INVESTMENT INSIGHT JAN 2023

Investment Services Department

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A SHORT REVIEW OF THE INVESTMENT MARKETS IN 2022

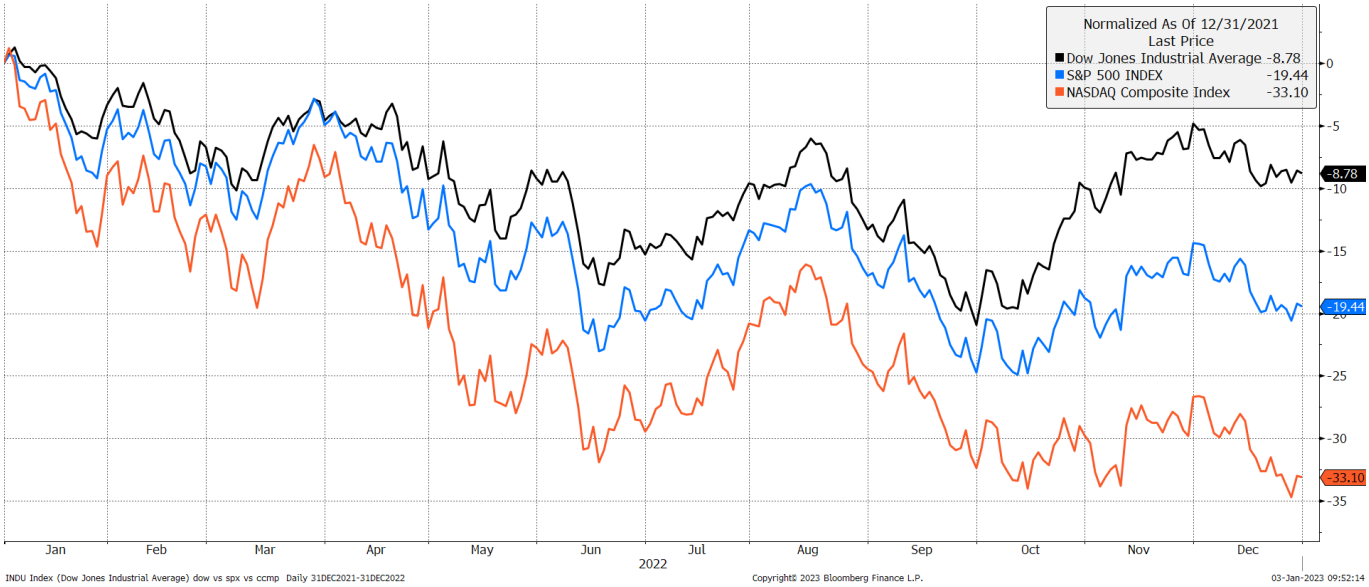
Last year, the investment markets were extraordinary volatile. The Russia-Ukraine war, the Chinese zero-Covid policy have deepened the global supply chain disruptions, global inflation soared at the fastest pace in nearly 40 years. The Federal Reserve and other major central banks have tightened their monetary policies and raised interest rate aggressively. Under such scenario, almost all asset classes posted negative return in 2022.

EQUITIES

Stimulated by the worldwide super low interest rate and abundant money supply environment after the Covid pandemic, investors enjoyed global bull markets in the second half of 2020 and 2021. The story was totally different in 2022 due to the sharp U-turn of monetary policies by most of the global major central banks. As the borrowing costs have risen rapidly, growth stocks suffered the most, the technology focused

Nasdaq Composite Index plunged over 30%. On the other hand, old economy stocks showed certain defense, even though they were still in red generally in 2022.

EXHIBIT 1: The old economy stock focused Dow Jones Industrial Average Index outperformed in 2022



Source: Bloomberg (as at 31/12/2022)

The Hong Kong Heng Seng Index and Heng Seng China Enterprise Indexes were two of the worst performing global major equity indexes in the first three quarters of 2022, they plummeted 23.98% and 25.63% respectively. The 14-month Relative Strength Index of the Heng Seng Index has even dived to the lowest level since 1967. However, the Hong Kong and Chinese stock markets were bottom out at the end of October after the 20th National Congress of the Communist Party of China as the uncertainties of Chinese economic policy direction were largely removed. At the same time, the Chinese economy also moves to reopen its border to the outside world as the Government started to lift most of the Covid policy restrictions in December. As at the end of 2022, both the Heng Seng Index and Heng Seng China Enterprise Indexes rebounded more than 35% since 31st Oct.

Benefited from different favorable factors, the Brazilian, Indonesian, Indian, Singaporean and Thai stock indexes were few exceptions that still delivered positive return in 2022. Due to the rising commodity price, the export revenue of Brazil and Indonesia has increased. The reopening of Singaporean and Thai economies in mid-2022 supported a strong economic rebound in the year end. At the same time, the investment sentiment of Indian market has been boosted up since many investors believe that India has strong potential to become the next “world factory” in the future.

TABLE 1: Global Stock Markets Performance (% In local currency)

Indexes	2022 Q4	2022 Full year	2021
S&P 500	7.55	-18.13	28.68
Nasdaq Composite	-0.78	-32.51	22.21
STOXX Europe 600	9.97	-9.88	25.82
DAX	14.93	-12.35	15.79
CAC 40	12.57	-6.71	31.88
Nikkei 225	0.75	-7.38	6.66
Hong Kong Hang Seng	15.03	-12.56	-11.84
Hang Seng China Enterprises	13.44	-15.63	-21.25
Shanghai Stock Exchange Composite	2.32	-12.81	7.05
Shanghai Shenzhen CSI 300	1.99	-19.83	-3.51
Singapore Straits Times	4.42	8.36	13.55
Korea KOSPI	3.78	-24.36	5.56
Taiwan TWSE	5.49	-18.83	26.92
India SENSEX	6.13	5.77	23.23
Indonesia JCI	-2.29	6.97	12.53
Thailand SET	5.19	3.51	17.70
Russia RTS	0.06	-32.02	21.73
Brazil IBOV	-0.27	4.69	-11.93
S&P Pan Arab Composite	-5.67	-5.68	32.66
MSCI World	9.89	-17.71	22.38

Source: Bloomberg (as at 31/12/2022)

FIXED INCOMES

Traditionally, fixed incomes, especially those investment grade bonds, should have low correlation with equities which can provide stable return with low volatility and diversification for the investment portfolio. In 2022, the aggressive rate hike of global major central banks triggered an unprecedent rise of bond yields. Like the U.S. 2-year treasury bond, the yield has risen from 0.73% at the end 2022 to the latest of more than 4.30%. Under such exceptional scenario, the Bloomberg U.S. Aggregate Bond Index, which reflects the performance of a basket of U.S. investment-grade bonds, was down 13.01% in 2022. Comparing with stock market performance, perhaps the decline looked moderate. However, before the slump in 2022, the Bloomberg U.S. Aggregate Bond Index had only recorded 4 negative annual returns since its launch in 1976 and the previous largest drawdown was only -2.92% in 1994.

TABLE 2: The Bloomberg U.S. Aggregate Bond Index has only recorded 4 negative annual returns before 2022

Year	% change	Year	% change	Year	% change
2022	-13.01%	**2007**	6.97%	**1991**	16.00%
2021	-1.54%	**2006**	4.33%	**1990**	8.96%
2020	7.51%	**2005**	2.43%	**1989**	14.53%
2019	8.72%	**2004**	4.34%	**1988**	7.89%
2018	0.01%	**2003**	4.10%	**1987**	2.76%
2017	3.54%	**2002**	10.25%	**1986**	15.26%
2016	2.65%	**2001**	8.44%	**1985**	22.10%
2015	0.55%	**2000**	11.63%	**1984**	15.15%
2014	5.97%	**1999**	-0.82%	**1983**	8.36%
2013	-2.02%	**1998**	8.69%	**1982**	32.62%
2012	4.22%	**1997**	9.65%	**1981**	6.25%
2011	7.84%	**1996**	3.63%	**1980**	2.71%
2010	6.54%	**1995**	18.47%	**1979**	1.93%
2009	5.93%	**1994**	-2.92%	**1978**	1.39%
2008	5.24%	**1993**	9.75%	**1977**	3.04%
		1992	7.40%	**1976**	13.39%

Source: Bloomberg (as at 31/12/2022)

CURRENCIES

2022 was full of uncertainties, investors have been flocking to the U.S. Dollar ("USD") to shelter from high investment volatility. The USD Index has surged to the highest level in near 2 decades in mid-September; The Japanese Yen has fallen below 150 against the USD, which has not been seen since August 1990 while the British Pound has also touched historical low against the USD on 26th September after the previous Chancellor of the Exchequer, Kwasi Kwarteng announced the huge tax cut plan. In the last quarter of 2022, the USD was weakened as investors betted the U.S. interest rate hike cycle may end soon in 2023. But still, the USD Index gained 8.21% in 2022 which was the best annual return since 2015.

EXHIBIT 2: The U.S. Dollar Index has rallied to the highest level in near 2 decades in September 2022

Source: Bloomberg (as at 31/12/2022)

A strong USD would have negative impact on U.S. companies that operate businesses in other countries because revenue earned in overseas are worth less in USD terms. Besides, U.S. exports also become more expensive abroad and the demand may be reduced. It explains why the earnings forecasts of many U.S. multinational companies have been downgraded and their valuations were revised down.

For the rest of the world, a strong USD will push up import price and may heighten inflation. In addition, it also increases repayment pressure to those companies or countries that borrow heavily in USD. As the USD rises and their local currencies depreciate, it will become more expensive to serve their debts.

TABLE 3: Major Currencies Performance (In terms of USD)

Currency	% Change in 2022 Q4	% Change in 2022
Euro	9.21	-5.85
British Pound	8.17	-10.71
Japanese Yen	10.39	-12.23
Hong Kong Dollar	0.62	-0.06
Chinese Renminbi (CNY)	3.15	-7.86
Australian Dollar	6.45	-6.20
New Zealand Dollar	13.39	-6.97
Singapore Dollar	7.15	0.71
South Korean Won	13.09	-6.05
Taiwanese Dollar	3.43	-9.88
Indian Rupee	-1.68	-10.15
Indonesian Rupiah	-2.18	-8.45
Thai Baht	9.03	-3.47
Russian Ruble	-18.94	1.32
Brazilian Real	2.56	5.59

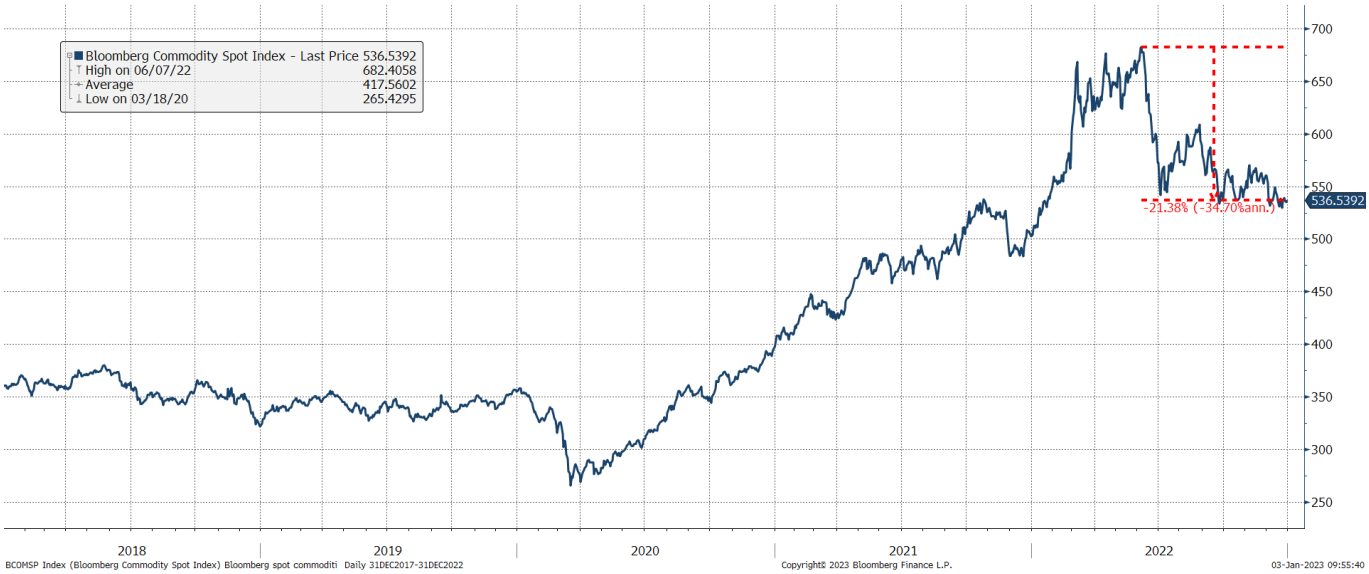
Source: Bloomberg (as at 31/12/2022)

COMMODITIES

Despite the recent price correction, commodity was still the best performing asset class in 2022. The Bloomberg Commodity Spot Index gained 6.44% and it was the fourth consecutive year of positive returns.

Russia's invasion of Ukraine in early 2022 caused sudden shortage of metal, energy and agriculture products and their prices have been boosted up drastically. For example, the oil price has rocketed to more than $120 a barrel which was not seen since 2008 while the wheat price has also surged to historical high in March 2022.

EXHIBIT 3: The Bloomberg Commodity Spot Index retreated more than 20% since its peak in June



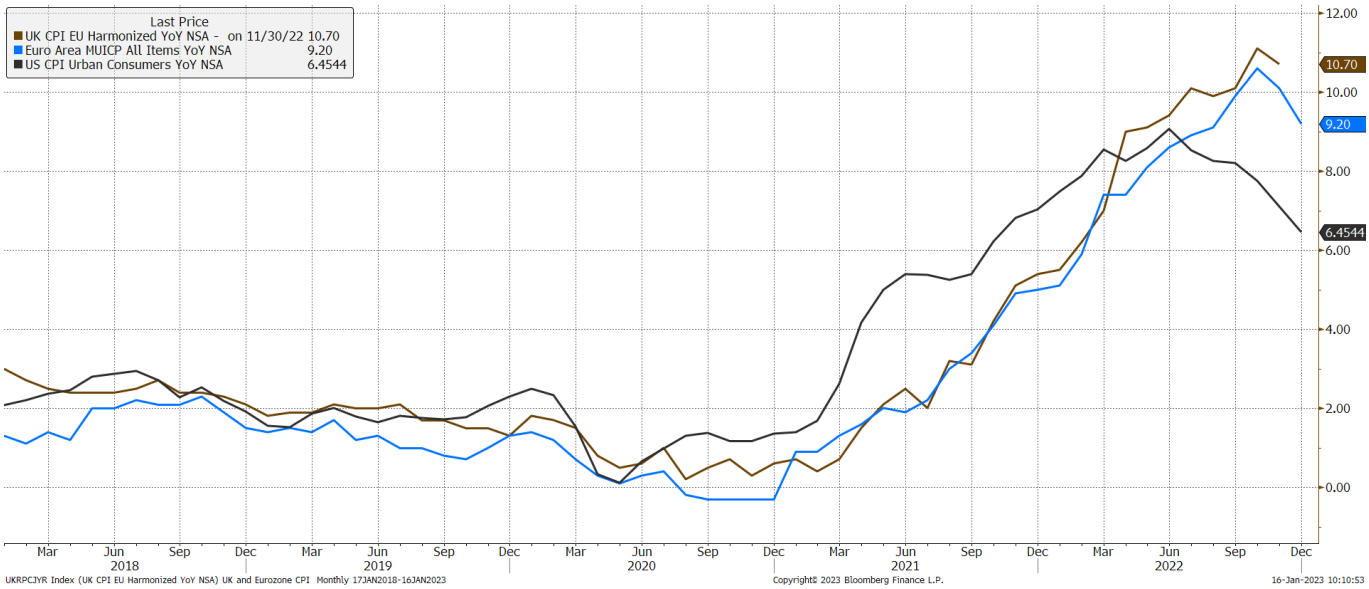
Source: Bloomberg (as at 31/12/2022)

Commodity price was peaked in June. Due to the worries of China Covid restrictions and global economic slowdown, the Bloomberg Commodity Spot Index retreated more than 20% afterward.

GLOBAL INFLATION AND THE POLICY STANCE OF MAJOR CENTRAL BANKS

After the most aggressive monetary tightening by the U.S. Fed and other global major central banks in decades, the U.S. inflation has slowed down in recent months while the consumer price in the U.K. and Europe seemed to be peaked in November although their rates were still very high, at around 10%. Although the inflationary pressure in 2023 is expected to be lower than last year, it is likely that global central banks may still maintain their hawkish stances, at least in the near term. According to the latest FOMC statement, the Fed will continue its tightening cycle until the inflation rate drops to the 2% target level. Based on the latest median estimate of all 19 Fed policymakers, the Fed funds target rate will increase to 5.1% at the end of 2023 from the current 4.25-4.5% range. The high interest rate environment may continue to cool down the economy and it will be unfavorable to those risky assets as well.

EXHIBIT 4: The Inflation may have been peaked in the U.S., U.K. and Europe



Source: Bloomberg (as at 31/12/2022)

Apart from the U.S., UK and European central banks, the policy stance of the Bank of Japan ("BoJ") cannot be neglected. On 20th December, the BoJ shocked the market by allowing its 10-year bond yields to rise to 0.5%, up from the previous limit of 0.25% and the Japanese Yen hit its biggest one day gain against the USD in 24 years. Although the BoJ insists to maintain its ultra-loose monetary policy, investors are afraid that the change of yield target band is the beginning of policy reversal. Historically, since most of the local investment tools in Japan provide little investment yields, many Japanese low risk investors are keen on foreign investments for a higher yield. If the BoJ shifts its accommodative monetary policy, bond yield will

rise and Japanese investors may no longer have to invest abroad. As a result, it may potentially change the flow of global funds and may have a huge impact to the global financial markets.

EXHIBIT 5: The Japan 10-year Government bond yield surged after BoJ's surprising decision of widening yield target band

Source: Bloomberg (as at 31/12/2022)

RISING RECESSION RISKS IN THE U.S. AND EUROPE

As warned by the International Monetary Fund ("IMF"), the global economy will be "tougher" in 2023 since the U.S., European and Chinese economies face slow down at the same time due to the Russia-Ukraine war, high interest rate and the widespread of Covid in China. The IMF expected that half of the European Union will be in recession while the U.S. would be more resilient. As the labor market remains strong, the U.S. may avoid recession, but the economic growth rate would be tiny. In case recession occurs together with persistent inflation, how the global major central banks react will have significant impacts toward the financial markets.

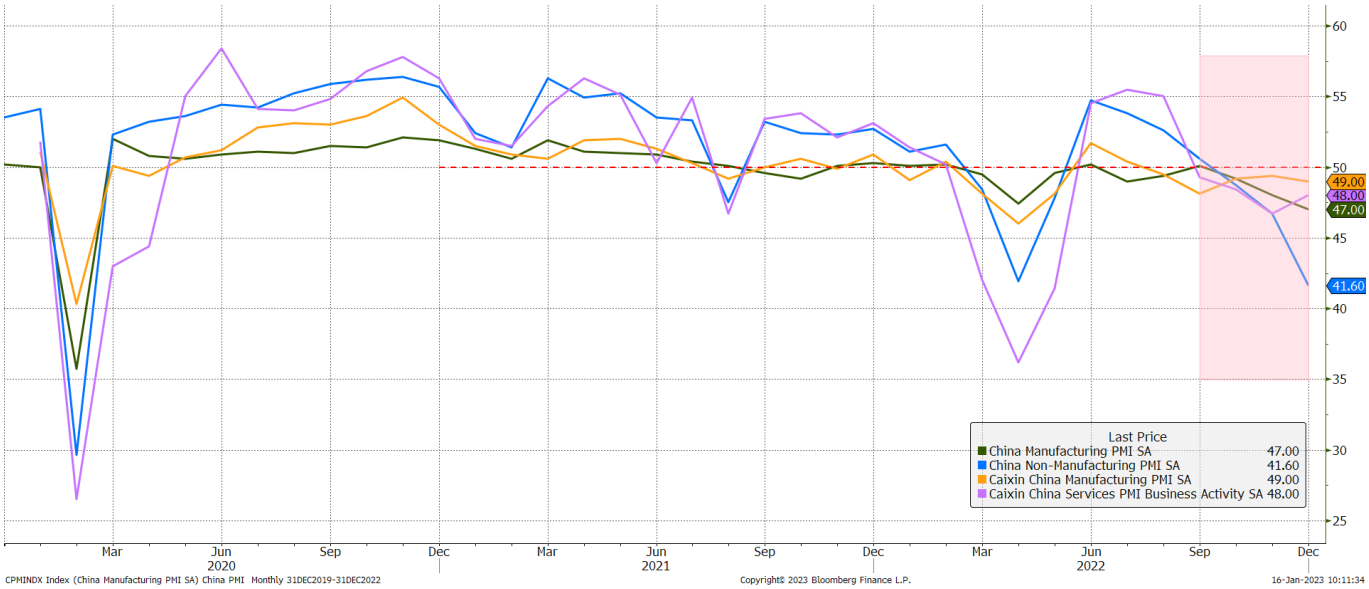
GLOBAL GEOPOLITICAL TENSIONS

The war between Russia and Ukraine has continued for more than 9 months, there is still no sign to end soon, and the uncertainties of supply chain disruptions remain high, especially in the area of energy and food supply. In addition, the China-U.S. relationship is also the focus. The on-going trade wars, economic sanctions imposed by each other will add instability to the financial markets and it seems that the tension is hard to be softened in the foreseeable future.

WIDESPREAD OF COVID IN CHINA

In the past few years, China's zero Covid policy had kept infections and deaths at a low rate, but the Chinese economy grew at the slowest pace in decades in return. As China has removed most of the Covid restrictions and started to reopen the economy at the end of December, Covid is expected to spread widely and speedily in the coming few months, private consumption and industrial production in China will slow down and the outlook of economic growth is gloomy in the near term. However, based on "living with virus" experience from the rest of the world, the reopening of China will bring economic activities back to normal in the long run and the Chinese economy may rebound sharply in the later period of 2023 which is good news to the global economy. However, since growth accelerates, China's demand for raw materials and energy may increase at the same time; it may potentially push up commodity price and add inflationary pressure to the globe.

EXHIBIT 6: The manufacturing and non-manufacturing activities in China have contracted since September 2022



Source: Bloomberg (as at 31/12/2022)

THE U.S. DOLLAR

In tradition, the USD and stock markets always move inversely. In 2022, most of the global stock markets made loss while the USD Index gained 8.21% which was its biggest annual return in 7 years. The strong USD was mainly due to the aggressive rate hike of the U.S. Fed which raised 425 basis points in 2022. Whether the USD will remain strong in 2023, the monetary policy from different major global central banks will be crucial. If the U.S. interest rate is peaked in mid-2023, the rising momentum of the USD may have a pause. Another factor we need to look at is the Russia-Ukraine war; The war has already triggered

the rise of commodity price and inflation, the U.K. and European economies are greatly weakened, and their currencies also are under downside pressure as investors are looking for safe haven asset, money flows to the USD. If the tension between Russia and Ukraine can be softened, the attractiveness of the USD will also be reduced.

5 INVESTMENT IDEAS IN 2023

HEIGHTENING RESCESSION RISK, INVEST IN A DEFENSIVE WAY

As mentioned earlier, the IMF expects half of the European Union will fall into recession in 2023 while the U.S. may avoid as the labor market remains robust though the country's economic growth will be much slower than previous years. Under downturn economic cycle with monetary tightening, global stock market performance is expected to be sluggish. Growth stocks with high valuation have already experienced painful correction in 2022, they may remain vulnerable though certain bargaining hunting opportunities may appear. Overall, a prudent and conservative approach with more focus on defensive investment tools is preferable in 2023.

FIXED INCOME WAS THE BIG LOSER IN 2022, BUT IT MAY BE TOTALLY DIFFERENT IN 2023

2022 was a devastating year for fixed Income due to the unprecedent aggressive rate hike of global major central banks. Although the rate hike cycle has yet to end, it is believed that it may not be too far from the ceiling and the valuation of investment grade bonds has come to an attractive level after the historical slump of bond prices.

CAUTIOUSLY OPTIMISTIC ON H.K. & CHINA STOCK MARKETS

China now is reopening its economy and it seems that it is good news amid the heightening global recession risk. The Chinese economy may have a sharp rebound in the second half of 2023 and the Hong Kong economy would be benefited if business activities can be gradually resumed to pre-pandemic level. 2022 was the third consecutive year that Hang Seng Index has made a loss and it is a very rare phenomenon in the history of the Index. Over the past 50+ years, it has only happened twice during the period of 1965 -1967 and 2000-2022 whereby coincidentally, the Heng Seng Index rebounded significantly in the following 4th year.

EXHIBIT 7: The Heng Seng Index has recorded 2 times that 3-year consecutive loss followed by a rebound in the 4th year in the past

Period 1 (Year 1965 – 1967)

Date	HSI Closing price	Annual change (points)	Annual change (%)
31/12/1968	107.55	41.19	62.07
29/12/1967	66.36	-14.89	-18.33
30/12/1966	81.25	-0.89	-1.08
31/12/1965	82.14	-19.31	-19.03
31/12/1964	101.45		

Period 2 (Year 2000 – 2002)

Date	HSI Closing price	Annual change (points)	Annual change (%)
31/12/2003	12575.94	3254.65	34.92
31/12/2002	9321.29	-2075.92	-18.21
31/12/2001	11397.21	-3698.32	-24.50
29/12/2000	15095.53	-1866.57	-11.00
31/12/1999	16962.1		

Current Period (Year 2020 – 2022)

Date	HSI Closing price	Annual change (points)	Annual change (%)
29/12/2023	???	???	???
30/12/2022	19781.41	-3,616.26	-15.46
31/12/2021	23397.67	-3,833.46	-14.08
31/12/2020	27231.13	-958.62	-3.40
31/12/2019	28189.75		

Source: Bloomberg (as at 31/12/2022)

THE IRREVERSIBLE TREND OF ESG INVESTMENT

Environmental, Social, Governance (ESG) investment is a fast-growing irreversible investment trend. Tacking global warming by limiting greenhouse gas emission now is a common goal of the world. In the coming decades, we are in the era of energy transition and it is believed that the renewable energy will become more and more important and attract huge money inflow. ESG does not only cover climate, companies that value the importance of social responsibility and corporate governance also attract global investment managers' attention.

GOLD WOULD BE BENEFITED IF THE U.S. DOLLAR WEAKENS

The strong USD in 2022 was mainly due to the aggressive rate hike of the U.S. Fed. If the U.S. inflation slows down in 2023, the Fed may ease their hawkish stance. Since the USD always has a negative correlation with gold price, gold would be benefited if the USD weakens. Also, other factors including the heightening global recession and geopolitical tension may also provide additional support to the gold price in 2023.

EXHIBIT 8: The USD and Gold always move inversely

Source: Bloomberg (as at 31/12/2022)

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