EXECUTIVE SUMMARY

Quarterly Investment Analysis

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<th>Market</th>
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<td>Global Investment Grade Sovereign</td>
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<td>European and US Investment Grade Corp</td>
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Source: HSIS. As of 16 Jan 2020. The views expressed were held at the time of preparation and are subject to change.

Symbol representation:
+ Positive: potentially may perform well relative to the relevant major global benchmark(s).
= Neutral: potentially may perform in line relative to the relevant major global benchmark(s).
- Cautious: potentially may not perform well or in line relative to the relevant major global benchmark(s).

Highlights

- Global economy is expected to stabilize in 2020, however will still potentially be affected by protectionism and geopolitical risks. Equity markets with significant returns in 2019 and relatively high valuations are more vulnerable to any emerging event risk.
- Leading large caps in Asia have strong balance sheets and stable cash flows. These companies would be the major beneficiary of potential rebound in global manufacturing activities. We are positive on China onshore and offshore equities thanks to an improved market liquidity and corporate earnings recovery.
- We prefer Asian credits vs the rest of the world due to valuation and new issue supply discipline in 2020, and expect the default rate in this region remain benign.

2019 was a year full of both challenges and rewards. Faced with much uncertainties, global markets went through the ups and downs of the Sino-U.S. trade talk, continuous slipping in manufacturing activities, Brexit event risk, and transition of US interest rate cycle. The U.S. yield curve has even become inverted at some points, triggering recession concerns. However, amid the reversed stance by the U.S. Federal Reserve from hawkish to dovish with three rate cuts and the numerous rate cuts by a number of central banks around the globe, the effectiveness of monetary loosening gradually mattered. On the other hand, China has stepped up its support measures to stabilize the economy and the impact is evidenced in economic data released in the recent months. In addition, it was announced in December that an agreement has been reached by China and U.S. on a first phase trade deal with mutual understandings to lower tariffs multilaterally, and to proceed with further negotiations in 2020. Thus major markets and asset classes finished 2019 with stellar returns with a few even recorded the best performances in recent years.

Looking forward to 2020, global economy is expected to stabilize in 2020, however will still potentially be affected by protectionism and geopolitical risks. Equity markets with significant returns in 2019 and relatively high valuations are more vulnerable to any emerging event risk, such as the conflicts between Iran and U.S. Cautions are warranted on U.S. high growth sectors e.g. technology, whereas Germany and Japan equities markets are also highly prone for profit taking given current expensive valuations, in our view. Diversification among high quality global stocks can reduce over exposure on single country and on U.S. growth sectors. On the other hand, although Asian equities will be challenged if crude oil prices continue to surge and US dollar turns strong again on risk event, we still
feel comfortable of holding on Asia due to its reasonable valuation. Leading large caps in Asia have strong balance sheets and stable cash flows, and many of them would be the major beneficiary of potential rebound in global manufacturing activities.

As for Hong Kong and China, the first phase Sino-U.S. trade agreement reached has largely relieved the concerns over the trade frictions. Now investors will shift focus to China’s economic performance and monetary policy. The mainland economy has shown many signs of improvements recently, including the recovery of manufacturing, official Purchasing Managers’ Index (PMI) has rebounded to above the level of 50 for two months consecutively, which reflected the effectiveness of a relatively loose monetary policy environment adopted since 2019. Investors should also note that if external shocks appear, Mainland A shares will be less affected by capital flight from risky assets versus other markets. For China equities, we like high-end manufacturing, semi-conductor, insurance, consumer, and health care sectors.

The "dot plot" of the U.S. Federal Reserve reveals that the expectations by the Fed is to stay put for interest rates in 2020, and market consensus is that the U.S. will remain in a low interest rate environment for a relatively long period of time. For bond allocation, high grade short duration U.S. dollar bonds is still a core stabilizer in an investment portfolio. In particular, for Asian high yield and investment grade bonds, their yields in general are higher relative to those of comparable credit ratings in the U.S. and Europe. In addition, the balance sheet of the mainland property developers have improved in recent years, the net new bond supply of Asian high yield might also drop leading to technical support for their performances. Other factors such as the continuous loosening stances by global and Asian central banks, and the improved trade relationships between China and the U.S., also are support for performances of Asian bonds.

Lastly on FX, we expect dollar to weaken a bit in the short term, and expect other currencies show some upside against the green back. In the medium term, we are most bullish on Euro on the back of Eurozone’s economic improvement and expect ECB to reduce its bond purchase program later this year.
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Investors still have confidence in US equities. The first-phase of Sino-SU trade deal announced, along with the US stepping out of recession in the short term drove investors’ optimism to pick up. Various favourable factors brought US stocks to a new high before the end of the year. Looking back at the US equity rally in 4Q19, it was driven by the defensive sector, followed by the cyclical sector; later on even the small and mid-cap stocks also caught up. All eleven S&P 500 industry sub-sectors have also been sought after benefit from sector rotation, reflecting that the overall rallies of US stocks were comprehensive, and investors still have confidence in US equities.

US shares are stretched at current high levels. The S&P 500 Index has gained more than 30% and nearly 9% for the whole year of 2019 and in 4Q19 respectively. Technically, the index is at the upper Bollinger Bands bracket, and the Relative Strength Index (RSI) is above 70, indicating that an overbought conditions. History showed that the chance of a technical correction in the first quarter of the following year is relatively high after a strong year-end Christmas rally, if there is no other strong catalyst. Coupled with the recent sharp gain in the market, the valuations of most US stocks have appeared stretched at current high levels and investors should wait for a better chance to enter the market. The S&P 500 Index is expected to run in the 3,150-3,300-point range in 1Q20, corresponding to a forecast P/E ratio of 17.4 to 18.3 times.

Personal consumption shines but manufacturing weighs. There have been a dividing line between the manufacturing/business investment side of the economy and the services/consumer spending side. The prior one have been weighted due to trade tensions and individual industrial issues. While the manufacturing industry has cooled, the employment situation in the US has continued to improve, fuelling the local property market and personal consumption. Healthy consumer activities and consumer confidence are expected to support the US local economy.

Presidential election generally support US stock market. Year 2020 is the year for US presidential election. Taking reference to the past 23 terms of US elections since 1928, there were 19 terms that the S&P 500 Index recorded positive returns during the election year. The Fed currently expects to stay “on hold” in 2020, having three rates cut in 2019. Historically, when the Fed cut rates consecutively for three times, the stock market picked up in the following year. Out of the last 15 times of rate cuts consecutively for three times, 11 times the S&P 500 rose after six months. Therefore, short-term monetary easing policy is generally good for stocks, especially after expanding the Fed’s balance sheet to prevent the economy from entering a recession.
Earnings need to step up. Looking forward to 2020, US stocks are still expected to receive support if constructive trade talks between US and China continues, US inflation remains moderate. The major risk in US stocks is high valuations in most shares. Most valuation metrics including PE ratios are stretched relative to history. That suggests that profits need to catch up in order to justify higher valuations. If the trade talks remain constructive, business confidence returns, employment and personal consumer confidence stay healthy, US corporate earnings may achieve an annual growth of 6% -9% in 2020, which will continue to support US stocks.

5G, Fintech, and consumption are the long-term themes. 5G industrial revolution will be the medium to long-term investment theme. Fin-tech would be another focus. Online spending is getting popular worldwide and widely used on smartphones and personal computers. Both themes are expected to drive some technology, finance and communications service sectors. Since the US relies on personal consumption for domestic growth, both confidence index and consumption data point to the fact that consumption in US has remained good, and sales have reached another record high during the Christmas season. Therefore, we are optimistic about the prospects of consumer-related sectors; those companies that can integrate online, physical stores, and leverage on the synergy of their strong brands are even more sought after.

Sector Outlooks

Healthcare / Biotechnology Healthcare sector has been sensitive to political risks. S&P 500 Healthcare Index is trading cheaper than S&P 500 Index trading at 17.5x forward PE. Managed Health Care has been under pressure in 2019 over concerns that a "Medicare for All" agenda could wipe out the need for the sub-industry. Those concerns faded in October last year when democratic candidate Elizabeth Warren announced to push back her timeline for implementation if elected. We expect Healthcare to outperform as its price catches up with earnings growth. Elections should be in focus once the Democrat presidential nominee is known. As long as Democrats do not orchestrate a "clean sweep" where they take control of the presidency and both houses of congress, we expect the sector to outperform as political risk gets priced out of the sector.

Information Technology / Communication Services S&P500 Technology Index and S&P Communication Services’ forward PE have now risen to nearly 23.2x and 19.7x respectively, above their historical averages. But we reckon valuation is not a reason to sell the sectors, though it adds pressure for the sectors to keep up earnings surprises and growth. 5G will in focus in 2020, as many major countries have rolled out their 5G plans and a whole range of innovations will benefit both technology and communication sectors. The bottom line is that technology is very much driven by earnings revision trends and those trends are bullish as we entered 2020.

Consumer-related. We continue to think patterns of consumption will move from physical shops to online, supporting the "digital consumer" and fin-tech" themes. Personal consumption globally have not slowed down, in spite of the possible slowdown in the economy in 2020. This change will continue to bring new opportunities not just in technology, but also in traditional sectors like retails, financials, logistics, supply-chains and distribution which are now readying for a future using robots, drones, virtual reality and much more. In general, we are still positive on consumer-related
sectors, on the back of strong job figures and healthy property markets supporting real disposable income. Low interest rate and strong consumer confidence all serve as solid support for the sectors.

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) policy-related uncertainties from US presidential elections.
INVESTMENT SUMMARY

- First phrase of Sino-U.S. Trade Deal reached.
- Economic data is picking up.
- EM central banks and governments are committed to stimulation of economies.
- The valuations of EM stocks are not cheap.
- Funds flowing back to EM.
- Individual EM might face social unrest risk.

First phrase of Sino-U.S. Trade Deal reached. Having gone through over a year of intense trade negotiation, China and the US narrowed down their indifferences and reached the first-phase of trade agreement. China will buy more US agricultural products, and the US will reduce tariffs on some Chinese products. The monetary amount reached by the both parties has little economic impact, but it help ease the decline in business confidence as trade conflicts have heightened uncertainties. We believe that the economic downturn in emerging markets (EM) once caused by the Sino-US trade tension has been reversed.

Economic data is picking up. EM economies have gone through the worst time, especially from manufacturing activities. The Markit Emerging Market Manufacturing Purchasing Managers Index has fallen to contraction zone in early 2019, and has gradually rebounded to expansion zone at 51 point. The Citi Economic Surprise Index-Emerging Market Export Index has rebounded from the lowest of -86.1 in April 2019 to the latest -8.5. The growth of EM economic activities have not yet fully recovered, but pickup from individual countries are seen. Economic growth in EM is expected to improve by 2020.

EM central banks and governments are committed to stimulation of economies. Since the end of the Fed’s interest rate hike cycle and the start of interest rate cuts, many EM central banks have also decisively followed their cuts. Among them, India, Brazil, and Turkey are the most aggressive. Liquidity in the market fueled stock market performance. On the other hand, local governments have increased their efforts to increase spending to support economic growth. Individual countries also successfully introduced market-friendly policies, like Brazil’s pension reform, India’s tax reform and Russia’s raising dividends payout from state-owned enterprises. Overall, the good performance of EM equities in 4Q19 is expected to continue in 2020.

The valuations of EM stocks are not cheap. Earnings from EM corporates have been impacted recording only single-digit growth last two years. But they are expected to see a significant rebound in growth to 14.9% in 2020. However, prospective PE ratio of emerging market index has reached 12.9 times, which is higher than its past five years’ average and indicated that EM stocks need to further improve their profitability in order to support equities’ performance.
Funds flowing back to EM. EM equities regained investors’ attentions, benefit from the first-phase of trade talk between China and the US coming into agreement, and prospects of global economy turning more positive. As of 18th Dec 2019, funds have flowed into EM equities for eight consecutive weeks. Despite a net negative outflow in 2019, funds flowing back to EM is expected in 2020.

Individual EM might face social unrest risk. The ripple-effects from social unrest has swept the world in 2019. That included anti-government demonstrations in many Latin American countries, which triggered their local currency plunge to a record low. The Indians were dissatisfied with their government’s policy of discriminating against Islam, which triggered a national protest. If proper measures are not implemented, social unrest would soon affect local consumer and business confidence, and is detrimental to the country’s stock market.

Region Outlook

Emerging Asia Sino-U.S. trade talks have progressed along the way. The Asian region will benefit the most since many Asian countries already have close trade relations with China. China has become its largest trading partner with South Korea, Taiwan and the ASEAN. Now that China and the US have reached the first-phase of trade agreement, it will help stabilize trade prospects in Asia when business confidence comes back and economic growth recovers. We expect manufacturing and export activities in North Asia to recover significantly, which are positive for local equities. The corporate tax cut bill introduced by India earlier also helps to boost corporate profits. Corporate earnings growth in Asia (excluding Japan) is expected to reach nearly 16% in 2020, and Asian equities are expected to resume its upward trajectory.

Latin America The successful implementation of pension reforms by Brazil government is viewed as positive by the market. Rating agency Standard & Poor has upgraded Brazil’s rating outlook to positive. The agency further commented the country could receive an investment credit upgrade if the country could further reduce its debt, improve its economic growth and continues with its structural reforms. Brazil’s Minister of Economy estimates that interest payment on debt will be the lowest in 10 years. However, the situation in other Latin American countries is not as optimistic as Brazil. Anti-government demonstrations broke out in Bolivia, Chile, and Colombia for different reasons, triggering outflow of funds from the region, and caused Latin American currencies to fall to historical lows. Although the intense situation eased in December 2019, social unrest is still a major risk in Latin America.

Emerging Europe Middle East Africa (EEMEA) Russian government are implementing guidelines to encourage state-owned companies paying out half of their profits as dividend in order to improve corporate efficiency. At present, Russian companies are gradually increasing their dividend payout ratios, which has exceeded 6% on average in overall up to now. High dividend yield made Russia an attractive investment market, as the ratio is expected to rise in the coming years. Turkey’s new central bank chair, a pro-government official, has cut interest rates four times in a row, from 24% to 12%, far more than market expectations. The decline in interest rates has made Turkish assets less attractive. We will pay attention if local currency...
fluctuation would bring Turkey back to inflation, which might trigger another economic crisis.

**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.
1Q 2020 Investment Outlook  

EUROPE

INVESTMENT SUMMARY

- European equities hit record high on subsided fears.
- Valuations will be subject to revaluations on fund flows and improved manufacturing data.
- ECB to maintain its loose monetary policies on sluggish inflation.
- Sino-US trade talks and UK-Europe tariff negotiation will be in focus.
- ECB to maintain its loose monetary policies on sluggish inflation.

European equities hit record high on subsided fears. Benefit from reaching of first-phase trade agreement between the US and China in 4Q19, global risky assets surged. Cyclical sectors were found the most outperforming in the European stock markets. After the British Prime Minister Johnson won the election in December, the European STOXX600 index hit a record high on abated Brexit fears. The European STOXX600 index rose by 23% in 2019, the best performance in 10 years, and the gain marked closely with the US major indexes. Investment sentiments were supported by reduced concerns on a number of risk factors. Having accumulated significant gains last quarter, European stocks might need to face short-term corrections in 1Q20, due to weak economic fundamentals in the region.

Valuations are subject to revaluations on fund flows and improved manufacturing data. Although the European stock market is at an all-time high, no significant inflow of funds has been seen. In fact, the European stock market has recorded a net outflows last two years. However, recent inflow of funds on fading risk from trade tensions and Brexit suggests that the European markets might regain international investors’ attentions. The improvement in corporate earnings is expected to attract continued capital inflows. Global manufacturing has shown signs of bottoming out, China’s official and Caixin manufacturing purchasing managers’ index (PMI) has returned to expansion levels over 50 points. Thanks to China’s the regained momentum from China export orders, which provides supports to manufacturing activities in Euro zone. Historically, the growth trend of Eurozone manufacturing PMI marks closely to growth in European corporate earnings. Further improvement in manufacturing data in the region would support earnings growth of export-oriented European companies, which will help revaluations of European stock markets. The prospective PE ratios of the European STOXX600 index is around 15 times, which is way lower than its historical high of 16.9 times, and is cheaper than the US S&P 500 Index at 18.3 times.

ECB to maintain its loose monetary policies on sluggish inflation. The new European Central Bank (ECB) President Lagarde maintained its negative interest rate policy, asset purchase plan and forward guidance after last Dec meeting. Although the latest economic forecast from ECB has not changed much compared to previous quarter, the assessment of the economic outlook has become slightly positive. Governor Lagarde said despite downside risk remains, the slowdown of the Eurozone economy has shown signs of stabilization. Although the recent statement reiterated that further interest rate cuts have declined, the ECB guided to buy debt at a pace.
of Euro 20bn per month until the inflation reaches its target at 2%, while the latest ECB inflation forecast shows that inflation will remain only 1.6% until 2022, which is still below its long-term target. It implies that ECB could maintain its negative interest rate and debt-buying program at least this year. Since both the Fed and BoJ have also expanded its balance sheet and continued its implementation of quantitative easing policies respectively, injection of liquidity to the market will provide support for global risk assets.

Sino-US trade talks and UK-Europe tariff negotiation will be in focus. European equities might face some negative factors despite many positive ones ahead. Trade representatives from Europe and the US will meet in mid-Jan to discuss tariff issues on steel, aluminum, and the “digital tax”. The US representative Wright Heizer has previously hinted to raise European commodity tariffs, in order to narrow the trade deficit between two parties. The draft agreement for Brexit submitted by British Prime Minister Johnson has included a provision that prohibits an extension of the transition period for the European Union. It would limit the final deadline of the UK-EU trade agreement before December 2020. If both parties fail to reach an agreement, it would trigger a “hard” Brexit. The Sino-US trade talks and UK-Europe tariff negotiation agreements between the United Kingdom and the EU could negatively impacted the economy and corporate earnings in Eurozone.

Germany Germany’s economy grew by 0.1% quarterly in 3Q19 and avoided a technical recession. However, manufacturing data is still weak, and it continues to weigh on servicing industry and overall economic performance in 4Q19. The recent corporate surveys showed that the German economy may be at a turning point, as German investor confidence rose sharply from -2.1 in the previous month to 10.7, and Ifo December business climate index rose to six. The ZEW survey showed that companies are more optimistic about their manufacturing activities and business prospects for the next six months. Historical data shows that difference of manufacturing PMI between Germany and the Eurozone has a correlation with the difference in performance of the German and the overall European stock markets. The German economy is expected to stabilize this year due to the conclusion of 1st phase of trade agreement between China and the US. The gap in future manufacturing PMI data between Germany and Eurozone could gradually narrow down. In addition, new leaders have been elected by the Social Democratic Party, which formed a coalition government with German Chancellor Merkel. The new leadership advocates increase in investment, minimum wages, and a fiscal policy that either avoids zero debt deficits, or increase stimulus policies. It will be beneficial to growth of German economy.

UK The market expects that the Brexit agreement would be passed by the UK Parliament and UK would leave the EU before the end of January 2020, following the victory of British Prime Minister Johnson. Therefore, investors’ focus is on trade negotiations between the UK and EU during this “transition period”. It should be noted that the draft agreement of Prime Minister Johnson will ban the government from extending the transition period beyond 2020. The tariff negotiations between the two countries will also be quite arduous. The market generally doubts if Johnson could reach a trade agreement with the EU in a short period of time, and the uncertainties would gradually increase during 2H20. Brexit has been a major risk in Europe, especially in UK. The lengthened delay has already dampened sentiment among British companies and consumers. But UK stock market might
Italy The Italian FTSE MIB Index still outperformed its European peers despite constant political controversy in the country last year. The 2020 budget proposed by the new coalition that are formed by the Five Star Movement Party and the Democratic Party was passed by the Congress at the end of December last year. It helps to maintain annual deficit as a percentage of gross domestic product (GDP) at 2.2%. The government planned to add VAT tax in 2021 and 2022, which may prevent Italy subject to EU discipline for budget issues in the future. However, the market generally believes that the newly formed government will face many difficulties. The regional elections held in Emilia-Romagna on 26 Jan is taken as a test for the coalition government. If the Democratic Party lose the election, or causes their leaders to resign, it could possibly terminate the parties' cooperation with the Five Star Movement Party, leading to a call for early election in Italy. The Italian stock market is expected to remain volatile until the election has clear results.

Risk Considerations: 1) Sino-US trade frictions 2) Economic slowdown in China 3) Trade negotiations between US and Europe 4) Trade negotiation between UK and EU
INVESTMENT SUMMARY

- Japanese equities performed strongly in 4Q19
- JCB poised to keep short-term rates and inflation
- Economic development and aging population are concerns
- Aggressive stimulus program to deal with economic downside risk.

Japanese equities performed strongly in 4Q19. The Nikkei 225 Average Index was hovering in the range of 20,000-22,000 points in the first three quarters of 2019. But the index broke out in the fourth quarter and climbed to 24,000 levels, benefit from the smooth Sino-US trade talk. Coupled with the continued inflow from foreign capital, the Nikkei 225 Average Index increased by more than 1,800 points last quarter and increased by more than 11% in 2H19. Summarizing the full year, the Nikkei 225 average index rose by 3641 points or 18.2%, reaching its 29 years' historical high since 1990. Thanks to interest rate cuts from major central banks. TOPIX Index also rose by more than 15%, and the TOPIX II Index, representing small and medium-sized stocks, also rose by more than 16%.

JCB poised to keep short-term rates and inflation. JCB hinted to put rates on hold in the near term. After the BoJ meeting last December, JCB announced to maintain all monetary policies and forward guidelines unchanged, and interest rates to remain at low levels. JCB maintained its assessment of economy in moderate expansion trend with core inflation at 0.5%, and lowered its assessment of industrial production due to negative impact from natural disasters. The bank replaced "increased" with "still high" risk in its recent statement, reflecting that downside risks from oversea economies have abated, but remain vigilant.

Economic development and aging population are concerns. Japanese stocks was one of the strongest countries among mature markets in attracting capital inflow (more than 50 billion US dollars) in 2019. But the country’s economic development needs to pay attention to, especially the government has revised downward the country’s economic outlook for four times last year, as the decline in automobile exports led to a decline in overall industrial production, including steel, chemical and electronic components. In addition, the long-term detriment on Japanese economic growth is the nation’s aging and declining population, which will affect overall consumption structure. The latest statistics released by the Ministry of Labor showed that the number of newborn babies in Japan in 2019 is expected to be less than 900,000, which is 54,000 less than in 2018 and is the lowest since 1899. If population issues could be improved, it would serve as a strong catalyst for Japanese stocks.

Aggressive stimulus program to deal with economic downside risk. Japan is proactive in its economic stimulus programs facing its downside risk. An economic stimulus plan of up to 26 trillion yen was announced in December 2019. The plan mainly focuses on three directions: disaster recovery and reconstruction, dealing with downside risks of overseas economies, and maintaining economic vitality after the Tokyo Olympics. Investment measures that aim for stimulating agricultural exports, and
various measures that prepare for sudden change in the global economy are introduced to minimize the risk of Japan's economic recession.

**Risk Considerations:**
1) Global economic slowdown; 2) Influence from Consumption Tax; 3) Strong JPY which affect exports; 4) Japan and Korea political tensions; 5) Aging population; 6) Insufficient local labour force; 7) Surge in debt due to significant economic stimulus measures; 8) Slowdown risk after Tokyo Olympic; and 9) Impact on agriculture due to US-Japan trade talk; 10) BoJ not able to achieve target inflation.
**INVESTMENT SUMMARY**

- The market focus will shift to the second round of trade negotiations. If progress is smooth, it is expected to benefit HK and China stock markets.
- In 2020, the main focus of the Chinese economy will be stability, and monetary policy will be flexible and moderate.
- Last year the PBOC reformed the interest rate formation mechanism, and liquidity is expected to be directed to the real economy more effectively.
- The Chinese government has recently announced a number of supporting real estate measures; relaxation of restrictions on settlements will help drive housing demand.
- China is working toward doubling its GDP by 2020; overall A shares could outperform HK shares.

The market focus will shift to the second round of trade negotiations. If progress is smooth, it is expected to benefit HK and China stock markets. HK and China stock markets performed well in the fourth quarter of 2019, mainly benefited from the improving risk appetite and monetary easing measure of the Federal Reserve. In particular, China and the US reached the first-phase agreement in principle and plan to officially sign it in mid-January 2020, which will help alleviate market concerns about trade frictions. Looking forward to 2020, the market focus will shift to the second stage of negotiations. Since intellectual property rights, industry subsidies and other issues will be involved, negotiations are expected to take longer to reach consensus. However, if there is progress in the China-US trade talks and no negative news appears, business confidence and consumer sentiment are expected to pick up, and HK and China stock markets are likely to benefit the most.

In 2020, the main focus of the Chinese economy will be stability, and monetary policy will be flexible and moderate. The purpose of the Central Economic Work Conference held in December was to set the tone for the 2020 economic outlook. The conference emphasized the importance of stability and ensured that the economy achieved high-quality growth. Monetary policy will change from appropriately moderate last year to moderate and flexible. For fiscal policy, the emphasis on the successful implementation of tax cut and fee reduction. For real estate policy, measures will be long-term oriented and city-specific with the aim of stabilizing land prices, house price and market expectation. After the meeting, the Economic Research Institute under the National Development and Reform Commission (NDRC) indicated that the Chinese economy is still making stable improvements over the long term, and it expects that economic growth in 2020 would remain at about 6.0%. In recent months, certain economic data have improved, and the improvement reflects the effectiveness of the easing measures in 2019. If the policy mentioned above continues to take effect and the economy can maintain its growth rate, corporate earnings will be expected to recover and will help the performance of HK and China stock markets.
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Last year the PBOC reformed the interest rate formation mechanism, and liquidity is expected to be directed to the real economy more effectively. The PBOC announced that it would cut RRR by 50 basis points on January 6 and that would release about 800 billion yuan of liquidity, which reflects the moderate and flexible monetary policy mentioned above. In fact, the Chinese government has reformed the interest rate formation mechanism last year, replacing the traditional loan benchmark interest rate with the Loan Prime Rate (LPR). The purpose is to improve the efficiency of interest rate transmission to reduce the financing costs of small & medium enterprises and micro-enterprises. In the future, there will be 18 quotation banks for LPR, which will provide one-year and five-year term quotes, and the LPR rate will be announced once a month. As such, interest rate formation will be more market-oriented. Recently, the PBOC has also expanded the scope of application for LPR. From January 1st this year, all newly signed existing floating interest rate loans will be based on LPR and will no longer be priced by reference to the traditional loan benchmark interest rate. This shows that PBOC’s monetary policy will play a more effective role and the real economy is expected to benefit.

The Chinese government has recently announced a number of supporting real estate measures; relaxation of restrictions on settlements will help drive housing demand. In terms of real estate, the Chinese government is focusing on city-specific strategies, and a number of good news was announced in December. For example, the Guangzhou Provident Fund Center introduced a new policy where residents from eight cities in Greater Bay Area (except Guangzhou) wishing to apply for provident fund loan for buying properties in Guangzhou will no longer need to submit a proof of fund usage. In addition, the Chinese government has also announced proposals for reforming the mobility of social talents. In particular, restrictions on urban settlements of less than 3 million permanent residents in urban areas will be removed. This proposal will facilitate the mobility of talents and help drive demand for real estate. Looking back at 2019, the housing price index of the top 100 cities in China has risen moderately, and large real estate developers have mostly reached the annual sales target. The growth will also promote economic growth in other industries and the Mainland.

China is working toward doubling its GDP by 2020; overall A shares could outperform HK shares. In terms of real estate, the Chinese government is focusing on city-specific strategies, and a number of good news was announced in December. For example, the Guangzhou Provident Fund Center introduced a new policy where residents from eight cities in Greater Bay Area (except Guangzhou) wishing to apply for provident fund loan for buying properties in Guangzhou will no longer need to submit a proof of fund usage. In addition, the Chinese government has also announced proposals for reforming the mobility of social talents. In particular, restrictions on urban settlements of less than 3 million permanent residents in urban areas will be removed. This proposal will facilitate the mobility of talents and help drive demand for real estate. Looking back at 2019, the housing price index of the top 100 cities in China has risen moderately, and large real estate developers have mostly reached the annual sales target. The growth will also promote economic growth in other industries and the Mainland.
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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

Hong Kong Property The Chief Executive released Policy Address 2019, which revise the mortgage requirement for first-time home buyers. The cap on the value of the property eligible for a mortgage loan of maximum cover of 90% loan-to-value (LTV) ratio will be raised from the existing HK$4mn to HK$8mn. For a property eligible for a mortgage loan of a maximum cover of 80% LTV ratio, the cap of its value will be raised from HK$6mn to HK$10mn. Brokers believe the lower down-payment requirement for the first-home buyers will be positive to transaction volume and narrow down NAV discount. Moreover, the Policy Address 2019 also introduce Land Sharing Pilot Scheme (LSPS). Developers can convert their farmland/brownfield to residential via participating in the LSPS, granting a higher plot ratio, and ~30% share of the incremental GFA will be used for private residential projects. Consensus believe the scheme will accelerate farmland conversion. De facto, thanks to the new mortgage insurance planning, properties transactions rose 70% yoy to 6,701 in Nov 2019. Better still, the current HK property stocks trade ~48% discount to NAV and ~4% dividend yield, the valuation is undemanding.

China insurance stocks In September last year, the 10-year Treasury bond yield in China hit a key level of 3%, but then it rebounded significantly, and the future trend may be relatively stable. From the perspective of the life insurance business of insurance companies, a stable interest rate on government bonds will help reduce reserve charges and increase bond portfolio reinvestment yield, both of which are good for earnings performance. Regarding property and casualty insurance, the auto insurance business performed steadily, but non-auto property and casualty insurance products maintained high growth and became the growth driver of the property and casualty insurance business. Such trend is likely to continue. Recently foreign investment has accelerated the expansion of different provinces in China. It is expected that this round of measures will help the foreign insurance companies that have established an excellent insurance agency team in China and deepen the development of their China business.

Healthcare The coming group procurement organization (GPO) tender for public hospitals will adopt “N-1” winner rule, instead of “3 winners” rule. N stands for number of bidders. It means that if there is 5 bidders, only 4 will win the bid. Also, there is maximum six winners for each generic drug. This gives each participant a higher chance of success for drugs with more than four bidders. However, for the drug with 3 or less bidders, the competition is likely to increase, as the one of them will be eliminated, comparing to previous “3 winners” rule. Market concerns on further drug price cut, resulting in share price weakness since mid-Nov 2019. Yet, share price decline in late 2019 might price in the concern. Also, this would accelerate market
consolidation and force drug makers to transform from generic drug makers into innovative drug makers. Large drug manufacturers with rich new drug pipeline are likely to gain market share in the long run. On the other hand, drug distributors have less direct impact from GPO tender. Distribution sector suffered from transiting from “Multi-Invoice” into “Two Invoice System” in 2018 and 2019. The short-term negative impact from “Two Invoice System” policy has stabilized and long-term benefits started to emerge. Large distributors are gaining market share.

Consumption In recent years, consumer stocks such as sportswear and beer have adopted a high-end strategy focusing on premium quality products. Due to the potential price hike of products, profit margins are expected to further expand and drive earnings growth. Benefiting from national sports policies to drive people to participate in sports activities, the total industry output value in 2020 is expected to reach 3 trillion yuan. In addition, Beijing will host the Winter Olympics in 2022, so winter sports such as skiing will become the focus of the industry. Also, in addition to the high-end routes for large-scale brewers in China, some companies have also tried to boost earnings and reduced costs by acquiring foreign beer assets and closing inefficient production facilities.

China Property Management Driven by positive profit alerts of several property management companies, the sector extended gain in 2H19. More importantly, some mid to large cap China developers plan / conduct spin-off of their property management business, and some of them with decent returns after listing. For the organic growth, China developers’ 11M19 contracted sales rose 20% yoy, which accounts for ~93% of full year target. Very often, brokers expect 2020E contracted sales would achieve double digit growth rate. There is no arguing that strong parent contracted sales will guarantee earnings growth rate for property management companies. Meanwhile, 9M19 per capita disposable income was up 6.1% yoy to RMB22,882. Scale and high quality services providers will benefit from the rising of middle class and consumption upgrade. Meanwhile, several property management companies conducted large scale M&A in this year, which results in increasing GFA under management and coverage cities. Companies can achieve synergies via improving operating leverage and brand equity. Historically, the sector is famous for light-asset model, high organic growth, development of value-added services, parent company support, and M&A opportunities. Looking forward, industry consolidation and M&As will continue. Players in large-scale, parent company support, quality brands, net cash positions and strong execution power will be major beneficiaries. The sector is trading at FY20E P/E ~19x, thanks to the strong growth rate and M&A potentials. The valuation remains undemanding.
**BONDS**

Phase two China-US trade talks may touch on sensitive topics, which may cap the further upside of US treasury yields.

The US Federal Reserve kept interest rates unchanged in December meeting last year. The latest dot plot shows Fed officials expected that the rate will stay on hold this year and may raise once in 2021. The Fed also dropped language from prior statement that “uncertainty about this outlook remain”. The end of this round of interest rate adjustments in the United States, coupled with the China-US phase one trade deal and the lowered risk of a hard Brexit, having reduced the demand of safe haven assets, driving 10-year US treasury yield from the low of 1.43% in early September to the level of 1.9%, but US airstrike killed top Iranian military commander, spurring geopolitical risks. US Treasury dropped and market sentiment may continue to be weak in the short run. However, given the Fed’s insurance rate cut last year, the low unemployment rate in the US and the positive development of China-US trade talks, the probability of further rate cut is expected to be low in this year. Unless the US-Iran tension further escalated to threaten the economic growth, the room for further downside of US treasury yield may be limited. Currently, the phase one trade deal is lack of content and details and the two parties will soon start a second phase of dialogue, which is likely to touch sensitive topics like government subsidy of stated-owned enterprises and technology transfer. The movement of US treasury yield will be more volatile if the coming phase of trade negotiation come to a deadlock again.

The European Central Bank (ECB) maintains a status quo stance, repeat rallies in European sovereign bonds unlikely.

A report released by the ECB in December has found that under a simulation of -1% deposit rate for three years continuously, although revenues of European banks will reduce, there is no impact to their lending capabilities. That reflect still has certain room before reaching the “reversal rate”. Newly appointed ECB President Christine Lagarde has expressed her support on that research. However, the openness of the ECB towards lower rates is not necessarily an indication of further rate cuts. In fact, she pointed out at the central bank meeting in December that the downside risks of the region’s growth outlook remained, however they had moderated. She believed there were signs that the economic slowdown had troughed and rebounded. The statement of the central bank did not signal further loosening to come. Thus despite the latest economic and inflation forecast remain weak, only about 10% of the market participants expect another rate cut in 2020. Amid the central bank inclination to stay put and refrain from further expansion of quantitative easing, it will be difficult for the European government bonds to repeat the strong rallies of last year.

Amid ECB cutting rate and reigniting the quantitative easing, the yields of the 10 years Bunds dropped to a low of -0.75% in August from the 0.25% level at the beginning of last year. An up and down trading range of 100 basis points, however it has rebounded to -0.19%, which has probably priced in a first phase Sino-U.S. trade agreement and reduced risks of a hard “Brexit” in January this year. This year economy of the Eurozone could benefit from the recovery in manufacturing sector and regain growth momentum, 10 years Bunds’ yields could rise further, however the turnarounds of the manufacturing sectors in the Eurozone and Germany remain to be confirmed and supported by
Credit improving for Asian countries and reasonable bond valuation make Asian bond may outperform.

Looking back at 2019, the Federal Reserve cut interest rates three times, and the European Central Bank also restarted its bond purchase program. Major global central banks continue to adopt accommodative monetary policies, increasing the incentives for international investors to look for yield outside developed market bonds such as the United States, Europe and Japan. Asian bond yields are generally higher than those in developed markets, helping to attract capital flow to Asia bonds. In recent years, many Asian countries are continuously improving their fundamentals through reforms. Indonesia, the Philippines, and Vietnam have each been upgraded by international rating agencies last year. At present, the sovereign ratings of many Asian countries have reached investment grade.

In China, the Central Economic Work Conference, which concluded in mid-December, mentioned that it aims to maintain a reasonable and adequate liquidity and reduce social financing costs with flexible monetary policy. The People’s Bank of China earlier reduced the MLF rate, reverse repo rate, loan prime rate (LPR), and the deposit reserve ratio of financial institutions, reflecting its accommodative stance of monetary, which would help China developers to cope with the financing needs of a large number of bonds due this year. In fact, developers’ land acquisition pace fell slightly last year. This would help increasing their balance sheet liquidity and alleviating the pressure on debt repayment. In addition to continuing to advocate that housing is “not for speculation”, the conference also focused on stabilizing housing prices and land prices, meaning some local governments may moderately relax real estate control measures in the future to promote stable and health development of the housing market.

In Addition, the National Development and Reform Commission announced in July last year that restricting the issuance of foreign debt by property companies can only be replaced by middle-term to long-term debt due within one year. It may significantly decrease the net supply of this year’s mainland high yield bond and thus technically support the relevant bond price’s performance. The Asian high yield bond has been led by mainland property bond for years, the current yield of mainland property bond near the past five-year average, which reflect that its valuation is reasonable at current level. Under the current low inflation and low interest rate environment, Asian yield bond is quite attractive to investors.

The Emerging market bonds that offer higher yields and received attentions from investors, but also come with higher foreign exchange, political instability and default risks.

The overall economy of emerging markets is still affected by global trade protectionism. It is expected that many countries may further renegotiate trade terms and tariffs, which will bring instability to the import and export trade of emerging markets. On the other hand, the global central bank continues to implement quantitative easing measures; the EU maintains negative interest rates in order to revitalize the economy and improve the business environment for companies. Emerging market central banks are expected and also have room to continue to cut interest rates to support local...
economies and businesses, thus emerging market bonds should benefit. But investors should be aware that further interest rate cuts in emerging markets would put pressure on local currencies. For example, the continued depreciation of Argentine Peso, Russian Ruble, and Brazilian Real has put pressure on those countries’ local currency-denominated debts.

The political stability of emerging markets has also attracted market attention. Many countries have mass protests in recent months, including Chile, Colombia, Ecuador, etc, against social injustice and corruption. Geopolitical issues such as Latin America may affect local economies. The market also paid attention to default risks of emerging market governments in recent months, especially Argentina’s national debt. S & P first downgraded Argentina’s long-term foreign currency sovereign rating to “selective default” and then upgraded it to "CC", but maintained its rating outlook as “negative”. Argentina’s default crisis has caused its government bonds to fluctuate sharply over the past period, and the market is closely watching whether this default situation will spread to other emerging market countries.

Risk factors:
1) Domestic economic slowdown 2) Deteriorating relations with trading partners 3) Currency exchange rate fluctuates greatly 4) Geopolitical issues 5) Asset prices have fallen sharply
INVESTMENT OUTLOOK

1Q 2020 Investment Outlook

16 Jan 2020

USD/XAU

12-Month Performance

Source: Bloomberg L.P.
As of 12/31/2019

INVESTMENT SUMMARY
- Gold demand rotation
- Uncertainty still exists
- Investment and hedge demand dominates gold prices

Rotating demand of gold

According to the World Gold Council (WGC) report, as of the third quarter of 2019, total global gold demand was 1,107.9 tons, an increase of 2.7% year-on-year and it was a little surprise. As we all know, India imposed a tariff on gold imports from early July, increasing from 10% to 12.5%. China's economic growth in the third quarter also slowed to 6%. Both China and India are big countries in demand for gold, all of which can be considered as factors that are not favorable for gold demand. However, actual figures show that in the third quarter the total global gold demand saw only a slight decline. It is worth noting that although the gold demand for jewelry dropped 13% quarter-on-quarter, investment demand surged 37% quarter-to-quarter. In the third quarter, there was a rare investment that was comparable to the demand for decorative gold (the investment demand was 408.6 tons, and the decorative gold demand was 460.9 tons). This is why the overall demand for gold has not fallen significantly with the decrease in demand for decorative gold. As for the central bank’s demand for gold, which everyone cares about most, it was only 156.2 tons in the third quarter, which was a big decrease of 78 tons on a quarterly basis, which is not expected by ordinary investors to increase. The figures reflect that gold trading is currently being rotated to ETF (Exchange Traded Fund).

Uncertainty still exists

With the expected completion of the first-phase trade agreement between Sino and U.S., and the victory of the British Conservative Party in the general election, the market's worries over the two major events that plagued the economic outlook have cooled and so as the rise of gold price. However, the market does not expect much from the first-phase-Sino-US agreement, and it is believed that negotiations will be more difficult in the future. In addition, British Prime Minister Johnson added a clause banning the extension of the transition period at the Brexit bill. As EU-UK brexit talks take time, the market worry that once the flexibility of transition period is lost, another Brexit "cliff" will appear. Besides, after the global central banks’ looming tide last year, the interest rate of over 70% national sovereign bonds has fell into a negative area. This reduces the opportunity cost of investing in gold, and helped gold price to recover some losing ground in the fourth quarter last year.

Investment demand dominates gold price

Gold price is mainly dominated by investment and hedging demand, and we expect that it will continue to be affected by global uncertainties this year. We should pay more attention to some major events that affecting the global economy, such as the Sino-US trade dispute, the global central banks’ monetary policy, and the EU-UK trade negotiations, etc. Besides, global
geopolitical risks appear to be heating up. The U.S. Department of Defense confirmed that the commander-in-chief of the Iranian Islamic Revolutionary Guard was killed in a U.S. air strike at Baghdad airport. The US military's high-profile air strikes are expected to exacerbate geopolitical tensions in the Middle East. Now the market is paying attention to Iran reaction. The more aggressive its counterattack, the more likely the price of gold will be stimulated by the news. In addition, North Korea cannot be ignored. North Korean leader Kim Jong Un has been dissatisfied with the slow progress of the US-North Korea summit, threatening to test-fire long-range and portable nuclear warhead missiles during New Year’s Day. North Korea is a lingering uncertainty factor, and the need for hedging is inevitable.

We expect the gold price to be more volatile in the future, with short-term breakthroughs driven by market risk aversion.
The risk of a no-deal Brexit is still on the table

The British Conservative Party won an overwhelming victory in the general election at the end of last year. The successful formation of a majority government will help stabilize British politics. It also hinted that Britain will leave the European Union as scheduled on the 31st of this month. Although the Brexit situation has become clearer, Britain still faces many challenges in the future. Johnson introduced a legal provision making it illegal for the UK to extend trade negotiations with the EU beyond 2020. European Commission President Ursula von der Leyen and several senior officials have questioned whether the two sides have enough time to reach an agreement, saying that the EU may need to extend the negotiation period with the UK. EU chief negotiator Barnier also pointed out that Johnson's timetable is unrealistic. The market is worried that if the UK cannot determine a new trade relationship with the EU by the end of this year, the UK will leave the EU without an agreement, which will seriously disrupt the UK economy and trade. In addition, the European Union accounts for nearly half of the total British trade, and the US accounts for about 15%. At present, no progress has been made in the trade negotiations between the UK and the US as well.

Britain faces crisis of division

The outcome of the British election not only determines the fate of Brexit, but also increases centrifugal forces in Scotland and Northern Ireland. In addition to economic and trade issues, Britain will also face the risk of national division in the future. In the Scottish referendum in 2014, voters rejected independence by 55% to 45%, but the Scottish National Party, which advocates staying in EU and holding a second independent referendum, won in the British election last year. It reflected the voters 'willingness to independence due to the UK 's determination Brexit is heating up, which provides a public opinion basis for another Scottish independence referendum. On the other hand, there has not been a final decision on how Northern Ireland and Ireland could resolve the border issue in long run, and the voice of advocating a unified referendum between Northern Ireland and the Republic of Ireland is growing. Northern Ireland’s Pro-Ireland Party Sinn Féin and the Social Democratic Labour Party won more seats in the British election than the pro-British Democratic Unionist Party. Sinn Féin stated that the result of the election was to pave the way for the Northern Ireland’s referendum. Northern Ireland's rising nationalism has exacerbated Britain's crisis of division.

Sterling is still struggling to escape volatility

At the Bank of England’s December monetary policy meeting last year, two MPC members continued to vote for a rate cut for the second consecutive month. It is worth noting that the central bank also lowered the UK’s fourth-quarter quarterly growth forecast and expected that local inflation will fall by
this spring. It can be seen that the Bank of England is still rather dovish, and a rise of interest rate is not likely in short term.

Recently, Sino-US trade tensions have further eased, and the outlook of the global economy has also improved, which may help the British economy to regain cyclical momentum. However, the trade uncertainty and the crisis of division after Brexit still exists and this will limit the upward momentum of the pound. Entering 2020, we believe the pound will continue to be volatile on Brexit talks.
INVESTMENT SUMMARY
- Sino-US tensions ease
- Australian economy outlook is optimistic
- RBA slows rate cuts

Sino-US tensions ease

The Sino-U.S. trade friction has lasted for more than a year, which has a negative impact on global economic growth and demand for commodities. Risk sentiment and the trend of the Australian dollar has also been affected. However, the market was finally relieved when China and the United States announced that they had reached a preliminary trade consensus in early December last year. Both China and the United States have temporarily suspended import tariffs on some of the products, and US President Trump has stated clearly that he will sign the first phase of a trade agreement with China on January 15 and will start the second phase of trade negotiations very soon. The second stage of negotiations may involve more key issues, such as technology transfer and industrial subsidies, making Sino-U.S. negotiations more difficult. As a fall out with China will be harmful to Trump in the run up to the U.S. election in November, the market is generally optimistic that the Sino-U.S. tension will continue to ease, and the outlook of global economy will also improve, which help support the performance of the Australian dollar.

Australian economy outlook is optimistic

Since China is Australia's largest trading partner, it accounts for more than one-third of exports and about 8% of Australia's GDP. China's economic prospects affect Australia's export and economic growth. Under the slowdown of global economic growth and trade tensions, the downward pressure of China's economy continued to increase last year, and its GDP in the third quarter increased by only 6% year-on-year, the lowest level in nearly 30 years. However, thanks to the first phase of the Sino-U.S. trade agreement and China's stimulus measures such as tariff reductions and support for infrastructure spending, the China's economy has shown signs of recovery in recent months. China's manufacturing activities expanded in November and December last year, new export orders increased, and the production index rose at the same time. The Economic Research Institute of the National Development and Reform Commission said that the mainland economy is expected to remain stable in long run, and the economic growth in 2020 will remain at about 6.0%. A stable growth rate of China's economy will boost Australia's economic outlook.

RBA slows rate cuts

The Australian dollar underperformed from February to November last year. In addition to the impact of Sino-U.S. Trade frictions, the Reserve bank of Australia (RBA) had cut its benchmark interest rate to a historic low of 0.75 in order to support economic growth and achieve inflation target. However, Sino-U.S. trade tensions have eased and the RBA has stopped its rate cuts since November last year. Further rate cuts are expected to be lower since then. According to Australian agency CoreLogic figures, Australian house prices...
rose 4% in the fourth quarter of last year, the largest three-month increase since November 2009. The stabilization of the local property market may also help decreasing the pressure to cut rates and support the Australian dollar’s upward trend. Although interest rate futures market price changes show that the market expects the RBA has 50% probability to cut the official interest rate by 25 basis points in February’s monetary policy meeting, it also suggests that market is generally expected that RBA will only have one rate cut in 2020.

Comparing with 2019, the RBA’s interest rate cut is expected to slow down this year. In addition, the market is generally optimistic on future Sino-U.S. trade negotiation and global economic outlook. It is believed that this will help the Australian dollar to perform this year.
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