EXECUTIVE SUMMARY

Quarterly Investment Analysis

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<td>Global Investment Grade Sovereign</td>
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As of 16 April 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

- The pandemic and risk off sentiment has tightened investment market liquidities, and both stocks and bonds were sold off. Conservative investors should continue to focus on high rated USD bonds. High yield bonds were hard hit in March and likely to remain volatile. If the economy eventually recovers, current wide credit spread might improve, but investors should watch out for low rated credits and energy related high yield names.

- After the sharp correction in US equities, the long term investment value has appeared. The focus is on technology, 5G, artificial Intelligence and related high growth stocks. We expect a strong market rebound when there is a good sign to indicate virus outbreak has peaked.

- The outbreak in mainland China has peaked, and economic activities are recovering. Coupled with the large-scale stimulus measures implemented by the Chinese government, improving liquidity would support HK China equities and China A shares. As high tech companies have already resumed production, Asian technology sector may be the first to rebound, which should support Asian equities.

As the COVID-19 outbreak spreads globally, both stocks and bonds were sold off. It turned around the optimistic backdrop at the beginning of the year, which included Sino-US trade truce, continued economic growth in the US, and reaccelerated momentum in Chinese economies to opposite direction. With wider spread of the outbreak, oil prices plunged and deleveraging took place among all asset classes, which further triggered liquidity crunches globally. Although the US Federal Reserve surprisingly cut rate and even restarted QE, fears and pessimisms still prevailed and investors retreated from risky assets to hold cash. The S&P 500 Index and Hang Seng Index dropped 20% and 16% respectively in the first quarter, the Bloomberg Barclays Global High Yield Bonds Total Return index came off more than 15%. Under the threat of global economic stagnation, recession and unemployment, the US rolled out a US$2 trillion stimulus plan and the G20 also started a US$5 trillion program along with the support from other major central banks to ensure liquidities in the markets. The Fed also cut rate to 0 – 0.25% and committed QE infinity to purchase unlimited amount of US treasuries and mortgage-backed securities. With so many countries rolling out significant rescue packages to counter the adverse effects from the outbreak, how would the market dynamics play out in the second quarter, and which asset classes worth our attentions?

Global markets are expected to be volatile on growing fears of a deep recession. Investment grade (IG) credits are relatively more resilient due to stronger cash positions and less refinancing needs of their issuers. IG are also subject less to the impact from liquidity crunch, and offers better price stabilities due to lower liquidity risks. Asian investment grades credits are even in better positions as Asian economies are less exposed to the impact from oil prices. Fluctuations of Asian IG driven by outflow are relatively lower, as 70% of investment in Asian credits are Asian investors, from which 40% of investment grades credit investors are institutional investors. Default rates from non-investment grade credits might surge due to recession risk. The yield
spreads of global high yield bonds are now at post-financial crisis highs, having been sold off in March. Even though it is hard to predict when the outbreak would be contained, we believed valuations of high yields will gradually return to their normal levels when global economies recover. The latest bond purchase commitments from the Fed on downgraded investment grade bonds and asset backed securities would help as well. However, downgrade risk of certain below-investment grade credits should not be ignored.

US equities rebounded after the recent major sell-off. But another wave of pullback is possible, as US will enter short-term recession according to market consensus. But valuations of US shares are back to their historical five-year average based on forward PE multiples. Taking the performance of S&P500 Index in 2008 as reference, the market experienced double bottoms in approximately 3-5 months apart, thereby establishing a base from which to rise again after the Fed rapidly expanded its balance sheet. US equities thus offer long-term investment values backed by over US$2 trillion stimulus and “unlimited” buying of bonds by the government, and expectations of corporate earnings to recover after the outbreak. We favour sectors that are less impacted or even boosted by the outbreak. Internet and tech equipment shares are good examples of beneficiaries from the current lockdown. People staying home rely on internet and technology devices to maintain their routine for work and studies. Healthcare sector is also benefit from higher demands of health-care services.

Chinese economy and Asian technology sector may be the first to show signs of recoveries, as manufacturing activities from high tech companies have resumed production after the outbreak has peaked in Asia. Even though oil prices plunged quite a lot, it turned out to be favorable to Asian countries that rely on imports of energy for domestic consumption in the long run. Valuations of Asian equities are below their historical average and cheaper than their global counterparts. Price to earnings multiples of HK shares are trading at their historical low, with Hang Seng Index’s price to book ratios at less than one time multiple, which is rare and should attract long term investors’ attentions. The effectiveness of the Chinese government’s anti-epidemic measures, coupled with large-scale stimulus measures, may lead to a faster recovery than other countries. The recently held Politburo meeting emphasized on launching of Central Government Special Bonds, which should help boost Local Government Special Bonds and deficit rates, and in a way maintain credit growth. More stimulus measures could be announced from the Two Sessions to be held in late April or early May. Chinese economy should improve in the second quarter when workers resume to work. On the other hand, the prolonged global outbreak, if cannot be contained, could negatively affect export from China.

On the other hand, emerging markets (EM) that rely on energy and commodity exports would be exposed to more risks. EM central banks may borrow USD using US treasuries as collaterals, which helps the stress on demand for USD from domestic corporations and investors. Many EM governments have rolled out fiscal and monetary policies to contain job security, stabilize growth and subsidize corporations facing difficulties. However, the level of effectiveness all depends on if the outbreak could be contained. The International Finance Association (IIF) expects economic growth in EM ex-China will stagnate; the Asia-Pacific region will grow by 2.4%, and countries in Latin America, Russia and South Africa will enter recession. Since financial budgets among EM countries are limited, the prolonged pandemic and suppressed energy prices would render EM economies that rely heavily on energy export to be more vulnerable.
2Q 2020 Investment Outlook

Equities

US
Emerging Markets (EM)
Europe
Japan
China / Hong Kong

Global Bond Market

Currencies

AUD/USD
USD/JPY
USD/XAU
INVESTMENT SUMMARY

- US equities ended its long-run bull market
- US economy will face contraction.
- The Fed launches coronavirus aid package to contain damage.
- Headwinds on corporate earnings growth.
- One silver lining from the selloff is a better valuation outlook.

US equities ended its long-run bull market. Fear of pandemic triggered global risk-off and funding stresses in the financial market, and further triggered a major market selloff in Q20. Stocks in the U.S. have entered a "bear" market, as the Dow Jones, S&P 500 and Nasdaq have tumbled more than 20% below their all-time highs since February. That ended a record-long bull run that started in 2009. The downturn was swift and sudden caused by rising fears of global pandemic that triggered market selloff. US stock futures hit the 5% levels circuit breaker for a few times in March, even though the Fed cut rates to prevent a sharp economic downturn. For the first quarter ended in March, Dow Jones and S&P 500 lost 22.7% and 19.6% respectively, while Nasdaq was down by 13.9% respectively, while Nasdaq was down by 13.9%.

US economy will face contraction. COVID-19 shock has led to a very sharp downturn in global GDP in the second quarter, as a result of the lockdown measures, global supply chains, business and personal activities disruptions. The IHS Markit flash composite PMI plunged to its all-time low in March, with the index falling to 40.5, indicating a global recession. The ISM Manufacturing Index fell to 49.1 in March, though it has been in contraction territory in six of the past eight months. The contraction was broad-based across activity indicators, implying a deepening recession. Nonfarm payrolls plunged by 701,000, and the unemployment rate soared to 4.4% in March. If the coronavirus virus cannot be contained as expected, unemployment rate could reach over 10%. Fed Chair Powell predicted a contraction in Q2 GDP, followed by a rebound in Q3, as the government has put in an immediate rescue package that includes a significant fiscal measures and unlimited quantitative easing policies.

The Fed launches coronavirus aid package to contain damage. Different from the financial crisis in 2008, the Fed’s actions have been quick and large to stem recession risks and credit risks this time. President Trump declared national emergency in mid-March over the spreading COVID-19, opening the door to up to USD50bn in federal aids to states and localities to combat the virus. At the last week of March, the government further approved a US$2.2 trillion economic stimulus programme. The Federal Reserve's balance sheet has expanded to a record of US$5.81 trillion as the central bank continued their robust purchases of treasury and mortgage-backed securities to help restore market order amid the coronavirus pandemic. Total assets held by the Fed rose by US$557 billion in the week through 1 April according to data published by Fed. USD Liquidity swaps with foreign central banks climbed by US$142.5 billion to US$348.5 billion, as the Fed also sought to ease access to dollar funding strain worldwide.
Headwinds on corporate earnings growth. We expect the economic and earnings impact from the pandemic in 2Q will be steeper than the 2008 financial crisis, as the size of the global policy responses has also exceeded that in 2008-2009 so far. Analysts are revising downward 2020 full year earnings decline in ranges of 0%-40% from their original 10% consensus growth estimates for US corporates. 2Q and 3Q results are likely to witness the greatest contraction before a recovery in 4Q. However, we are just at the beginning of the earnings downgrade cycle. It is hard to quantify the impact on earnings, as the ultimate effectiveness of huge government spending remains to be seen. So far, the aviation, hospitality, leisure, travel, and energy stocks are worst hit. There is still uncertainty over the outlook of the post-pandemic recovery due to lack of clarity on the duration and severity of the global pandemic. But we believe the unlimited QE package from the Fed serves as a cushion for severe downside.

One silver lining from the selloff is a better valuation outlook. So far, the market is trading neither on fundamentals (monetary & fiscal stimulus) nor on technical but on the development of the pandemic. Yet, another wave of drawback is believed to take place in the markets during 2Q to reflect all negative headlines before it may find a floor. In 2002-2003 and in 2008-2009, the market experienced double bottoms in approximately 3-5 months apart, thereby establishing a base from which to rise again. One silver lining from the selloff is a better valuation outlook. We think these stimulus measures will be sufficient to prevent a very negative long-term effect of the COVID-19 pandemic on the global economy. We have also observed that the liquidity measures of global central banks have started to ease some of the stresses in financial markets.

Sector Outlooks

Information Technology / Communication Services Despite the flight to safety, S&P500 Technology Index still managed to outperform the market after the selloff in 1Q. Global government’s imposed lockdown in many major cities adds on the demand for internet and technology devices to support daily routine. The recent technology capex spending, especially among the software companies, have been steady so far. 5G industrial revolution remains the medium to long-term investment theme. 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. We are optimistic about the prospects of consumer-related sectors, with those companies that can integrate online, physical stores, and leverage on the synergy of their strong brands.

Consumption. S&P 500 Consumer Staple Sector is the most outperforming sector in 1Q, as disruption in life-style during the coronavirus outbreak changed personal consumption to weigh on food and necessities, hypermarkets & supercenters, and household products. Near-term, we are more positive on consumer staple than consumer discretionary sector, during periods of economic slowdown and uncertainty. But 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.

Healthcare includes hospitals, health maintenance organizations, healthcare technology and equipment, pharmaceutical and biotechnology companies. Near-term, a spread of the coronavirus in the US would likely lead to a surge in demand for healthcare services. Many biotechnology companies participated in treatments and vaccines in curbing the Covid 19 virus. S&P500 Healthcare Index was the second most outperforming sector during 1Q. We believe better fundamentals in earnings and valuations would support the sector. The healthcare sector has many positives, including an aging global population and a growing middle class in emerging markets, all of whom will demand more extensive drug treatments and medical care over time.

Risk considerations: 1) Further escalation of tensions between China and US; 2) Slowdown of economic growth from Coronavirus impact; 3) further slump in 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. 7) The outbreak remains around the globe.
The COVID-19 pandemic hits the global economy. Since the first quarter, the virus has ravaged the world, and the total number of diagnoses has rapidly increased to more than 1 million. Many countries have implemented strict anti-epidemic measures, including reducing social activities, home quarantine, even lockdown in several countries and cities and prohibiting foreigners from entering. Some countries have begun to control the epidemic under various stringent measures, but the impact on the economy is not minor. First of all, the stay-at-home order and lockdowns have brought the consumer market closer to doom, and the disruption of various supply chains has also affected the resumption of manufacturing. The ban on foreigners from various countries has also brought the tourism industry to a halt, further punishing consumption. The International Finance Association (IIF) expects that this year's economic growth in emerging markets will plummet to 1.1%, economic growth in EM ex-China will stagnate, and countries in Latin America, Russia and South Africa will enter a recession. In 2020, the economic growth of non-Chinese emerging economies will be 0%, of which only the Asia-Pacific region will grow by 2.4%, and Latin America and Central and Eastern Europe, Middle East & Africa (CEEMEA) will grow by -2.7% and -0.5% respectively.

Many governments and central banks implement economic stimulus measures and loosen monetary policies. With the spread of the epidemic, many countries in emerging markets have successively launched fiscal and monetary policy measures to contain job security, stabilize growth, and support companies to overcome difficulties. Emerging market central banks have cut interest rates sharply, and some have even lowered interest rates to historical lows. The Fed allows foreign central banks to borrow US dollars on US Treasury bonds during the epidemic to ease the needs of USD by companies and investors in emerging markets. However, the effectiveness of the relevant stimulus measures will depend on when the epidemic will subside. The financial strength of emerging market countries have always been limited, and the prolonged epidemic will make the financial markets of emerging markets vulnerable.

Oil fell on oversupply fears. The epidemic is spreading around the world. The isolation policy of many countries has caused the demand for aviation and transportation to fall sharply, while the demand for energy is also greatly reduced. The International Energy Agency (IEA) expects that the daily demand will be greatly reduced by 20 million barrels. At the same time, the production cut agreement between OPEC and Russia may not ease oversupply issue, causing oil prices to fall to $20 level, a decline of more than 60% in the first quarter, the largest drop in history. The current oil price level is lower than the production costs of many oil exporting countries. At the
same time, it will affect the foreign exchange income of these countries and worsen the vulnerable economy.

EM may detonate the next crisis. In recent years, emerging markets have been affected by various unfavorable factors and their financial conditions have been weakened. Many analyses have pointed out that emerging markets are worse than they were before the 2008 financial tsunami. Over the past few years, emerging market companies have issued record-breaking dollar bonds. However, the Fed repeated interest rate hikes, Sino-US trade frictions, the recent coronavirus epidemic and the plunge in oil prices have pushed many emerging market currencies to the brink of historical low. Emerging market rescue programs and measures of lockdowns further eroded financial strength. The recent sharp decline in global stock markets has further led investors to withdraw funds in emerging markets. IIF showed that a total of 83.3 billion U.S. dollars of funds were drained from emerging markets in March. The International Monetary Fund (IMF) said that emerging markets need at least USD2.5 trillion to weather the crisis. If the epidemic continues, it is believed that many emerging market countries will be stretched and even unable to repay US dollar bonds. Or trigger another wave of crisis.

Region Outlook

Emerging Asia Asia is the first region to be plagued by the epidemic, but as countries take strict anti-epidemic measures, the epidemic is largely under control. China has begun to speed up the process of resumption of manufacturing. The manufacturing PMI has also returned to 50 expansion levels. South Korea and Taiwan have strong economic strength, sufficient foreign exchange reserves, and the economy does not rely on the production of natural resources. North Asia is expected to benefit from China's economic recovery. The trade deficits and fiscal deficits of India and Indonesia once plagued the market. Although the situation has improved in the past few years, the epidemic situation continues to erode the financial strength of the two countries. Thailand is the most recent country that has implemented lockdown policy, and it has had a significant impact on the economic growth which relied on tourism industry.

Latin America The stricken Latin American economy once again is facing severe challenges. Latin American countries are heavily dependent on foreign investment and natural resource demand. When the global economy entering recession, capital outflows and resource export revenue declines will put pressure on Latin America's currency and even constitute a debt crisis. The Brazilian government's tightening policy in Congress has been hit hard. Earlier Congress authorized a monthly increase in aid to poor citizens. President Bolsonaro vetoed the increase in aid, but Congress still voted against the president's veto decision. The government estimates that the expenditure will reach 217 billion reais in the next 10 years, accounting for about 20% of the savings from the previous pension reform, which led investors to sell Brazilian assets and the reais fell to a record low. With Mexico economy is too reliance on oil exports and the US economy, it will fall into a dilemma.

Emerging Europe Middle East Africa (EEMEA) The plummet of oil prices has caused oil-producing countries to face difficulties and reduced revenue from resource exports, which has weakened the ability to introduce stimulus...
measures. The Russian government’s finances are stretched and it has not been able to launch huge bailout measures like other countries. On the contrary, President Putin plans to increase the dividend tax (from 2% to 15%) and deposit tax (deposits and local government debt holdings to offshore entities with more than 1 million Russian rubles levied on 13% interest rate income), which is considered to be aimed at the rich, thereby expanding government revenue to provide anti-epidemic funds. At the same time, although the central bank kept interest rates unchanged earlier, it does not rule out raising interest rates in Q2 to support the exchange rate of the Russian ruble, which is opposite to the global central banks. The Russian ruble has fallen by 30% year-to-date.

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. 5) The outbreak remains around the globe.
European equities hit record high with worst quarterly loss since 2002.
As the COVID-19 pandemic has brought significant impact on the global economy, the European countries were also not immune and for most of the last 2 months of the quarter, Europe was actually the most severely affected part of the world. With a widespread outbreak beginning in Italy and along with a high fatality rate, it soon eventually become very serious for other parts of the region, including Spain and the UK. Germany and France were also recording a high number of cases. At first markets brushed aside the economic fears over the coronavirus outbreak in early February. Optimisms grew as certain forward looking economic data, e.g. manufacturing Purchasing Managers Index (PMI) were on the rise despite still in contraction territory earlier in the quarter. In fact, the STOXX Europe 600 Index made historical high, similar to the US indices, sometime in mid-February. Ironically, the index closed the first quarter with a quarterly loss of 23%, its worst performance since 2002. The loss had already been diminished by a quarter by March 31st as the benchmark bounced back from a mid-March low amid the looming monetary and fiscal policies. As certain forward looking economic data, e.g. manufacturing Purchasing Managers Index (PMI) were on the rise despite still in contraction territory earlier in the quarter. In fact, the STOXX Europe 600 Index made historical high, similar to the US indices, sometime in mid-February. Ironically, the index closed the first quarter with a quarterly loss of 23%, its worst performance since 2002. The loss had already been diminished by a quarter by March 31st as the benchmark bounced back from a mid-March low amid the looming monetary and fiscal policies despite a weak outlook of the fragile economies, and also the signs of peaking in terms of the number of cases in Italy lifting the sentiment in the markets. Overall all 19 groups of the index were down in the first quarter, with the travel and leisure industry faring the worst among them.

No doubts that European economies are in serious conditions. As the COVID-19 outbreak has turned into a pandemic, it has also brought serious shocks to the domestic demand and exports of the European continent. Italy has been one of the most severely hit area, significant impacts are seen on other European economies as well. The final value of the Manufacturing Purchase Managers Index (PMI) of Eurozone dropped down to 44.5 in March, the worst since July of 2012. Service PMI also was reported to be at 26.4, the lowest since inception from July 1998. As the data revealed, the stoppage of economic activities and the lockdown policies implementation have led to the inevitable economic recessions. Although consumer confidence index only dropped by 11.6%, less than expected, the data collection of it had been actually completed earlier than its original schedule, and the reality might have been much worse. The vice president of the European Central Bank (ECB), Luis de Guindos, already said the outbreak will cause the first quarter to fall into economic recession, and despite his prediction of a recovery in the second quarter, economic growth for the whole year will still be negative. Since the stay at home order was implemented on March 17 under a nationwide lockdown, the French central bank estimates that economic activities will be dragged down by 1.5% on an annualized basis every two weeks. First quarter will contract by 6%. Italian government already promise to guarantee 500 billion EUR worth of corporate loans. European Union Finance Ministers Assembly also just agreed to implement jointly an aid program of 540 billion
EUR, originating mainly from the European Stability Mechanism (ESM), overall European Union has contributed 3200 billion Euro jointly.

Relative to the Federal Reserve in the US, monetary policy stimulus of the Eurozone pale in comparison. The ECB maintained its interest rate at the March meeting, only adding capacity to their quantitative easing and liquidity tools by adding 120 billion Euro of net asset purchase until year end, and eventually decided to purchase bonds under 6 months of maturities. In addition, ECB has lowered its collateral requirements by temporarily raising its risk tolerance via including lower credit quality assets for acceptance as collaterals in order to avoid banks from stopping to lend. At the same time, there are ECB members calling for issuances of “Coronavirus bonds” for relaying proceeds to members in needs. President Largarde urges leaders of the EU to increase spending, emphasizing on the importance of supportive fiscal policies. However, her calls only received responses from certain leaders. In contrast, Germany has somewhat been skeptical and only until April, they were able to establish consensus, but the “Coronavirus bonds” are still under discussion.

Regional Outlook

Germany  German economy was supposed to benefit from the Sino-US trade agreement signed at the beginning of the year, raising expectations of a possible turning point for the economic slowdown. German stock markets also had done well, however as the outbreak spreads, its impact on them were inevitable. Although the death rate in Germany has been relatively low, however the number of confirmed cases still has not apparently peaked in early April. Political circle in Germany has also been skeptical about fiscal stimulus, as Prime Minister Merkel said she had not seen the need for typical stimulus earlier and her conservative alliance were still divided over that. Although the European Union has just passed a joint program, whether it would help the German economy still remain to be seen. However as supply chains in some countries and industries have already reactivated after their outbreaks have peaked, Germany might have an advantage for her recovery amid its reliance on exports and industrials, as demands returns from the other regions.

UK  As expected the UK parliament passed the Brexit bill in late January and UK officially exited the European Union on January 31. Thus the market focus was immediately on the EU and UK trade negotiations in the “transitioning period”. However, as the outbreak spreads, UK eventually also had to implement “stay at home order” similar to what other countries have done and the similar impact on stock markets have also been brought upon them. Although the Bank of England has reduced interest rate by 0.15% on an urgent basis in March, along with expansion of national debts and corporate bonds by 200 billion GBP, the newly appointed President also was willing to supply unlimited liquidities via a new commercial papers facility. However, the most impacted sector has been the domestic banking industry amid the general headwinds against the banks’ net interest rate margins. In addition, the Bank of England has also encouraged banks to cancel and stop paying dividends earlier in order to prepare for future needs. Such move will diminish the attractiveness of banks to stock investors greatly. On top of that, we have to be mindful of the Brexit bill of Boris Johnson which prohibits the transitional period of the trade negotiations be extended beyond 2020. Markets are doubting his abilities to complete that within such limited time,
which might surface as new risks for the second half of the year. On the other hand, the UK stock market has lagged global counterparts for years and its relatively lower valuations vs. other European countries might turn out to be supportive.

**Italy**  Italy, the most severely hit country by the outbreak, also has a high fatality rate and the first country needed to implement the “stay at home” order. Thus the economy was the first one to be impacted and most significantly as well. In mid-March, a stimulus of 25 billion EUR were already announced, along with a request to the EU Parliament for raising the limit of her fiscal deficit to a level slightly lower than 3% of the GDP. In early April, the government also provided guarantees for loans of 500 billion EUR to the corporations. Another program of 100 billion was also announced by the EU to help hard hit countries including Italy and Spain to save jobs. Although the outbreak there seem to have peaked in April, the post-outbreak impact on the fiscal deficit and the lasting effect cannot be ignored. When the Italian budget was passed in the parliament last December, the annual deficit to GDP ratio was maintained at 2.2% and the government already planned for new value added taxes in fiscal 2020 and 2021 to cover the deficit and avoid penalties from the EU. However how to deal with the deficit after the outbreak and stimulus program remain the biggest challenge facing Italy going forward. One of the solutions could be the “Coronavirus bonds” proposed by some EU members. Up until now, there is no consensus though.

**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 5) The outbreak remains around the globe.
Japan's stock market underperformed in the first quarter of 2020. The global spread of pandemic outbreak and a plunge in oil prices led to a selloff across the board in different assets including global stocks, with most markets down by 20% to 30%. Japanese equities are not immune, with the Nikkei 225 Index pulling back for more than 7,700 points in the first quarter. Even though many major central banks and governments responded proactively to the outbreak, which prompted a market rebound in mid-March, the Nikkei Index still finished last quarter down by 4,739 points. The TOPIX was down more than 18%; the TOPIX II index that represents small and mid-sized companies was down more than 28%.

The outbreak has affected Japan. Mr. Kuroda said since last October, the Bank of Japan (BoJ) has bought 2.04 trillion yen in equity exchange-traded funds (ETF). If the Nikkei index fell below 19000 points, the central bank’s holdings of ETF value would be below its purchasing cost. The BoJ announced an emergency meeting in March to launch more quantitative easing measures for rescue, including higher targets in annual purchase of ETF, further quantitative easing, adjusting corporate bonds and commercial paper purchases, etc., But it could not mitigate pressures on the market. In addition, BoJ pointed out that domestic economic activity is likely to remain weak due to the impact from the epidemic. In the medium to long term, inflation expectations will be roughly unchanged, but may show some weakness in the near term, reflecting the central bank's concerns about long-term inflation to be mild.

Japanese economic data continued to be weak. Although retail sales rose year on year in February due to higher sales from drugstores and supermarkets, they are driven by epidemic-related anti-epidemic products. The overall Japanese economy remained weak, with manufacturing activity continuing to contract and the final PMI for services sector falling to 33.8 from 46.8 in February. BoJ's March tankan report showed that business sentiment among Japanese largest manufacturers deteriorated for the fifth quarter in a row, which is the first negative reading in seven years. But the real concern is still from the coronavirus pandemic, as it forced the delay of Olympic Games in Tokyo, and have negated all the positive financial boost that could have brought by the long-awaited Olympic effect. It also negatively affected Japan's tourism, as inbound tourists reduced significantly (down by 55%yoy according to Japan's tourism Bureau’s forecast at the end of February; travelers from South Korea down by 80% and from China by more than 85%). Japan's tourism has been a pillar of the country's economy, thus the development of the outbreak and its impact to Japan's economics need to be closely watched.
Japan have rolled out more stimulus packages. The Japanese government had announced a ¥26 trillion stimulus package last December mainly for post-disaster recovery and reconstruction. With the outbreak this year, Prime minister Shinzo Abe announced additional emergency stimulus measures of ¥108 trillion, which is equivalent to 20% of Japan’s GDP. The scale is unprecedented, and it includes more than ¥6 trillion in cash to help Japanese households and SMES, ¥26 trillion for social security and tax payments, and other measures for immediate needs. The authorities aim to mitigate the impacts from the outbreak and at the mean time to minimize the risk of entering recession.

Risk Considerations: 1) economic slowdown caused by the Coronavirus pandemic ; 2) many issues caused by the Tokyo Olympics postponement delay ;3) Influence from Consumption Tax; 4) Strong JPY which affect export; 5) financial pressures faced by the government due to overspending ; 6) Aging population; 7) BoJ not able to achieve target inflation.8) Insufficient local labour force 8) The outbreak remains around the globe.
The trend of the US dollar remains the focus of the market, and it is important to pay attention to the impact of its trend on the performance of Hong Kong stocks. It is worth noting that during this round of volatilities, different types of assets tended to hedge and flowed to the US dollar, resulting in a shortage of U.S. dollars and a tightening of liquidity. The U.S. dollar has risen sharply relative to other currencies, and the U.S. Federal Reserve provided a lot of liquidity before the U.S. dollar turned softer. During the period, the exchange rate of the Chinese yuan once dropped to 7.16 (US dollar against offshore Chinese yuan), which was similar to the peak of US-

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Chinese trade friction last year. It is important to pay attention to the impact of the US dollar on the market outlook of Hong Kong stocks.

The effectiveness of the Chinese government’s anti-epidemic measures, coupled with large-scale stimulus measures, may lead to a faster recovery than other countries. As the epidemic in Europe and the United States affects local consumption and demand, the export performance of the China will also worsen. Some brokers have recently estimated that Chinese exports will fall by 12% year-on-year in 2020. Therefore, in the recent Politburo meeting, stimulus measures were particularly emphasized, especially the launch of Central Government Special Bonds. It is worth noting that these special government bonds have only been issued twice in the past. Major brokerage estimates that the size of the entire stimulus package in 2020 will reach 16% of this year’s Chinese GDP. Therefore, it is foreseeable that the credit growth in China will increase rapidly, and the Chinese government may allow for a more moderate Together with the increase in Local Government Special Bond and a higher deficit rate, property market regulation. Although the Two Sessions will be held in April, there will be more and more news about stimulus measures. With the effectiveness of anti-epidemic measures and large-scale stimulus measures, it cannot be ruled out that the Chinese’s economic recovery could be faster than other countries.

Risk Considerations: 1) Although mainland healthcare expert says the chance of a second outbreak in China is not high, if the imported cases again drive the epidemic, the recovery time in China may be longer than expected; 2) If the European and American epidemic remains for a long time, demand for and the performance of Chinese exports could see a greater impact; 3) Hong Kong’s economy continued to decline in the first half of this year, and the economy outlook is uncertain.

Focus Sectors

Hong Kong Property. Given the outbreak of COVID-19, global central banks launches easing monetary policies and results in low interest rate environment. Although HK banks does not follow to cut prime rate, HKMA already revised down basic rate to 0.86%, which will improve investment sentiment on property market and property stocks as follows: 1) Reduction of future funding costs of developers, 2) Positive for investment properties valuation from declining the capitalization rate (Cap rate), and 3) Decreasing interest expenses for mortgagees, who use HIBOR as a benchmark rate. More importantly, HK private residential completion was down 35% yoy to 13,640 units in 2019. There is no point in arguing that the shortage prevails in the future. At present, HK property sector trades at ~50% to 60% discount to NAV. De facto, developers repurchased / major shareholders increased stake for their company. That means, current valuation is undemanding. More importantly, HK developers have low gearing ratio / net cash holdings, which will provide abundant financial support for expansion after the epidemic.

China financial stocks For insurance sector, in the epidemic, fewer customers go out and that could affect premium growth for the first quarter, but the nature is temporary. According to SARS experience, sales performance should rebound rapidly after the epidemic subsides. At present, the mainland insurance industry is dominated by a number of large insurance
companies. The market share of domestic insurance companies exceeds 90%. Therefore, the recent opening up to foreign investors will not pose a threat, but will be conducive to the introduction of new insurance products and services. In summary, the market penetration of life and health insurance products in China is still low, and there is a lot of room for development. It can be noted that companies with advantages in fintech can open up business opportunities by combining customer data with artificial intelligence.

In terms of risks, it is worth monitoring whether the impact of the epidemic will continue, and also the state of the economic recovery and personal consumption power will determine the growth rate of insurance premium income.

For China banking sector, large banks’ NPL coverage ratio was 234% at end-19. The high NPL coverage would provide earnings buffer for potential rise in NPL. Despite net interest margin pressure and potential rise in NPL, earnings of large China bank is expected to have stable growth with decent dividend yield.

Healthcare The group procurement organization (GPO) tender would continue adding pressure on generic drug prices, which is well expected by the market. As pharma market in China is still fragment with top 10 players accounting for ~15% of market share, it is believed that price cut would accelerate market consolidation. Market share of generic drug will decline and innovative drug would be the sector focus. Drug makers is transforming 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. Also, new products launches would accelerate in the coming years, helping valuation re-rating for large pharma. On the other hand, contract development and manufacturing organization (CDMO) provides R&D services to pharma, covering drug discovery, development, testing and manufacturing which would benefit from pharma’s increasing R&D spending.

Consumption The outbreak in China has affected consumption and the public’s desire to go out, which had a temporary negative impact on the retail consumer industry, especially catering, sportswear and physical stores. Although the retail performance in the short term is affected by uncertainties, the long-term growth prospects are still good, especially the pent-up demand during the period will be released in the future. In recent years, basic consumer stocks such as sportswear and beer have adopted a product premiumization strategy. Due to the price increase of products, profit margin is expected to further expand and drive profit growth. In terms of risks, it is necessary to monitor the effectiveness of the Chinese economic stimulus measures and whether they can sufficiently stimulate consumer sentiment.

Technology Under the epidemic, online traffic has soared, and demand for mobile games, videos, and social media has increased. Therefore, internet stocks performed well. As for the mobile gaming industry, after the tightening of supervision last year, the current speed for games to receive approval has been normalized. In addition, e-sports and live broadcast activities are more active, making the online gaming ecosystem and consumer behaviour more mature, which is conducive to the continued growth of the industry. In addition, new retail model is also the mainstream of the industry, which provides users with personalized services through internet, big data, artificial intelligence and other technologies. It combines online services, offline physical stores and national logistics networks to comprehensively enhance consumer experience. Although the epidemic still affects consumption, it is believed that pent-up demand will be released again in the future. On the risks side, due to the weak economic situation in China, investments in online...
advertisements has decreased, so the current slowdown in the industry may continue into the second half of 2020.

**China Property Management** Property management companies 2019 results are in line with expectations / positive profit alert figure. Some of them are even higher than expectations / positive profit alert figure. Management remains positive on the sector outlook, and the future growth driver mainly comes from the growth rate of GFA under management, M&As, 3rd party projects, value-added services and public projects. That said, bearing in mind that the outbreak of novel coronavirus dampens market sentiments, and some of the operations of property selling centers and construction sites were halt. HK listed China developers 1Q20 contracted sales was down 16% yoy, and developers also revised down FY20E sales target to 10% yoy. If the virus could be under control in 2Q20, the impact on the future of GFA delivery and GFA under management will be limited. That said, if the epidemic cannot be settled, it will affect the growth rate of GFA under management in the middle to long term. Due to the economic slowdown and outbreak of novel coronavirus resulting in uncertainties, property management companies with public project exposure is more preferred. Public projects are those properties managed by the local government like hospitals, schools, museums and so forth. Public project is famous for strong customers’ loyalty, high profitability, and stable cash flow. That said, there is a need of relationship network with the local government, and entry barrier is high. In these days, property company partook in public projects via M&As, and some listed company has public projects thanks to the SOE parent company background. We are still positive on the 2Q20 outlook of property management sector. Their strong net cash holdings will make M&As possible.

**HK Utilities** US Fed cut rate twice in March and US 10-year treasury yield has fallen to <1%, the lowest level in past decades. Yield spread between HK utilities and US 10-year treasury yield has widened, increasing the attractiveness of HK utilities. Despite weak HK economy, HK electricity sector is protected by Scheme of Control. Their earnings are based on net fixed asset, instead of power demand, and they have increased CAPEX plan for the coming years which would drive their earnings growth. HK water is also protected by 3-year water supply agreement between HK and Guangdong governments. They will negotiate the next 3-year agreement in 2H20 which is expected to have flat tariff.
Bonds

The global financial market is volatile amid raging epidemic. High rated bond is relatively stable. The novel coronavirus epidemic has spread around the world since March. Even if the Fed unexpectedly cut interest rates or started quantitative easing, it did not alleviate market concerns. Investors were pessimistic about the economic outlook and tended to increase their cash on hand. Risky asset prices fell sharply. Bloomberg Barclays Global High Yield Total Return Index fell 15% in the first quarter of this year, while Bloomberg Barclays Global Aggregate Total Return Index, which represents investment grade bonds, fell only about 0.3%, reflecting its stronger resistance to falling under volatility markets as these bond issuers have relatively sufficient cash levels and better financial conditions, and the related bonds were more liquidity in the secondary market. In particular, most countries in Asia are not crude oil and commodity export areas, and therefore are less affected by oil price fluctuations. Besides, more than 70% of Asian bond investors are from Asia, which is a significant increase from less than 50% during the financial crisis in 2008 to 2009. Among them, about 40% investment grade bonds are held by long-term investors such as banks, insurance companies, retirement funds and sovereign wealth funds, which helps reduce the volatility caused by liquidity tensions.

High yield bonds fell significantly along with risky assets. Corporate cash flow pressure and default risk have risen. Tight liquidity in the investment market is one of the main reasons for the plunge in high yield bond prices. Bank of America liquidity risk indicator has risen sharply since the beginning of March, reflecting that investors’ asset realization and deleveraging have made market liquidity pressures higher and higher. Global stock and bond markets have experienced significant capital outflows for several weeks, of which high-yield bonds, one of the risky assets, were being sold off as well.

In addition, unlike investment-grade bond, high-yield bond is very sensitive to changes in the economic cycle. Now that the spread of the epidemic has caused the economy to enter a recession, leading to higher default risk. Although many governments plan to provide relief funds and low-interest loans to enterprises, which can help solve short-term liquidity problems, the amount of relief fund is limited and the loan is need to be repaid finally. So if the epidemic stays for a longer period of time, many companies may have liquidity problem and even unable to pay debts. At present, many countries are strictly implementing epidemic prevention measures such as the closure of cities, which has caused varying degrees of impact on different industries. Standard & Poor’s earlier pointed out that the epidemic affected mainland property sales and slowed construction progress, which was unfavorable to the industry’s leverage and profitability. It also mentioned that some property developers may be subject to liquidity issue in the coming months. As for the United States, the epidemic had already hit sectors such as aviation, tourism, and consumer discretionary. Due to plummeted crude oil prices, energy-related companies were further negatively affected with a shale gas drilling company applied for bankruptcy protection on the first day of April. This round of oil price collapse is mainly due to weak global demand and price wars among oil-producing countries. The former depends on the development of the epidemic, while the latter involves some political issues. Before the clearance of these factors, it may be difficult for oil price to come back to level of the beginning of the year. The plunge in high yield bond price not only...
Investment Outlook

Global HY market valuation is at its lowest level

Source: Bloomberg, as of 8 Apr 2020

Emerging Markets LatAm Bond movement

Source: Bloomberg, as of 8 Apr 2020

Global HY market valuation has fallen to its lowest level after the plunge. The overall high-yield bond market spread has soared since March, from 400 bps at the beginning of the year to the highest level of 1,200 bps. With the liquidity injection from central banks, the global high yield bond credit spread fell slightly at the end of March, but it is still at its highest level since the financial crisis and is far above the long-term average. Recall that the 2008 financial crisis originated from a subprime storm and was a financial market structural problem. It is essentially different from the disaster like epidemic, but both of them have caused the economy to face recession and the corporate credit quality to be deteriorated. Looking back 2008, there is a more meaningful rebound of high yield bond after the global stock market bottomed out, and it took more than 9 months to return to a more reasonable valuation level. Although it is difficult to predict when the epidemic will be under control, if risk events fade out and the global economy gradually regains its growth momentum, it is believed that the valuation of high yield bond is likely to gradually return to the historical average.

Global economic growth has slowed while default risks in emerging market countries have once again attracted attention. Under the impact of the novel coronavirus, the world may face negative growth this year. In emergency moves, the Fed has twice cut interest rates to almost zero interest rates this year while central banks in Russia, Indonesia, the Philippines and other emerging market countries have also cut their interest rates. Many governments are expected to continue to adopt expansionary monetary and fiscal policies in response to the negative impact of the epidemic, but it is accompanied by increasing government financial stress. In the past few months, financial market volatility has caused funds to flow into the safe-haven USD, which is not conducive to emerging market currencies. Among them, the Russian ruble and the Mexican peso have depreciated by about 20% against the US dollar. Because emerging market countries in general have many foreign currency denominated debts, the strong US dollar undoubtedly makes their debt problems worsened.

On the other hand, oil prices fell sharply after OPEC and Russia failed to reach consensus on production cuts together with the decreasing demand. The prospects of oil or energy dependent countries and companies have worsened, and they even need to deploy capital reserves to cope with the dilemma. At the end of March, S&P downgraded Mexico’s credit rating from BBB+ to BBB as the shocks from the spread of epidemic and plunge in oil prices will further harm Mexican economic outlook. Moody’s has recently downgraded the sovereign ratings of Argentina, Ecuador and Zambia as well. Under the stagnation of stalled trade, low commodity prices and slowing economic growth, the default risk of vulnerable emerging market countries has once again attracted market attention.

Risk factors:
1) The novel coronavirus may cause economic downturn 2) The currency exchange rate fluctuates greatly 3) The risk of default rises 4) Oil prices remain low for a long time 5) Asset prices fell sharply
**INVESTMENT SUMMARY**
- Epidemic situation increases market volatility
- AUD is undervalued?
- China will not have a "second wave" outbreak?

**Epidemic increases market volatility**
Affected by the spread of the global epidemic, many countries blocked the cities and the economic activities were hit hard. The downturn in investment sentiment has led to large fluctuations in asset prices. For example, the Australian dollar, which has following the global economic trend in past, once fell sharply to a 17-year low of about 55 US cents. Besides, the implied volatility of the one-month option related to the Australian dollar has soared to the usual 5 times to about 30%. Reflecting the unclear nature of the epidemic, the global irrational scramble for cash (US dollars) has led to a massive sale of non-US dollar assets. In addition, at the informal meeting of the RBA in March, the announcement of interest rate cuts to an all-time low of 0.25% and the first introduction of a quantitative easing policy of AUD 12.7 billion have made the Australian dollar worse. For the Australian dollar future trend? We think the focus is on when the new coronavirus outbreak is under control. Once the epidemic is under control, the current near-zero interest rate environment of major global central banks is expected to drive rapid economic improvement. At that time, with the rising demand for commodities, it is expected to be benefit on Australian dollar.

**Australian dollar is undervalued?**
From the perspective of value investment, Australia's two main export iron and coal prices are both much higher than their lows level set in 2015, but the Australian dollar exchange rate has hit a 17-year low. Some of the reasons may be related to the gradual control of the epidemic situation in the Mainland. The Hubei Provincial Government announced that Wuhan will lift the control measures for the passage leaving Wuhan from April 8. With the gradual resumption of production and resumption of production in the Mainland, the suppressed demand for various industries and trades is expected to be released. Coupled with the market's expectation that the central government will increase infrastructure projects to boost the economy, etc., the recent iron and coal prices have stabilized and have not been affected by the market's irrational selling. As coal and iron are the main exports of Australia, the stable prices of both are expected to benefit Australia's trade performance and the Australian dollar's mid- to long-term performance.

**China will not have a "second wave" outbreak?**
Zhong Nanshan, senior expert group leader of the China National Health Commission, said that as countries take strong and powerful measures to control the epidemic, it is expected that the global epidemic will be controlled by the end of April, and China will not have a "second wave" outbreak. Zhong Nanshan, as an expert in this field, may have a reference role in his speech. As the outbreak in the mainland is gradually under control, the Australian dollar has rebounded from a 17-year low to 60 US cents. However, as the current epidemic in Europe and the United States is not clear, the market still
tends to hold (cash) US dollars as a hedge, which will relatively limit the short-term upside of the Australian dollar.

We believe that the uncertainty of the global epidemic is still high, and the impact on the economy has not yet fully emerged, so we expect the Australian dollar’s short-term performance to remain volatile.
The epidemic may cause the Japanese economy to fall sharply
Japan's GDP contracted in the fourth quarter of last year, and the economy is showing signs of recession. Affected by the epidemic, the number of local tourists in Japan has decreased significantly. Together with the increase in consumption tax since October last year, it has affected Japanese national consumption. The new pneumonia epidemic has severely damaged Japan's real economy and deepened the market's concern that the Japanese economy will lose its growth momentum. Japan's Prime Minister Abe announced in early April that Tokyo, Osaka and other seven regions entered a state of emergency for a month, accounting for about half of Japan's economic output. As many retail and entertainment companies have suspended their business, the market expects that Japan's GDP will inevitably decline sharply in the first quarter of this year, and economic output will be reduced by up to 20%.

Economic losses caused by the delay of the Tokyo Olympics
As the Japan economy was hit by the increase in the consumption tax rate in 2019, it expects Tokyo to welcome more than one million tourists during the Olympics and boosts the local tourism industry. The coronavirus epidemic has already caused a decline in the global tourism industry. According to data released by the Japan Tourism Agency, the number of foreign tourists visiting Japan in February 2020 decreased by 58% from the same period last year, the largest decline since the 2011 Kanto earthquake and tsunami. The decrease in tourists is expected to cause significant economic losses. On the other hand, in order to prepare for the Tokyo Olympics in July, Japan has spent at least US $10 billion. However, the International Olympic Committee and the Japanese government announced that the Olympic Games would be postponed for one year. The market expects that the huge amount of additional funds due to the delay of the Olympic Games will cause more than 600 billion yen economic losses to Japan.

Easing measures may weaken the yen
Although the cabinet meeting finalized an emergency economic response of 108 trillion yen in early April, which is equivalent to 20% of GDP, unprecedented in scale, and promised to take all measures to deal with the economic impact of the epidemic, but the market It is still widely expected that Japan’s economic performance in the first quarter of this year may be worse than the negative 6.3% in the fourth quarter of last year, and there may be a chance of a technical recession. On the other hand, the central banks of many countries around the world have adopted easing monetary policies, and the Bank of Japan is no exception.

The yen and gold have always been regarded by the market as traditional hedging tools. However, since August last year, their trends began to diverge, reflecting that while the new coronavirus epidemic is still
spreading, the market is not confident in the Japan economy and yen. Funds tend to flow into other safe-haven assets such as the US dollar and gold and this is expected to limit the performance of the yen in the second quarter of this year.
New pneumonia epidemic continues
As the new pneumonia epidemic continues, market sentiment fluctuates and gold price fluctuations increase as well, but overall it has been hovering at a high level in recent years. This is mainly due to the market's pessimistic shift in macroeconomic expectations, which has led to the sale of risky assets and the flow of funds to safe-haven products. It is expected that investment demand will continue to support the trend of gold in the second quarter.

Investment demand dominates gold price
Although the global economic slowdown will affect the demand for gold to a certain extent, especially the demand for gold jewelry, but driven by risk aversion, the market demand for gold investment is much higher than the reduced demand for gold jewelry under the economic slowdown. The latest data from WGC shows that the scale of global gold ETF asset management in the first quarter of this year still recorded a record increase of 298 tons, with a total net inflow of USD 23 billion. The net inflow of gold ETFs in various regions in March was 3.6 billion, which has recorded an increase for the fourth consecutive month.

Major central banks return to easing
The spread of the epidemic in various countries has exacerbated the risk of global economic slowdown. The central banks of the United States, the United Kingdom, Australia, Canada and many emerging market countries have all returned to easing in response to the impact of the new pneumonia epidemic on their economies. For example, the Fed has repeatedly lowered interest rates and restarted quantitative easing. In the next few months, it will purchase US $ 500 billion in government bonds and US $ 200 billion in mortgage-backed securities, and promises to reinvest all the bonds after maturity. ECB increases the purchase of 120 billion euros of net assets and allows banks to reduce the capital adequacy ratio, and announce new long-term refinancing operations (LTRO) tools. BOJ further relaxes monetary policy and increases the purchase of listed exchange-traded funds (ETFs) and other high-risk assets. RBNZ also reduced the official cash rate to 0.25% and promised that the interest rate will be maintained for at least 12 months.

The market's anticipation of global economic growth deceleration is difficult to reverse. The low interest rate environment, economic growth doubts, trade protection threats and geopolitical turmoil are expected to continue this year, which will help increase investment demand of gold and benefit gold prices.
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