June 30th, there is about 50% of the European Union’s population vaccinated with at least one shot of covid 19 vaccine, much higher than the 13% figure reported in the 1Q. As vaccination speeded up, many European countries began to relax anti-pandemic restrictions partially and lead to the economic recovery expanding beyond the manufacturing industry to the services industry. The preliminary Euro zone service Purchasing Manager Index (PMI) rose to 58 in June, the highest since Jan 2018. In addition to releasing the pinned up purchasing power of consumers in the Eurozone, relaxation of traveling restrictions will speed up the recovery pace of the service industry. The EU already lifted the restriction of U.S. residents travelling to the EU in June. And since July 1st, holders of European vaccination passport can travel to any EU country without begin quarantined. Such arrangements accompanied by the traditional summer traveling peak season in Europe will benefit the physical consumer services industry including the hotels, premium retailing, and hospitalities. Thus lifting their earnings as well. The manufacturing activities will remain expansionary at an accelerated pace, however the manufacturing input price index rose to the record high of 88.0, shortages of raw materials and labour will bring cost increase pressure. Such will test the pricing power of factories and in turn narrowing the corporate earning margins partially.
The variant virus might delay the economic reopening again. The highly transmissible Delta virus is spreading in Europe with the figures of newly confirmed cases rebounding and also making some European countries delaying their relaxation of pandemic control. If the number of newly confirmed cases spikes up, lock downs and travelling restrictions might be imposed in many countries again, which would be detrimental to the recovery of the service industry and threatening to the economic recovery of the Eurozone. However, as there is already half of the population vaccinated with at least one shot of vaccine in the Eurozone, the number of hospitalization and deaths should be kept at low levels and reducing the pressure to reintroduce new lockdowns measures.

Regional Outlook

Germany: German economic data reveals the accelerating economic recovery there. The composite PMI rose the highest in 10 years at 60.4 in June. The Ifo economic institute expects that 3Q economic growth to be 3.6%, recovering much of the 1.8% contraction in the 1Q. With the election upcoming on Sept 26th in Germany, market focus might be shifting from the economic data to the election results. According to the survey in June, earlier support of the Green party has shifted to German Chancellor Angela Merkel's CDU and CSU conservative coalition. However, the Green party is still sitting in second place with the possibility of a coalition government under CDU / CSU with the Green party. However, the CDU / CSU coalition has a stance that the European Recovery is a one-time temporary measures, and has refused to make it a permanent too. Such stance could become an obstacle to the EU unification. However, the leader of the Green might also become the next Prime Minister of Germany. Uncertainties in the election outcomes will make the German equities market become more volatile in the 3Q.

UK: As the pandemic control relaxed gradually and boosting consumer spending, the Bank of England raised forecasts of the UK GDP to grow at 7.25% and expect that the economy will recover to pre-pandemic level. The central bank also began to modify its monetary policy with a slowdown in the weekly bond purchases. Although the Bank of England forecasts that the inflation will rise 3% yoy, higher than the target of 2%, however it is only temporary in nature without the need to tighten monetary policy as determined by the central bank. With the support of monetary policies, the value stock heavy UK equities market will continue to benefit as the local and global economies recover. There is concern of the variant virus as the new cases in the U.K. rebounded again in June, causing the delay of the lifting of the last phase of the lockdown. If the pandemic continues, it is counter-productive to the domestic market focused cyclicals.

France: The French CAC index returned 19.5% in the first half of the year leading the European markets, which reflects the optimistic sentiment of the investors towards the French economic outlook. The increase in the business confidence in June was higher than expected at the highest level since 2007, with the service sector confidence largely improved due to the economy reopening. The French central bank forecasted the GDP to grow at a rate of 5.75% this year. Even if the restriction policies are reintroduced as a result of the resurgence of the pandemic, the central bank is still cautious confident that the impact on the French economic growth is minimal. The presidential election will be held in April next year in France. The right winged leader Marine Le Pan did not win the local election in June, which might reflect the difficulty for her to challenge Emanuel Macron as the next president of France. In addition, the economic recovery will also be favourable to his election campaign. The reduction in political uncertainty could favour the sentiment of the French equities market.

Risk Considerations: 1) variant virus causing the governments to impose lockdown restrictions again ; 2) earlier than expected monetary tightening by major central banks; 3) Sino-Europe tensions; 4) German election.
**CHINA / HONG KONG**

**INVESTMENT SUMMARY**
- A-shares and HSI fell from their highs in 1Q21, and consolidated in 2Q21
- The A-shares might rebound after consolidation
- Regulatory risks continue to affect the tech sector
- The mainland government may increase monetary and fiscal stimulus to promote the economy
- Corporate earnings support the medium and long-term performance of A-shares and HSI
- Traditional stocks and tech stocks both support the market performance

The A-shares and HSI consolidated in 2Q21. HSI fell back from their highs in the first quarter, and consolidated in the second quarter, with little change throughout the quarter. The fluctuations were only less than 1,800 points and only rose 1.6% qoq. The mainland's monetary policy remained neutral, and the southbound net inflows into HK reduced. As a result, high-value tech stocks continued to be under pressure and consolidated at low levels. On the contrary, as the U.S. 10-year bond yields fluctuated between 1.4% and 1.8%, large financial stocks also stabilized, supporting the performance of the HSI. As for A-shares, the large caps sought after by funds and retail investors, such as liquor and electric vehicles, generally consolidated after falling at a high level. The CSI300 Index rose slightly by 3.5% throughout the quarter.

The A-shares might rebound after consolidation. In the second quarter, the CSI300 Index performed better than the Hang Seng Index and the Hang Seng Technology Index. One of the reasons is that the market is worried about interest rate movements and inflation expectations. As Hong Kong stocks are more affected by external factors than A-shares, the latter's performance is relatively stable. In 2Q21, the CSI300 Index broke through the rampant zone, and recently fell into the return range again. However, it is believed that the current situation is similar to the fourth quarter of last year. After the index has been consolidated, there is still a chance to break through and challenge 5,500 points.

Regulatory risks continue to affect the technology sector. Beginning in 1Q21, the Mainland has strengthened the supervision of the Internet finance sector, including tightening of online microfinance and the removal of Internet deposit products; on the other hand, the regulatory authorities have increased their anti-monopoly supervision over the Internet industry, and many investigations on many tech companies have been filed, and most of them have not yet officially ended, so the market is full of haze, causing the tech sector to fall sharply from its high at the beginning of this year. Nevertheless, as the results of the investigation are released one after another, the regulatory authorities will have clearer requirements for the tech companies, and reduce the regulatory risks of the sector. Moreover, the market will once again focus on the earnings quality and growth prospects of the tech companies. Since valuations have fallen to a more reasonable level, it supports the recovery of the tech sector.

The mainland government may increase monetary and fiscal stimulus to promote the economy. In 1H21, the mainland's export growth was very strong, mainly because the external epidemic drove demand for goods, compared with the slower growth of fixed investment. After the epidemic, consumer habits have changed and they are more inclined to consume online, which helps support consumption growth. In addition, the market expects that the vaccination rate in the Mainland will reach 70-80% by the end of the year, so consumption will continue to recover moderately. In terms of exports, signs of peaking have recently begun to appear, so the contribution to the Mainland’s GDP may decrease in 2H21. Therefore, the government needs to increase monetary and fiscal stimulus in 2H21 (PBOC announced RRR cut on 9 Jul) and boost fixed asset investment to promote GDP growth. This includes new infrastructure, that is, technological infrastructure, which will be one of the focuses of the 14th Five-Year Plan. Therefore, investors should pay attention to the technology and new infrastructure sector.

Corporate earnings support the long-term performance of Hong Kong stocks and A-shares. Last year, the epidemic led to an economic downturn and a decline in corporate profits. However, the government eased monetary policy to support the economy's rebound from the bottom. China manufacturing PMI has been above 50 for 16 consecutive months, indicating the continued expansion of the manufacturing industry. The mainland
3Q 2021 Investment Outlook 13 July 2021

government is expected to cut interest rates and Required Reserve Ratio (RRR) to support economic development in the third quarter, which will help promote corporate profits to maintain growth. As of July 9th, Bloomberg’s consensus forecast shows that CSI300 earnings will increase by 17% and 13% respectively this year and next year; the profit of the HSI will increase by about 9% and 12% respectively this year and next year. Although the valuation of the stock market is affected by the government’s increased supervision, the mainland economy continues to pick up, and corporate profits improve, which will support the performance of A-shares and HSI.

Traditional stocks and tech stocks both support the market’s performance. Since 1Q21, the Mainland has launched anti-monopoly investigations on some large Internet companies and strengthened industry supervision. This has caused the tech stocks to fall from the peak and consolidate in the second quarter. Their performance has lagged behind healthcare, consumer, financial, and policy-supported companies such as new energy and electric vehicle industry. With the improvement of the macro economy, the traditional economic sectors, which are more sensitive to the economy, are expected to continue to improve; while the valuation of tech stocks has fallen from a high level to a more reasonable level, it is believed that with regulatory requirements, the market will become clear and the faster earnings growth of tech stocks is expected to rebound supporting the performance of the market.

Risk factors: 1) The worsening of the epidemic will affect the progress of customs clearance between the Mainland and Hong Kong; 2) The Mainland has stronger supervision of tech companies than expected, which will hit tech stocks and even the valuation of Hong Kong stocks; 3) Hong Kong’s economic recovery is slower than market expectations; 4) The People’s Bank of China changed its monetary policy and substantially tightened monetary policy, which affected asset prices.

Sector outlook

Hong Kong property sector 1Q21 total number of residential units under construction soared 1.4x yoy to 2,200 units, and down 69% qoq. Consensus expects shortage to continue in the future. Meanwhile, the contract value of first hand residential property was up 66.2% yoy (+53.3% mom) to HK$24.95bn in May. The demand for high quality residential units is still strong. HK economy recovery, shortage in residential market and low interest rate results in oversubscription and price hike for the launch of new residential projects. Very often, HK property stocks have strong financials for landbank replenishments and business expansions. At present, the Big Four trades at ~50% discount to NAV, and dividend yield ~4.5%. Valuation is undemanding.

Hong Kong leasing landlord and REITs At present, HK leasing landlords focus on the operation of high end shopping malls and offices. As of 9 Jul, the scale of HK vaccination already >4mn. In addition to the relax of social distance measures, vaccination helps to boost domestic consumption and support for HK retail sector. Some high end mall operators said tenants are planning to expand retail area and set up new flagship stores. The reopening of China and HK border would be the next catalyst. Grade A office is still challenging, but the upcoming of Cross-border Wealth Management Connect will attract more China’s financial institutions to setup HK operations. REIT sector continues to benefit from retail and F&B recovery. The relax of investment restrictions, higher gearing ratio cap, M&As in China and overseas market will drive REIT’s earnings growth rate. Meanwhile, the market is waiting for the inclusion of REITs in Stock Connects.

Macau gaming sector Although China and HK have some confirmed COVID-19 cases in Jun, China and HK government implements effective social distance measures, and vaccination rate is on the increasing trend. Thus, the situation is likely to be under control. In fact, China, HK and Macau government are discussing cross border. As such, we believe the reopen border of China, HK and Macau is just a matter of time. Meanwhile, gaming operators and Macau government also expect a strong summer performance this year. Macau gross gaming revenue soared 8x yoy in Jun, and accumulated gross gaming revenue in 1H21 already reaches 30-40% of pre-pandemic level. Very often, the market is speculating on the resumption of self-service kiosks. Thanks to the opening of new casinos and the availability of new infrastructures for transportations, the outlook of Macau gaming sector is expected to improve in 2H21.
Banking sector During 2Q21 quarterly meeting, the Monetary Policy Committee of PBOC expressed that the domestic and overseas macro environment is still challenging. China’s monetary policy must be flexible and precise to maintain reasonably ample liquidity. Also, State Council stated to use monetary easing policy, such as RRR cut, in the suitable time. On 9 Jul, PBOC announced to lower RRR by 0.5ppt. This might alleviate the previous market concern on PBOC’s monetary tightening. Driven by improving China’s economy, fundamental of China banking sector also saw improvement. According to CBIRC 1Q data, non-performing loan (NPL) ratio of China banking sector has declined for 2 consecutive quarters and non-performing loan coverage ratio also rebounded. But in 2H21, PBOC is likely to keep reasonably ample liquidity and guides to lower market rate. Thus, net interest margin of China banks will be still under pressure in 2H21. On the back of easing NPL ratio but NIM pressure, market estimates China banking sector to keep stable earnings growth. Currently, China banks’ PB ratio is still far below their 10-year historic average. Improving fundamental will drive sector re-evaluation.

Healthcare sector Centre for Drug Evaluation released draft of new guidance on clinical trials of oncology drugs in early July 2021. The new policy mentioned that the best support care should be used as the control arm for randomized clinical trials. The new guidance will set higher standards for clinical trials. Although current pipelines now under clinical trials will not be impacted, market expects that this might reduce the number of R&D projects, in turn which will negatively impact on China business of contract research organisations (CROs). However, HK-listed CROs have high revenue exposure on overseas, so the new guidance might not have material impact on the listed-CROs. On the other hand, new guidance set a high barrier for new drug players to get approval or expand indications. In contrast, this might reduce the market competition against the existing drugs. It is believed that volatility will increase for China healthcare sector, given higher policy risk. Also, market consolidation of CRO and pharma will accelerate which will benefit large players in the long-run.

Consumption sector The sportswear sector performed strongly in the second quarter, as the Tokyo Olympics will be held in July this year, and health awareness among consumers after the pandemic has increased. Looking forward, 2022 Beijing Winter Olympics will be held next year, and it is expected to further stimulate sporting goods consumption. In recent years, individual retailers have chosen to manage their own retail stores to reduce their reliance on distributors, which is more positive to their earnings performance. However, it should be noted that the valuation of the sector is higher after the strong second quarter, and stable earnings performance is required to support the valuation. For the dairy sector, the product premiumization strategy taken by the leading companies has been effective, as it continues to help increase product average prices and gross profit margins. In addition, manufacturers have diversified their products through the acquisition of other dairy brands, which also helps achieve diversified growth. On the other hand, the sales of infant milk powder may be temporarily affected this year, as couples may delay childbirth during the pandemic, resulting in a temporary decline in demand. For the auto sector, the industry recovery continues, but there is still a relative shortage of auto semiconductor components and that cost of production has increased due to higher raw material prices. As a result, profit margins could be under pressure in 2Q and 3Q this year. However, chip supply is expected to return to a more balanced state in 2H21. The medium to long term recovery story is still expected to be intact.

Technology sector Tech stocks generally delivered solid earnings in 1Q21. However, the leading e-commerce enterprises generally use part of this year's gains for medium to long-term investments. As a result, earnings growth this year will have a temporary slowdown. At present, the market has generally lowered the profit forecasts of such companies, and share prices have also reflected as such. Looking forward to the third quarter, if China's anti-trust investigation comes to an end, the market may once again focus on the high growth potential of the technology sector. In addition, if the Southbound funds actively enters into the Hong Kong stock market again via Stock Connect, tech stocks whose valuations have declined are more likely to attract inflows. However, it should be noted that the current policy risks have not been completely played out, and competition between China and the U.S. in the tech sector could still heat up and result in higher volatilities for the tech sector.
Pending recovery in US labor market slowed down the rising momentum of US long-term Treasury yields. Treasury yields were volatile in the last quarter, affected by the inflation concern. U.S. 10-year Treasury yield recorded a quarter high at 1.754% while the quarter low was found at 1.354%, which is equivalent to 40 basic point difference. U.S. Treasury Secretary Janet Yellen said that the Federal Reserve might at some point have to raise interest rates to cool off as economy moving too fast. Her comment was followed by the Federal Reserve officials' surprising 'eagle' signal released in June and together made investors worry about the sooner tapering schedule. There are 3 key changes to be aware in the latest FOMC meeting minutes. First, inflation expectation was risen up to 3.4% from 2.4%. Second, officials were penciling in two rate increases in 2023, according to the dot-plot chart. Third, Fed opened the door to pull back on its bond-buying stimulus. Although Fed Chairman Jerome Powell said in testimony on Capitol Hill that the dot-plot represented a way for the Fed to communicate expectations but not Fed policy, as well as it was very unlikely the U.S. would see 1070-style inflation, the market was pricing in an earlier tapering. The recent record high price indices and weak employment data confused the market on the pace of economic recovery. U.S. 10-year Treasury yield has lost its rising momentum and have seen some short term weakness. We expect reopening of society and economic recovery would send an improving set of employment data, as well as seeing the long-term treasury yields to pick up again. IG bonds may underperform other bond classes in the foreseeable future, given its higher rate sensitivity. Investors may monitor the duration of their portfolios closely in the coming quarter, and also the volatility caused by the change of yield curve.

Asian US bonds underperformed, awaiting more positive catalyst. The valuation of Asian bonds is still at an attractive level, amid specific refinancing difficulties brought uncertainty. Asian bonds underperformed in the last quarter, resulted by the fears over default of some sizable Chinese financial institutes and property developers. Nevertheless, there is more room for the Asian central banks to maintain their loosening monetary policy. It means the rates are unlikely to change in short term and would be more stable among Asian countries, in comparing to DM market. The consensus expects the default rates are 3-4% and 2-3% for Asian bonds and China HY bonds respectively. Given the ample liquidity in Asian market, as well as the 40-50 credit spreads over U.S. and European IG bonds, Asian IG bonds are still attractive in term of fundamental valuation. We expect a positive catalyst that inflation would drive investors’ risk appetite and capital will flow into Asian bond market for better yields. However, China’s recent policies on balancing the economic growth and deleveraging, which should help in avoiding risks in long term, may lock the China bond yields in a narrow range.

Eurozone Treasury bond yields recorded small gains, amid loosening monetary policy maintained in the area. The Eurozone government bond yields generally rose in the second quarter this year, while the German 10-year bond yield has risen to the level of 3-year high. Since the beginning of 2Q21, many of the economic indicators have signaled that the recovery of Eurozone’s economy is speeding up. Especially when society reopening was allowed, a significant economy bouncing back is expected in the coming months. The President of European Central Bank (ECB) Christine Lagarde said that the Bank’s monetary policy has helped lessen inequality during the pandemic, the Eurozone economy is beginning to rebound but the recovery remains fragile. She also agreed ECB should maintain the Pandemic Emergency Purchase Program (PEPP) until at least March 2022, or in any case, until they judge that the coronavirus crisis phase is over. It means favorable economic prospects would continue to enhance the profitability of enterprises, thereby improving the credit quality. We expect abundant liquidity would also continue to support the Eurozone bond market and the credit spread in the market would continue to narrow.
Mind the capital outflow amid slowdown in emerging markets’ recovery. Apart from some positive signs, the global economic recovery was slowed down by the relatively-high infection rates in some emerging countries, as well as their slow vaccination process. On the other hand, Turkey, Brazil and Russia have already raised the rates and the market is worrying that other central banks in the area would follow when inflation is going too fast. Investors should be aware of the capital flow in the emerging markets, especially when FED would start to discuss about a sooner tapering schedule. The end of US loosening monetary policy is not favorable to the asset values and currencies of emerging markets. It may also result in capital outflow from the emerging bond markets and price volatility follow.

**Risk considerations:** 1) The spread of COVID-19 variant delays the economic recovery; 2) The currency exchange rates fluctuate sharply; 3) Default rate increases; 4) Asset prices fall sharply
The recovery momentum of the European economy is increasing
With the gradual easing of coronavirus lockdown restrictions and an acceleration in vaccination programs in the Eurozone countries, consumer sentiment has become more optimistic, and the service industry is gradually returning to normal operation. The Eurozone June IHS Markit Services Purchasing Managers Index (PMI) soared to its highest reading since July 2007, manufacturing activity is growing at the fastest rate on record, and the composite PMI has jumped to its highest level in 15 years. As for the Eurozone, investor confidence also rose for the fifth consecutive month in July, reaching the highest level since February 2018, showing that the recovery momentum of the European economy is increasing.

EUR/USD is unlikely to rebound strongly in short-term
If compared with the US composite PMI in June, which is 63.9, the Eurozone composite PMI only registered at 59.2, but the gap between the two is narrowing. However, inflation pressures in the Eurozone is significantly milder than that of the United States. The Fed sees first interest rate hike coming as soon as 2023, and the market expects that the Fed may send the first signal that a reduction in asset purchase is on the table as early as August to September this year. However, the European Central Bank reiterated in its June monetary policy statement that the PEPP is expected to last until at least the end of March next year. As more and more central banks turn to a hawkish tone, the dovish stance of the European Central Bank becomes more and more lonely, and the euro, as a low-yield currency, may face difficulties. If US economic data continue to support the market's expectations that the Fed will tighten ahead of schedule, the interest rate gap between the US and the Eurozone may expand further. Taking into account this monetary policy divergence, the EUR/USD is unlikely to rebound strongly in short-term.

The rebound of Covid may drag the feet of the pound
On the other hand, although the UK's vaccination rate is satisfactory, 86% of adults have received at least one dose of the vaccine as of early July, the country can’t avoid Covid rebound again. The Delta, variant virus which was first discovered in India, spread rapidly in the local area, and newly diagnosed cases once rebounded to the highest level since January. Activities in the British manufacturing and service industries remained strong in June, but the rate of expansion has fallen slightly from May, which show the negative impact of the Covid rebound on the economic outlook. The England’s plan to lift most Covid-19 restrictions from July 19 has so far not been affected, and the impact on the UK economy at this stage is limited. However, if the epidemic continues to worsen, the uncertainty may significantly drag the feet of the pound.

The BOE failed to adopt hawkish tone and weigh the pound
Although the Bank of England took the first step in changing its loose monetary policy in early May, and decided to slow down its bond purchases, reflecting its optimism about the economic outlook, the MPC became more conservative in the June meeting. Governor Bailey said that the British economy may return to a state of low growth, and the factors that will promote the rise of British inflation will be short-lived, so he believes that they should not overreact. The market generally believes that the severe epidemic in the UK is the main reason behind the bank’s patience. The UK’s economic growth is stable at present, but if the Bank of England fails to adopt more hawkish tone, it is believed that the short-term performance of the pound will be restricted.

Regarding the pace of tapering, it is expected that the European Central Bank and the Bank of England will lag behind the Fed. However, given that the euro and the British pound have already showed massive decline, we expect that the two currencies will face less downward pressure and hold around the range-bound trading zones in 3Q until the Fed give exact date as to when the rollback of its bond buying program will begin.
INVESTMENT SUMMARY
- Canada is hitting national vaccination target
- Canada's economy is expected to rise
- The Bank of Canada will resume rates hike

Canada is hitting national vaccination target
According to Bloomberg data, as of the end of June, one dose of vaccine in Canada accounted for 66.7% of the total population. Based on the current daily average of about 478,000 vaccination doses, it only takes about one month for Canada to reach 75% of herd immunity. It is expected to reduce the risk of the Delta variant virus spreading. The current border closure ban between the United States and Canada will expire on July 21. Canadian Prime Minister Trudeau has made it clear that if the local first dose vaccination rate reaches 75% and the two dose vaccination completion rate reaches 20%, he will consider reopening the border with the United States. Since the local two-dose vaccination rate has reached 19.5%, which is quite close to the target, once the US-Canada border is reopened, coupled with the peak summer tourism period between the two places, it is expected to help boost prospects of local tourism and service industry.

Canada's economy is expected to rise
The US Biden administration's large-scale infrastructure plan has been approved by the House of Representatives, and is now awaiting approval by the Senate. It is understood that the plan will last for 5 years. Mainly used for transportation and water infrastructure construction. At present, about 75% of Canada's goods are sold to the United States, so if the U.S. economy can accelerate growth, it will be good for Canada's exports and the economy. According to the latest trade data, Canadian exports in April fell 1% to 50.2 billion Canadian dollars on a month-to-month basis, mainly due to the shortage of automotive chips. However, exports to the United States still increased by 1.4% month-on-month to 37.1 billion Canadian dollars. It drove a trade surplus of 594 million Canadian dollars that month, the third month of surplus in the first four months, and the first since 2017. With satisfactory performance in foreign trade, the Canadian economy is expected to rise.

The Bank of Canada will resume rates hike
In order to drive the economic recovery after the epidemic, the Canadian government will spend 101.0 billion Canadian dollars in the next three years, accounting for about 5% of GDP. The huge fiscal stimulus policy is expected to bring sufficient support to the economy. However, the side effects of the ultra-low interest monetary policy are gradually emerging. For example, the annual inflation rate in May was as high as 3.6%, which significantly exceeded the 2% inflation target set by the central bank. In addition, the local property market is also very hot. The MLS property price index in May also rose by 24.4% year-on-year. This will provide a rationale for the Bank of Canada to gradually tighten monetary policy. In fact, the Central Bank of Canada announced the reduction of debt purchases as early as April, and hinted that it would resume interest rate hikes as soon as the second half of next year, becoming the first developed country central bank to tighten monetary policy, earlier than the Fed's 2023 interest rate hike expectations.

However, as the Federal Reserve and other central banks also took a tough stance, Canadian central bank officials have expressed concern that a stronger Canadian dollar exchange rate will be detrimental to exports. These are the factors that expected to limit the Canadian dollar's upward space.
**3Q 2021 Investment Outlook**

13 July 2021

**AUD/USD, NZD/USD**

**INVESTMENT SUMMARY**
- Compared with Australian dollar, the New Zealand dollar is more favourable
- Australia's basic factors are not weak
- The RBNZ expects to raise interest rates in September next year
- Compared with the AUD, the NZD is more attractive

**Compared with Australian dollar, the New Zealand dollar is more favourable**
The monetary policy of Australia and New Zealand is very different. Although Australia's economy is not weak, the Bank of Australia (RBA) insists on raising interest rates until 2024, which may be even later than the Fed. Of course, the RBA's remarks cannot be fully trusted, and it cannot be ruled out that as the local economy further improves in the future, the RBA may raise interest rates sooner. However, since the RBA has repeatedly threatened not to raise interest rates before 2024, its remarks can be regarded as a factor that is negative for the Australian dollar exchange rate.

**Australia's basic factors are not weak**
Australia's trade surplus in May was as high as A$9.7 billion, which was close to a historical high, mainly due to the ideals of iron ore exports. Australia's trade has recorded a 41-month consecutive surplus, which can have a positive effect on boosting local GDP growth in the second quarter. As for the local property market, according to the figures released by the local property consultant company CoreLogic, the average property price in Australia in May increased by 10.6% year-on-year, mainly due to the low interest rate environment.

Employment is the economic link that the RBA is most concerned about. The RBA has been insisting on waiting for 2024 to raise interest rates on the grounds that the job market is not ideal. But what is the actual situation in the Australian job market? Australia's latest May unemployment rate was 5.1%, which is basically returning to the level of December 2019, the pre-epidemic level. However, if we look at the annual wage growth rate in the first quarter, it is only 1.5%, which is far less than the usual 2% annual wage growth rate before the epidemic. The Bank of Australia is using this as an excuse, believing that the Australian economy is still lagging behind, and is therefore unwilling to raise interest rates early. However, apart from slower wage growth, other parts of the Australian economy are strong. If the global epidemic improves further in the coming months, the RBA really lacks justification for maintaining interest rates unchanged.

**The RBNZ expects to raise interest rates in September next year**
Unlike RBA, the Reserve Bank of New Zealand (RBNZ) has set a timetable for raising interest rates in September next year at its May meeting. In view of the strong economic growth in the first quarter, the quarterly and annual GDP growth rates were as high as 1.6% and 2.4% respectively, which was far better than the contraction originally expected by the RBNZ. In addition, the RBNZ issued a statement at the end of June that the local economy has fully recovered to its pre-epidemic level. The market is now focusing on future interest rate meetings and whether the RBNZ will push for an earlier interest rate hike schedule. According to the changes in the New Zealand dollar interest rate futures price, the current market expects that the probability of the RBNZ raising interest rates in February next year is 81%. The Bank of New Zealand's next interest rate meeting is scheduled to be held on July 14.

In addition to the GDP figures for the first quarter, there are two figures worthy of our reference when analyzing the New Zealand economy. As we all know, milk is New Zealand’s main export, so changes in international milk prices can directly affect local export earnings. Although international milk prices have fallen from their highs in March this year, the decline has not been significant, and the current price is still at a relatively high level since May 2014. The local property market is also hot. According to the Real Estate Association of New Zealand (REINZ), the local average house price rose sharply by 24.7% year-on-year in May. Hot property prices are expected to force the RBNZ to tighten monetary policy sooner.

Page 18, Total 21 Pages
Compared with the AUD, the NZD is more attractive
When the Australian dollar and the New Zealand dollar are compared, it is expected that New Zealand, which is more aggressive in monetary policy, can look higher. However, the biggest risk for the two currencies is that the vaccination rates of the two countries are low at the same time, and both are less than 30%. After Delta, now comes Lambda, which is a more contagious variant. If these two viruses broke out locally, the situation would be unthinkable.
3Q 2021 Investment Outlook  13 July 2021

Disclaimer

This document has been produced and issued by Hang Seng Investment Services Limited (“HSIS”) for reference and information purposes only. This document does not constitute, nor is it intended to be, nor should it be construed as any investment advice, offer or solicitation to deal in any of the securities or investments mentioned herein. Redistribution or adaptation in whole or in part of this document by any means or in whatever form is strictly prohibited. This document is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution would be contrary to law or regulation.

The information contained in this document is based on sources which HSIS believes to be reliable but has not independently verified. Any projections and opinions expressed herein are expressed solely as general market commentary and do not constitute investment advice or guaranteed return. They represent the views of HSIS or the investment advisor(s) who wrote this document at the time of publication and are subject to change without notice. No guarantee, representation, warranty or undertaking, express or implied, is made as to the fairness, accuracy, timeliness, completeness or correctness of any information, projections and/or opinions contained in this document and the basis upon which any such projections and/or opinions have been made, HSIS and the relevant information providers accept no liability or responsibility in relation to the use of or reliance on any such information, projections and/or opinions whatsoever contained in this document. Investors must make their own assessment of the relevance, accuracy and adequacy of the information, projections and/or opinions contained in this document and make such independent investigations as they may consider necessary or appropriate for the purpose of such assessment.

HSIS is a subsidiary of Hang Seng Bank Limited which is part of the HSBC Group. Except as otherwise disclosed, HSIS has no interest in the securities of the companies discussed in this document or member companies within the same group of such companies as at the date of issuance of this document. Companies within the HSBC Group and/or their officers, directors and employees may have positions in and may trade for their own account in all or any of the securities or investments mentioned in this document. Companies within the HSBC Group may have provided investment services (whether investment banking or non-investment banking related), may have underwritten, or may act as market maker in relation to these securities. Commission or other fees may be earned by the HSBC Group in respect of the services provided by them relating to these securities or investments.

The securities or investments referred to in this document may not be suitable for all investors. No consideration has been given to any particular investment objectives or experience, financial situation or other needs of any recipient. Accordingly, no representation is made with regard to the appropriateness of any of the securities and/or investments referred to herein for any particular person’s circumstances. Investors must make investment decisions in light of their own investment objectives, financial position and particular needs and where necessary consult their own professional advisers before making any investment. This document is not intended to provide any investment advice and should not be relied upon in that regard.

Investment involves risks. Investors should note that value of securities and investments can go down as well as up and past performance is not necessarily indicative of future performance. Foreign investments carry additional risks not generally associated with investments in the domestic market, including but not limited to adverse changes in currency rate, foreign laws and regulations. This document does not and is not intended to identify any or all of the risks that may be involved in the securities or investments referred to herein. Investors should read and fully understand all the offering documents relating to such securities or investments and all the risk disclosure statements and risk warnings therein before making any investment decisions.

The investment advisor(s) who prepared this document certifies(y) that the views expressed herein accurately reflect the investment advisor’s(s’) personal views about the company(ies) or products covered therein and that no part of his/her/their compensation was, is or will be directly or indirectly related to the specific views contained in this document.

© Copyright. Hang Seng Investment Services Limited. ALL RIGHTS RESERVED.

No part of this document may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior written permission of Hang Seng Investment Services Limited.

(HSIS 03/18)
Disclosures

HSIS has in place procedures to identify and manage any potential conflicts of interest that arise in connection with the advisory operations. HSIS’s investment advisors and its staff who are involved in the preparation and dissemination of advisory studies operate and have a management reporting line independent of HSBC Global Markets and Global Research business. At the time of publication of this document, HSIS’s affiliated companies will from time to time sell to and buy from customers the securities / instruments, both equity and debt (including derivatives) of companies covered in HSIS on a principal or agency basis or act as a market maker or liquidity provider in the securities / instruments mentioned in this document. Chinese wall procedures are in place between the advisory business operations and other banking operations to ensure that any confidential and price sensitive information is handled in an appropriate manner. HSIS and HSIS’s affiliated companies does and seeks to do business with companies covered in its commentaries. As a result, investors should be aware that the company may have a conflict of interest that could affect the objectivity of this document.

Investment advisor(s) is(are) paid in part by reference to the profitability of Hang Seng Bank Limited which includes brokerage commission revenues and fee income.