INVESTMENT INSIGHT- July 2018

Investment Services Department

Altruist®

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When "American First" Policy clashes with "Made in China 2025" Strategic Plan

In line with the forecast in the previous "Investment Insight", the global investment market was in a roller coaster in the second quarter of 2018. Although the geographical tension between the U.S. and North Korea was softened following the US-North Korea Summit held on 12th June, 2018 and the signed joint statement, the concern of trade war between the U.S. and global major countries was heightened.

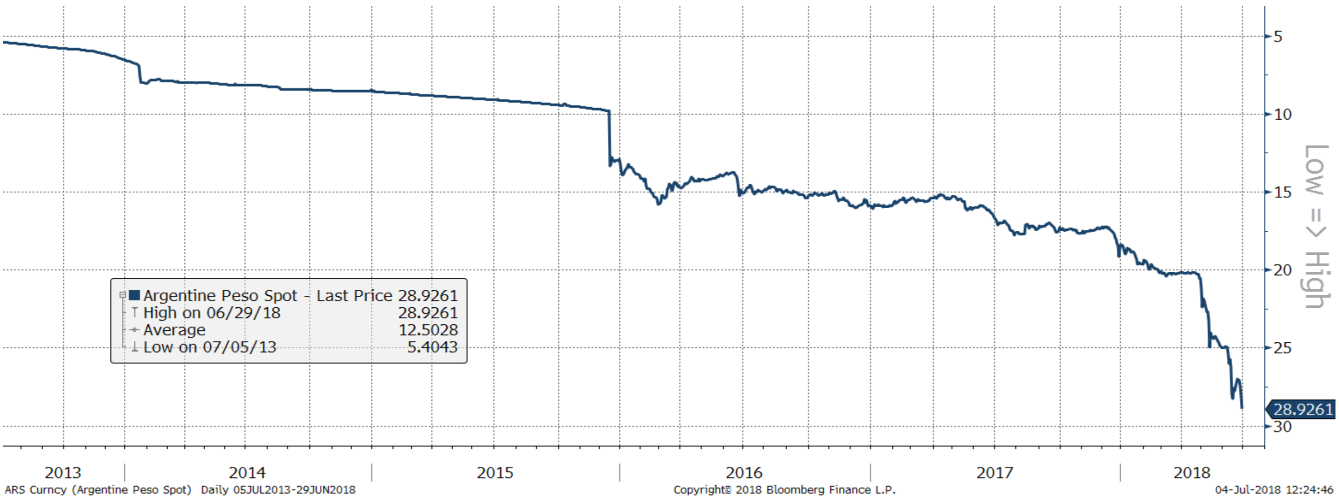
On 6th July, the U.S. officially imposed tariffs on USD 34 billion worth of Chinese goods, which then led China to fire back with similar sized retaliatory tariffs on U.S. products immediately. The U.S. President Donald Trump even threatened to extend tariffs to USD 500 billion of goods made in China, about the amount that all of U.S. goods imported from China in 2017. On 10th July, the U.S. fired the second shot. The Trump administration released a list of USD 200 billion worth of Chinese exports to the U.S. that could be subject to a new 10% tariffs. The tariffs will not go into effect immediately but will undergo a two-month review process, with hearings from 20th Aug to 23rd Aug. In the meantime, measures taken by the European Union, Canada and Mexico in response to US tariffs imposed on steel and aluminum import from the beginning of June have also come into force. It is no doubt that the United States is now embroiled in a multi-front trade war.

While the U.S. Trump's Government advocates the "American First" policy, the Chinese Government aims to achieve its "Made in China 2025" long term strategic plan. The trade war between the U.S. and China is not only an economic issue but also a political tug of war and it is believed that it is not easy to come to an end in the near term. Who will be the winner of the trade war? If we look at the recent investment market, so far, the U.S. may be the winner as the U.S. Dollar and stock markets remain strong comparing to the falling Chinese A-shares and Renminbi. The medium-to-long term impact is still unpredictable but it will probably push up the consumer price and slow down the economy in the U.S. as well.

However, it is worth to note that the U.S. midterm election which is sometimes regarded as a referendum on the sitting president's and/or incumbent party's performance will be held in the coming November. All 435 seats in the United States House of Representatives and 35 of the 100 seats in the United States Senate will be contested. Currently both House of Representatives and Senate are dominated by the Republican. If the Democrats get back the control power of the Congress in the coming election, the U.S. trade policy may have chance to shift.

On the other hand, growth trends in the U.S. and Europe also appeared to diverge. According to the latest released economic data, the U.S. economy regained its growth momentum while the European economy appeared to have slow down in the second quarter of 2018. Besides, the Federal Reserve has raised its benchmark interest rate 7 times since 2016 and it is believed that the interest rate hike cycle will continue in the near future. The interest rate hike cycle and strong economy in the U.S. cause the U.S. Dollar to become the strongest currency in 2018 and the strong U.S. dollar is the nightmare of the emerging markets and hurt their vulnerable economies. At the end of June 2018, the MSCI Emerging Market Index has retreated over 15% since its peak in January this year. Among the emerging countries, Argentina seemed to be the weakest; the country's interest rate has been raised to 15% and the Argentine Peso has depreciated over 50% against the USD this year. The country also asked the International Monetary Fund ("IMF") for USD 50 billion loan, which was the biggest loan amount in the IMF's history.

EXHIBIT 1: Don't Cry For Me, Argentina! Argentine Peso dropped to the historical low against the U.S. Dollar



Source: Bloomberg (as at 29/6/2018)

The escalating trade war and U.S. interest rate hike cycle are two of the major risks to the global investment markets right now and it is expected that market volatility will continue in the second half of

2018. However, up-and-down is always a normal aspect of investment market environment. After the recent market correction, the valuation of some major equity markets begins to have attractiveness and perhaps it may also be a good buying opportunity in the long term.

TABLE 1: Global Stock Markets Performance

	2018 Q2 Return		2018 YTD Return	
Indexes	**Local Currency**	**USD**	**Local Currency**	**USD**
Dow Jones Industrial Average	1.26%	1.26%	-0.73%	-0.73%
Euro STOXX 50	3.37%	-1.79%	-0.47%	-3.32%
Euro STOXX 600	4.27%	-0.94%	0.08%	-2.79%
DAX	1.73%	-3.35%	-4.73%	-7.47%
CAC 40	5.47%	0.20%	2.81%	-0.14%
Nikkei 225	4.08%	-0.21%	-1.06%	0.55%
Hong Kong Hang Seng	-2.53%	-2.50%	-1.64%	-2.06%
Hang Seng China Enterprises	-6.19%	-6.16%	-3.87%	-4.28%
Shanghai Stock Exchange Composite	-9.12%	-13.73%	-12.91%	-14.45%
Shanghai Shenzhen CSI 300	-9.05%	-13.66%	-12.02%	-13.58%
Singapore FSSTI	-3.32%	-7.03%	-2.26%	-4.15%
Korea KOSPI	-4.89%	-9.37%	-5.56%	-9.13%
Taiwan TWSE	0.31%	-4.12%	2.80%	0.15%
India SENSEX	7.94%	2.69%	4.69%	-2.38%
Indonesia JCI	-4.79%	-8.42%	-7.05%	-11.51%
Thailand SET	-9.26%	-14.34%	-7.34%	-8.65%
Russia RTS	-5.91%	-5.91%	1.69%	1.69%
Brazil IBOV	-14.76%	-27.12%	-4.76%	-18.50%
S&P Pan Arab Composite	3.65%	3.65%	12.33%	12.33%
MSCI World	1.96%	1.96%	0.74%	0.74%

Source: Bloomberg (as at 29/6/2018)

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

	Change in 2018 Q2	Change in 2018
Currencies	**In terms of USD**	
Euro	-5.19%	-2.67%
British Pound	-5.77%	-2.26%
Japanese Yen	-4.04%	1.74%
Hong Kong Dollar	0.03%	-0.42%
Chinese Renminbi (CNY)	-5.22%	-1.73%
Australian Dollar	-3.57%	-5.17%

New Zealand Dollar	-6.48%	-4.65%
Singapore Dollar	-3.74%	-1.94%
Korean Won	-4.58%	-3.94%
Taiwanese Dollar	-4.52%	-2.28%
Indian Rupee	-4.81%	-6.72%
Indonesian Rupiah	-3.92%	-5.32%
Thai Baht	-5.84%	-1.64%
Russian Ruble	-8.94%	-8.15%
Brazilian Real	-14.71%	-14.65%

Source: Bloomberg (as at 29/06/2018)

Review Highlights and outlook around the globe:

U.S.

- The U.S. economy slowed more than the previous estimate in the first quarter amid the weakest performance in consumer spending in nearly five years. The GDP of the first quarter was only increased at 2% annual rate which was lower than the previous estimate, 2.2% and the growth rate in the previous quarter, 2.9%. However, it is believed the slowdown should be temporary as the robust job market and the tax cut package regained the growth momentum in the second quarter.

- The non-farm payrolls increased by 213,000 in June of 2018. It was the 93rd consecutive month of job gains, showing the job market is robust in the U.S. On the other hand, the unemployment rate rose from 3.8% to 4% but it may be good news as an increase of job seekers of approximately 600,000 people who were not participating in the labor force now rejoin the labor market. However, the level of wage growth was only at 2.7% which was not higher than the current inflation and reflected that many new jobs are in lower-wage sectors of the economy.

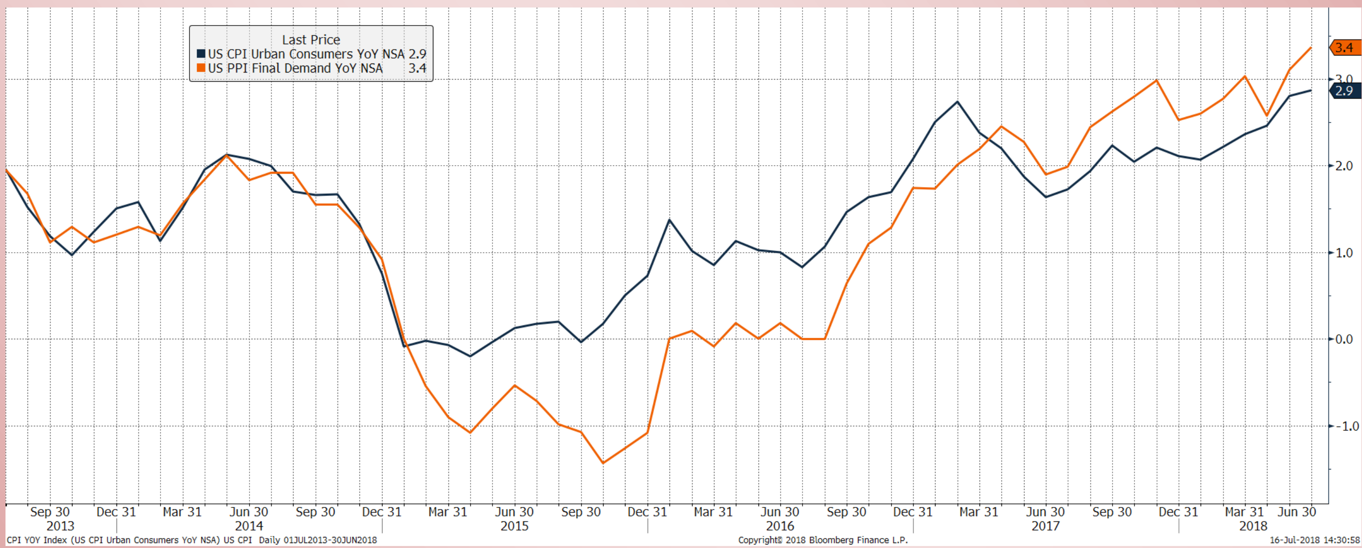
- Besides, growth was seen in both manufacturing and service sectors in the U.S. The Institute of Supply Management's manufacturing and non-manufacturing index rose to 58.7 and 58.6 respectively. Firms remained optimistic about business conditions and the overall economy although concerns about the trade war were heightened.

- According to the data from the Commerce Department, U.S. retail sales jumped 0.8% in May which was the biggest advance since November 2017. Year-on-year, retail trade grew 5.9% in May, compared with a 4.8% rise in April. The strong retail sales report reflected that Americans were willing to spend more because of the strong consumer confidence and positive economic outlook.

- The new homes sold in May were at a seasonally adjusted annual rate of 689,000, up from 646,000 in April. The South reported monthly sales growth of 17.9%, while sales were flat in the Midwest and fell in the Northeast and West. May's median sales price dropped 3.3% from a year ago to $313,000. However, the decline was mainly because the sales growth was concentrated in the South, where new homes are generally cheaper.

- According to the report published by the Labor Department, the consumer price index rose 0.1% in June when comparing with May. Year-on-year, the inflation rate rose to 2.9% which was the highest since December 2011. Excluding food and energy, the core inflation was up 0.2% from the prior month and 2.3% from June 2017. Besides, since the Producer Price Index also jumped 3.4% from a year earlier in June, the strongest gain since late 2011, it is likely that consumer price inflation continues heading up in the coming months.

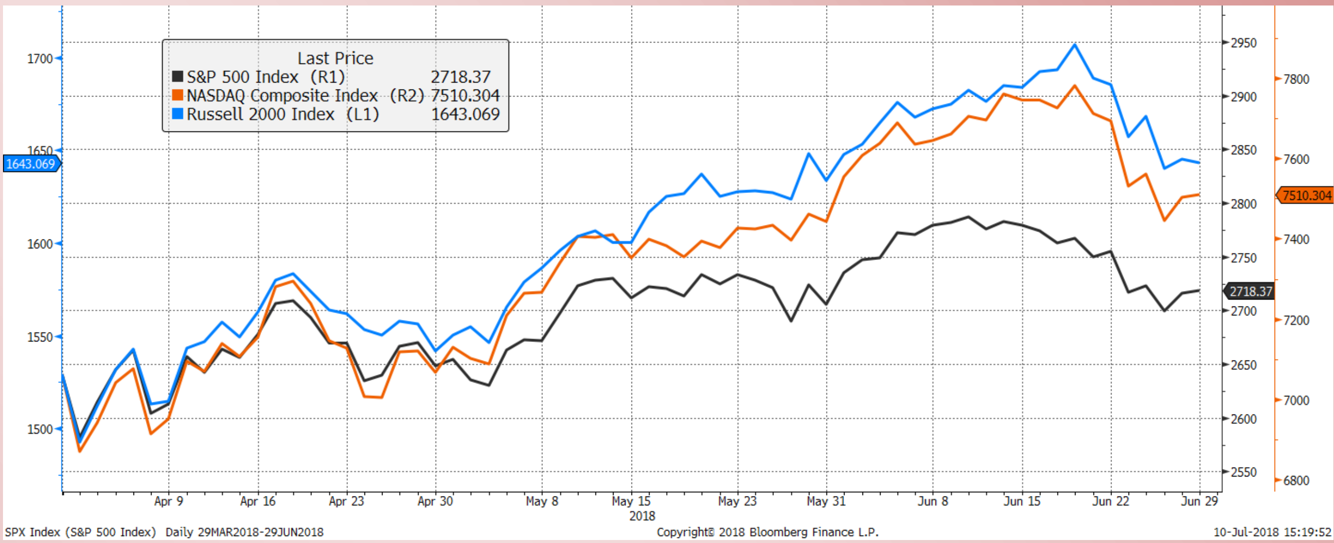
EXHIBIT 2: Rising CPI and PPI in the U.S.



Source: Bloomberg (as at 29/06/2018)

- The U.S. is the strongest performing major equity market this year. Technology and small-to-medium companies stocks outperformed the market, the S&P 500, Nasdaq Composite and Russell 2000 Index recorded 3.43%, 6.6% and 7.45% gain respectively in the second quarter. Looking forward, it is believed that the U.S. bull market may still have room to run due to the robust economic fundamental and strong corporate earnings in the U.S. However, the escalated trade tension may be the biggest threat to the economy and may trigger stock market correction. Since the stock market valuation in the U.S. is not cheap right now, investor may consider taking a break and waiting for a market correction buying opportunity for a medium to long term investment.

EXHIBIT 3: U.S. stock continued to rally in the second quarter



Source: Bloomberg (as at 29/06/2018)

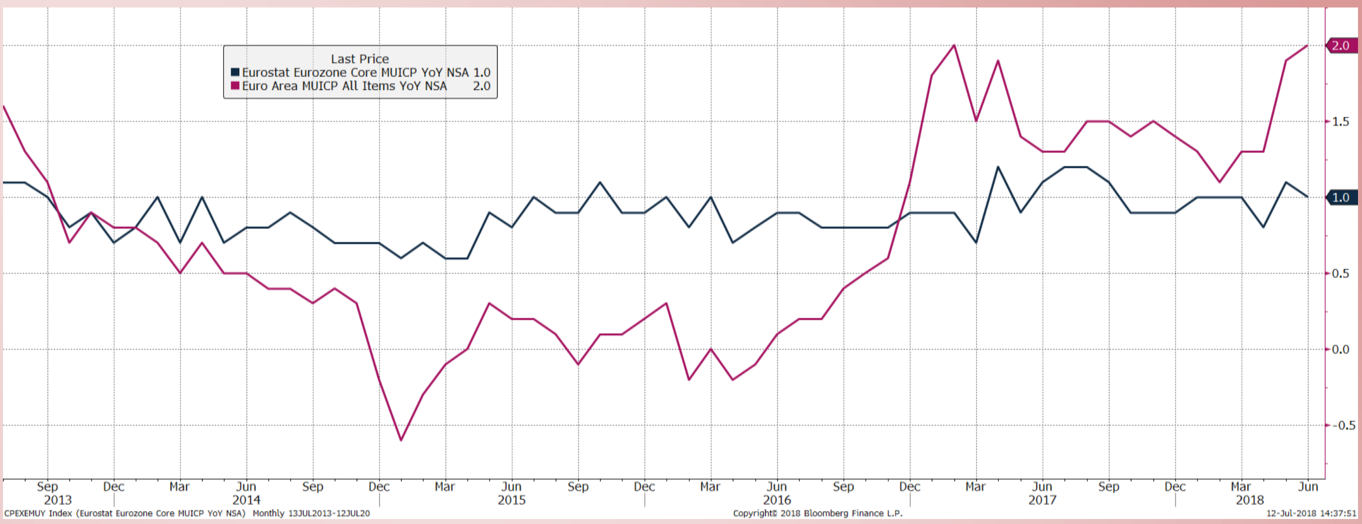
Europe

- The Eurozone economy grew at the weakest pace since mid 2016 in the first quarter of 2018. The GDP expanded 0.4% in the first 3 months of 2018 on quarter-over-quarter basis. Compared with the same quarter of the previous year, the Eurozone economy grew 2.5%. Economists have broadly forecast that growth in the Eurozone would accelerate later in the year. However, most of the economic data in the second quarter have also underwhelmed.

- The final IHS Markit Eurozone PMI Composite Output Index posted 54.9 in June, up from 54.1 in May and the earlier flash estimate of 54.8. However, the average reading over the second quarter as a whole (54.7) was the weakest registered since the final quarter of 2016. The manufacturing activities slowed to an 18 month-low due to the widespread concerns about trade barriers and their impact on economic activity. On the other hand, services sector performed better as the non manufacturing PMI jumped to 4-month high of 55.2 from 53.8.

- Due to the rise of oil price, the preliminary estimate of Eurozone annual inflation rate rose to 2% in June which was the highest reading since April last year and hit the European Central Bank' s target. However, the core inflation rate which excludes those volatile prices of energy, unprocessed food and tobacco remained weak. It was expected to slow to 1% in June from 1.1% in previous month.

EXHIBIT 4: Eurozone inflation hit 2% in June but the core price had little change

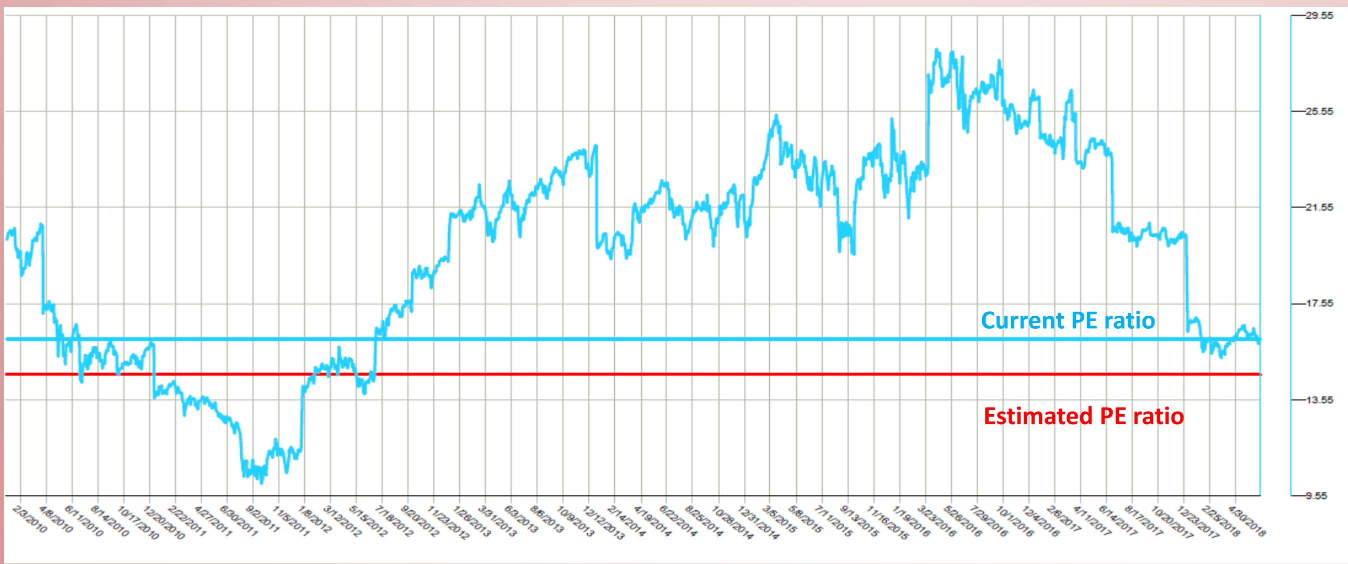


Source: Bloomberg (as at 29/6/2018)

- Since the consumer price was picking up gradually, the European Central Bank confirmed that the monthly pace of the net asset purchases will be reduced to €15 billion from September to December 2018, and will then end. The central bank also expected that the key interest rates to remain unchanged at least through the summer of 2019.

- The Europe Stoxx 600 Index was flat in the first half of the year. In terms of valuation, the price-to-earnings ratio of the Europe Stoxx 600 Index was the lowest since the Europe Debt Crisis, and the current valuation may have reflect the potential political and economic slowdown risk in the region and we would maintain cautiously positive investment outlook towards European equities in medium to long term.

EXHIBIT 5: The valuation of Europe Stoxx 600 Index

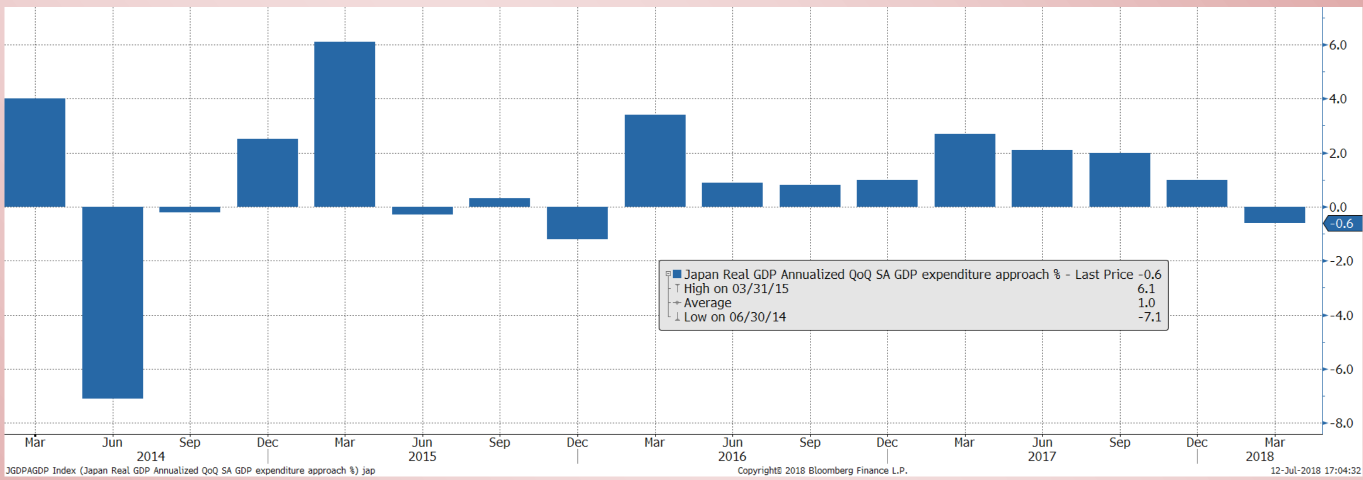


Source: Bloomberg (as at 29/6/2018)

Asia

- The Japanese economy contracted 0.2% quarter-on-quarter in the first three months of 2018, unchanged from the preliminary figure. On an annualized basis, the economy shrank 0.6% which was also the same as the preliminary estimate but worse than the market consensus of a 0.4% contraction. Although there was a rise in business spending, household consumption which represented 60% of the GDP declined unexpectedly. It was Japan’s first economic contraction since the fourth quarter of 2015 and ended the longest straight period of expansion for Japan since the late-1980s.

EXHIBIT 6: The Japan economy contracted in the 1st quarter of 2018



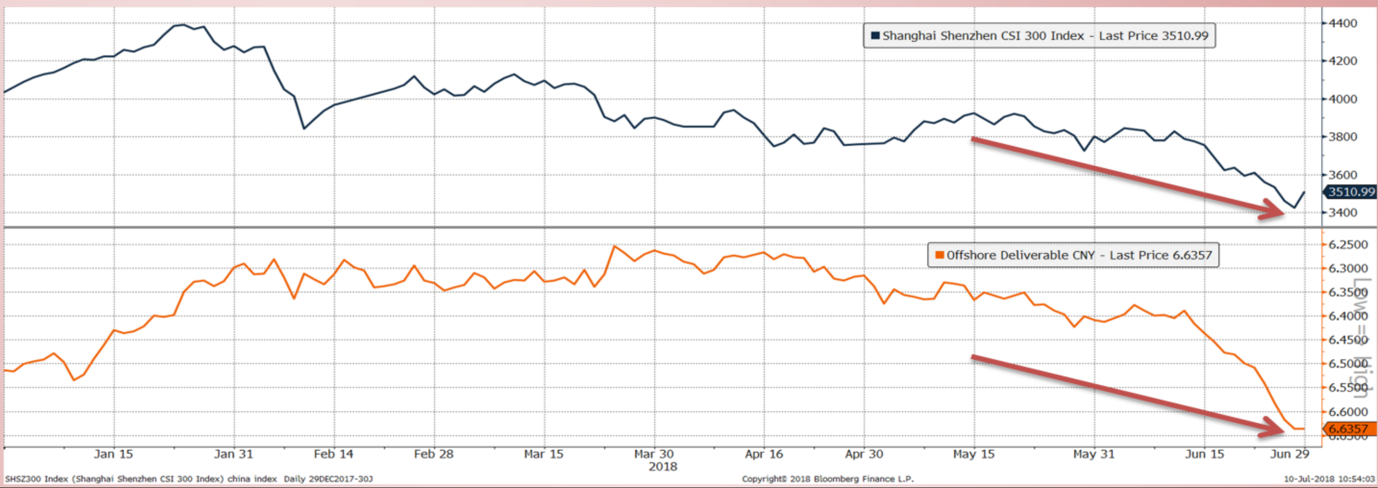
Source: Bloomberg (as at 29/6/2018)

- While the volley of tariff threat between the U.S. and China dominated the news headlines, the China domestic demand also showed slow down. The fixed-asset investment — a core driver of Chinese growth that includes spending on new buildings, machinery and infrastructure — grew at its slowest annual pace since 1995 through the first five months of this year. Retail sales, an indicator of consumer demand, also increased at their slowest pace since 2003. Besides, the recent released industrial production also missed expectation.

- To encounter the potential economy slowdown, the People’s Bank of China(“PBoC”) cut the reserve requirement ratio by 0.5% again in June this year. The reserve reduction would released CNY 700 billion cash and was restricted to serve two purposes. State-owned and large banks would use CNY 500 billion for "debt-to-equity swaps" while the other banks, including foreign lenders, would use the remaining CNY200 billion to lend to small-to-medium enterprises (“SMEs”). It is believed the move aimed at relieving corporate default pressure from financial deleveraging reform and providing a cushion for SMEs that could be affected by trade wars.

- The Renminbi and Chinese A-Share were also the market focuses in the second quarter. Due to the threat of the trade war and the divergent monetary policies between the PBoC and the Fed, the Renminbi depreciated over 5% against the U.S. Dollar in the past three months. In the stock market, even though the MSCI started to add Chinese A-shares to its MSCI Emerging Market Index in June, the investment sentiment did not show any improvement. The CSI 300 Index posted 12% loss this year which was one of the worst performing major global equity indexes.

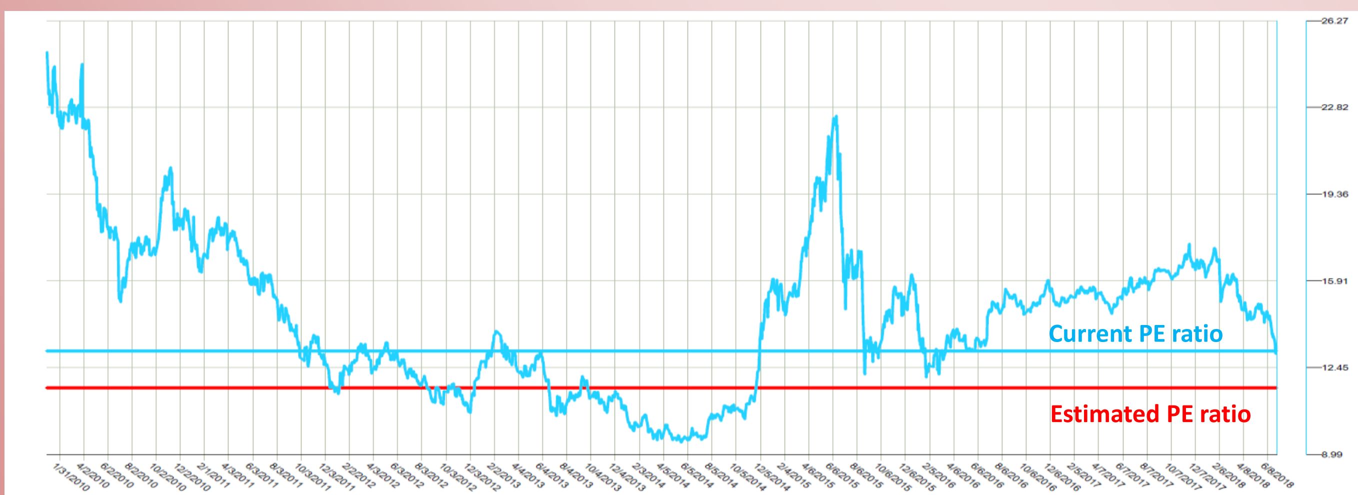
EXHIBIT 7: Falling Chinese A-shares and Renminbi



Source: Bloomberg (as at 29/6/2018)

- After the recent market correction, the current and estimated price-to-earnings ratio of the CSI 300 Index was traded at about 13 and 11 times respectively as of end of June and the valuation now is relatively cheap comparing to the past few years. Although there are still a lot of market uncertainties, aggressive investors may consider accumulating the Chinese A-shares gradually for long term investment due to the low valuation.

EXHIBIT 8: The valuation of CSI 300 Index

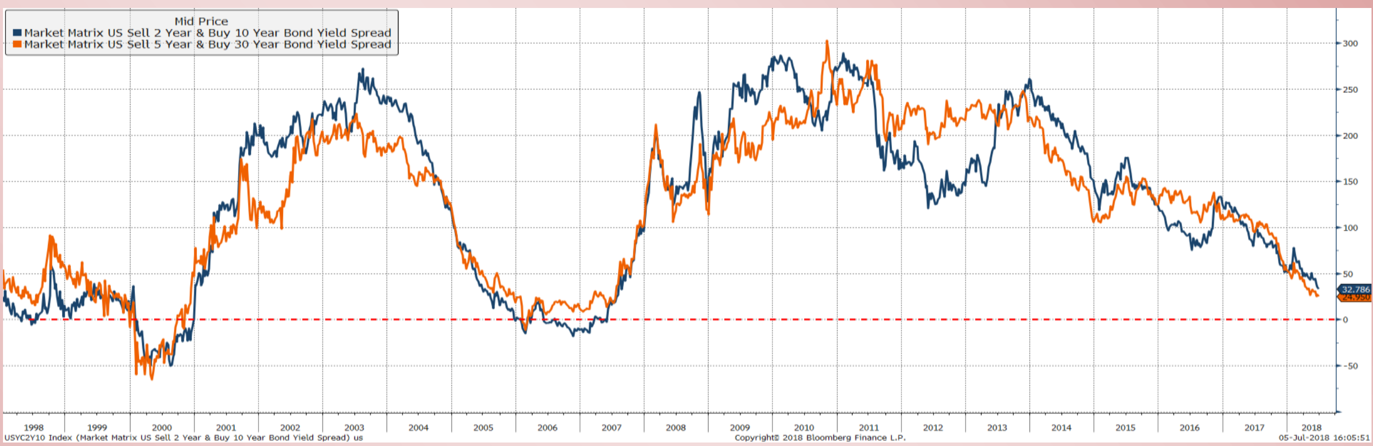


Source: Bloomberg (as at 29/06/2018)

Fixed Income

- Despite the Federal Funds Rate has been raised 2 times this year to a range of 1.75% to 2%, long-term rates have not kept pace, causing the yield curve to flatten. The difference between 2-year and 10 year U.S. treasury yield narrowed to only 32.8 basis points ("bps") from 51.2 in the beginning of this year and the spread between 5- and 30-year U.S. treasury yield also fell from 52 to 25 bps as well.

EXHIBIT 9: The spread between short dated and long dated treasury yield narrowed

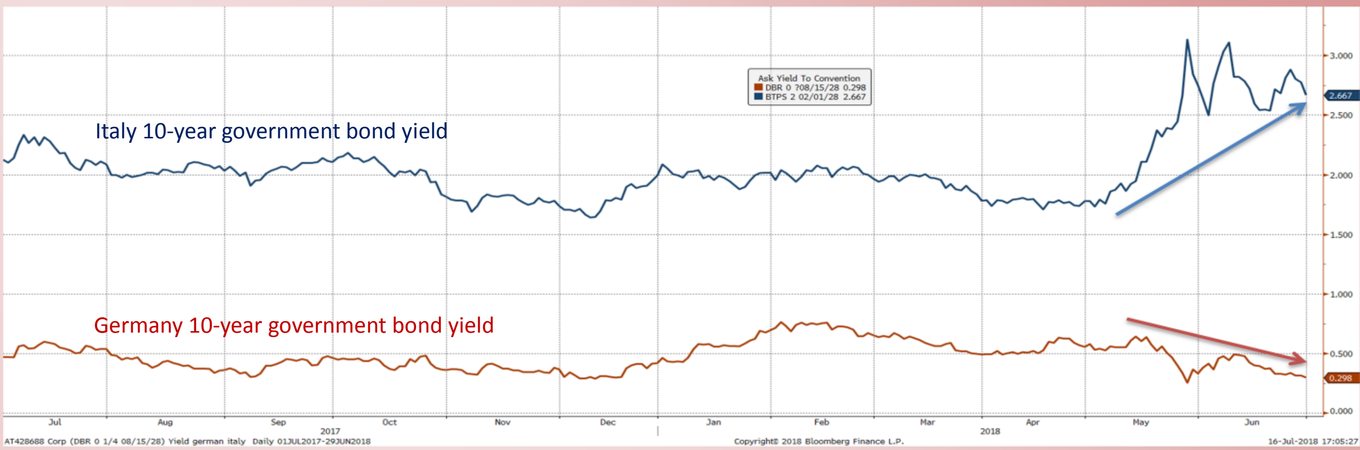


Source: Bloomberg (as at 29/06/2018)

- In a healthy economy, the yield curve slopes upward and investors paid more to lend money for longer periods as a reward for taking the risk that inflation and interest rates may move higher in the future. When spreads between short- and long-term rates narrow, it may suggest that the market believes economic growth and inflation are not sustainable and may fall in the future.

- Across the Atlantic, the yield spread between the Germany and Italy 10-year government bond was widened in the second quarter. Italy's government bonds were sold off because of political uncertainty. Investors were afraid that the Italy's new anti-establishment government would bring radical changes including the shift of the country's refugee policy and the plan to increase government expenditure. Investors were looking for safe asset and the spread between Germany and Italy 10-year government bond yield has been widened from 1.286% to 2.369% during the second quarter.

EXHIBIT 10: The spread between Germany and Italy 10-year government bond yield has been widened



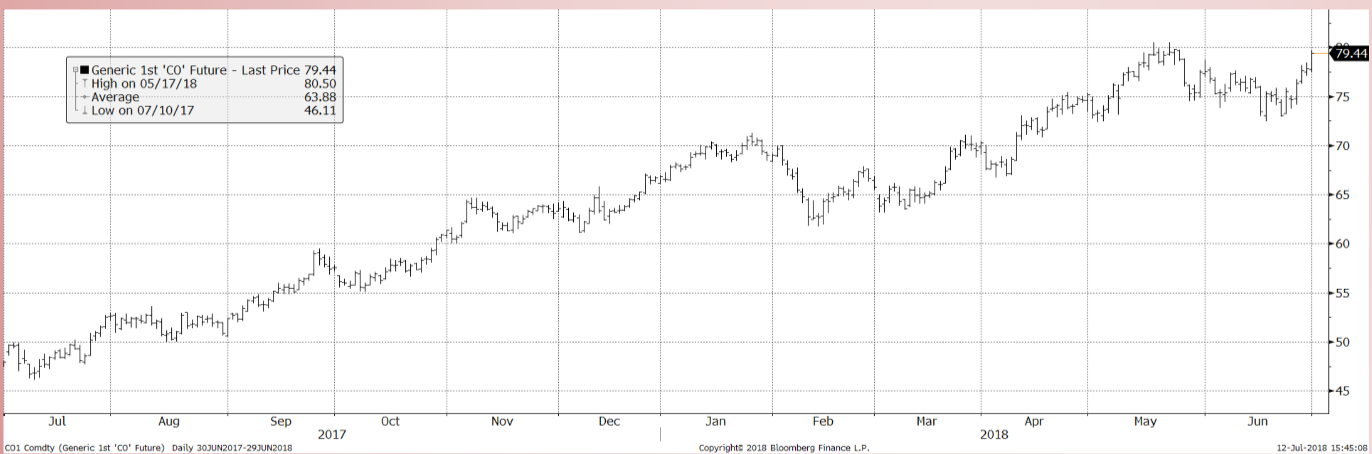
Source: Bloomberg (as at 29/06/2018)

Commodities

- The U.S. dollar is a significant factor when it comes to commodity prices as it tends to have an inverse value relationship with raw material prices. The dollar index turned higher and posted a 5% gain over the quarter and was 2.5% higher for the first half of this year after falling 9.9% in 2017. Crude oil and natural gas were up in the second quarter while gold, platinum, copper and zinc prices declined.

- Crude oil has surpassed USD 80 per barrel for the first time in nearly 4 years in June as the Trump administration's decision to pull out of the Iran nuclear deal stoked fears of tighter supplies; further declines in Venezuelan production also supported the market. However, crude prices pared gains after Saudi Arabia and Russia signaled the possibility of easing current supply curbs.

EXHIBIT 11: Crude oil surpassed USD 80 per barrel



Source: Bloomberg (as at 29/06/2018)

- Looking forward, the oil price may remain strong in the near term as the supply was tight. However, on the demand side, forces including trade protectionism threaten the global economy which may limit further increase of the oil price.

- The precious metals sector of the commodities market posted an overall loss in the second quarter of 2018. Platinum was the biggest loser while gold also fell over 5%. Since the U.S. Federal Reserve will likely further tighten its monetary policy and two more interest rate hikes is expected this year, the precious metal may continue to have a bearish outlook in the near future.