INVESTMENT INSIGHT July 2016

Investment Services Department

Altruist®

Altruist Financial Group Limited
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When the only certainty is uncertainty

In the era of Greenspan and Bernanke, we were so used to the unequivocal messages from the US Federal Reserve (the Fed), which gave investors the "what to expect" in the Fed's policies (including US interest rate trends and monetary policies), thus their implications to the financial market going forward. Today, the globe is still looking up to the Fed for its directional guidance, but the vision is blurred as the Fed becomes increasingly "data dependent" as per Chair Yellen. In fact, in the press conference following the Federal Open Market Committee (FOMC) meeting in mid-June, Fed chair Yellen used some variation of the word "uncertainty" 13 times according to a Reuters tally. Adding to the global uncertainty was the surprising result of the British referendum, to have 52% voted to leave the European Union ("Brexit"), which shook the market. Perhaps the United Kingdom is no longer united as the nation is divided like never before. The outcome sent jitters across the market as this could be the start of the breaking up of European Union with populist on the rise. The global investment environment is getting astoundingly complicated as we are having a cocktail of unprecedented low interest rate environment, deflationary pressure, anemic economic growth and heightened political instability around the world. The only certainty is uncertainty in the market.

Upon the confirmation of "Brexit" on June 24th, the British pound sank to its 31-year low. Global stock markets and oil prices plunged. Fitch and Standard & Poor downgraded Britain's credit rating by one and two levels respectively. Investors flocked to seek refuge in safe-haven assets such as investment grade bonds (sovereign bonds in particular), precious metals, Japanese yen, Swiss Franc and US dollar. For the first half of the year, gold, silver, Japanese yen surged 24.3%, 35% and 16.5% respectively; 10-year and 30-year G7 sovereign bonds yields plummeted to all-time lows; four developed countries had their 10-year sovereign bonds in negative yield territories, including Japan, Germany, Switzerland and Denmark. The yield of 10-year US Treasury bond fell through the 1.5%-floor to 1.471%, and apparently continued digging.

As shared in our previous editions of Investment Insight, we anticipated 2016 to be a year of higher volatility and lower return, with Japan and Europe facing a particularly difficult year. In addition, we expected Asian and emerging markets to outperform developed markets with the exception of China which is undergoing the process of structural reform. The result as shown in Table 1 below pretty much echoed with the above expectation. As we can see, the performance of the majority of emerging countries stock markets beat that of the developed countries as at June 30th. We continue to favor Asian equities as we believe the direct impact of "Brexit" to Asian countries should be limited. The overall share of UK exports accounts for less than 3 % of GDP for all Asian countries, and the fundamentals of Asian countries have improved substantially over the last decade. We have also recommended investors to overweight investment grade corporate bonds in these times of high volatility to mitigate risk for their overall portfolio, while we expected gold to be in a choppy trade pattern unless we have an emergence of black swan event. In fact, the Bloomberg Global Investment Grade Corporate Bond Index rose 7.5% in the first half of 2016 and we remain unchanged in our view that inclusion of this asset class is prudent especially during times of turmoil. What surprised us were the "Brexit" black swan and thus the gold price rally. Despite the absence of inflation, gold may continue its upward trajectory in the midst of further monetary easing, negative interest rate environment, as well as heightened political and equity risk. Investors, however, should also be mindful that gold price is already at its 2-year high thus additional weightings in the portfolio should be placed with caution. In terms of currency, safe-haven currencies such as US dollar, Japanese yen and Swiss Franc should remain strong for obvious reasons thus corresponding impact to the other currencies can be expected as exchange rates are relative. Needless to say, that would include the Chinese yuan, the euro, and the British pound.

"Brexit" is a process, not an event. There is evidence that risks have begun to crystallize and surely there will be a lot more to unfold ahead of us. Without a doubt, the hard-earned growth around the globe would be curtailed significantly. Against the backdrop of globalization, coupled with the unforeseeable political risk at play, the rippling effect of "Brexit" is beyond prediction by even the most experienced politicians and economists. In this era of negative interest rate and low inflation, perhaps maintaining a higher cash level would be a defensive strategy worth considering.

TABLE 1: Global Stock Markets Performance

	2016 Q2 Return		2016 YTD Return	
	Local Currency	USD	Local Currency	USD
Dow Jones Industrial Average	2.07%	2.07%	4.31%	4.31%
Euro STOXX 50	-1.90%	-4.56%	-9.41%	-7.69%
Euro STOXX 600	-0.39%	-3.09%	-7.34%	-5.58%
German Stock Index DAX	-2.86%	-5.49%	-9.89%	-8.56%
CAC 40	-0.66%	-3.35%	-5.74%	-3.94%
Nikkei 225	-6.95%	1.44%	-17.38%	-3.43%
Hong Kong Hang Seng Index	2.39%	2.35%	-2.46%	-2.58%
Hang Seng China Enterprises Index	0.35%	0.30%	-6.46%	-6.57%
Shanghai Stock Exchange Composite Index	-1.64%	-4.62%	-16.50%	-18.60%
Shanghai Shenzhen CSI 300 Index	-1.08%	-4.08%	-14.65%	-16.80%
Singapore FSSTI	1.49%	1.33%	0.25%	5.31%
Korea KOSPI	-1.27%	-2.12%	0.47%	2.74%
Taiwan TWSE	0.18%	0.13%	5.07%	7.38%
India SENSEX	7.18%	4.99%	4.38%	2.38%
Indonesia JCI	5.00%	4.51%	10.96%	16.74%
Thailand SET	3.83%	3.75%	14.61%	17.64%
Russia RTS	7.18%	7.18%	24.24%	24.24%
Brazil IBOV	2.94%	15.19%	18.86%	47.61%
S&P Pan Arab Composite Index	2.34%	2.34%	-1.05%	-1.05%
MSCI World Index	1.20%	1.20%	1.02%	1.02%

Source: Bloomberg (as at June 30, 2016)

TABLE 2: Major Currencies Performance (In terms of USD)

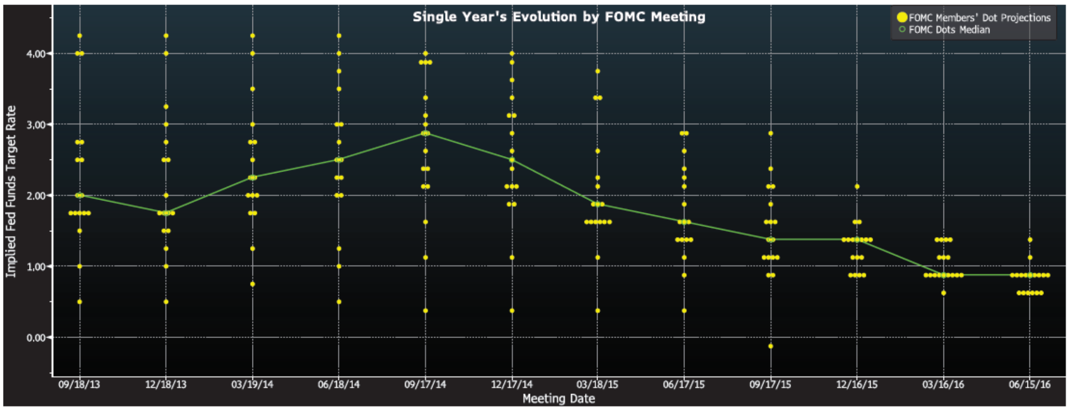
	Change in Q2 2016	2016 YTD change
	In terms of USD	
Euro Dollar	-2.41%	2.25%
British Pound	-7.31%	-9.67%
Japanese Yen	9.08%	16.49%
Hong Kong Dollar	-0.02%	-0.11%
Chinese Renminbi (CNY)	-2.92%	-2.32%
Australian Dollar	-2.69%	2.26%
New Zealand Dollar	3.26%	4.44%
Singaporean Dollar	0.09%	5.29%
Korean Won	-0.72%	1.80%
Taiwanese Dollar	-0.15%	2.01%
Indian Rupee	-1.89%	-2.03%
Indonesian Rupiah	0.30%	4.30%
Thai Baht	0.13%	2.69%
Russian Ruble	4.82%	15.05%
Brazilian Real	11.83%	23.39%

Source: Bloomberg (as at June 30, 2016)

U.S.

- Since the raise of the benchmark interest rate by 0.25% at the end of 2015, the Federal Reserve has left the target range for its federal fund rate unchanged for the fourth time this year in its June session. As shown in the minutes from FOMC meeting held on June 14th – 15th, Fed policymakers decided to wait for additional labor market data and the outcome of the upcoming referendum in U.K. before raising the rates. According to the calculation of implied probability of rate hike from the Fed Funds Futures as at June 30th, the probability of rate hike is 0% in July, September and November, and only 9.2% in December. The lower fed funds rate as predicted by the Fed "dot-plot" for the next three years in June reflected a higher sense of caution when compared to the same in March. Obviously, the Fed is apprehensive of both the local and external factors of the economy, thus we won't be surprised if the Fed increases the rate only once, or even not to increase, in 2016.

EXHIBIT 1: Changes in "Dot Plot" over last 12 FOMC meetings for interest rate projection for 2016



Source: Bloomberg (as at June 30, 2016)

- According to the final reading as released by the Bureau of Economic Analysis, the gross domestic products of U.S. grew at a seasonally adjusted annual rate of 1.1% in the first quarter, which was the slowest pace in one year. The increase reflected positive contributions from personal consumption expenditures, exports, residential fixed investment, state and local government spending. Imports, which are a subtraction in GDP, decreased. There were indications that the GDP figure for the second quarter may improve as retail sales and home sales rose in April and May, but the business spending remained weak and job growth has slowed which may put minuses on the equation.

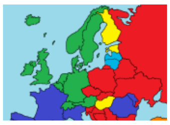
- The Institute for Supply Management's (ISM) Manufacturing PMI came in at 53.2 in June, which was at a 16-month high and way above the market expectation of 51.4. Of the 18 manufacturing industries, 13 were reporting growth in June. However, a survey conducted by ISM after the British referendum showed that most manufacturers were concerned about the impact on manufacturing from the strength of the U.S. dollar; nevertheless, a strong majority believed that they would not alter their business strategy or capital spending plans because of the event. The ISM Non-Manufacturing PMI of the same month also managed to hit 7-month high at 56.5, which was an increment of 3.6% from that of May. Key contributors to the figure included a boost in new orders, new business as well as a recovery in employment.

- The final reading of the University of Michigan's consumer sentiment index for the United States fell from 94.7 in May to 93.5 in June 2016. A sub-index tracking consumers' expectations was the main source of weakness, registering a decline from 84.9 to 82.4, while the sub-index linked to consumers' evaluation of the current situation came in at 110.8, compared to 109.9 in the month before. Consumers were overall less optimistic about the future economic prospects, but the data suggested a moderate rate of growth in consumer spending ahead.

- Job growth for June was the strongest in 8-months as the total non-farm payroll employment increased by 287,000, a surprisingly high figure when compared to market expectations (at 175,000) and the downwardly revised figure in May (at 11,000). This eased a lot of concern from investors regarding a slowing down of the labor market and global stock markets responded positively on the day of announcement. Unemployment rate in June increased by 0.2% over the month to 4.9% due to an improved labor participation rate, which should be comprehended as a positive sign to the labor force. As at June, average hourly earnings have risen by 2.6%.

- While labor statistics may exhibit big swings over individual months, we do see a trend of steadfast improvement in all aspects of the labor market. The two ISM PMIs are also promising. Indices on property market, including Case Shiller Home Price Index and NAHB Housing Market Index continued their upward trajectory over the past five years. Due to the "Brexit" event, the Fed had all the reasons, or even excuses, to postpone the rate hike to after the presidential election, or even next year. We do not see fundamental weakness in the U.S. economy but a slowdown in growth rate would be likely in the near future as a result of the drag from the global uncertainty.

Europe



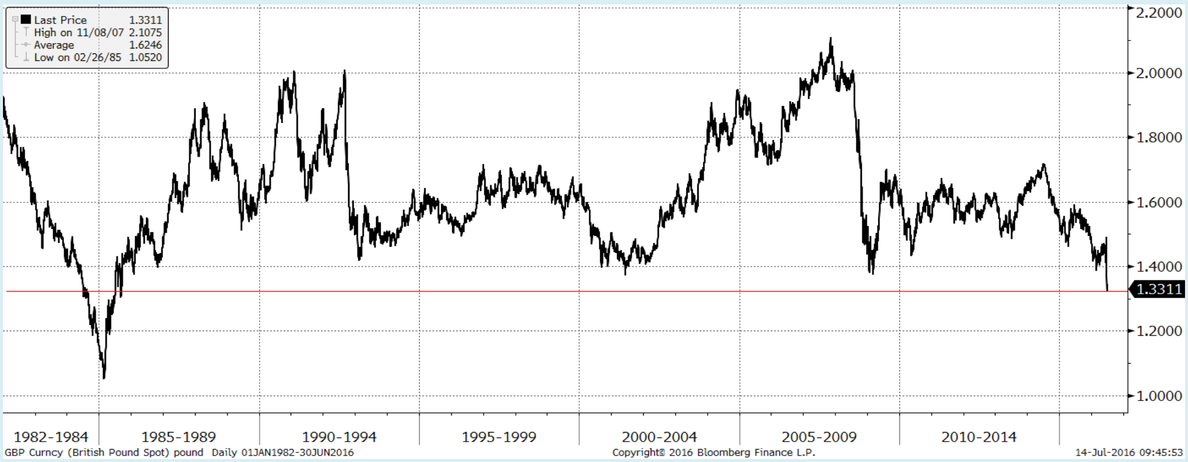
- According to the economic data released recently, the Euro zone economy had shown some improvements. The Euro zone industrial production rose 1.1% in April 2016. This was the first gain in the last three months. The rise in industrial production was mainly due to the rise in the output of non-durable consumer goods, consumer goods, capital goods, and energy sector.

- Besides, the Euro zone business activity expanded at its fastest rate this year in June, as the Markit PMI for the Euro zone climbed to 52.8 from May's 51.5, higher than the earlier flash reading of 52.6, and was slightly above market expectation.

- The Euro zone also returned to inflation in June after four months of falling or stagnant consumer prices. The inflation in the 19 countries sharing the Euro rose 0.1% year-on-year in June from -0.1% in May. The rate was above the average expectation of economists.

- However, it is believed that the encouraging economic data may not be sustainable and the fragile Euro zone economy may go from bad to worse since the UK electorate finally voted to leave the European Union on 23 June 2016, which the decision may hurt the economy of both UK and Euro zone in the coming future. In the financial market, the result of Brexit referendum immediately sent the Pound to a 31-year low and all major European stock markets had a massive decline.

EXHIBIT 2: Pound fell to 31-year low after the “Brexit” referendum



Source: Bloomberg (as at June 30, 2016)

- Despite the global stock markets rallied in the last few trading days of June as investors' fear eased and most of the European equities index recovered the previous loss, the European banking sector remained weak as investors worried that the Italian banks' non-performing loans problem might deteriorate. In Italy, around 17% of the banks' loans (€360 billion) was sour which was nearly 10 times of the level in the U.S. Even during the worst period of the 2008-09 financial crisis, the ratio in the U.S. was only 5%. Among all publicly traded banks in the Euro zone, Italian lenders accounted for nearly half of total bad loans. Italian Prime Minister Matteo Renzi has asked for an emergency €40 billion taxpayer-funded bank bailout. However, this was vetoed by Germany, citing European Union rules that bank bailouts must be funded by bond-holders before taxpayers.

- Subsequent to the Brexit referendum, Italy will hold a constitutional reform referendum in autumn this year. Italy's upcoming referendum will deal with major Senate reforms. If the referendum approves, it may improve the stability of Italy's political environment and allow Renzi to push through laws aimed at improving the country's economic competitiveness. If it fails to approve, Renzi's government will fall, and may plunge Italy back into the type of political chaos last seen after the ousting of former Prime Minister Silvio Berlusconi. According to the recent research paper issued by Citi, the referendum may pose a higher risk for EU stability than the "Brexit" vote.

- It seems that both the political and economic environment in Europe will become more and more unpredictable in the near future. For this reason, we remain cautious towards the investment outlook of the European equity market.

Asia

- Japanese Yen rose over 16% and was the strongest currency among that of all major developed economies in the first half of 2016. The global stock market had been on a roller coaster ride in 2016. We experienced a massive stock market selloff due to the introduction of circuit breaker mechanism of Chinese A shares market in the beginning of the year, while "Brexit" triggered market fear in late June. Funds flowed into Yen as investors were looking for safe haven for their assets although Japan had already adopted a negative interest rate policy since January 2016.

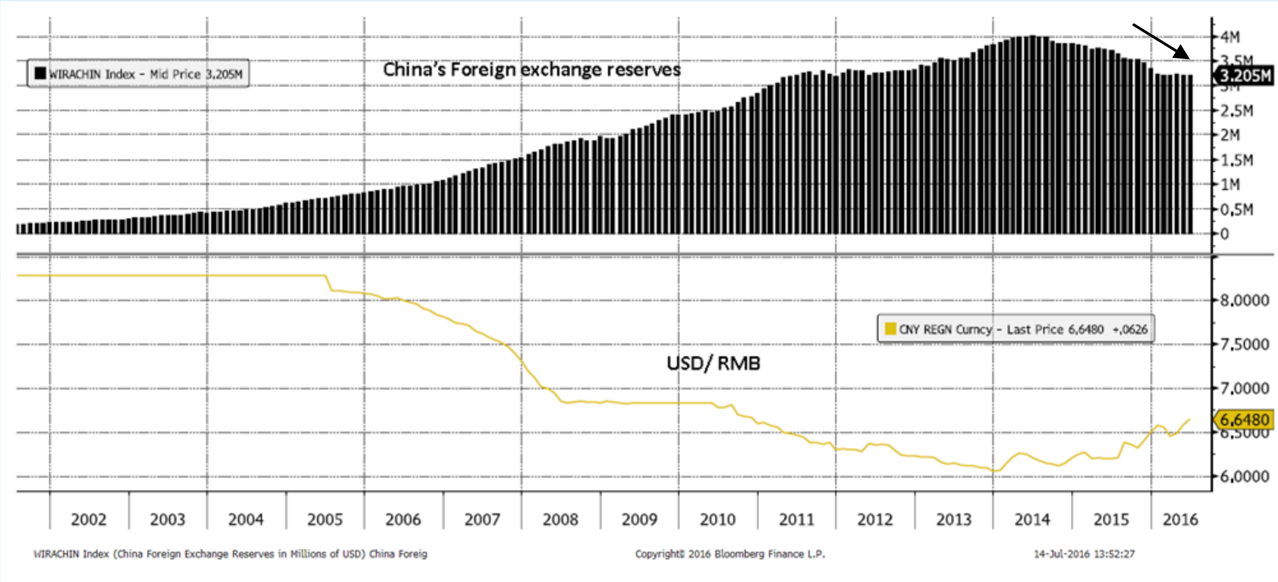
- As the Japanese stock market was always negatively correlated with the Yen, the Nikkei 225 index fell over 17% in the first 6 months of 2016. Strong Yen caused weak export and falling stock market hurt the economic sentiment. Both manufacturing and service sector of the country fell into contractionary zone. In June, the manufacturing PMI was recorded at 48.1 while the service sector PMI dropped to 49.4. It is believed that the Bank of Japan may have new rounds of fiscal and monetary stimulus policies in the second half of the year, however, we remain cautious towards the investment market of Japan due to vague global economic outlook and increasing market volatility.

EXHIBIT 3: Negative correlation between Japanese stock market and Yen

Source: Bloomberg (as at June 30, 2016)

- Renminbi was one of the market focuses in the second half of the year. Although the China's foreign exchange reserves rose $13.4 billion to $3.21 trillion in June, recovering from a five-year low in May, Renminbi dropped by almost 3% in the second quarter against the USD which was the highest quarterly decline in history and it was at five and a half years low. It is hard to predict as to when the Renminbi devaluation trend will halt as the capital outflow of the country continues even though the government has already adopted several capital control measures.

EXHIBIT 4: Change of China's foreign exchange reserves and Renminbi against USD



Source: Bloomberg (as at June 30, 2016)

- On 14 June, MSCI announced that it would delay the inclusion of China's A shares in its emerging markets index until it saw further improvement in market accessibility to foreign investors. The decision was somewhat unexpected as many analysts had recently projected that Chinese financial authorities had largely met MSCI's demands to allow more access to foreigners.

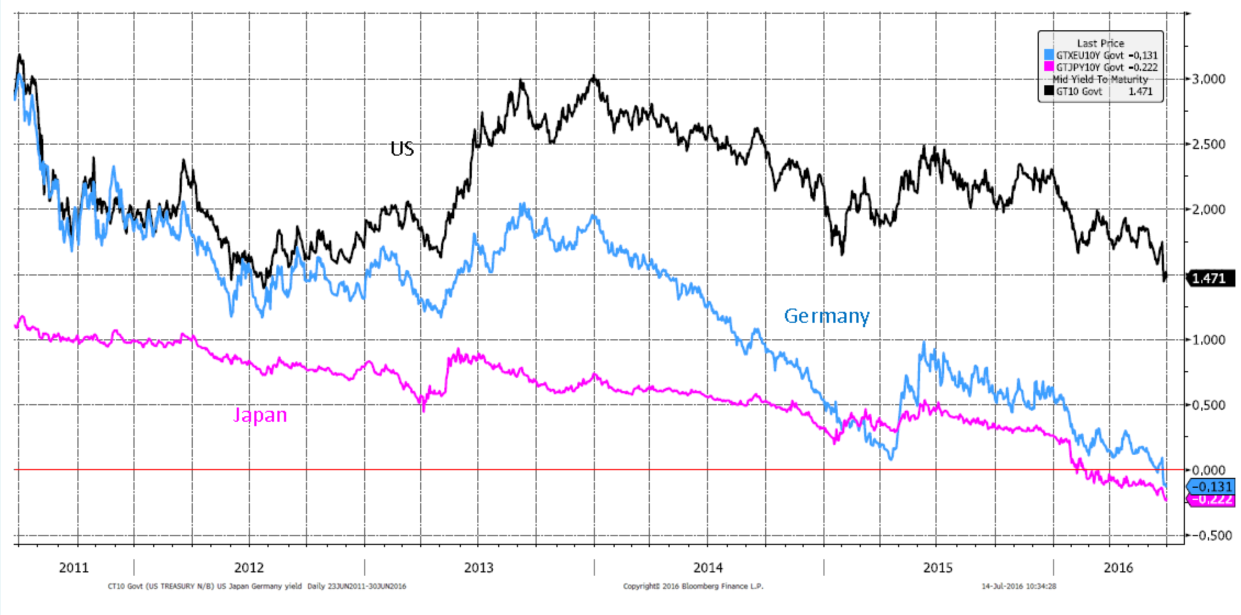
- However, the MSCI decision did not hurt the market sentiment of A shares. In the second half of June, CSI 300 had a steady performance despite the “Brexit” incident. It is believed that the inclusion of Chinese A shares in MSCI Index is a matter of sooner or later, so perhaps it is not a bad timing to accumulate Chinese shares now for medium to long term investment after the massive drawdown in the first half of 2016.

- As mentioned in the last “Investment Insight”, we were optimistic towards the investment outlook of Asian equities. Although the return of the MSCI Asia ex Japan and MSCI South East Asia Indexes was flat in the second quarter, we maintain a positive investment outlook towards Asian stock markets due to their reasonable valuation and relatively high dividend

Fixed Income

- The sovereign bond yield of those major developed countries slid to historical low after the "Brexit" event since investors were looking for safe haven for their assets due to market uncertainty. The 10-year government bond yield of Japan and Germany even fell into negative zone.

EXHIBIT 5: Falling yield of 10-year sovereign bond of major developed countries



Source: Bloomberg (as at June 30, 2016)

- As weak global economic growth and volatile investment market condition would be likely after the "Brexit" event, investors were expecting that the global low interest rate environment will be maintained for a while. Since the government bond yield of U.S. and European countries were becoming decreasingly attractive, it may drive funds into higher yield fixed income assets. Among all, Asian and other emerging market bonds may be the next target for yield-chasing investors. Sovereign bonds of countries like China and Malaysia have comparable credit ratings, but the yield of which is still much higher than those western developed countries.

TABLE 3: 10-year government bond yield and credit rating of different countries

Countries	10 year Government Bond Yield (Local currency)	Local currency Long term Debt (S&P)	Foreign currency Long term Debt (S&P)
U.S.	1.470%	AA+	AA+
Germany	-0.132%	AAA	AAA
France	0.179%	AA	AA
Spain	1.157%	BBB+	BBB+
Italy	1.254%	BBB-	BBB-
UK	0.862%	AA	AA
Japan	-0.227%	A+	A+
China	2.817%	AA-	AA-
India	7.448%	BBB-	BBB-
Indonesia	7.379%	BB+	BB+
Malaysia	3.727%	A	A-
Mexico	5.878%	A	BBB+
Russia	8.280%	BBB-	BB+

Source: Bloomberg (as at June 30, 2016)

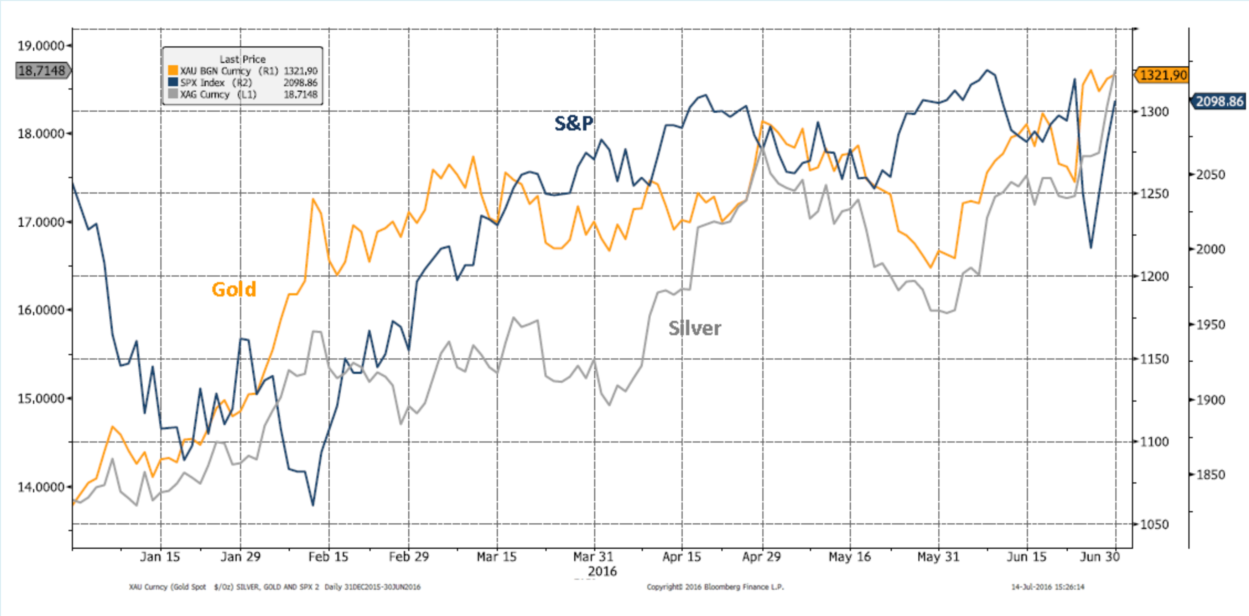
Commodities

- Gold is by tradition a type of safe-haven asset that investors would flock to during severe market turbulence, and it is especially so when the opportunity cost of holding this no-income commodity become negligible in a low / negative interest rate environment. During the plunge of global stock market in February and the “Brexit” event in June, gold managed to become one of the best investments by delivering a return of 16.41% in the first quarter and 24.5% in the first half of the year. Gold always has a special place in a portfolio for its ability to diversify due to its low correlation with other asset classes, but investors should be reminded that it is never meant to be a risk-free asset, as it doesn’t pay par value or a fixed coupon like a bond or a perpetuity.

- In comparison to gold, performance of silver was even more jaw-dropping in 2016, and outshined gold by far as at June 30^{th} this year. Return in the first quarter and the first half of the year was 12.03% and 34.6% respectively. Silver, in addition to its property as one of the precious metals, has wide industrial uses which contributed to its recent soar in price. We should be mindful however that silver trades at a volatility of two to three times that of gold because of its lower trading volume, so it is a more speculative investment by nature.

- Crude oil has been on roller-coaster ride in 2016. Crude oil price fell off the cliff in mid January and early February, but managed to make an astonishing come-back in the second quarter. Brent futures and WTI futures have soared 84% and 78% respectively as at June 30^{th} from their recent trough in the first quarter, but experienced strong resistance at around USD50 per barrel. Price for crude oil futures was in the driver’s seat for global equities’ price movement in the first quarter, as it was suggested that falling-through of USD25-level may trigger distress and defaults of oil companies. As oil prices have gained strong support at over USD40 per barrel, their correlation with global equities dropped in the second quarter. Looking forward, the global slowdown of economic growth will place pressure on crude oil, thus the policies from OPEC and the inventory level would be the key determinants in oil price.

EXHIBIT 6: Price movement of Gold, Silver and S&P 500 in the first half of 2016



Source: Bloomberg (as at June 30, 2016)

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