Investment Services Department

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Stepping into the post-pandemic inflation era

2021 Q3 market highlights

- *Global inflation pressure is accelerating, and it is expected that the U.S. Fed will start "tapering" soon.*
- *China's tightening regulation and China Evergrande debt crisis weakened investment sentiment.*
- *Hong Kong stock market was the biggest loser in the last quarter; the Hang Seng Index and Hang Seng China Enterprises Index plummeted 13.88% and 17.12% respectively.*

Due to the supply chain disruption caused by the previous COVID-19 lockdown of several countries and the rising demand driven by the release of consumer's excessive saving and infrastructure stimulus provided by the governments of major economies, the price of a variety of commodities keeps on rising, the Bloomberg Commodity Spot Index which tracks 23 energies, metals and crop futures contracts climbed to the historical high level at the end of September.

The accelerating commodities price triggers the threat of inflation. The consumer price and producer price continue to rise globally, and central banks of Russia, Brazil, South Korea, New Zealand, Norway, etc. have already raised interest rate this year to tackle the elevating inflation. Although the U.S. Federal Reserve ("Fed") and the European Central Bank ("ECB") currently still maintain their ultra-loose monetary policies, the policymakers have started considering tightening measures. The Fed has even indicated that they will reduce their monthly bond purchase program as soon as in November and interest rate hike will likely to happen in late 2022.

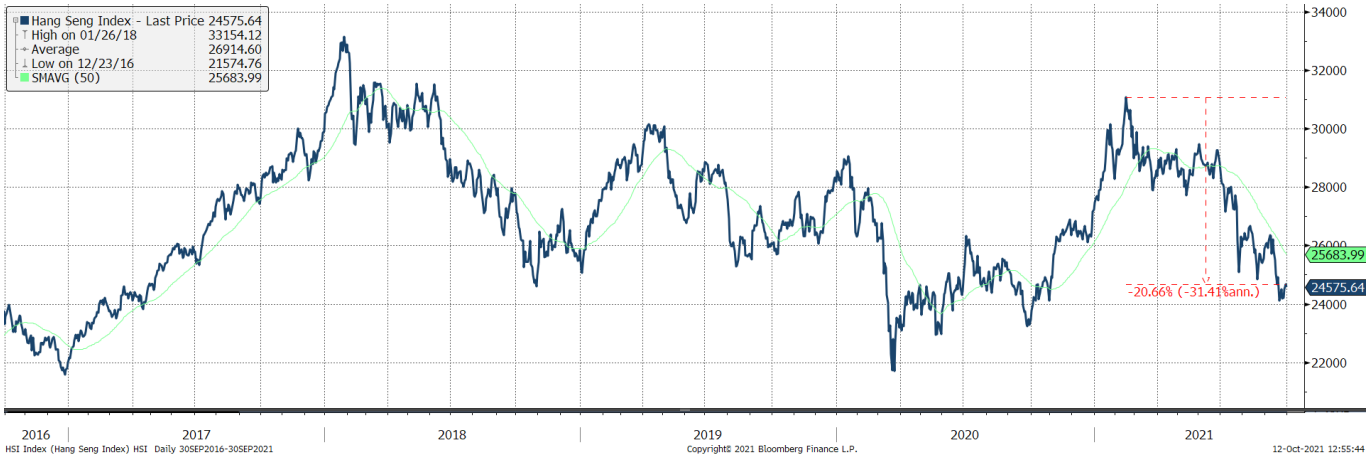
The U.S. Treasury yield surged again in the last quarter due to the monetary tightening expectation, the benchmark U.S. 10-year treasury yield has rebounded to 1.5% level at the end of September and the rising yield caused the U.S. and European stock markets retreated about 5% from their historical high levels.

EXHIBIT 1: The Bloomberg Commodity Spot Index surged to the historical high level

Source: Bloomberg (as at 30/09/2021)

The other market focus in the past 3 months was the Hong Kong and China stock markets. In the beginning of the third quarter, the market sentiment was hurt by a series of new regulatory controls to different sectors introduced by the Chinese Government and it was getting worse since mid-July when the debt problem of China Evergrande, the second largest property developer in China, intensified into a crisis condition. The Hang Seng Index and Hang Seng China Enterprises Index were two of the biggest losers which plummeted 13.88% and 17.12% respectively in the third quarter.

EXHIBIT 2: The Heng Seng Index plunged over 20% from its peak in February 2021



Source: Bloomberg (as at 30/09/2021)

Global economy experienced a sharp rebound this year although the recovery is uneven across countries as those major economies recorded strong growth while many developing countries still lag behind. We are now stepping into the post pandemic era which is full of rapid changes and uncertainties. Looking ahead, it is believed that several risk factors below would bring challenges to the investment markets.

Virus variant

There is no doubt that vaccination is highly effective in preventing serious illness of COVID-19. However, the infection rate has not been slowed down significantly due to the virus variant. As the Northern Hemisphere is entering winter soon and most of the countries in the region have relaxed COVID-19 related restriction, the risk of another outbreak cannot be ignored. Besides, there are clear inequalities in term of vaccination coverage across the world. According to the latest data, around 48% of the world population has received at least one dose of COVID-19 vaccine but the vaccination rate in those low-income countries was only 2.5%.

Accelerating Inflation

While most of the developed countries are currently adopting accommodative monetary policies and the interest rates are at the record low levels, more and more evidence showed that inflation keeps on rising and many economists started changing their views and believe that the surge of price level is not a transitory nature. As mentioned, even though the U.S. Fed will start tapering soon, it is expected that the interest will be maintained at the current level in the coming 1 year. However, if the inflation goes further, the central bank may turn to a more Hawkish stance and it may bring unfavorable impacts to the investment markets.

Chinese Government policy direction

In the past quarter, the Chinese Government's tightening regulation has frightened the investment markets, the recent economic data also showed a mixed economic growth outlook. In the coming months, investor should pay attention to the Chinese Government policy direction. Besides, the upcoming virtual summit between President Xi Jinping and President Joe Biden by the end of this year would also be another market focus.

TABLE 1: Global Stock Markets Performance

	2021 Q2 Return		2021 YTD Return	
Indexes	**Local Currency**	**USD**	**Local Currency**	**USD**
S&P 500	0.58%	0.58%	15.91%	15.91%
Nasdaq Composite	-0.22%	-0.22%	12.67%	12.67%
STOXX Europe 600	0.96%	-1.41%	16.90%	10.64%
DAX	-1.74%	-4.05%	11.24%	4.74%
CAC 40	0.44%	-1.92%	20.05%	13.62%
Nikkei 225	2.90%	2.57%	8.82%	0.83%
Hong Kong Hang Seng	-13.88%	-14.09%	-7.49%	-7.86%
Hang Seng China Enterprises	-17.12%	-17.33%	-16.57%	-16.91%
Shanghai Stock Exchange Composite	0.44%	0.63%	4.89%	6.23%
Shanghai Shenzhen CSI 300	-5.99%	-5.81%	-5.04%	-3.83%
Singapore Straits Times	-0.21%	-1.20%	11.60%	8.50%
Korea KOSPI	-6.91%	-11.17%	7.16%	-1.54%
Taiwan TWSE	-2.71%	-2.50%	17.80%	18.97%
India SENSEX	12.66%	13.08%	24.87%	22.87%
Indonesia JCI	5.38%	7.14%	7.10%	5.01%
Thailand SET	2.13%	-2.84%	13.83%	1.27%
Russia RTS	9.10%	9.10%	32.96%	32.96%
Brazil IBOV	-12.48%	-19.73%	-6.75%	-11.67%
S&P Pan Arab Composite	6.87%	6.87%	30.90%	30.90%
MSCI World	0.10%	0.10%	13.45%	13.45%

Source: Bloomberg (as at 30/09/2021)

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

	Change in 2021 Q2	Change in 2021
Currencies	**In terms of USD**	
Euro	-2.34%	-5.21%
British Pound	-2.58%	-1.43%
Japanese Yen	-0.16%	-7.22%
Hong Kong Dollar	-0.27%	-0.43%
Chinese Renminbi (CNY)	0.19%	1.28%
Australian Dollar	-3.61%	-6.07%
New Zealand Dollar	-1.20%	-3.97%
Singapore Dollar	-0.91%	-2.62%
South Korean Won	-4.88%	-8.24%
Taiwanese Dollar	0.05%	1.64%
Indian Rupee	0.12%	-1.58%
Indonesian Rupiah	1.31%	-1.84%
Thai Baht	-5.26%	-11.47%
Russian Ruble	0.54%	2.28%
Brazilian Real	-8.70%	-4.49%

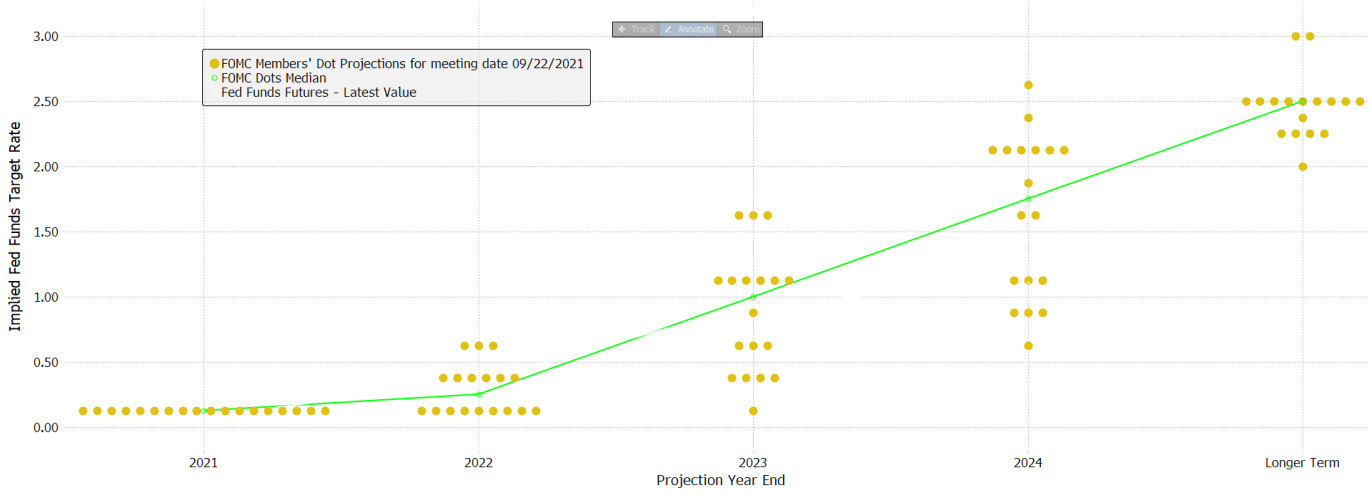
Source: Bloomberg (as at 30/09/2021)

Review Highlights and outlook around the globe

United States

- In line with forecasts, the U.S. Fed left the fed funds rate steady at 0-0.25% and bond-buying at the current $120 billion monthly pace during the September 2021 meeting. Still, the central bank said the economy has made progress toward employment and inflation goals and if progress continues broadly as expected, a moderation in the pace of asset purchases may soon be warranted. The Fed also signaled interest rate increases may follow more quickly than expected, with 9 of 18 policymakers projecting borrowing costs will need to rise in 2022.

EXHIBIT 3: Half of the U.S. Fed policymakers projected interest rate rise in 2022 during the FOMC meeting in September



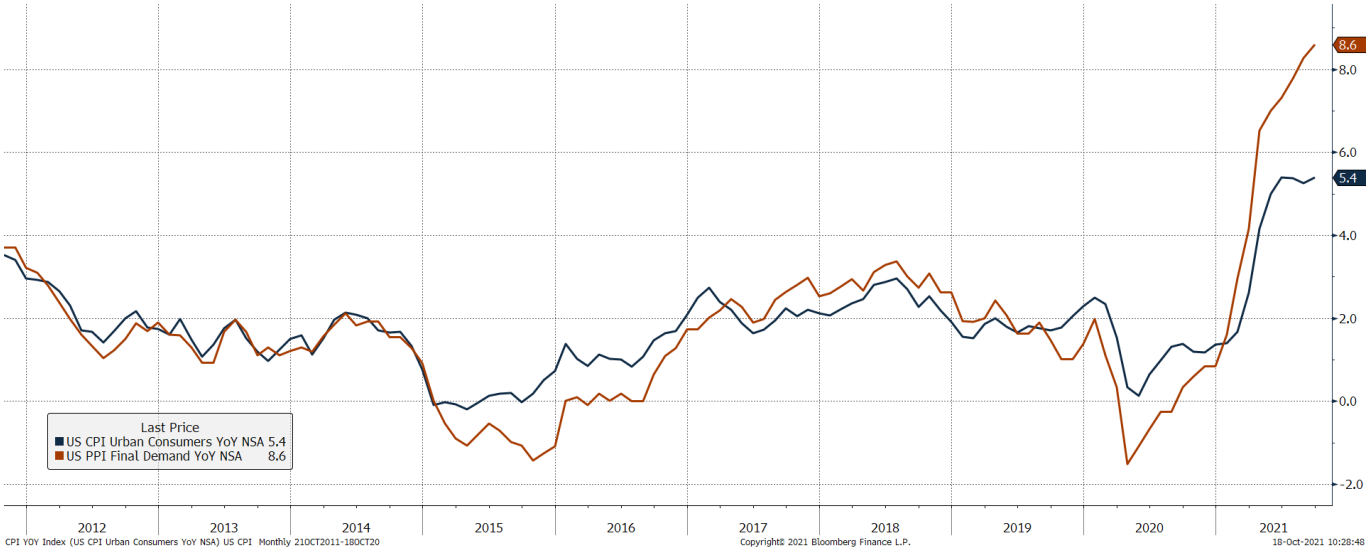
Source: Bloomberg (as at 30/09/2021)

- The ISM Manufacturing PMI rose to 61.1 in September 2021, which was one of the strongest rates of expansion since 1983, boosted by solid increases in production and new orders, as well as a slight rebound in employment levels. At the same time, factories experienced longer delays getting raw materials and paid higher prices for inputs. The services sector continues to show strong growth as well, the ISM Services PMI edged higher to 61.9, up from 61.7 in August. This marked 16 consecutive months of growth.

- The U.S. new home sales jumped 1.5% to a seasonally adjusted annual rate of 740,000 in August, which was the highest reading in 4 months. However, new home sales still remain well below 977,000 in August of 2020 as high prices due to rising material costs continue to weigh on buyers' affordability. The median sales price has increased to $390,900 from $325,500 a year earlier.

- The U.S. inflation pressure is soaring. According to the Department of Labor, the Producer Price Index (PPI) jumped 8.6% from a year earlier in September which was the biggest advance since the data was first measured back in November 2010. At the same time, the Consumer Price Index edged up to a 13-year high of 5.4% in September from 5.3% in August and above market expectations of 5.3%.

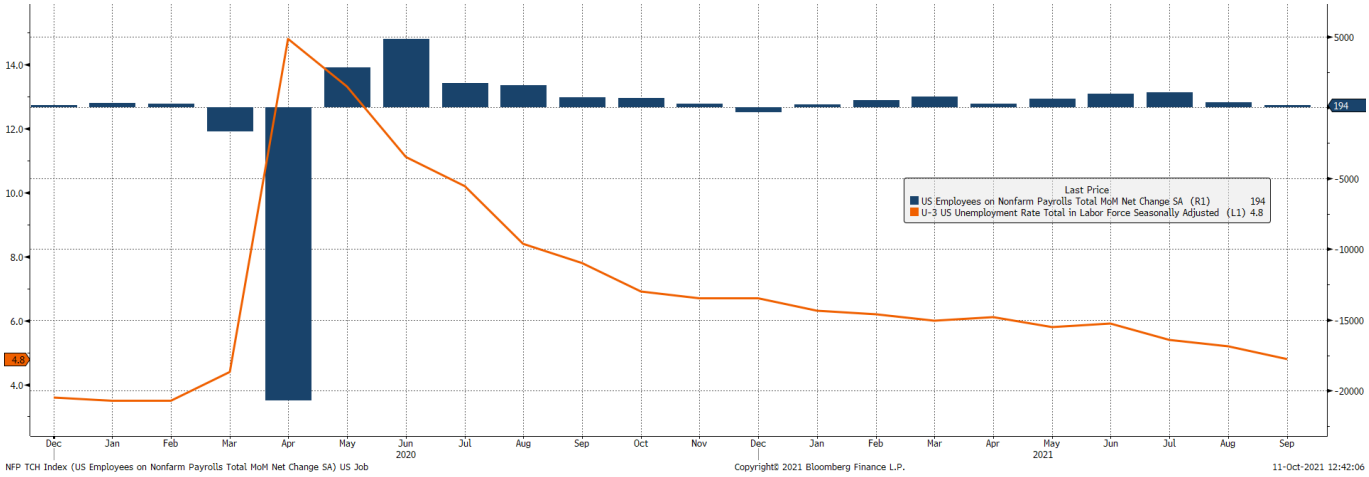
Exhibit 4: Soaring inflation pressure in the U.S.



Source: Bloomberg (as at 30/09/2021)

- The job market data in September was mixed. While the unemployment rate dropped to 4.8%, the lowest rate since March 2020, the economy only added 194,000 non-farm jobs in September, falling short of the 366,000 gains posted in August, well below the forecast from economists of 500,000 increase and was the lowest growth this year. Nonfarm employment has increased by 17.4 million since a recent trough in April 2020 but is still down by 5 million, from its pre-pandemic level in February 2020. At the same time, the average hourly earnings for all employees on U.S. private nonfarm payrolls rose by 19 cents, or 0.6% to USD30.85.

EXHIBIT 5: The September Nonfarm payroll was the weakest this year



Source: Bloomberg (as at 30/09/2021)

- The deepening worry of inflation resulted in the U.S. treasury yield rising, and the rising yield subsequently caused the S&P 500 and Nasdaq Composite Index pulled back from the historical high level in late September. As the market has gradually digested that the Fed will have "tapering" soon, it is believed the attention will go back to the corporate earnings. The S&P 500 recorded the highest year-over-year earnings growth in over a decade in the second quarter of 2021. If the earnings growth continues in the coming earnings report season, the bullish momentum of the U.S. stocks is expected to go on.

Europe

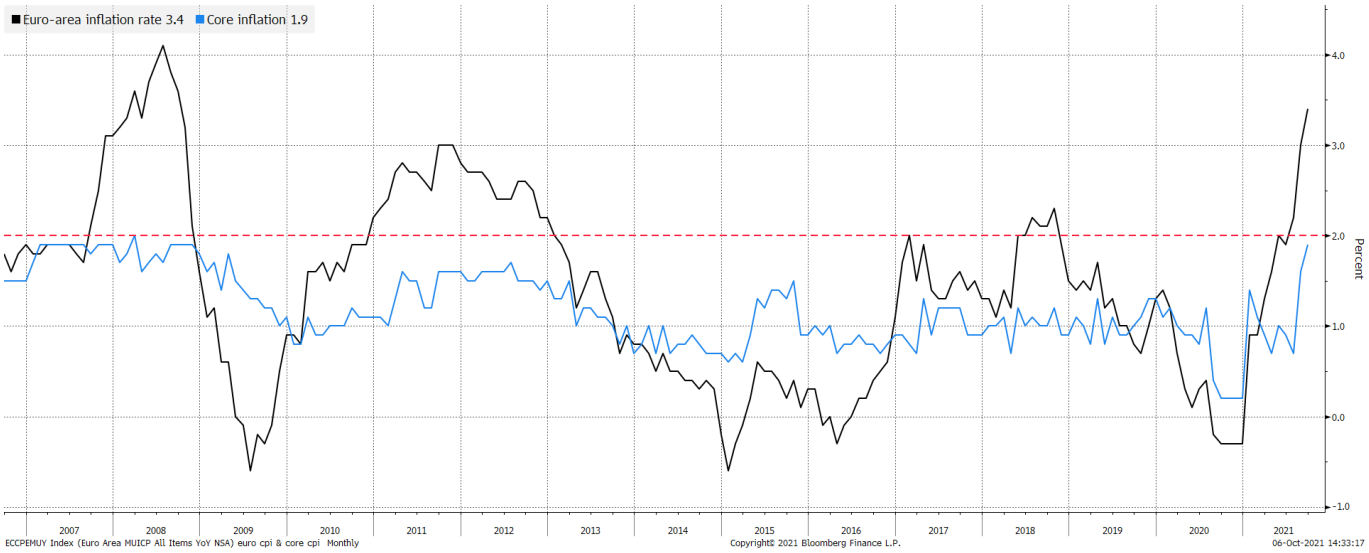
- Since the restrictions were lifted gradually in the second quarter, the European economy recovered rapidly. Compare with the same period last year, the GDP of Eurozone jumped 14.3% in the second quarter and it rose 2.2% on a quarterly basis. The U.K. economy also recorded a strong growth, it grew 5.5% and 23.6% on a quarterly basis and yearly basis respectively and the level of GDP is now only 3.3% below where it was before the pandemic.

- Like other parts of the world, the inflation pressure is going up in the Eurozone and the UK. Driven by the rise of energy price, the Eurozone Consumer Price Index rose to 3.4% year-on-year in September, up from 3% a month ago and was over the expectation of 3.3%. The consumer prices in the U.K. also rose by 3.2% from a year ago in August, it was not only much higher than 2% in July and 2.9% market estimation, but also the biggest annual increase in more than 9 years.

- The ECB left interest rates at record-low levels but said it would start conducting a moderately lower pace of net asset purchases under the Pandemic Emergency Purchase Programme ("PEPP") for the

rest of the year due to improved economic and financial conditions. At the same time, the Bank of England("BOE") left its benchmark interest rate at a record low of 0.1% and its bond-buying program unchanged at a total of GBP 895 billion by the end of this year during its September 2021 meeting. However, policy tightening appeared to gain some momentum as two policymakers voted for an early end of government bond purchases, compared with only one in the August meeting.

EXHIBIT 6: The inflation is also going up in the Eurozone



Source: Bloomberg (as at 30/09/2021)

- The STOXX Europe 600 Index retreated about 5% from its peak in mid of August due to the fear of inflation and the rise of energy price but it still gained over 16% this year. Looking ahead, it is believed that the investment outlook of European stock is still positive. Due to a high vaccination rate in the region, the business activities in Europe have gradually come back to normal, corporate earnings are improving continuously and support equities valuation. In addition, the ECB is unlikely to change its accommodative monetary policy too soon since its inflation pressure is relatively mild when compared with the U.S. and most of the developed countries.

Asia

- India was the best performing stock market in Asia this year, the India Sensex Index has risen about 25% this year and was more than double from its pandemic low in March 2020. One of the reasons of the strong rebound is due to the massive COVID-19 vaccination. Nearly half of all eligible adults have received at least one dose of the vaccine, most states have lifted lockdown curbs, business

activities resumed and the Indian economy even recorded 20.1% GDP growth for the quarter ended June 2021. In addition, sustained foreign fund inflows and record number of retail investors also support the rally.

EXHIBIT 7: The India Sensex Index now was more than double from its pandemic low in March 2020

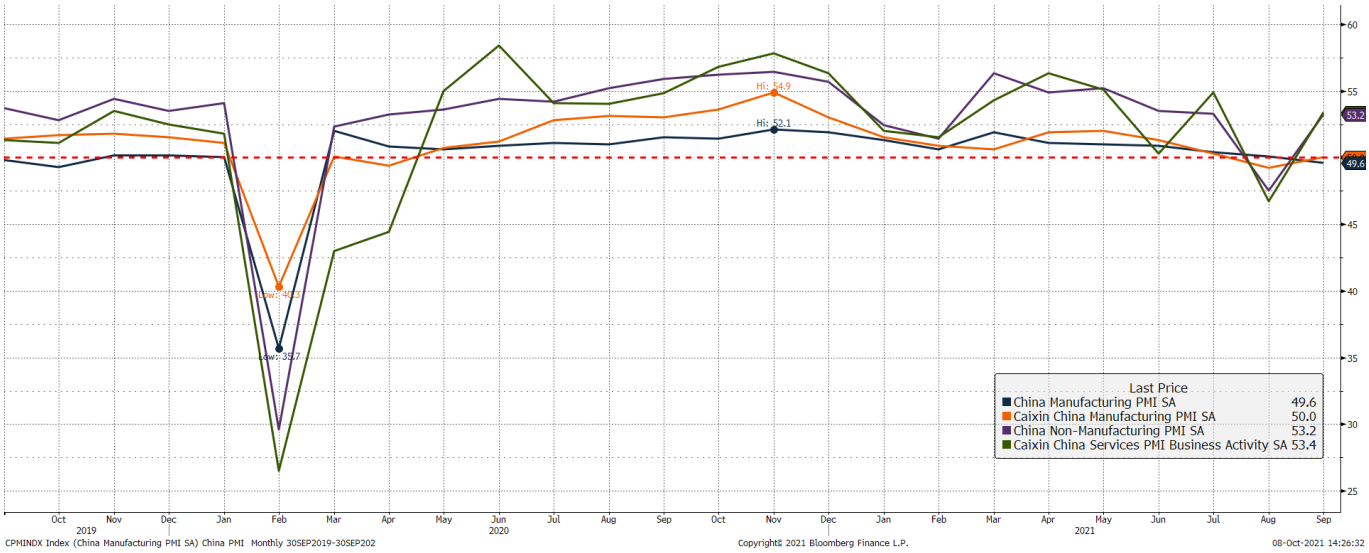
Source: Bloomberg (as at 30/09/2021)

- Thailand's current account deficit is expected to hit a record of USD 15.3 billion this year mainly due to the low number of tourist arrival. It will be the first shortfall since 2013 and the Thai Baht has already depreciated more than 11% against the USD this year which was the weakest currency in South East Asia.

- The recent economic data showed a mixed picture for the economic growth of China. Due to wider curbs on electricity and rising input prices, China's factory activities unexpectedly shrank in September. The official manufacturing Purchasing Manager's Index (PMI) was at 49.6 in September versus 50.1 in August, which was the first time falling into the contraction zone since February 2020. At the same time, The Caixin China manufacturing PMI which gauges China's most privately-run middle and small-size manufacturers stabilized at 50 in September from 49.2 in previous month, indicating the downward pressure on the economy was still high.

- On the other hand, the service sector returned to growth in September. Both the official non-manufacturing PMI and Caixin Services PMI rebounded to expansion zone and recorded 53.2 and 53.4 respectively.

EXHIBIT 8: The Chinese PMI figures showed mixed economic outlook



Source: Bloomberg (as at 30/09/2021)

- Affected by the China Evergrande Group's debt crisis, new regulations from the Chinese Government for sectors ranging from gaming and entertainment to technology and private education, the Hang Seng Index was down about 23% from its peak in February this year and its price-to-book ratio was traded at around 1 which was almost at the lowest point in 20 years as of the end of September. The current investment sentiment in Hong Kong and China stock market definitely is very bearish and it is hard to predict when it will go to the bottom. However, investment market should have cycle and if investor have a medium-to-long term investment horizon and can accept short term volatility, it may be a good timing to invest Hong Kong stock market right now.

EXHIBIT 9: The price-to-book value of Heng Seng Index at the lowest level in 20 years

Source: Bloomberg (as at 30/09/2021)

Fixed Income

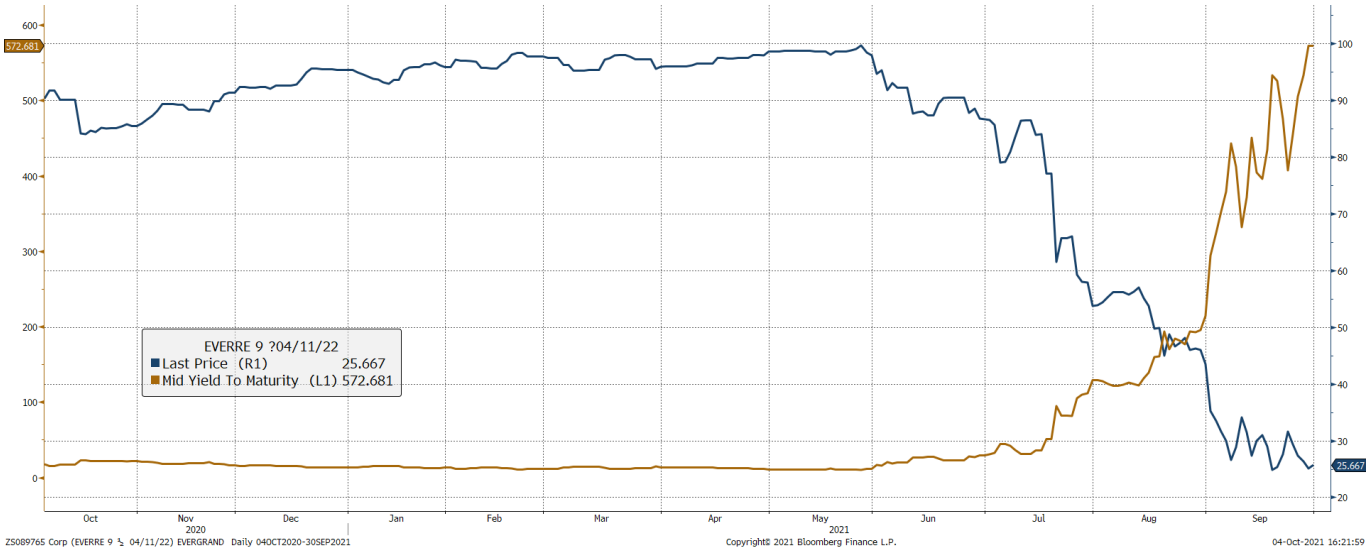
- As the U.S. Fed indicated that it may soon begin "tapering" and its latest projection also signaled half of the major Fed officials now see a rate hike in 2022, the benchmark 10-year U.S. Treasury yield rebounded to 1.5% level, its highest since June. As inflation likely elevates in the coming few months, it is believed that the U.S. 10- year treasury yield will continue to rise in the rest of this year and may reach near the year-high of 1.74%.

EXIBIHIT 10: The 10-year U.S. Treasury yield rebounded to 1.5% level

Source: Bloomberg (as at 30/09/2021)

- The rising default risk of China Evergrande, the second largest property developer in China, was one of the market focuses in the last quarter. As of the end of September, the company's most short dated USD bond with maturity in April 2022 has fallen to about 25% of its par value and its yield-to-maturity also rocketed to 572%. At the time of writing this report, there are still a lot of uncertainties about the Evergrande crisis and if a disorderly collapse happens, it is believed that it will bring systematic risk to the Chinese property sector and hurt the financial system. It may also spillover to other parts of the economy and ultimately, the Chinese economy growth may slow down further.

EXHIBIT 11: The price of Evergrande bond plunged while its yield-to-maturity rocketed



Source: Bloomberg (as at 30/09/2021)

Commodities

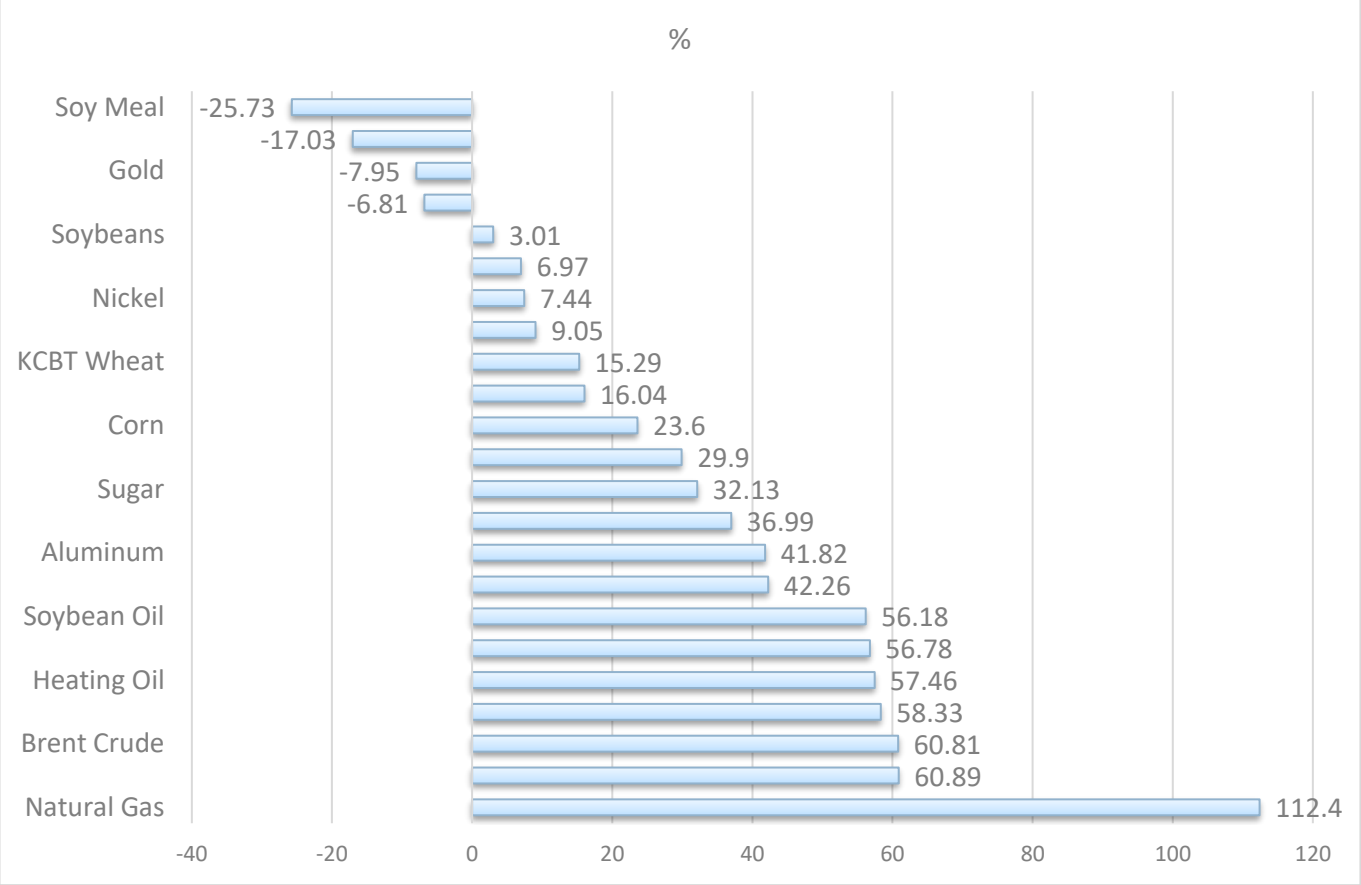
- Gold traded in a narrow range between USD 1,720 and USD 1,820 in the past few months without any clear bullish or bearish direction. However, as the Fed will start tapering soon, the downside pressure of gold may increase even though the global economic outlook is still quite uncertain.

EXHIBIT 12: Gold traded in a narrow range in the past few months

Source: Bloomberg (as at 30/09/2021)

- Apart from gold, a broad range of commodities surged this year. The Bloomberg Commodity Spot Index which tracks 23 energies, metals and crop futures contracts climbed to historical high level. The biggest gainer were energy commodities such as natural gas, which have rocketed amid shortage in both Europe and China. Oil also jumped to the highest since November 2014. Aluminum and copper have shot up due to global supply shortage and a drought in Brazil has also pushed up the price of coffee and sugar. The surge in commodities price may trigger inflation going further and global central banks may tighten their monetary policies earlier as a result.

EXHIBIT 13: The price of a broad range of commodities surged in 2021



Source: Bloomberg (as at 30/09/2021)

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