恒生銀行 HANG SENG BANK

2Q 2024 Investment Outlook

Position for Yield Opportunity

& Trends Investment that You Need to Watch

17 Apr 2024

Contents

恒生銀行 HANG SENG BANK

2Q Asset Allocation: Position for Yield Opportunities

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Global Asset Allocation # Global Bond Market # Global Equities # Asian Equities # Commodities

- **Position the portfolio for yield opportunities before rate cuts.** Higher than expected March inflation figures in the US may have caused a bit of the delay of US Fed's rate cuts expected by the market, as well as those by central banks of the Eurozone and the UK. However, since the Fed funds rate is currently at an abnormally high level of its history, we expect rate cuts and interest rate normalization to begin this year. Prior to the rate cuts, capital will flow into bond assets in order to lock up higher yields

- **Increase investment-grade (IG) corporate bond and high-yield (HY) bond holdings this quarter.** Our strategy is to reduce cash holdings, while increase the exposure to credits this quarter. Currently yields to maturity of 2 to 6 years IG corporate bonds are at an attractive level of about 5.4% which is a historical high. We also expect the HY bond market to perform stably under a soft-landing economic scenario in the US and the Eurozone, and the valuation gap between Asian HY bonds and those of other regions would continue to narrow amid a lowered and reasonable default rate in Asia this year

- **Expect performances of EM Asia equities to revive.** Amid consecutive rate hikes in Europe and US during 2022 and 2023, EM Asia equities have lagged and underperformed their peers in other regions. As rate cuts by the Fed and the ECB are likely to begin later this year, EM Asia equities should benefit from the return of global fund inflows. As EM Asia equities index price has stayed quite flat in the past two years vs DM equities, a variety of high dividend sectors and stock choices can be identified in EM Asia, and it will help investors to build diversified and income focused portfolios

- **Mainland and Hong Kong stock markets to recover along with the economy.** The latest Chinese leading economic indicators, particularly the manufacturing PMI, have improved and may boost investors‘ expectations of recovery in economic growth, and in turn drive performances of the stock market in the short term. If property sales in the Mainland could recover in Q2 extending the trend seen in March, domestic consumptions could also be boosted. It will be supportive to the performance of the A share and Hong Kong stock markets, in our view

- **Temporarily reduce exposures in energy and gold related investments this quarter.** We had entered 2024 with very bullish views on oil and gold. Crude oil and gold prices rose sharply in the past 2 months amid heightened geopolitical tensions in Middle East, and this has also driven the significant performance of the related stocks. In Q2, investors may take some profits first, and then await oil and gold prices to consolidate before rebuilding their positions

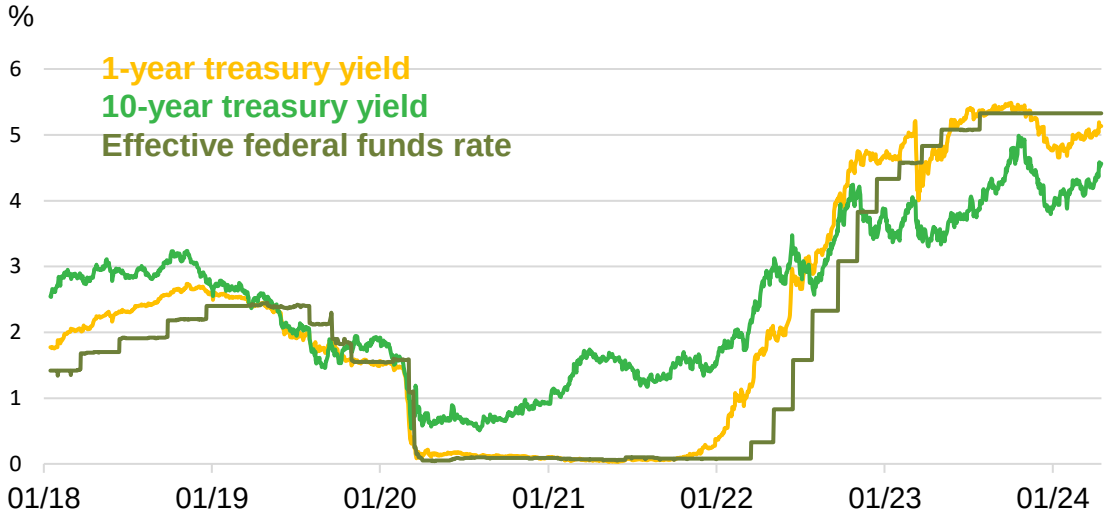
Position for Yield Opportunities before Rates Cut

Higher than expected March CPI in the US may cause a bit of the delay of Fed's pivot, while central banks of the Eurozone and the UK may also wait for a longer period before cutting rate as market has now priced in. However, noting that Fed funds rate is currently at an abnormally high level historically, we expect the Fed would go ahead to cut rates this year to begin the normalization of the US interest rate environment. The market has also slightly postponed the timing of rate cuts for both the Eurozone and the UK recently. However, due to a noticeable slowdown in inflation within the region, the current market perception is that the Eurozone and the UK may cut rates slightly earlier than the US, but the time difference should not be significant. As for the Bank of Japan, despite finally ending its negative interest rate policy, the yen has declined afterwards. Analysts and traders believe that the BOJ's policies still lean towards a dovish stance, and thus there will unlikely be any surprise to the market in the short term. With the eventual onset of the rate-cut cycle, we anticipate that the yields of the US Treasury benchmarks will trend downward along with the Fed funds rate over the next two years. Before the rate cuts, global capital will likely be flowing into bond assets to lock in higher yields.

Increase Holdings of IG Corporate and HY Bonds

In Q2, investors can increase holdings in assets such as corporate credit while reducing cash / money markets positions. Currently, the yields to maturities of the 2 to 6-year investment-grade corporate bonds are around 5.4%, nearing level of historical highs, making them quite attractive. Investors can implement fixed income strategies of the medium to long term before benchmark rates start to decline later this year.

Federal Funds Rate Moved in Sync with Short and Long-Term US Treasury Yields



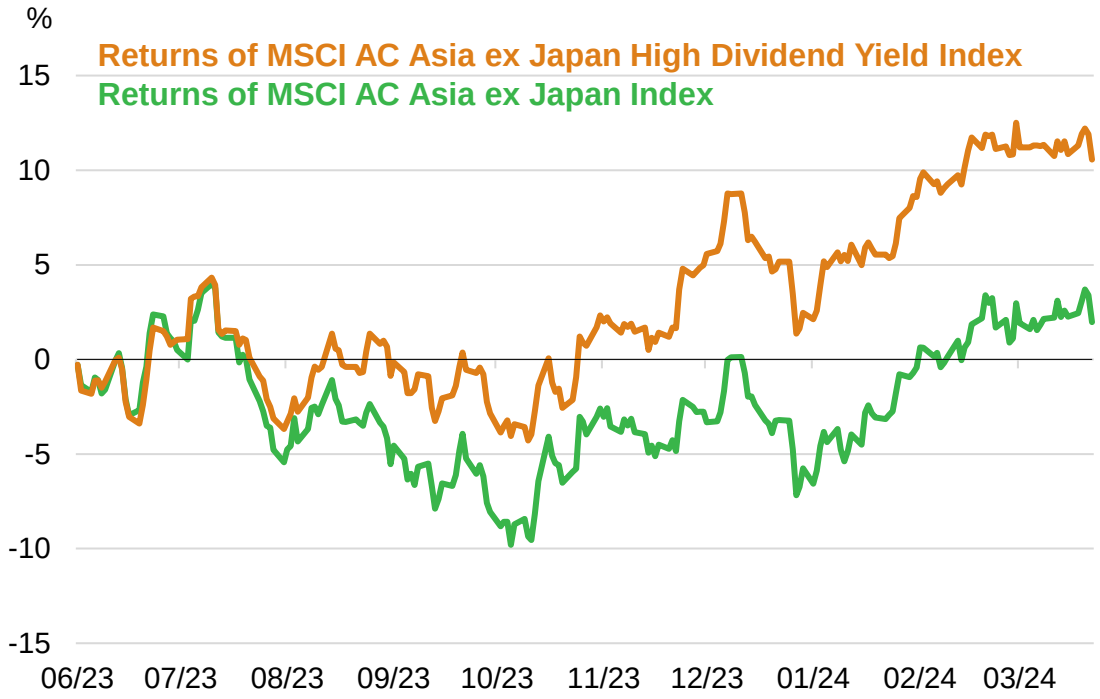
Source: Bloomberg, last updated on 15 Apr 2024

Simultaneously, we expect the global HY bond markets to continue performing steadily amid the economic soft-landing scenario in the US and the Eurozone. On the other hand, we note that the default rates for Asian HY bonds would turn much lower this year relative to the past 2 years. Therefore, Asian HY bonds are expected to narrow its valuation gap with HY bonds of other regions.

Expect Performances of EM Asia Equities to Revive

In Q1, developed markets (DM) equities surged and continued to break record highs, driven by optimism towards inflation and rate cuts and non-stop enthusiasm in the Artificial Intelligence (AI) topic. While AI presents numerous investment opportunities, we observe that some sectors which have already seen significant gains are

Asian High-Dividend Stocks have Performed Better than Asian Stocks



Source: Bloomberg, last updated on 14 Apr 2024

likely to face some setbacks. Therefore, our equities strategy for DM equities in Q2 will be slightly more conservative relative to that in Q1. On the other hand, amid consecutive rate hikes in Europe and US during 2022 and 2023, EM Asia equities have lagged and underperformed their peers in other regions. As the Fed and ECB are likely to begin cutting rates later this year, EM Asian equities should benefit from the return of global fund inflows. As EM Asia equities index price has stayed quite flat in the past two years vs DM equities, a variety of high dividend sectors and stock choices can be identified in EM Asia, and it will help investors to build diversified and income focused portfolios

Mainland and Hong Kong stock markets to recover along with the economy

Since February, the Chinese government had supported the capital to support the Mainland stock market and further proposed capital market reforms as well as policies to boost valuations of Central State Owned Enterprise (SOE) companies. Both the Mainland and Hong Kong stock markets rebounded since then, with the Central SOE sectors including telecom and energy outperforming, aid their high dividend yields and low valuations.

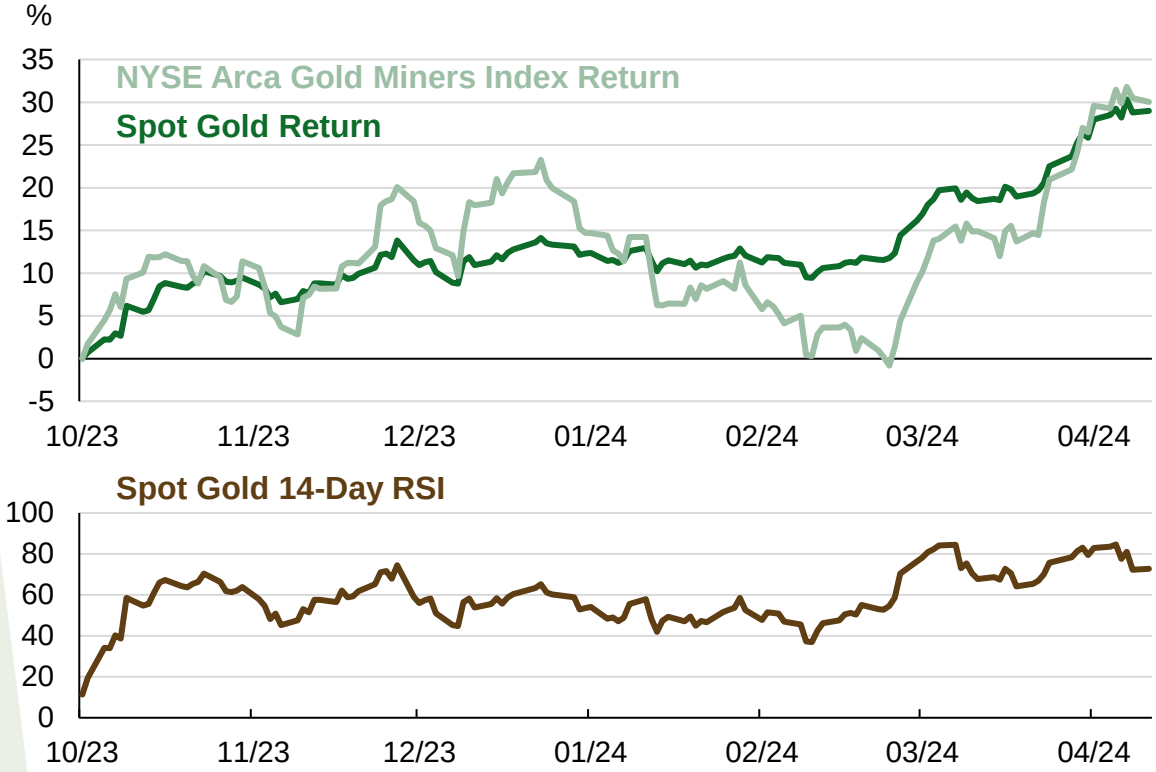
The March economic leading indicator, in particular the Manufacturing Purchase Manger Index has exceeded expectations, as the new order index rebounded significantly. We believe that investors' anticipation of economic recovery will once again drive the stock market in the near term. Looking ahead, in addition to the actions by the government strengthening infrastructure investment and pushing manufacturing upgrades, we think the domestic consumption and home sales recovery will also be crucial in to drive the growth.

Previously, many local governments have relaxed home purchase restrictions, and banks has enhanced financing for the real estate industry. If the mainland property market can show strengthening signs of recovery in Q2 similar to those observed in March, consumer confidence could improve, thus supporting the sentiment and performance of A-share and Hong Kong stock markets.

Reduce Exposures to Energy and Gold Investments

We had entered 2024 with a very bullish view on oil and gold since Dec 2023. Crude oil and gold prices rose sharply in the past 2 months amid heightened geopolitical tensions in the Middle East, and this has also driven the related stocks' significant outperformances. In Q2, investors can take some profits first and wait for oil and gold prices to consolidate before rebuilding their positions.

Significant Surge in Gold-Related Assets Since Mid-February



Source: Bloomberg, last updated on 15 Apr 2024

Equities Market Views

Markets	Analysis*	Comments
US	●●●	➢ Analysts continued to raise forecasts of US economic growth and corporate earnings, but uncertainty over the timing of Fed's rate cuts could cause consolidations in the short term
Europe	●●	➢ European Central Bank lowered inflation forecasts. Market expects rate cuts in June. Recent economic improvements support European stocks, but earnings still stagnant
Asia	●●●	➢ The rise of generative AI and AI PC have brought growth prospects of Asian technology supply chain, while Asian high dividend stocks could weather the global market volatility
Latin America & EMEA	●●	➢ Certain emerging countries face heightened geopolitical or domestic political risks, continuing to drag the performance of regional stock markets. However, rate cuts in the US and the Europe later on could provide some support to the stock markets
Mainland & Hong Kong	●●●	➢ Manufacturing and property sales have gradually improved. Chinese economy is on track to recover, boosted by policies favouring replacement of consumer goods and large equipment. SOE reforms and internet stock earnings recovery will help the sentiment

Source: HSIS

***Symbol representation** :

●●●

The particular asset/market potentially may perform well relative to the relevant major global benchmark (s)

●●

The particular asset/market potentially may perform in line relative to the relevant major global benchmark (s)

●

The particular asset/market potentially may not perform well or in line relative to the relevant major global benchmark (s)

Fixed Income Market Views

Markets	Analysis*	Comments
DM Sovereign Debt	●●	➢ The Fed maintained its forecast of three interest rate cuts this year. The dovish tone of major central banks will pave the way for stable performance of sovereign bonds
EU & US IG Corp	●●●	➢ US firms delivered satisfactory earnings in general, and bond yields are at historically high level, providing opportunity for investors to lock in higher return before rate cut
Asia IG Corp	●●●	➢ Asia has moderate inflation and better growth prospects, compelling bond yields will continue to attract fund inflows
US High Yield	●●	➢ US economy remains resilient, increasing the chance of a soft landing, which supports the performance of US high yield bonds
Asia High Yield	●●●	➢ Valuation of Asian HY bond is relatively low. The declining default rates are expected to narrow the valuation gap of Asian HY compared with those in other regions
EM Debt	●●	➢ Dovish tones of major global central banks helped support emerging market debt, and stable macroeconomic outlook favors IG Asian emerging market sovereign debt

Source: HSIS

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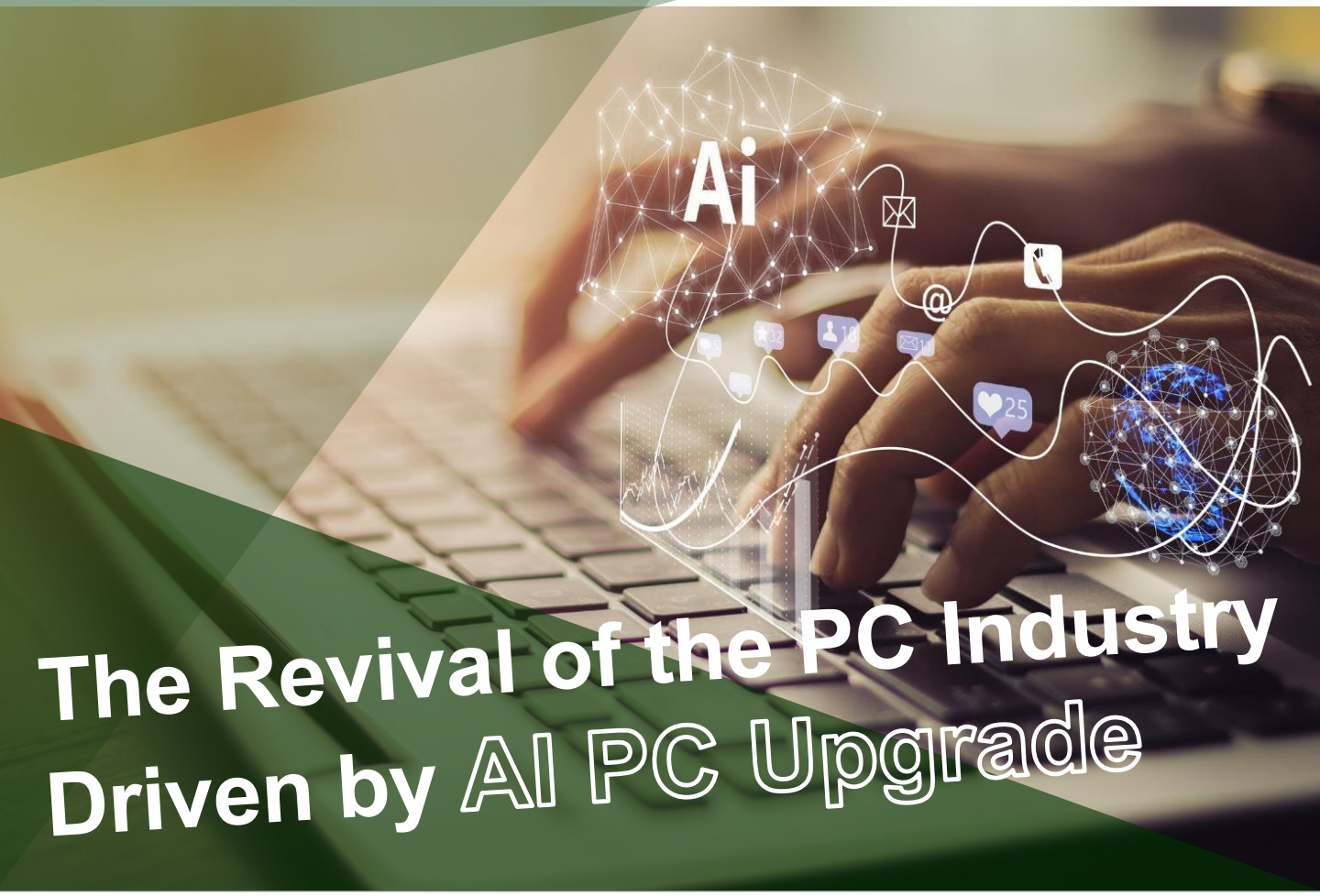


The Revival of the PC Industry Driven by AI PC Upgrade

US Tech Sector # Asian Tech Sector

AI enhances the development of Personal Computers

Generative AI has become an investment hotspot in the past two years, boosting the stock prices of related technology giants. With breakthroughs in AI technology, AI PC have emerged. AI PCs utilize dedicated hardware accelerators to support high-performance computations. AI PCs can learn user behaviors, adjust system settings, providing a more personalized experience. Traditional PC brands are accelerating the launch of AI PCs, fueling the upgrade trend and investment opportunities to the entire PC supply chain in the US and Asia. Asian traditional PC-related stocks, which have remained dormant for many years, are now seeing an influx of capital.

What is the difference between AI and traditional PCs?

AI PCs can learn users' usage habits, automatically adjust settings to provide more appropriate services, and can even proactively help users complete tasks, bringing changes to personal computers. In contrast, traditional PCs only execute commands step by step, so the two have differences in design, hardware and software:

Better user experience: AI PCs use AI technology to improve user experience. For example, when users are having video conferencing, the computer can automatically adjust the screen brightness, automatically improve picture and sound quality, make communication smoother, and provide a more personalized experience.

Smart software: AI PCs have more built-in smart functions, such as automatically adjusting computer performance to save power or improve work efficiency.

Smarter hardware: AI PCs are equipped with special hardware, such as neural processing units (NPU) or specific graphics processors (GPU), to enhance AI calculations. This allows them to handle complex calculations faster and more efficiently.

Super performance: Thanks to specialized AI hardware and software, AI PCs can process tasks with large amounts of data faster. No matter you are playing large video games, editing videos, or running complex software, AI PCs can provide a smoother experience.

Enhanced security: Some AI PCs use AI technology to improve security and can more intelligently identify and defend against network attacks, protecting user data and privacy.

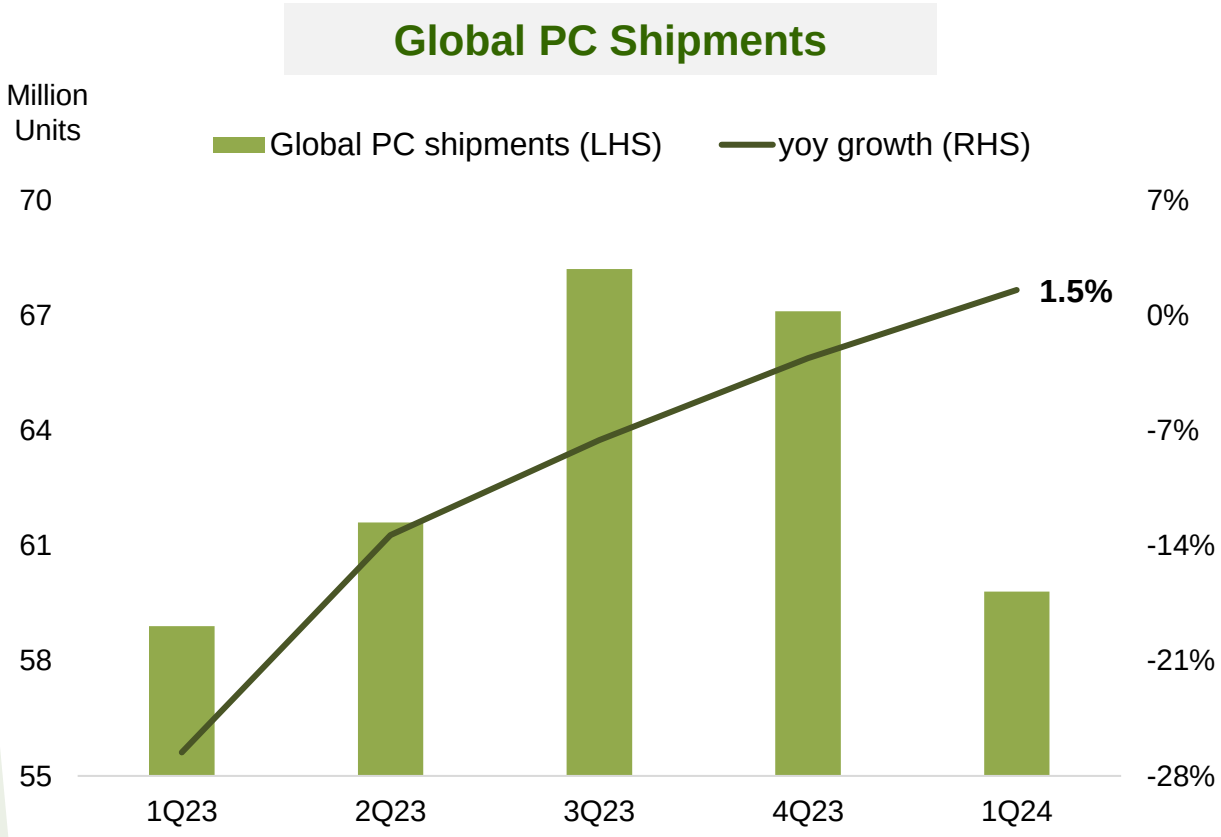
In summary, AI PCs use the latest technology to provide a faster, smarter, and more personalized experience, making daily work and entertainment more efficient and enjoyable.

	AI PCs	Traditional PCs
User experience	Use AI to improve user experience, including sound optimization, image processing, personalized settings	The user experience is relatively fixed, with few personalization and automatic improvement options
Hardware	Equipped with specialized AI hardware accelerators such as neural processing units (NPU) or specific graphics processors (GPU)	Mainly relies on general-purpose hardware, and there is no hardware specifically designed for AI computing
Software	Built-in more AI-driven software and functions, such as automatic performance adjustment, smart security protection	The software functions are relatively basic and mainly rely on traditional software optimization rather than AI driving
Performance	Excellent performance in handling AI tasks and big data processing, able to improve computing speed and efficiency	May perform poorly when processing complex AI tasks, efficiency and speed are limited by hardware
Safety	Use AI technology to enhance device security, such as preventing malware attacks through behavioral analysis	Security performance mainly relies on traditional anti-virus software and protective measures
Price	Due to more high-end hardware and advanced tech, the price may be higher	Prices vary depending on configuration, but are generally lower
Positioning	For users who need to process large amounts of data, image processing, and efficient computing needs	Suitable for daily use, office work, games and other scenarios that do not specifically require a large amount of AI calculations

Market potential and investment opportunities

According to market research firm IDC, global PC shipments in 1Q24 increased by 1.5% yoy, the first growth in two years, and returned to pre-epidemic levels in the 1Q19, partly due to AI PCs driving enterprise demand. Moreover, according to forecasts from other market research firm Canalys, 19% of PC shipments will be equipped with AI functions in 2024, and this will increase to 60% by 2027. This shows that the market's acceptance of AI PCs is expected to continue to increase.

Major PC manufacturers are currently investing heavily in developing AI-enabled PCs and emphasizing the importance of integrating AI into devices. In addition, the AI chips recently launched by large chip



Source：Bloomberg, IDC, as of end of the first quarter of 2024

designers can provide unprecedented computing power and provide the hardware foundation for AI PCs. With the rapid development of AI technology, AI PCs are expected to make significant progress and drive innovation in many industries, creating opportunities for investment.

The AI PC upgrade trend is driving hardware manufacturing and outsourcing companies, primarily in Taiwan and South Korea. Meanwhile, several areas are expected to benefit from the rise of AI PCs:

Computer and chip manufacturers: With the development of AI PCs, the demand for specialized AI chips and high-performance GPUs will increase significantly, which provides chip manufacturers with huge room for growth. At the same time, computer manufacturers are also expected to benefit from rising market demand for AI computers and higher prices.

Software developers: The high performance of AI PCs relies on software improvements and AI-driven applications, including operating systems, office software. This creates new market opportunities for software developers.

Computer and network security: As AI technology continues to improve, computer security has become more important. This has opened up new business areas for security software developers, especially companies that use AI in computer and network security.

Innovative Developments & Investment Potentials in Healthcare

Healthcare Sector

Why Healthcare underperformed and its future outlook ?

In recent years, much attention in society and the media has been focused on innovations in technology, particularly in the realm of artificial intelligence (AI) since 2023. This trend has also driven up the stock prices of tech stocks. In 2023, the S&P 500 Information Technology Sector Index rose by 56%, outperforming the broader market's 24% return. Clearly, the market has a strong interest in the tech sector. However, one area that has been relatively overlooked is the healthcare sector. Last year, this sector rose only 0.3% marginally, primarily due to the decreased covid related spending after the pandemic and the pressures faced by biotechnology companies in a high-interest environment.

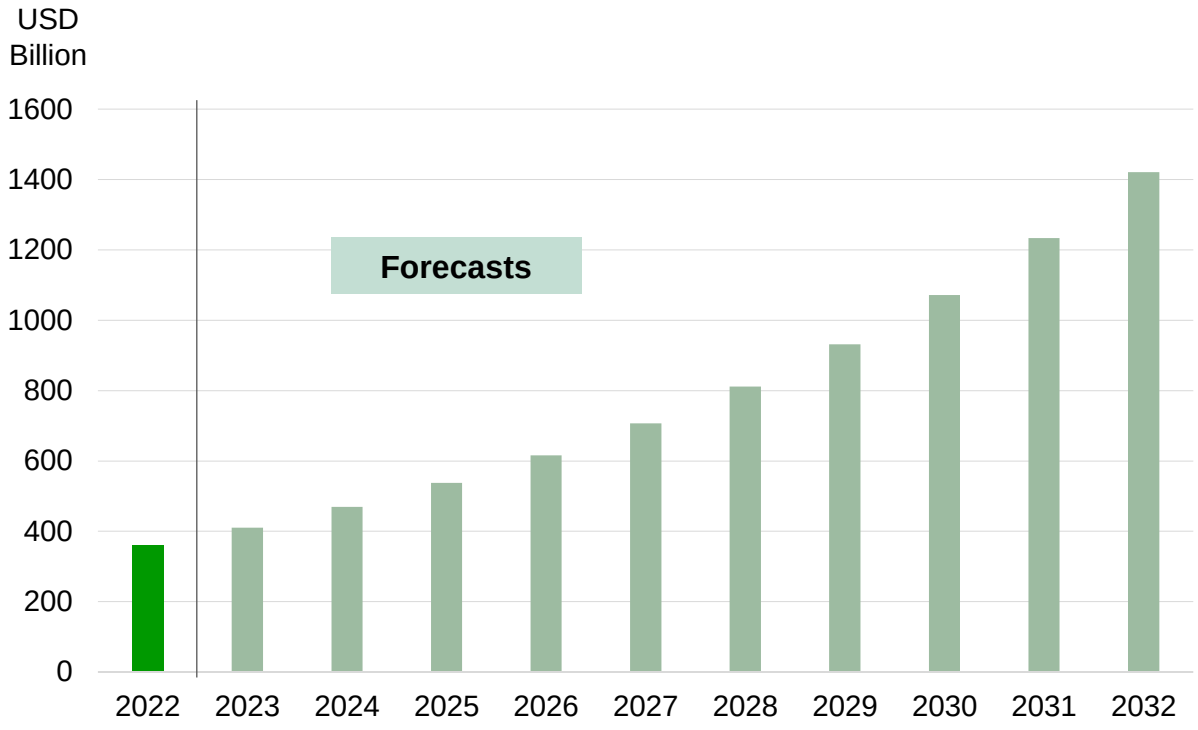
On the other hand, as per the latest market consensus on earnings forecasts for US sectors, heathcare is one of the only 2 sectors that are expected to achieve higher EPS growth than the index for each years in the next 3 years, indicating that the market believes the sector is poised for a revival in earnings growth after a subdued period of more than a year.

In fact, the impact of technological innovation and breakthroughs on developing new medical technologies and enhancing healthcare services cannot be underestimated, especially in light of how we have dealt with and overcome the pandemic in recent years. An obvious example is that without the advanced technology related to the rapid development of covid vaccines, the pandemic might have lasted longer than it did. In addition, provision of medical services might have practically been dismantled during the pandemic if we had not have the technology that helped us to continuously provide it. Last, but not least, many of the drugs that are used to treat other disease nowadays, might not even have been developed without the continuous advancements in gene related medical technology. Overall, the adoption of technology and the resulting breakthroughs in pharmaceutical and biotech has continuously opened new opportunities for future earnings growth.

Biopharma companies expected to grow at high rates

One of the most important parts of the healthcare industry is pharmaceutical development. With the advancement of technology, many biopharma companies are actively using new genomic sequencing and data processing techniques to develop more targeted and effective drugs. In recent years, the most prominent example is definitely the GLP-1 agonists that have drawn the market's attention. GLP-1 agonists was originally used to treat diabetes, but it was found that users lost weight after treatments of GLP-1 agonists, thus it was extended to clinical trials on obese patients and has successively

Market Size of Biopharmaceuticals is Growing



Source: Precedence Research, July 2023

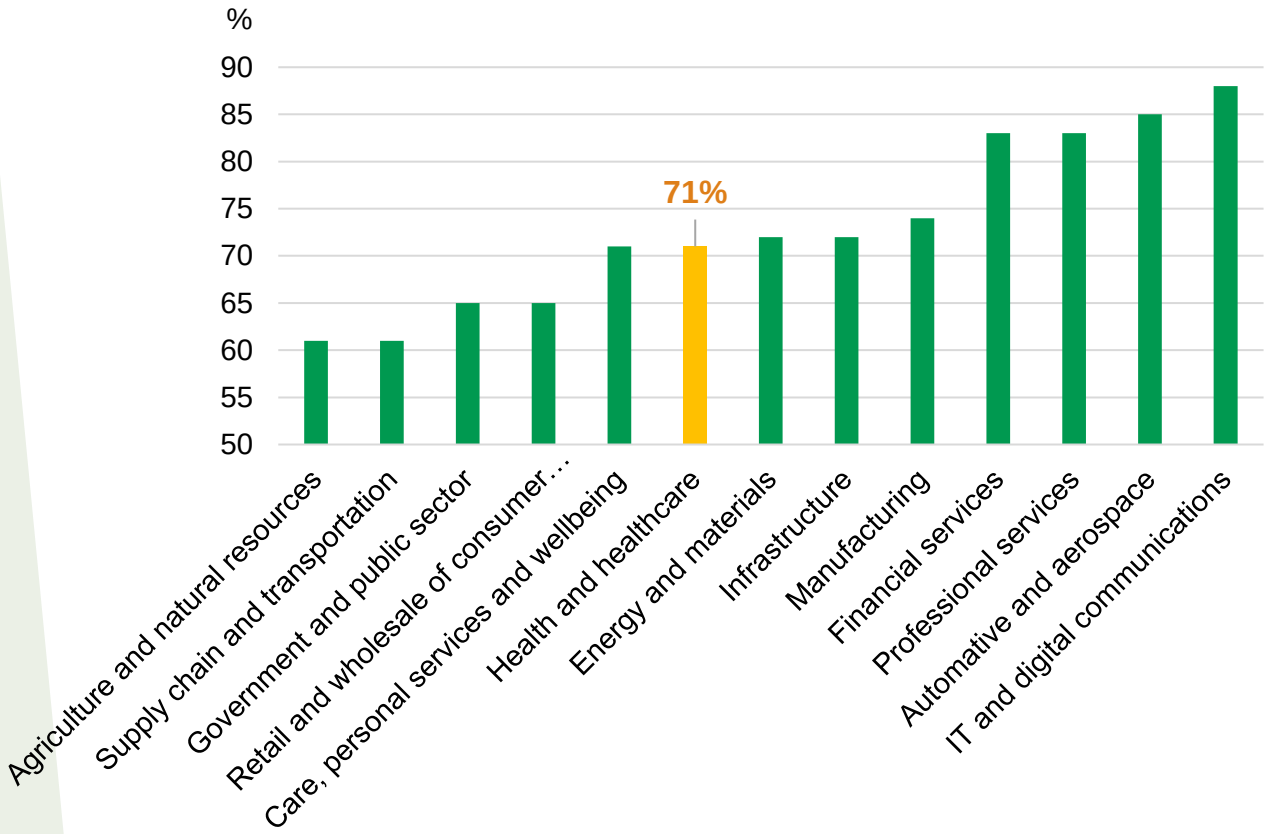
achieved positive results. The weight loss effect of GLP-1 agonists is as high as 15% to 25%, so it has set off a craze, and the related companies have also become the focuses of the market.

According to data from the World Obesity Federation, the proportion of the global obese population in 2020 is 38%, and it is predicted that by 2035, this proportion will exceed half, reaching 51%. Meanwhile, studies estimated that only 2% of obese people globally are receiving treatment. Therefore, as the obese population increases and obesity treatments become more widely available, the potential of GLP-1 agonists is clear. It is believed that in the long run, the market demand for weight loss drugs will continue to increase, which will bring long-term positive returns to biopharma companies, which in turn will make investments of their stocks more lucrative.

Artificial intelligence in healthcare improve profitability

The stock market rally in 2023 was led by the tech sector driven by AI. In fact, the role of AI in the healthcare industry has just begun to emerge, and it is currently used in medical imaging, such as AI endoscopy - assisting medical staff in analyzing endoscopic images through real-time data to help identify abnormal conditions; AI Medical imaging diagnosis can use algorithms to identify early diseases and match similar cases in various medical images (such as X-rays and computed tomography). In the future, AI has great potentials in medical applications. For example, it can provide personalized

Share of Organizations Globally Which are Likely to Adopt AI by 2028



Source: World Economic Forum, May 2023

treatment based on the patient's genome, improve continuous monitoring of patients, assist in drug research and development, and even support the management system of hospital operations. The increasing penetration of AI in healthcare helps to improve the accuracy of diagnosis, monitoring and treatment. For companies that adopt relevant high-end technologies to develop products, using AI in healthcare products lead to huge business opportunities because new products may be able to meet potential market demands and may come with a greater bargaining power in pricing strategy.

Digital healthcare expands the scope of investments

Since the pandemic, delivery of medical services has taken a drastic leap forward as telehealth services became the mainstream preferred way across the globe to seek consultation with doctors under social distance restrictions. Such practices are still existing to a certain extent even after the pandemic. The most obvious reason is the convenience offered and the altered habits of the general public. In fact, the telehealth services is only a small part of the overall digital healthcare developments. Other major areas of digital health include health information technology which facilitate easier access and standardization of health information with reasonable costs, and mobile health which could contribute to better lifestyles. The overall benefits are potentially large in scale and diverse in natures. They potentially include efficiencies improvement to reduce costs, better access to improve social equality, and also more personalized information to increase qualities of services or health. It also has opened possibilities in mobilities, at-home care and bi-lateral interactions between the patients and the medical providers. On the other hand, it could also be faced with challenges such as new regulatory issues, information security and legal implications. The developments will be secular and continuous.

Market Performance Review

3-month Performance		12-month Performance
10.2%	S&P 500 Index	27.9%
7.0%	STOXX Europe 600 Index	12.0%
4.4%	MSCI AC Asia Index	9.1%
1.6%	MSCI AC Asia Pacific Ex. Japan Index	2.5%
-3.0%	Hang Seng Index	-18.9%
-4.8%	MSCI EM Latin America Index	15.5%
6.6%	Bloomberg Asia USD HY Bond Index	9.16%
2.1%	Bloomberg Global High Yield Index	12.91%
0.3%	Bloomberg Asia USD IG Bond Index	4.69%
-2.1%	Bloomberg Global Aggregate Index	0.49%
3.1%	Dollar Index	1.9%
-0.8%	GBP/USD	2.3%
-1.8%	CNH/USD	-5.4%
-2.2%	CAD/USD	-0.2%
-2.3%	EUR/USD	-0.5%
-4.3%	AUD/USD	-2.5%
-5.4%	NZD/USD	-4.4%
-6.8%	JPY/USD	-12.2%
16.1%	WTI Crude Oil Future	9.9%
8.1%	Gold	13.2%
3.0%	Copper Future	-2.1%
-26.6%	Iron Ore Future	-21.2%

Source: Bloomberg, last updated on 31 March 2024

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