INVESTMENT INSIGHT- October 2017

Investment Services Department

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Is It Complacency or Prosperity?

The investment market marched on strong in the third quarter with the momentum carried forward since the turn of the year, regardless of the hustle and bustle from the provocative dialogues among some of the top world leaders. Global investors remained complacent despite the confirmation of U.S. balance sheet run-off, the increasing tension in Korean Peninsula, the political and financial instability in respective European countries, and the gradual removal of monetary accommodation in many countries. The third quarter performance of major stock markets across the globe in terms of USD was positive in general. Some of them were especially impressive, such as Russia RTS and Brazil IBOVESPA, which delivered a return of 23.45% and 16.82% respectively. Asia did well too, with Thailand SET gaining well over 9%, while Hong Kong Hang Sang Index and Shanghai Stock Exchange Composite Index both gained more than 8%; key European stock markets posted gains as well, as reflected by a return of 6.26% on Euro Stoxx 600. Last but not least, the U.S. stock markets continued to rise across its major indexes, as Dow Jones Industrial Average, S&P 500, Nasdaq and Russell 2000 rose to their all-time-highs at the end of September. In terms of currency, the U.S. Dollar Spot Index continued with its downward trend since the turn of 2017 despite a minor rebound in September, ending up with a loss of 2.67% during the quarter. Accordingly, the majority of the G10 currencies appreciated against the U.S. dollar over the same period, with the exception of Japanese Yen, Swiss Franc, and New Zealand Dollar. Bond indices, including global aggregate, U.S. aggregate, Pan-European aggregate, Asian Pacific aggregate and the inflation-linked sector, all climbed steadily from July to mid-September, but since then much of the gains has been eroded subsequent to the FOMC's confirmation of the balance sheet reduction in October, and Yellen's hawkish rhetoric at the National Association for Business Economics (NABE). The high yield bond sector, however, managed to stay steadfast throughout the entire quarter as investors seemed to gain confidence from the improving corporate earnings and business environment. Being one of the traditional safe haven assets, gold benefited from the decline of U.S. dollar and heightened geopolitical tension over the last three months, but the gain was curbed as the US dollar spiked in September. Oil prices bounced back substantially in the third quarter, as driven by signs of easing of the three-year crude glut, and the production cut among global producers of the Organization of the Petroleum Exporting Countries. The price of WTI crude increased by 12.23% quarterly, which is the strongest gain since the second quarter of 2016, while that of Brent crude increased by 20% over the same period.

The calmness of the market was surprising, almost strange, to a lot of experienced investors. In U.S., the CBOE Volatility Index, being viewed as a traditional Wall Street's fear gauge by reflecting the bets of options traders on the direction of the S&P 500, was at its all-time-low of 9.51 on 29th September. The fact that S&P 500 is in its second-longest bull market in history, and the planned down-sizing of the Fed's balance sheet which will definitely squeeze liquidity in time, apparently did not trigger worrisome stresses at all. Perhaps the market sentiment is boosted by the tax reform as proposed by the Trump administration, which is the most radical tax-cut reform in the last thirty years; and investors are getting increasingly confident with the encouraging corporate earnings which give support to asset valuation. In fact, the four-quarter average for every major economic metric in the latest CNBC All-America Economic Survey is at a 10-year record high. In Europe, the "Brexit" talks are making very little progress to date, thus there is deep uncertainty to be addressed. In Germany's recent federal election, the parties that dominated German politics for years lost support at the ballot box to a very young yet far-right party – the Alternative for Germany (AfD), implying that populist nationalists are gradually gaining grounds. The looming Independence declaration by Catalonia in Spain subsequent to its recent referendum and possibility of civil riots cannot be eliminated. This populist movement may induce instability in respective countries and the same may spread in the Continent in time. As the Euro Area is showing signs of recovery, minutes of meeting from the European Central Bank showed that the policymakers will start to discuss a scale-back of the Asset Purchase Program which has been in place for years. While the fundamentals and performance of stock markets in Asia are encouraging, Japanese Prime Minister Shinzo Abe called for snap election in October to seek confirmation of public support on his tough position against North Korea, as he saw the threats from North Korea "real and present danger." Needless to say, Abe's concern is not without grounds, as action that may be taken from North Korea's supreme leader Kim Jong-un is extremely unpredictable, and he is capable of putting the globe at stake in every aspect with his military aggression.

While global asset prices have delivered impressive performance in general over the last 12 months, one may not want to ignore the impact from possible incidents such as an oncoming cyclical recession, unexpected inflation spike, irrational exuberance, sudden liquidity squeeze from a u-turn of central bank policies, or a geopolitical shock. With the increasing deployment of passive strategy via program trading, emergence of any of the said events may eventuate in amplified response from the market, triggering domino effect. As such, we prefer to shift to a slightly more defensive position, and partial profit-taking can be a worthwhile option for those who have profits on the books. With regard to equities, Asian emerging markets are still preferred over developed markets due to their improving economic metrics and their relatively lower valuation overall. Among developed markets, we believe that European equities will outperform that of North America and Asia Pacific countries despite the uncertainties ahead, judging from the state of recovery of the core European countries. In terms of fixed income assets, as the monetary accommodation policies start to reverse in some major developed economies, sovereign bonds of such countries may not perform as well as that of emerging market countries which have room for interest rate cut and better economic growth prospect. Unconstrained and strategic bond funds which allow the fund manager to seek opportunities from fixed income assets across a spectrum of duration, currency denomination and credit qualities will definitely have an edge in a rising rate environment.

TABLE 1: Global Stock Markets Performance

	2017 Q3 Return		2017 YTD Return	
	Local Currency	USD	Local Currency	USD
Dow Jones Industrial Average	5.58%	5.58%	15.45%	15.45%
Euro STOXX 50	4.77%	8.35%	12.44%	25.83%
Euro STOXX 600	2.75%	6.26%	10.52%	23.68%
German Stock Index DAX	4.09%	7.64%	11.74%	25.05%
CAC 40	4.28%	7.85%	12.56%	25.96%
Nikkei 225	2.24%	2.00%	8.18%	12.04%
Hong Kong Hang Seng Index	8.62%	8.55%	29.80%	28.83%
Hang Seng China Enterprises Index	7.38%	7.30%	20.78%	19.88%
Shanghai Stock Exchange Composite Index	6.28%	8.36%	10.12%	15.18%
Shanghai Shenzhen CSI 300 Index	5.83%	7.90%	18.25%	23.68%
Singapore FSSTI	1.13%	2.62%	15.07%	22.73%
Korea KOSPI	0.12%	0.06%	18.45%	24.90%
Taiwan TWSE	2.76%	3.46%	16.49%	21.33%
India SENSEX	1.60%	0.47%	18.85%	23.62%
Indonesia JCI	1.40%	0.32%	13.41%	14.02%
Thailand SET	7.28%	9.28%	11.70%	20.24%
Russia RTS	16.82%	16.82%	3.13%	3.13%
Brazil IBOV	18.11%	23.45%	23.36%	26.73%
S&P Pan Arab Composite Index	0.76%	0.76%	4.74%	4.74%
MSCI World Index	4.96%	4.96%	16.53%	16.53%

Source: Bloomberg (as at 29/9/2017)

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

	Change in 2017 Q3	Change in 2017
	In terms of USD	
Euro Dollar	3.40%	12.33%
British Pound	2.86%	8.57%
Japanese Yen	-0.11%	3.96%
Hong Kong Dollar	-0.05%	-0.71%
Chinese Renminbi (CNY)	1.93%	4.39%
Australian Dollar	1.89%	8.68%
New Zealand Dollar	-1.69%	3.97%
Singapore Dollar	1.37%	6.57%
Korean Won	-0.12%	5.45%
Taiwanese Dollar	0.36%	6.38%
Indian Rupee	-1.07%	4.06%
Indonesian Rupiah	-1.07%	0.01%
Thai Baht	1.86%	7.57%
Russian Ruble	2.52%	6.56%
Brazilian Real	4.58%	2.77%

Source: Bloomberg (as at 29/09/2017)

Review Highlights and outlook around the globe:

United States

- The Federal Reserve left the target range for its federal funds rate unchanged at 1 % to 1.25 % during its September 2017 meeting, which was in line with market expectation, and has also confirmed that it will initiate the $4.5 trillion balance sheet normalization program as described in the June 2017 Addendum to the Committee's Policy Normalization Principles and Plans.

- Inflation uncertainty supports gradual hikes in the Federal funds rate, Fed Chair Yellen said in a speech at the NABE meeting, suggesting another rate hike this year is still on the table. Chair Yellen also added that the outlook is uncertain and some key assumptions underlying employment and inflation could be wrong. Thus, a revised assessment could lead to an easier policy path. As at 29th September, the probability of a rate hike in December 2017 according to calculation from Fed fund futures price is 70%.

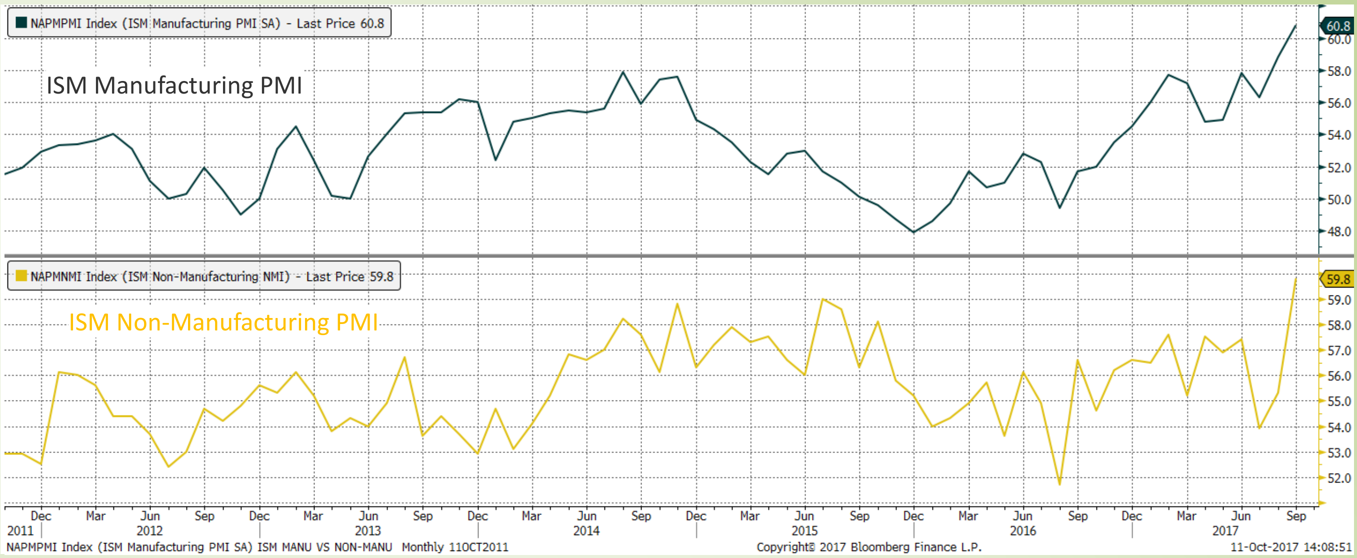
- The U.S. economy expanded an annualized 3.1 % on quarter in the second quarter of 2017. It was the strongest growth rate since the first quarter of 2015. The boost to growth came from stronger-than-expected consumer spending. With GDP accelerating in the second quarter, the economy grew 2.1 % in the first half of 2017. However, the disruptive impact on the economy from the hurricanes will be reflected in the third quarter figure.

- Non-farm payrolls fell by 33,000 in September of 2017, following an upwardly revised 169,000 gain in August, which was way below the market expectations of a 90,000 gain. It was the first drop in payrolls since September of 2010, which was likely a reflection of the impact from Hurricanes Irma and Harvey on the decline of employment in food services and drinking places as well as a hit on growth of some other industries. Despite the disappointing non-farm payrolls figures, unemployment rate unexpectedly fell to 4.2 % in September 2017 from 4.4 % in August and below market consensus of 4.4 %. The figure was at its lowest since February 2001, as the number of unemployed persons declined by 331,000 to 6.8 million. Meanwhile, the labor force participation rate rose by 0.2% to 63.1%, its highest level since March 2014.

- The trade deficit in the United States narrowed to USD 42.4 billion in August 2017 from a revised USD 43.6 billion in July, and was at its lowest in 11 months. Exports grew 0.4% to the highest level in more than 2-1/2 years while imports fell 0.1%. The nation's trade deficits with China and the European Union both shrank in August. Despite the narrowing in August, the overall trade deficit was still growing on an annual basis. It was up 8.8% in the first eight months from the same period in 2016, according to Commerce Department's data.

- The Institute for Supply Management's Manufacturing PMI in the US rose to 60.8 in September of 2017 from 58.8 in August, beating market expectations of 58. It is the highest reading since May of 2004, boosted by a rise in new orders, production and employment. The Institute for Supply Management's Non-Manufacturing PMI index for the United States jumped to 59.8 in September of 2017 from 55.3 in August, beating market expectations of 55.5. It was the highest reading since August of 2005, mainly boosted by a rise in production and new orders, despite the impact on the supply chain from the hurricanes.

EXHIBIT 1: ISM Manufacturing PMI and Non-Manufacturing PMI



Source: Bloomberg (as at 29/09/2017)

EXHIBIT 2: Chicago Board Options Exchange Volatility Index at its historical low

Source: Bloomberg (as at 29/09/2017)

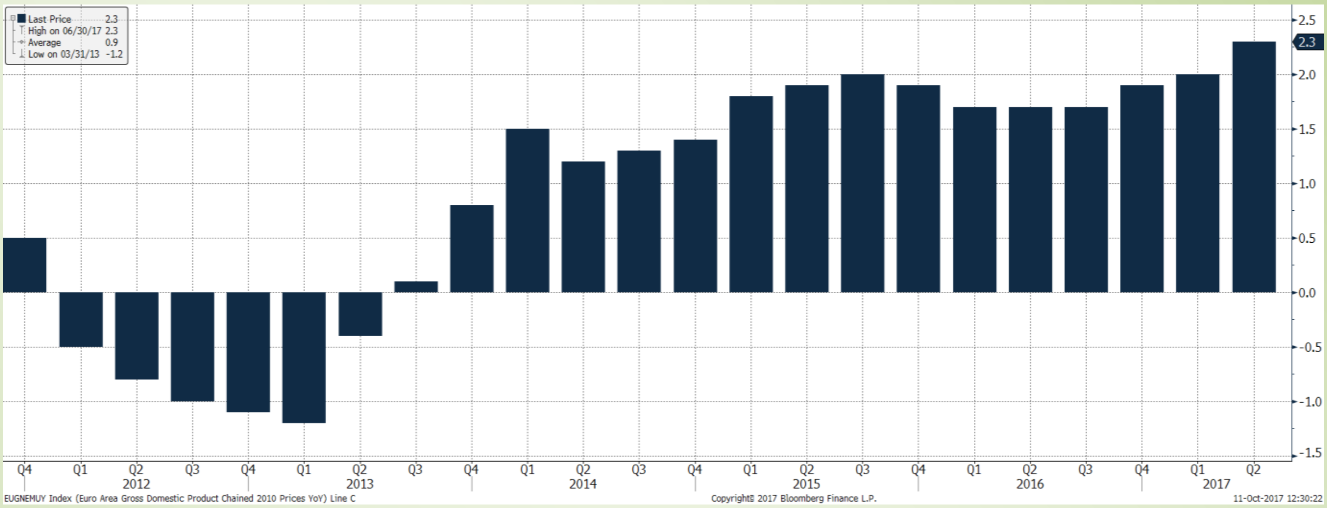
Europe

- The GDP growth of the Eurozone was at the fastest pace since the debt crisis in the second quarter of 2017. During the period, the economy expanded 2.3% year-on-year or 0.6% compared with the previous quarter. The acceleration was mainly driven by growing domestic consumer spending and investment, while the export growth slowed down as a result of the strong Euro.

- It is expected that the economic growth of Eurozone will remain robust in the third quarter.

The IHS Markit Eurozone PMI Composite Index rose to 56.7 in September from 55.7 in August. Manufacturing production rose at the quickest pace since April 2011. The rate of expansion in services business activity improved to a four-month high and was one of the best seen over the past six years.

<u>EXHIBIT 3: The GDP growth of the Eurozone was at the fastest pace since the debt crisis</u>



Source: Bloomberg (as at 29/09/2017)

- The inflationary pressure remained subdued in Europe. According to the Eurostat, consumer prices in the Eurozone rose 1.5% year-on-year in September which was below market expectation of 1.6% but in line with the figure in August. Besides, the core inflation, excluding energy, food, alcohol and tobacco, slowed from 1.2% to 1.1% which was at three-month low.

- The European Central Bank ("ECB") left its monetary policy unchanged during the meeting in September 2017 and the monthly asset purchase program would be maintained at the current pace of €60 billion per month. However, President Draghi indicated that the ECB would have more detailed discussion on the wind down of its quantitative easing program at the meeting in October.

- Chancellor Angela Merkel's Conservative Alliance won the German election, but a steep drop in its support and an anti-immigrant party's surge signaled political turbulence ahead for Europe's largest economy. The nationalist Alternative for Germany ("AfD") founded less than five years, would not only enter the German parliament for the first time, but would be the third-largest party in the Bundestag. Besides, it will be the first time in more than a half century to have a far-right party in Germany parliament.

- The tension between Catalonia and the Spain's Federal Government went into the boiling point in the beginning of October. The regional Government of Catalonia held the Catalonia's independence referendum on 1st October 2017. Out of 2.2 million Catalans ballots counted, about 90% were in favor of independence, however, both the Spanish government and the European Commission regarded the referendum as illegal. At this moment, we still do not know the fate of Catalonia but it seems that separatism may spread in the other part of Europe.

- Despite unexpected political events took place one after the other, the fundamental of European economy improved gradually. While the strong Euro may impact the export, the Eurozone recovery was increasingly driven by domestic demand recently. Besides, the current valuation of European stocks also looked more attractive than that of the U.S. The Euro STOXX 600 Index has only risen around 10% in USD term this year; it is believed that European equities are still worthy of buy-and-hold at this level for medium-to-long term investment.

Asia

- After Moody's credit rating downgrade in May this year, the Standard and Poor's ("S&P") also cut China's sovereign credit rating to A+ from AA- on 21st September. According to S&P, China's prolonged period of strong credit growth has increased its economic and financial risks although this credit growth had also contributed to strong real gross domestic product growth and higher asset prices.

- Although the China's Finance Ministry refuted the downgrade and claimed that S&P overestimated China's economic difficulties, the Chinese Government imposed a new round of property-cooling measures in eight second-tier cities 2 days after the credit rating cut. The eight cities that have rolled out new property curbs are Chongqing, Nanning, Nanchang, Changsha, Xian, Wuhan, Shijiazhuang and Guiyang. Under the latest regulations, most of these cities have stipulated that homebuyers should hold on for at least two to five years before they can resell any newly purchased flats.

- Caixin's survey and the Chinese Government's poll of the country's business activities in manufacturing and services sectors diverged in September. The official manufacturing PMI rose to 52.4 in September which was the highest since April 2012. At the same time, the official non-manufacturing PMI also rose to 55.4 from 53.4 in August, the highest level since May 2014.

- On the other hand, the Caixin's survey, which mainly covers the business activities of small to medium private companies, reflected that those smaller Chinese enterprises continued to struggle and only could grow at a slower pace. The Caixin China General Manufacturing PMI recorded at 51 for September, down from a six-month high of 51.6 in August. Besides, The Caixin services purchasing managers' index fell to 50.6 in September, the lowest reading since December 2015 and one of the weakest since the survey began in 2005.

- To support the country's small and medium private businesses, at the end of September the People's Bank of China ("PBOC") announced to cut the reserve requirement ratio for banks that meet certain requirements for lending to small business and the agricultural sector starting from 2018. According to the statement from PBOC, the targeted reserve requirement ratio cut was a "structural adjustment" instead of a monetary policy shift.

- In Japan, the economy advanced 0.6% quarter-on-quarter in the second quarter of 2017, below the preliminary estimates of a 1% expansion. On an annualized basis, the economy grew by 2.5%, weaker than the preliminary 4% growth estimates as well. Business spending grew much slower than expected and private consumption rose slightly less than anticipated. Despite the downward revision, Japan has maintained a sixth straight quarter of growth which was the longest run of economic expansion since 2006. Besides, according to the Bank of Japan's latest Tankan quarterly survey released on 2nd October, the overall business outlook was improving and Japan's business confidence climbed to the highest since September 2007.

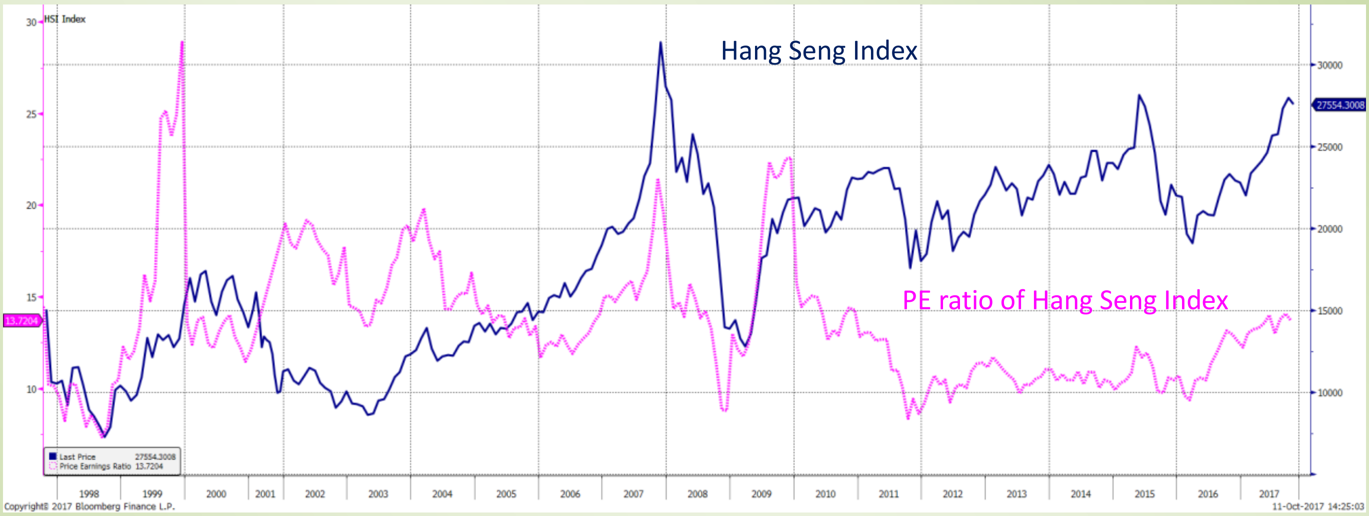
- On political side, the Japanese Prime Minister Shinzo Abe dissolved the parliament in late September and announced a snap general election on 22nd October. Abe has seen a surge in popularity in light of North Korean nuclear tests, and it is widely opined that he is seeking to consolidate his power through the election so as to increase his chances of extending his premiership next year by winning a third three-year term of the leader of the ruling Liberal-Democratic Party.

- In line with the election, Abe also announced he would order a new 2 trillion yen (USD18 billion) economic package by making use of the revenues generated from the planned consumption tax rise in October 2019. The stimulus would focus on the increase of the spending on pre-school and higher education, as well as business investment so as to improve productivity.

- In India, the economy expanded 5.7% year-on-year in the second quarter of 2017, below 6.1% in the previous period and market expectations of 6.6%. It was the weakest growth rate since the first quarter of 2014 due to a slowdown in consumer spending and exports. It seems that the combined negative short term impact of the demonetization and introduction of goods and services tax (GST) is more disruptive to the economy than the expectation earlier.

- The MSCI Asia Pacific Index continued the rally in the third quarter and has gained for nine straight months which was not seen since July 2007. Among all, Hong Kong Hang Seng Index was one of the best performing markets, it rose 8.62% and 29.8% in the third quarter and year-to-date respectively as at 29th September 2017. Although most of the Asian equity indexes are at recent- year-high, we still favor Asian stock markets as it is believed that the Asian economy can benefit the most from the global economic expansion. Besides, the valuation of the stock markets is still at a reasonable level. Like Hong Kong Hang Seng Index, it was trading at the price-to-earnings ratio of around 13.9x as at the end of September which was only at historical average level and far below overbought zone.

EXHIBIT 4: The PE ratio of Hang Seng Index seems to be far from overbought zone



Source: Bloomberg (as at 29/09/2017)

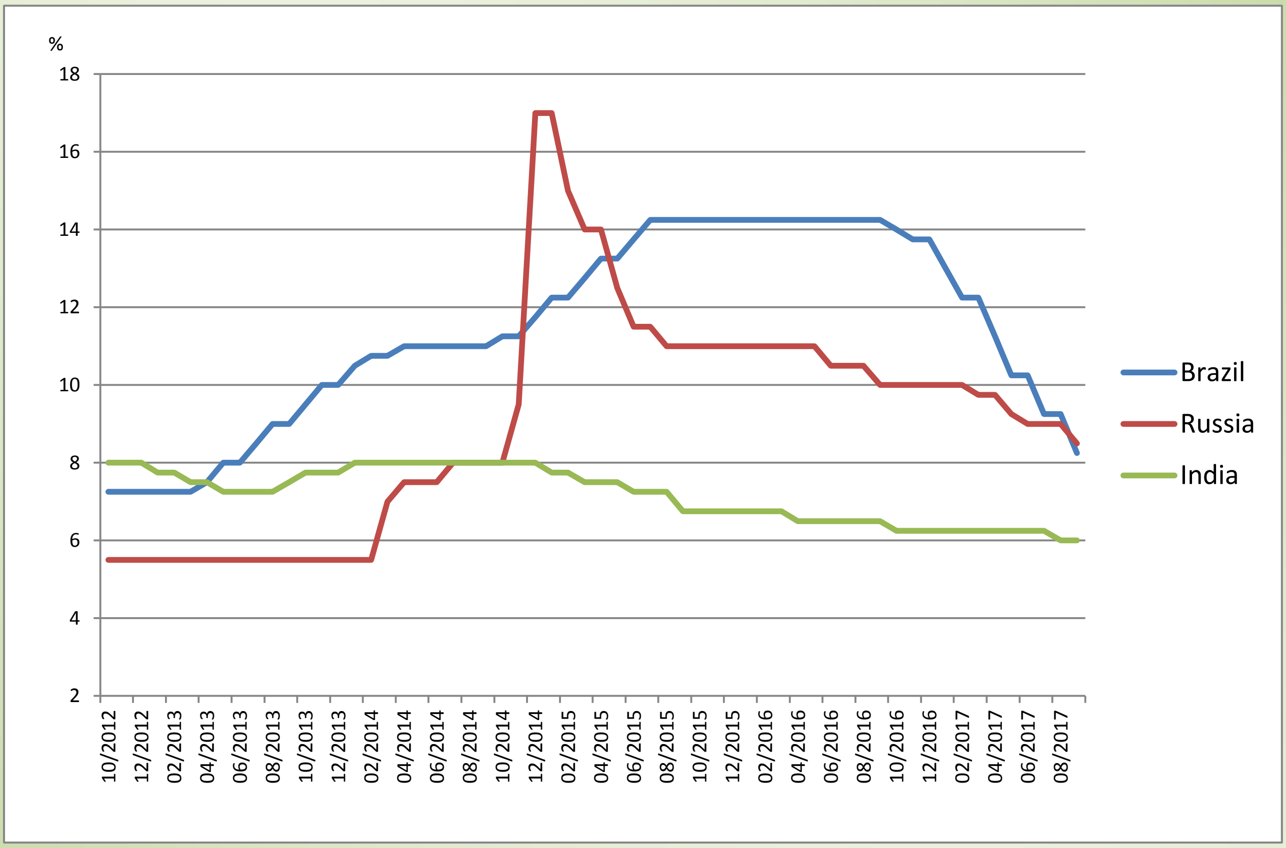
Fixed Income

- The Federal Open Market Committee left the interest rate unchanged during the meeting in September. However, the policymakers confirmed that they will reduce the balance sheet starting from October according to the "Addendum to the Policy Normalization Principles and Plans" announced at the meeting in June. Since the balance sheet normalization process was widely expected and Fed Chair Janet Yellen has also emphasized that the central bank would only tighten its monetary policy "gradually" in view of the uncertainties around inflation. As a result, there was no big negative impact towards the U.S. bond market so far.

- In Europe, both Bank of England ("BOE") and European Central Bank ("ECB") kept their monetary policy unchanged during their meeting in September. However, according to the meeting minutes and recent speeches from the key members of BOE and ECB, it is believed that monetary tightening in U.K. and Eurozone will not be too far away.

- Except Bank of Japan, it is anticipated that the central banks of major developed economies will tighten their monetary policies in the coming future. On the other hand, the story is different in the world of emerging markets. Due to decreasing inflationary pressure, the interest rate of emerging markets like India, Russia and Brazil were cut to recent-year-low. The lower interest rate environments together with stronger economic growth due to global recovery support the price of emerging market bond.

EXHIBIT 5: The interest rate of major emerging markets were cut to recent- year-low



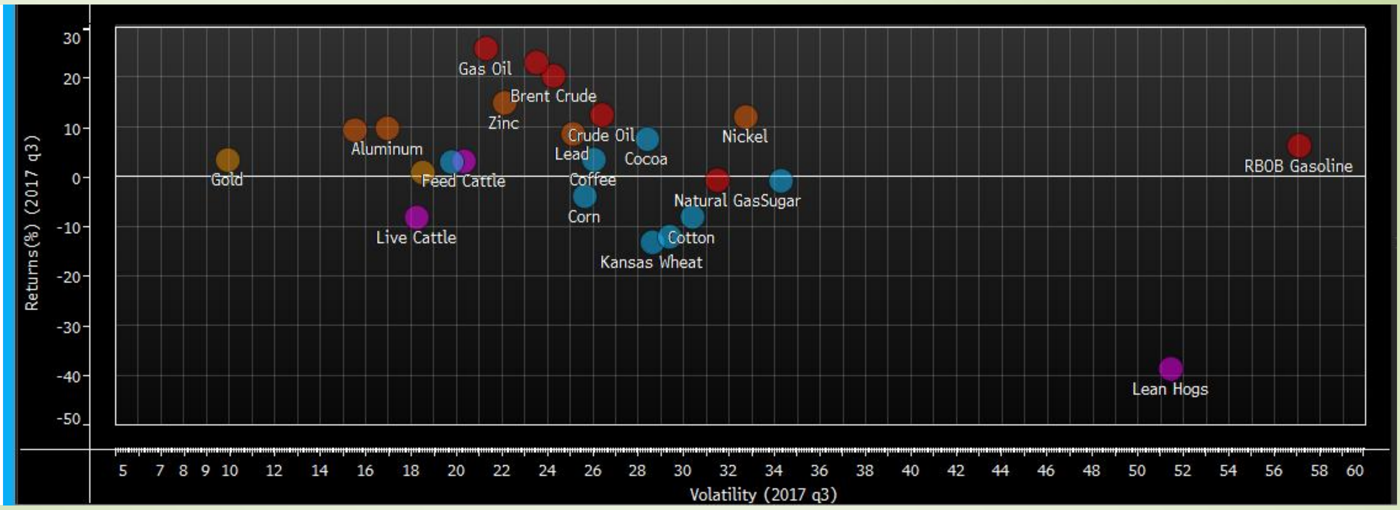
Source: Bloomberg (as at 29/9/2017)

- In medium term, we will maintain a neutral view towards the investment outlook of fixed income sector and prefer to have a diversified bond portfolio which includes bond issuers from different sectors with different credit qualities and maturities which mentioned in the previous “Investment Insight”. It is thought that the pace of monetary tightening of major central banks will not be radical since the current global inflationary pressure is low and the global economic recovery is still at a fragile stage and there are still quite a lot of uncertainties around. Besides, the heightening geopolitical risk in North Korea, more occurrences of terrorist attacks and political turmoil incidents around the world may upset the market anytime and it is believed that fixed income may still be a good tool for hedging the market risk.

Commodities

- The S&P Goldman Sachs Commodity Index, which tracks 24 commodities, rose by 7.22% in the third quarter. Results were mixed however, across different sectors. The economically sensitive energy and metals were clear winners while the agriculture and livestock sectors suffered.

EXHIBIT 6: Return of different commodities tracked in S&P Goldman Sachs Commodity Index in 2017 Q3

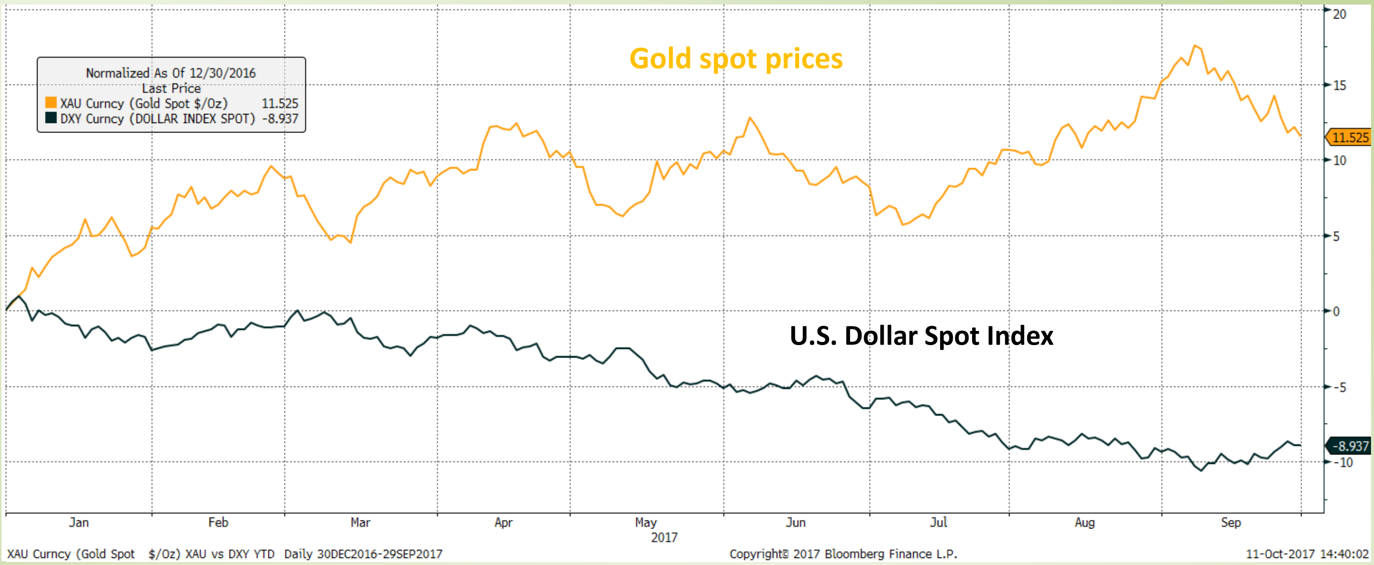


Source: Bloomberg (as at 29/09/2017)

- The compliance among the producers of OPEC in their crude-oil-output-cut agreement, as well as the Hurricane Harvey effects in late August on petroleum related product transportation, boosted oil and gas prices. It was agreed among the OPEC members that the production cut will continue until the first quarter of 2018, and as the cartel will convene again in Vienna on November 30, the market will monitor closely as to whether the current plan will be altered or extended. Investors remained cautious in general however, as higher prices may trigger an increase in U.S. energy production investment which will in turn curb prices.

- As expected, gold rose as U.S. dollar declined during most of the quarter, along with the missile testing in North Korea; but as the dollar rebound, gold began to head downwards. The prices of these two assets have been closely mirroring each other for most of 2017. As for the third quarter, gold rose a modest 3.07% while the U.S. dollar Index declined 2.67%; as with the year-to-date result, gold gained a total of 11.53% while the U.S. dollar index dropped by 8.94%.

EXHIBIT 7: Return on gold spot prices vs U.S. Dollar Spot Index in 2017



Source: Bloomberg (as at 29/09/2017)

- The slowdown of the China economy and a scaling-back of excessive production capacity during 2015 and early 2016 weighed on the global commodities market. As improvements are evident in Chinese economies, this conventionally commodity importing country could be of strong support for raw material markets in the months ahead, in particular, the base metal sector including copper, lead, aluminum and zinc.