INVESTMENT INSIGHT OCTOBER 2019

Investment Services Department

Altruist Financial Group Limited
進邦滙理有限公司

CIB 香港保險顧問聯會會員 Member of the Hong Kong Confederation of Insurance Brokers

Are you ready for the era of ultra low Interest rate?

Last quarter market highlights

- *The U.S. stocks have climbed to historical highs again while the Hong Kong Hang Seng Index dropped almost 8% in the past 3 months.*
- *The U.S. Federal Reserve has cut the Federal funds rate twice while the European Central Bank "ECB" resumed quantitative easing after 9 months and cut deposit rates for the first time in 3 years.*
- *The U.S. 30-year treasury yield reached record low and the spread between 2- and 10-year U.S. treasury yield has inverted for the first time since 2007.*

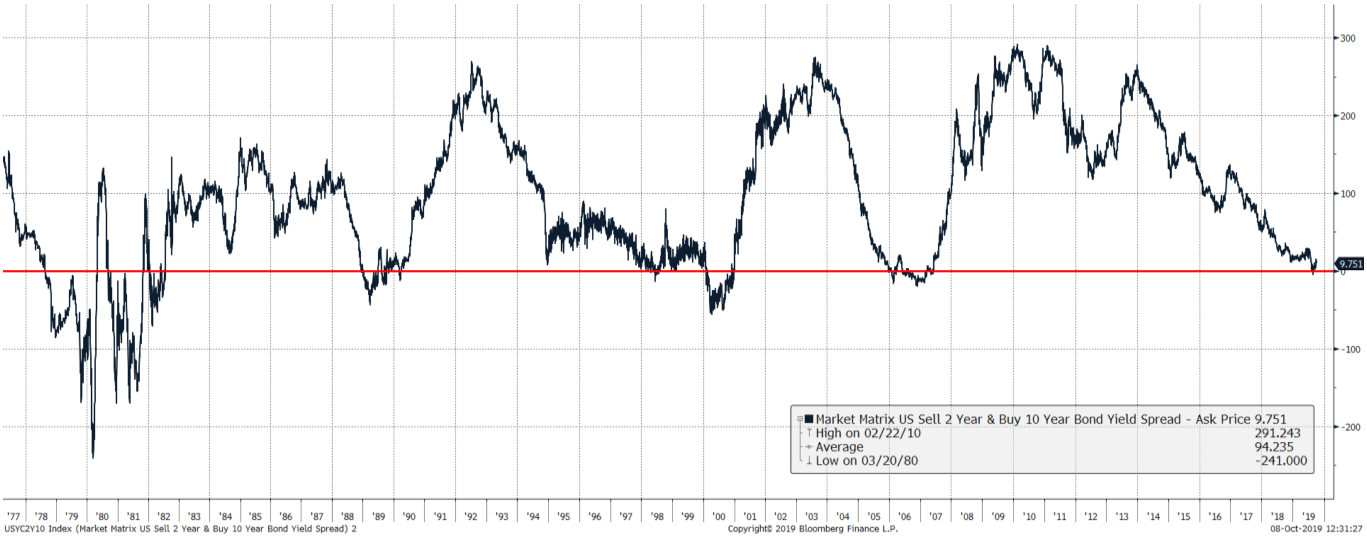
There was a divergence in terms of stock market performance between the Western and Asian countries in the 3rd quarter of 2019 as the MSCI World Index gained 0.66% while the MSCI Asia ex Japan Index dropped almost 4% during the period. The U.S. stock markets remained the most robust, the Dow Jones Industrial Average, S&P 500 and Nasdaq Composite Index, have all climbed to record highs in July. On the other hand, the Hong Kong Hang Seng Index performed the worst among those global major equity Indexes due to the trade conflict between the U.S. and China and continuous anti-government protests.

The trade conflict between the U.S. and China was ongoing and the threat of global economic slowdown was becoming more obvious. We saw the largest number of interest rate cuts by global central banks since the Financial Crisis in 2008 in the 3rd quarter of 2019. Among those leading central banks, the ECB, ironically, cut its deposit rate and decided to restart quantitative easing program on 1st November which the central bank stopped 9 months ago. Besides, the U.S. Federal

Reserve also has cut the federal funds rate twice in the past 3 months and the latest Fed funds rate futures indicated there was a high probability that the interest rate will be lowered 2 more times by the end of this year.

With global monetary easing policies and heightening market uncertainty, it seems that investors were becoming more risk-averse and increase their investment exposure in fixed income. As a result, the bond price was pushed up while the yield dropped. In the last quarter, the U.S. 30-year treasury yield has fallen to record low and the spread between 2- and 10-year U.S. treasury yield has inverted for the first time since 2007. In addition, over USD 17 trillion of bonds worldwide, which was the record high amount, have been pushed into negative yields territory.

<u>EXHIBIT 1. The spread between 2 and 10-year U.S. treasury yield has inverted for the first time since 2007 in late August 2019</u>



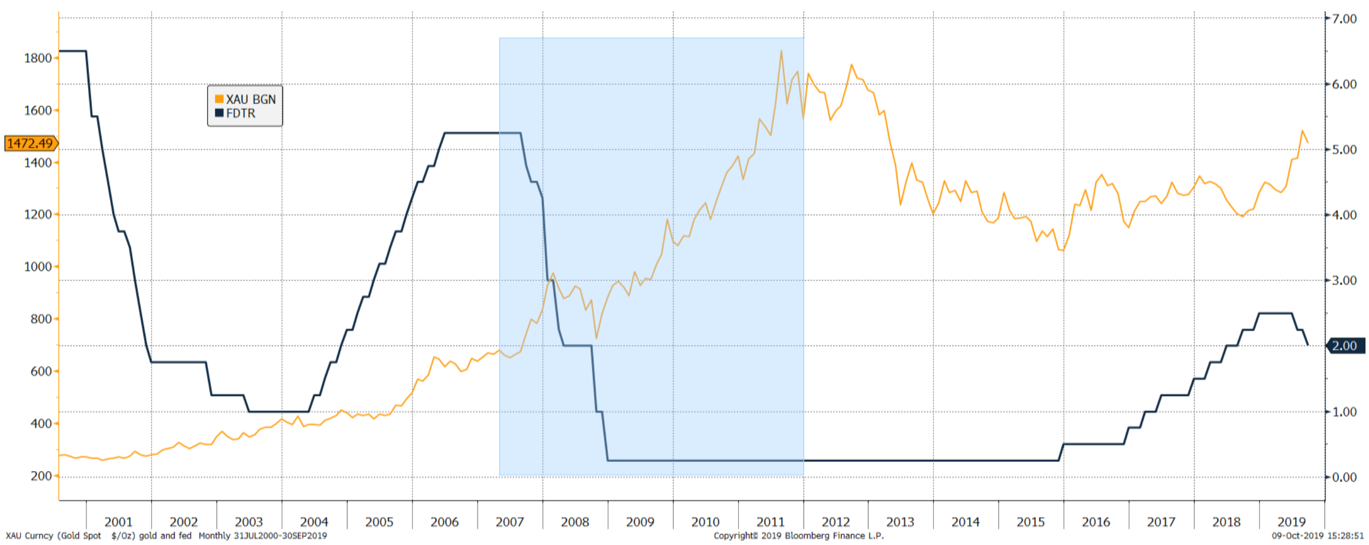
Source: Bloomberg (as at 30/09/2019)

> *"In the past 40 years, when the 2- and 10-year U.S. treasury yield inverted (the yield of 2-year is less than the yield of 10-year), the U.S. economy always entered into recession soon afterwards. It included the Early 1980s Recession, 3rd Oil Crisis in 1990, Dot-Com Bubble in 2000 and Sub-prime Mortgage Crisis in 2007."*

The global economy currently is affected by different political issues. The U.K. will leave the European Union ("EU") on 31st October, will no-deal Brexit really happen? If it happens, what will be the damage to the U.K. and European economy in both short term and long term? In Hong Kong, it seems that there is no solution to the political unrest caused by the extradition bill amendment since June. When will the unrest go to the end and when the economic activities in Hong Kong be back to normal? Among all, it is believed that the most influential political event is still the trade conflict between the U.S. and China. The tight trade relationship between both countries has been over 1 years. While the economies of the U.S. and China were only slowing down, the global manufacturing activities have already slumped to contraction zone and many European and Asian export-oriented countries, like Germany, Korea, Singapore etc., were on the edge of economic recession. The trade negotiation between the U.S. and China is unpredictable. Although both countries reached "Phase one" deal in early October, the economic and trade frictions between the two countries has not fundamentally improved as the U.S. has not removed its tariffs on Chinese goods and China's countermeasures were still in place. There are still a lot of unsettled items, the Sino-American relations are full of variables and it is hard to have a real breakthrough in the near term.

It seems that the global economy has entered a period of "synchronized stagnation" with weak growth in some countries and no growth or a mild contraction in others. Although it is thought that a global recession remains unlikely, it will be prudent to take a more defensive investment approach in the current investment environment. Besides, as the bond yield and interest rate of those global major economies continue to fall, some even turn to negative, the opportunity cost of holding gold is largely reduced and it will support the price of this traditional safe-haven asset.

Exhibit 2. Gold rallied in the previous U.S. interest rate cutting cycle



Source: Bloomberg (as at 30/09/2019)

Looking ahead

- *The progress of the trade talk between the U.S. and China will dominate the investment markets.*
- *In the era of negative yield and heightening recession risk, a more defensive investment approach will be preferable. In addition, gold may be considered as the safe-haven asset again.*

TABLE 1: Global Stock Markets Performance

	2019 Q3 Return		2019 YTD Return	
Indexes	**Local Currency**	**USD**	**Local Currency**	**USD**
Dow Jones Industrial Average	1.83%	1.83%	17.51%	17.51%
Nasdaq Composite	0.18%	0.18%	21.56%	21.56%
Euro STOXX 600	2.69%	-1.43%	20.32%	14.55%
DAX	0.24%	-3.79%	17.70%	12.17%
CAC 40	2.73%	-1.39%	23.70%	17.77%
Nikkei 225	2.98%	2.72%	10.76%	13.07%
Hong Kong Hang Seng	-7.49%	-7.82%	4.30%	4.21%
Hang Seng China Enterprises	-5.01%	-5.35%	4.55%	4.46%
Shanghai Stock Exchange Composite	-1.36%	-5.24%	19.32%	14.81%
Shanghai Shenzhen CSI 300	0.85%	-3.13%	29.56%	24.66%
Singapore Straits Times	-4.72%	-6.74%	5.30%	3.78%
Korea KOSPI	-3.17%	-6.45%	1.53%	-5.57%
Taiwan TWSE	4.12%	3.92%	16.02%	14.11%
India SENSEX	-1.43%	-3.86%	8.29%	6.79%
Indonesia JCI	-0.76%	-3.21%	1.80%	4.27%
Thailand SET	-4.64%	-4.34%	7.53%	14.40%
Russia RTS	-0.41%	-0.41%	32.47%	32.47%
Brazil IBOV	3.74%	-4.46%	19.18%	10.86%
S&P Pan Arab Composite	-4.32%	-4.32%	7.58%	7.58%
MSCI World	0.66%	0.66%	18.16%	18.16%

Source: Bloomberg (as at 30/09/2019)

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

	Change in 2019 Q3	Change in 2019
Currencies	In terms of USD	
Euro	-4.17%	-4.95%
British Pound	-3.21%	-3.65%
Japanese Yen	-0.21%	1.49%
Hong Kong Dollar	-0.36%	-0.09%
Chinese Renminbi (CNY)	-3.94%	-3.77%
Australian Dollar	-3.85%	-4.24%
New Zealand Dollar	-6.77%	-6.79%
Singapore Dollar	-2.09%	-1.37%
South Korean Won	-3.47%	-6.72%
Taiwanese Dollar	0.11%	-1.03%
Indian Rupee	-2.60%	-1.55%
Indonesian Rupiah	-0.47%	1.37%
Thai Baht	0.28%	6.42%
Russian Ruble	-2.54%	7.49%
Brazilian Real	-7.37%	-6.78%

Source: Bloomberg (as at 30/09/2019)

Review Highlights and outlook around the globe

United States

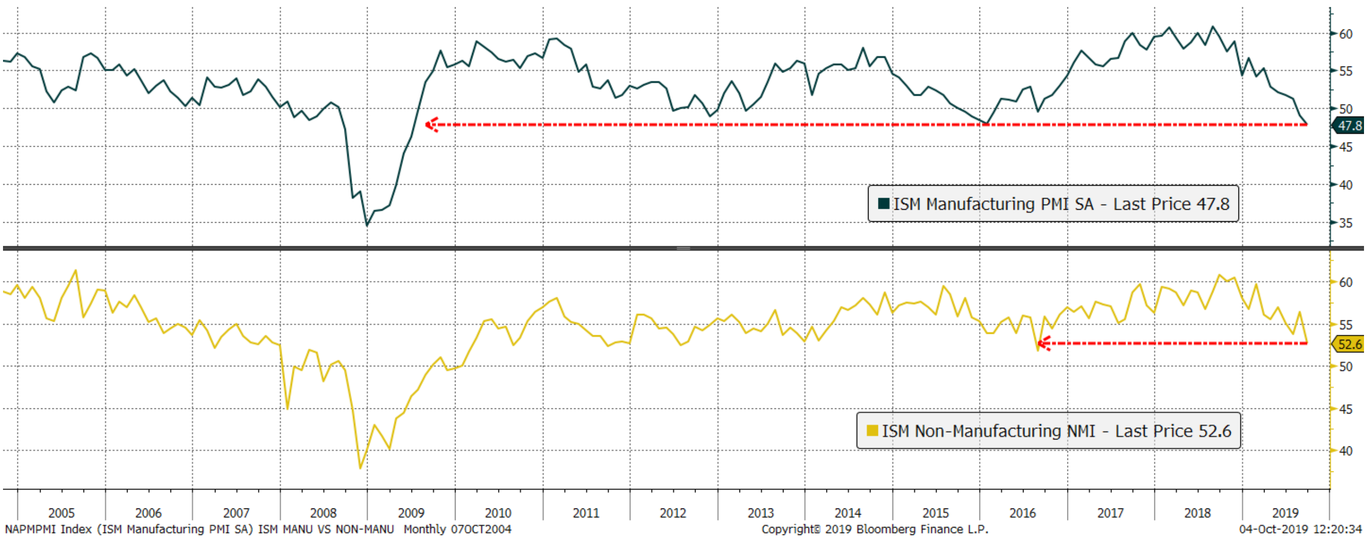
- The U.S. economy expanded at an annual rate of only 2% in the 2nd quarter which was in line with the previous estimate but lower than the last quarter's 3.1% growth. The government expenditure continued to soar and the consumer spending growth was still robust; but those gains were offset by slumps in business investment, exports and commercial and residential new construction.

- It is expected that the U.S. GDP growth may slow down in the coming quarters. According to the data from the Commerce Department, the U.S. consumer spending, which accounts for more than two-thirds of U.S. economic activity, only edged up 0.1% in August. Besides, orders for non-defense capital goods excluding aircraft, a closely watched proxy for business spending plans, dropped 0.4% in August which reflected the weakened business investment.

- Besides, the ISM Manufacturing PMI in the U.S. dropped to 47.8 in September 2019 from 49.1 in the previous month, missing market expectations of 50.1 and it was the second consecutive month of PMI contraction. The latest reading pointed to the steepest month of contraction in the manufacturing sector since June 2009, amid ongoing trade tensions with China. Although manufacturing makes up just over a tenth of the GDP of the U.S., slowing in the sector combined with cooler business investment and economic growth puts the longest-ever American expansion in a more precarious position.

- Slowdown was also seen in non-manufacturing side. The September ISM non-manufacturing index dropped sharply to 52.6 from 56.4 in August and much below the market consensus of 55. It was also the lowest reading since August 2016.

EXHIBIT 3. Falling manufacturing and non-manufacturing activities in the U.S.

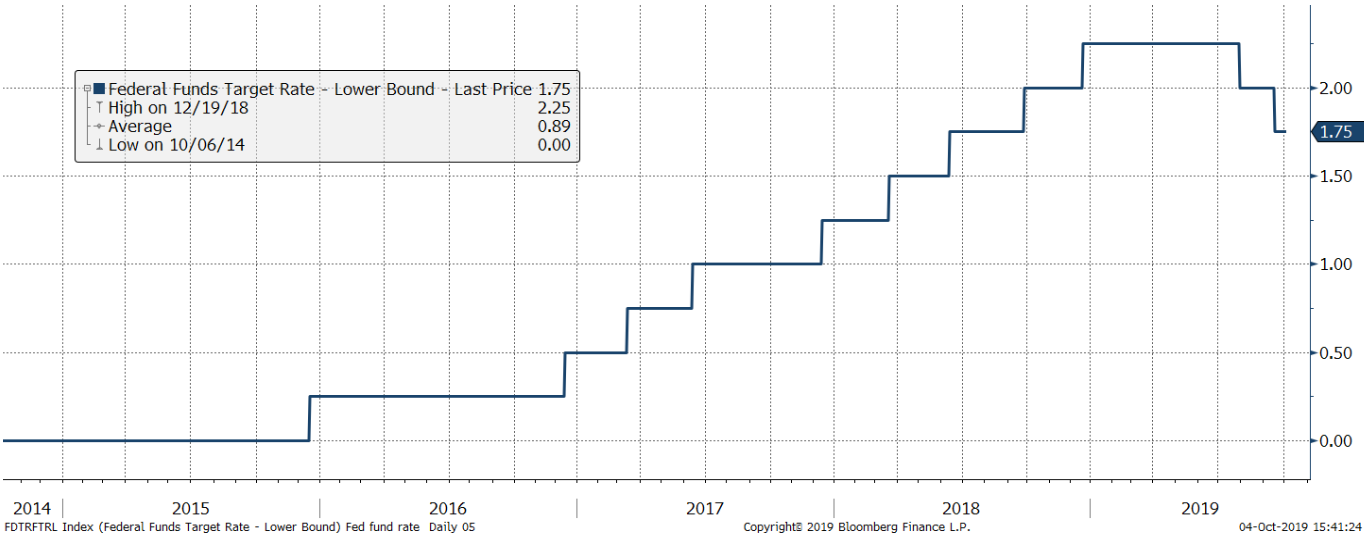


Source: Bloomberg (as at 30/09/2019)

- The U.S. unemployment rate fell to 3.5% in September which was 50-year low. However, the wage growth was slowing down. The average hourly earnings in September recorded the first monthly drop since October 2017. Over the past 12 months, average hourly earnings have increased by 2.9%, which was the slowest pace of growth since July 2018.

- The Federal Reserve has lowered the Federal funds rate twice in the last quarter. Although the U.S. economy still maintained growth, it is obvious that the momentum has weakened. After the release of disappointing ISM's manufacturing and non-manufacturing data, the Fed funds rate futures were almost fully pricing in a 25 basis points "bps" cut at the meeting on 30th October and a high chance of another cut by December.

EXHIBIT 4. The Federal funds rate lowered twice in the last quarter



Source: Bloomberg (as at 30/09/2019)

- Due to low mortgage rate environment, the U.S. homebuilding surged to more than a 12-year high in August. According to the data from the Commerce Department, Housing Starts jumped 12.3% to a seasonally adjusted annual rate of 1.364 million units in August, the highest level since June 2007. In addition, the existing home sale in August also rose 1.3% from a month ago to a 5.49 million annual rate, the fastest pace since March 2018.

- Among all major developed countries, the U.S. economy is still the healthiest. Besides, the dovish stance of the Federal Reserve and the recent lessening trade tension between the U.S. and China also support the U.S. stock market sentiment. However, as there are still a lot of unsettled items between the U.S. and China countries and the Sino-American relations are full of challenges and variables, it is believed that the progress of the coming trade negotiations will continue to dominate the market direction in the near future.

Europe

- The Eurozone quarterly economic growth was confirmed at 0.2% in the second quarter of 2019, slowing from a 0.4% expansion in the previous period. Germany's economy, which is the largest in the bloc and relies heavily on exports, contracted by 0.1% on the quarter, posting the worst performance in the euro zone.

- Operating conditions in the Euro area's manufacturing sector continued to deteriorate in the past few months, the IHS Markit Eurozone Manufacturing PMI fell to 45.7 in September, down from 47.0 in August. It was the lowest reading since October 2012 and the 8th successive month in the contraction zone. The region's manufacturing downturn was led by Germany, Europe's economic engine, with the respective PMI fell to 41.7, its lowest level since June 2009.

- The annual inflation rate in Euro Area was at 1% in August 2019, unchanged from the previous month and in line with a preliminary estimate and market expectations. It remained at the lowest inflation rate since November 2016, as energy prices fell while cost of food, alcohol & tobacco rose further.

- In order to boost growth and inflation amid global trade tensions and Brexit uncertainty, the ECB reactivated its quantitative easing program. During the meeting in September, the ECB approved a new round of bond purchases at a monthly pace of €20 billion starting from 1st November. The central bank also left its main refinancing operations rate unchanged but lowered the deposit interest rate by 10bps to -0.5%.

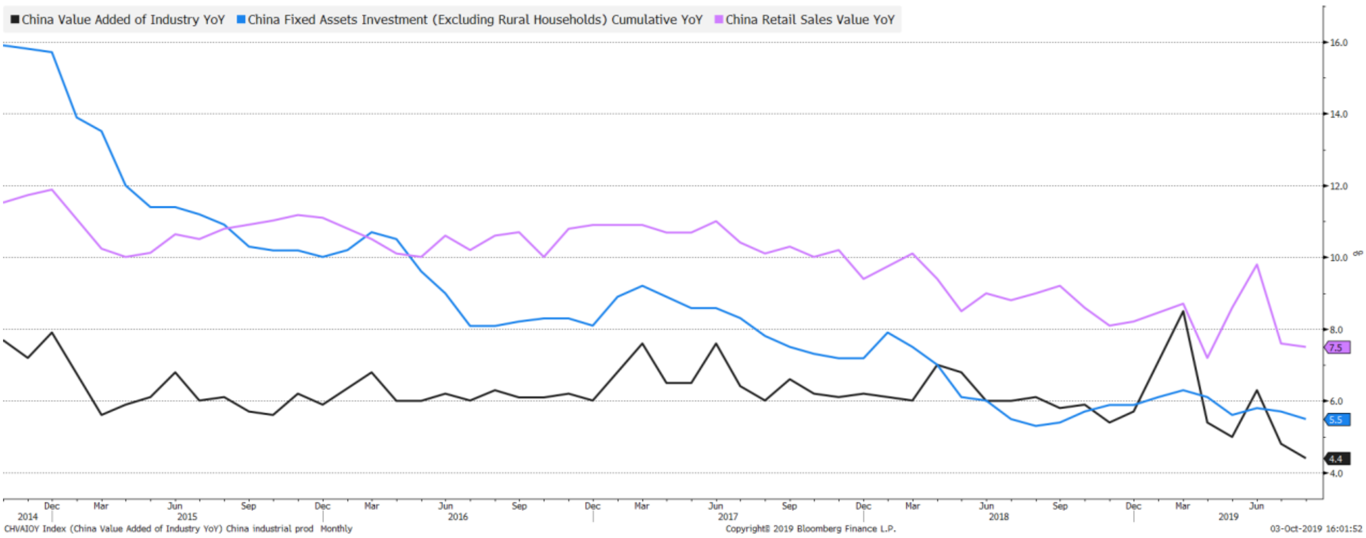
- Although the European economy is weakening and the Brexit is full of uncertainties, the Euro STOXX 600 has risen over 20% this year. As the ECB resumed quantitative easing, it is expected that the market liquidity will be abundant, and it may stimulate the stock market in the near term. However, it is believed that the medium-to-long term investment outlook of the European stock market will fall back to the region's fundamental.

Asia

- As pork prices continued to surge due to the outbreak of African swine fever in China, China's annual inflation remained at 2.8% in August while the core CPI which strips out volatile food and energy prices, edged down to 1.5% in August from 1.6% in July. It was the 12th straight month of growth less than 2%. Meanwhile, the producer price index contracted 0.8% year-on-year, reflecting weakening commodity prices as well as persistent reduction in industrial demand.

- The Chinese economy grew at the slowest pace in 27 years during the second quarter and economic activities seemed to have further cool down in recent months. According to the data from the National Bureau of Statistics, value-added industrial output in China rose only 4.4% in August from a year earlier, far below economists' expectations of 5.2% growth and was slower than the 4.8% increase in July. Fixed-asset investment outside Chinese rural households climbed 5.5% in the January-August period from a year earlier, slightly below expectations. Retail sales in China rose 7.5% in August from a year earlier, a tick down from the 7.6% gain in July and below expectations for a 7.9% rise.

EXHIBIT 5. THE economic activities were cooling down in China



Source: Bloomberg (as at 30/09/2019)

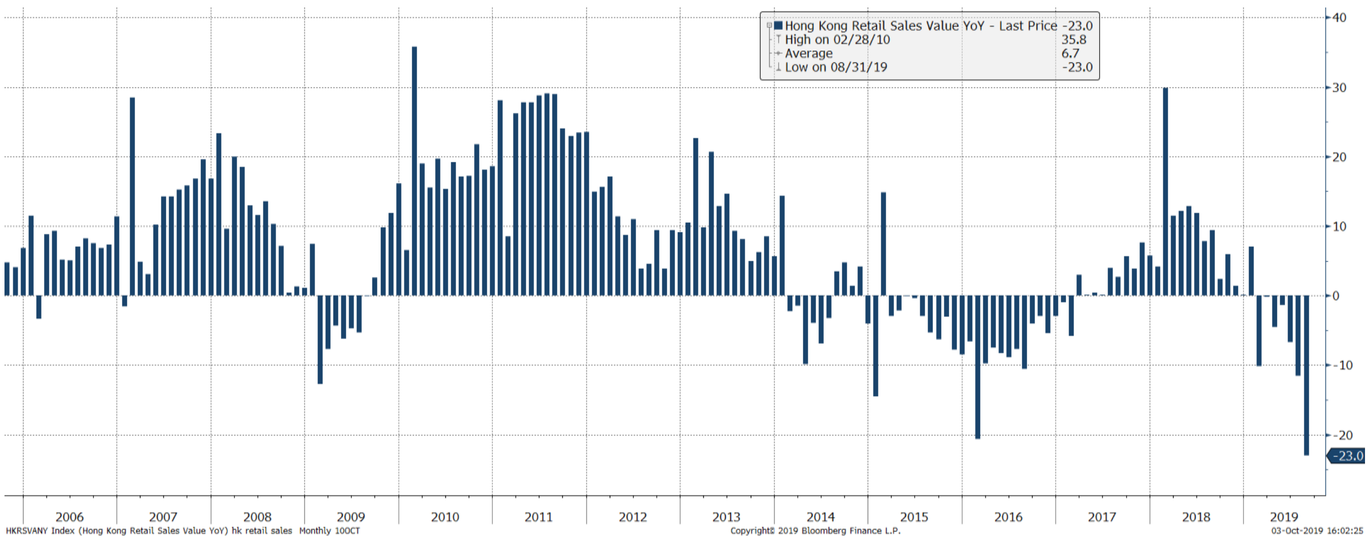
- In order to boost the economy, the People's Bank of China "PBOC" decided to cut the reserve requirement ratio "RRR" by 50 basis points "bps" for all banks, with an additional 100 bps cut for qualified city commercial banks on 6th September. The broad-based cut, which released 800 billion yuan in liquidity, has been effective on 16th September while the additional targeted cut which will release 100 billion yuan, will be effective in 2 phases on 15th October and 15th November. The PBOC has now slashed the ratio seven times since early 2018. The size of the latest move was at the upper end of market expectations, and the amount of funds released was the largest so far in the current easing cycle.

- On 22nd September, India cut corporate tax massively in a surprise move in order to lift the country's economic growth from 6-year low. Indian company will now be taxed at a rate of 22%, down from 30%. The tax rate for new manufacturing firms incorporated after October this year will even cut to 15%, if they start production before March 2023. At this moment, it may be too early to say whether the corporate tax reform will stimulate the economy or not, however, the Indian stock market responded positively, and the S&P BSE Sensex Index jumped 5.3% on the day of the tax cut announcement and it was the biggest one-day gain since 5th May 2009.

- Japan has increased its sales tax from 8% to 10% on 1st October after 2 delays in October 2015 and April 2017. The new rate applied to nearly all goods and services though most food would be exempted, and the government has also offered several measures this time so as cushion the impact, including rebates for certain purchases made by electronic payments. However, according to the past sales tax hike experiences in 1997 and 2014, the tax increase hurt consumption and the economy fell into recession ultimately. Amid the current global trade tension, it is believed that the near-term economic outlook of Japan is hard to be optimistic.

- In Hong Kong, the retail sales plunged a record of 23% year-on-year in August, a seventh consecutive month of decline, amid the double whammy of anti-government protests and the U.S.-China trade war and it was worse than the 21.48% fall during the period of Asian Financial Crisis in September 1998. Tourist arrivals also fell 40% in August comparing to last year, with hotel occupancy rates down to around 50%.

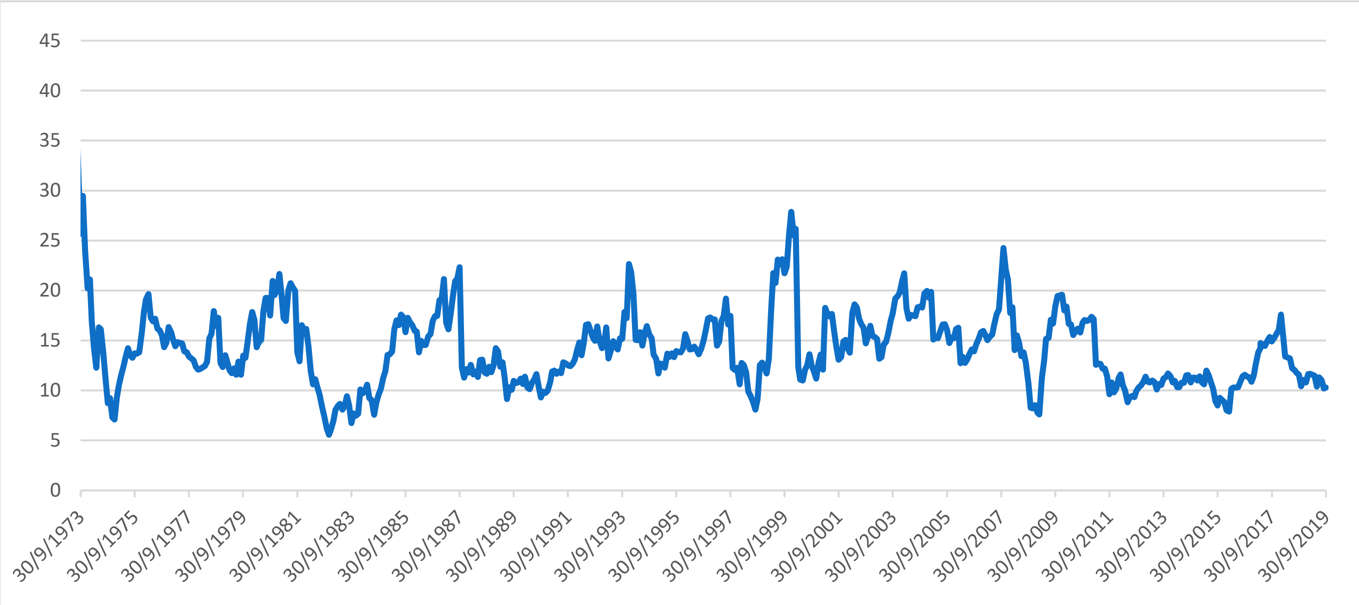
EXHIBIT 6. The August retail sales plunged a record 23% year-on-year in Hong Kong



Source: Bloomberg (as at 30/09/2019)

- Hong Kong stocks performed the worst among all major equity markets in the last quarter due to the ongoing trade conflict between the U.S. and China and the anti-government protest. We understand that the Hong Kong local economy will encounter difficulties in the coming quarters and the stock market may remain vulnerable. As of the end of September, the price-to-earnings ratio of the Hang Seng Index was traded at 10.29 times which was below the average level in recent years. The current stock market valuation may have already reflected the negative factors. Besides, more than half of the constituent stocks of the Hang Seng Index are H Share, Red Chip or other mainland China companies which their revenues are not come from Hong Kong. For the above reasons, it may be a bargain hunting opportunity for aggressive investors in a medium to long term.

EXHIBIT 7. The price-to-earnings ratio of Hang Seng Index currently at a relatively low level

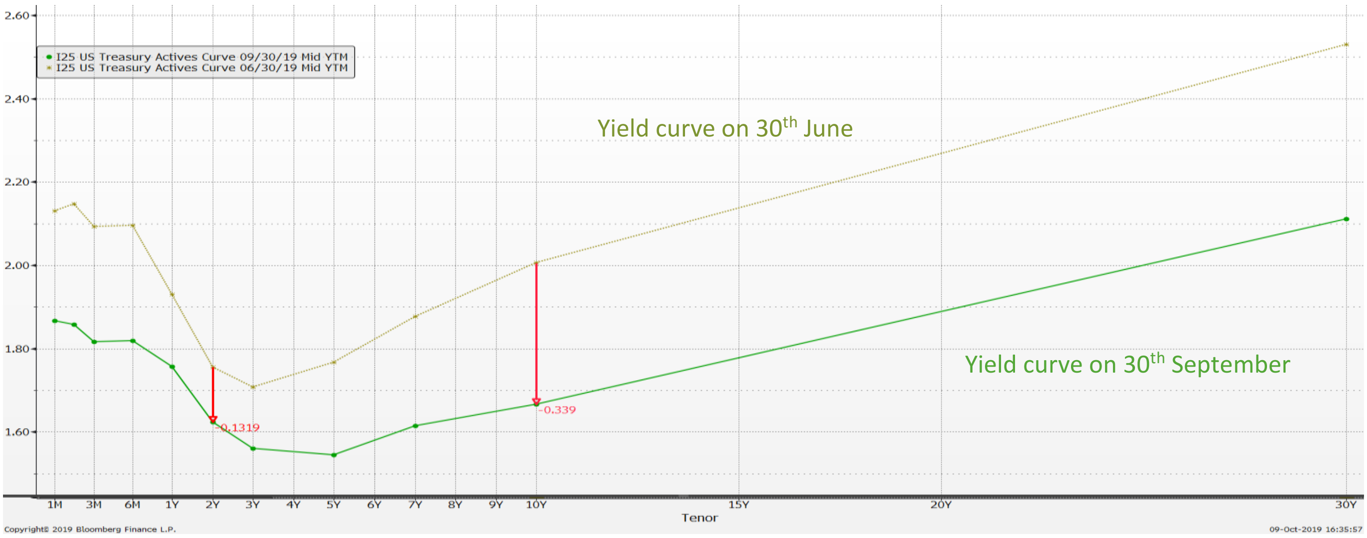


Source: Hang Seng Indexes Company Limited (as at 30/09/2019)

Fixed Income

- The fixed-income market generated relatively strong returns in the third quarter driven mainly by the falling interest rate. In the U.S., the treasury yield curve declined, and it also flattened as interest rates on the longer end of the curve fell further than the shorter end. In late August, the spread between the 2-year and 10-year treasury has even inverted which was the first time since 2007.

EXHIBIT 8. The U.S. treasury yield curve declined and flattened



Source: Bloomberg (as at 30/09/2019)

- However, the high yield bond sector recorded mild loss in last quarter. The Bloomberg Global High bond Index dropped 0.67%. Compared to investment grade corporate and sovereign bonds, high yield bonds are more volatile with higher default risk among underlying issuers. They are more sensitive to the economic outlook and in times of economic stress, default rate may surge.

- At this moment, we still have not seen the rise of default rate. However, as the global economy is going to the low-growth stage and the risk of recession is rising, corporate earnings will fall, and default rate may rise in the near future. Under such scenario, it may be better to overweight fixed income with a higher credit rating.

Commodities

- Oil prices were on a roller coaster ride in the third quarter. Oil price had surged in the mid-September due to the drone attacks on Saudi Arabian oil processing facilities. However, as Saudi's oil production quickly recovered and the risk of global economic slowdown was rising, the oil price slid in the second half of September. Brent Crude Oil Futures and WTI Crude Oil Futures recoded 8.7% and 7.53% loss respectively in the past 3 months.

- Oil prices are affected by demand and supply. The demand falters since the market is worried about the deteriorating global economy. At the same time, the supply is ample as the record high U.S. Shale oil production offsets the impact of OPEC and its alliance's supply cut. In view of the weakening demand and ample supply, it is expected that the weak trend of oil price is likely to continue unless geopolitical risk increases unexpectedly.

EXHIBIT 9. Oil prices were on a roller coaster ride in the third quarter

Source: Bloomberg (as at 30/09/2019)

- Gold price gained 4.5% in the third quarter and has climbed to USD 1,552.55 per ounce in early September. Since the central banks across the world adopt loose monetary policies, it is believed that global low interest rate environment will be maintained for a longer period. As a result, the opportunity of holding gold will be largely reduced and we hold our cautiously optimistic investment view towards the yellow metal.