

Investment Outlook

Second quarter 2016

HSBC   
Private Bank

# Volatility presents risks and opportunities



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Dear client,

Since our last publication, we have passed several milestones. The Paris climate agreement implies a long term commitment to substantial investment in green energy and investor interest in this sector is growing rapidly. Secondly, central banks continue to innovate and the move to negative interest rates by the Bank of Japan as well as the recent stimulus package announced by the European Central Bank (ECB) indicated that monetary accommodation may go deeper and stay with us for longer than many think. Some recent data suggests that oil prices and inflation may no longer be falling and although it is too early to say that we have passed these milestones as well, they are critical elements to watch.

Markets remain fragile and volatile. They corrected sharply until mid-February, only to realise, that maybe, some of the concerns they had started to price in, were overdone. We highlighted in our other publications that, in our view, the fears of a US recession, a credit crisis and global 'Japanisation' (widespread and long term deflation) were exaggerated.

The investment environment will remain interesting, with a scope for upside in performance, as we see continued economic growth, but we envisage scope for significant volatility as well. If the UK referendum on the 23rd June 2016 leads to an exit from the EU, this would likely lead to a sharp correction in GBP, a spike in the UK inflation and potential volatility for the Eurozone assets as well. Oil prices continue to determine market movements in both directions, while later in the year, the US presidential election will start to influence the market sentiment.

In line with our expectations, our four major themes for 2016 remain very relevant and can give us some longer term direction. Our 'lower for longer' theme refers to low bond yields, which should continue to support investment grade credit, equity high income strategies, the search for relative value through hedge funds, and also EM bonds, where we have added to our exposure recently. The 'globalisation versus localisation' theme highlights the 'Brexit' risk, and opportunities in the network economy. China's multi-faceted transition continues but clear communication of government policy remains crucial before sentiment can rebound. Finally, we continue to differentiate in emerging markets on the basis of fundamentals and remain more selective in EM equities than in EM bonds, until we see stabilisation in the Chinese data or feel confident about the long term stability of oil prices.

Overall therefore, volatility and opportunity are both likely to remain with us, because we believe that some of the market fears are exaggerated. We see value in some markets and therefore remain invested, but continue to be selective. We hedge the unnecessary currency risk, remain diversified and use volatility to exploit opportunities or let active fund strategies do this for us.



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With best regards,

*Willem Sels*



## Our four leading themes for 2016

### Theme 1: Bond yields – Lower for longer

Our premise was that overcapacity in manufacturing, low commodity prices and low wage growth would lead to low inflation in much of the world, keeping monetary policy accommodative and causing bond yields to fall further. Markets joined us in this view, and probably even took it a little too far in the month of February. At one point, they believed the Federal Reserve (Fed) would no longer hike interest rates at all in 2016, and inflation breakeven rates suggested that US inflation would remain below the Fed's target for the next 10 years. By comparison, we still expect to see two rate hikes in the US this year and do not believe that inflation can remain this low for much longer.

Where do we stand now? Inflation may start to bounce back if commodity prices start to stabilise, as we expect. Core inflation (excluding food and petrol prices) has also ticked up somewhat in the US. It is fair to assume, though, that overcapacity in emerging markets (China in particular) will continue to put a cap on inflation and that the larger than expected stimulus package by the European Central Bank (ECB) and an enhanced bond buying will continue capping any significant upside in global safe haven bond yields. On the 10th Of March 2016, the ECB overwhelmed the markets by extending its bond buying programme to 80bn euros per month until March 2017 and including corporate bonds on its buying list. This is likely to put further downward pressure on the European bond yields.

As a result, the theme remains in place and the search for yield should continue. In addition, the inclusion of non-financial Investment grade corporate credit in the ECB'S recently expanded QE programme should boost investment grade credit further. Equity strategies that create shareholder value through dividend pay-outs or share buybacks should also reap benefits. However, as we think that inflation expectations are now too low, we shift out of conventional US Treasuries and UK gilts into inflation linked bonds. Moreover, as a result of the tentative improvement in some emerging market fundamentals (a possible stabilisation of oil prices and the USD), we add selectively to our exposure to emerging market (EM) debt and recently upgraded our view on the local currency EM debt.

### Theme 2: Globalisation versus Localisation

Globalisation has come further under threat with 'Brexit' supporters gaining momentum in some polls. Recently, European Union states under the Schengen agreement have discussed whether to reinstitute border controls. After decades of global and regional integration, this could mark a turning point or at least a pause in globalisation.

However, global connectivity in the virtual world continues to gain momentum. Intel Corporation believes that the current 15 billion connected devices will grow to over 200 billion by 2020. Many technology companies reported Q4 2015 earnings ahead of expectations and continued to speak positively about connectivity and the growth in the Internet of Things (IoT). Beyond the technology sector, companies in other industries have also focused on embedding connecting devices into their end products, such as appliances and switches, automobiles, wearables including watches, and industrial machinery. Indeed, large market participants have expressed excitement about growth potential in these market segments for years to come.

We believe that companies focused on networking hardware, software, processing and routing will continue to experience a secular tailwind for revenues related to interconnectivity. While traditional globalisation seems to be stalling, virtual globalisation powers ahead and we believe it will outgrow the broader economy on a multi-year basis.

### Theme 3: China in transition

As we suggested in our 2016 outlook, China has been struggling to balance the longer term transition of its economy (from investments and exports to consumption) with the shorter-term management of its current economic slowdown. Markets equally struggle to reconcile these two different horizons, and continue to look for more clarity on China's short-term policy.

Some clarity on FX policy was recently provided by the Chinese officials, who explained CNY would now be managed against a basket of currencies and have been at pains to stress that the currency would not be devalued to gain competitiveness. A stable currency seems a prerequisite and a good first step to temper capital outflows and allow for further cuts in interest rates or bank reserve requirements. Indeed, it seems likely that monetary support will be combined with fiscal stimulus and continued reform, as suggested recently by the Chinese central bank governor. We continue to believe that China has the monetary and fiscal means to ease the cyclical slowdown, and that genuine longer term concerns over leverage are unlikely to block the near term need for monetary accommodation. As a result, market sentiment should find some support and should rebound in H2 2016, when we believe data will stabilise. We believe CNY will weaken slightly (to USD/CNY 6.9 by the year end) and maintain a small overweight on China due to attractive valuations, with a preference for Hong Kong listed H-shares over A-shares, which are listed in mainland China.

### Theme 4: End of the 'BRICS' - But select opportunities in EM remain

Emerging Markets (EM) remain a mixed bag and we continue to believe that it is important to distinguish between them, avoiding generalisations such as the 'BRICS'. However, the outlook is getting somewhat more supportive for the asset class in general. In fact, EM demonstrated a resilient performance across a myriad of asset classes in recent weeks, despite a broader 'risk-off' sentiment in January, triggered by volatility on European financials and expectations of lower US growth.

Instead, the market's re-pricing of a slower and more gradual US hiking cycle and a weaker USD, supported EM through lower external debt servicing costs. A bigger than expected stimulus package by the ECB and lower Japanese rates have provided further support to EM local rates and renewed inflows from foreign investors looking for yield. Meanwhile, a rebound in oil and commodity prices, along with improved communication by the PBOC's Governor, regarding China's efforts to proceed with its FX reforms, allowed EM assets to perform well compared to the developed markets (DM).

The main risks for EM, namely commodities, China's growth fears and US rates, are likely to remain an overhang in the short-term and a potential source of continued volatility, however we believe that they are not as intimidating as they looked in the recent months. Our base-case scenario is for steady but low global growth, the Chinese economy finding its bottom towards the second-half of the year, USD losing steam against the majors, whilst arguing that the bulk of EM FX weakness is behind us.

While hard currency debt can typically better withstand any short-term uncertainty, we also incorporate select local currency bonds which may benefit from the above mentioned drivers. EM equities have demonstrated higher sensitivity to global growth concerns, however, may remain somewhat more volatile, despite their recent outperformance versus DM. Valuations are cheap and are nearing an inflection point which could provide a catalyst for further upside when clarity about Chinese and global growth improves.

### Hard Currency Debt

After reaching 5-year highs, we believe EM spreads are attractive, given low core rates and our expectation of a gradual interest rate hiking cycle. However, we remain selective.

We believe the investment grade segment remains particularly appealing. Average EM credit metrics remain stronger than their DM peers, whereas volatility may actually decline going forward as a number of Russian, Brazilian and commodity names have already been downgraded and removed from Investment Grade indices. At the same time, select BB names are also offering interesting entry points and some are likely to benefit from our expectations of commodity price stabilisation.

Latin American debt was the main underperformer last year and investors who can stomach volatility may be rewarded over the longer-run. After a string of sovereign downgrades, we are starting to turn less bearish on Brazil from a valuation perspective. However, the corruption investigations and their impact on political uncertainty, business confidence and stalling economic growth are likely to remain key headwinds. We therefore find better value in Brazilian exporters who are still likely to benefit from BRL weakness. Mexico remains amongst our preferred pick as spreads are looking appealing after the recent commodity price weakness. We remain on the sidelines in Argentina, but acknowledge that the swift implementation of market-friendly reforms and the recent successful conclusion of holdout negotiations should be key catalysts to regain market access.

We have turned cautious on the GCC (Gulf Cooperation Council) sovereigns, as we still expect double-digit deficits and thus an increased bond supply. Select Dubai corporates however retain appealing valuations. South African valuations have recently shown some signs of stabilisation since a confidence crisis in December 2015. But we remain cautious given the risk of a ratings downgrade.

### Local Currency Debt

After posting 3 years of negative returns, and in conjunction with our expectations of a slow US rate normalisation cycle and lower downside risk for oil prices, we believe that valuations for local currency debt are likely to find a bottom this year. The search for yield should create investor flows benefiting both hard and local currency debt.

Mexican bonds are likely to outperform. MXN weakened sharply due to the global market volatility, as it is the most liquid currency in EM. But authorities recently intervened to prevent further depreciation. Mexican local debt has the room to outperform, with the central bank likely to pause policy alteration until the next Fed move and as the peso gravitates to a stronger expected target. Given our more constructive view on RUB and attractive carry, Russian local debt may be well supported in the medium term, although oil prices are likely to remain a deciding factor determining the currency's contribution to total returns.

### Equities

EM equities are very sensitive to changes in the market's risk sentiment and changes in global growth and hence we think it is still a little too early to upgrade the broad EM asset class. We believe that concerns on US growth are too pessimistic, and expect commodity prices to recover from their recent lows, but Chinese growth could take some more time to stabilise.

Valuations are looking cheap, however, and we have an overweight position in Mexico, as its business cycle improvement is supportive of earnings growth. Mexico is still poised to reap benefits from a US outsourcing shift due to its improved competitiveness versus China and its supply chain efficiencies. We upgraded our view on the Philippines, given our expectations that the strong macro story will remain underpinned by strong domestic demand in an election year. In the rest of Asia, we see the emergence of the Asian middle class consumer benefitting from rising regional wealth and urbanisation. In terms of our themes, we identify consumer stocks as among the biggest beneficiaries of long term growth.

### Fast moving markets

Markets have been very volatile since the start of the year, driven by fears as well as hopes, with the effect amplified by uncertainty and low market liquidity. Some investors with low conviction have stayed on the side-lines, while many others have been changing their mind from being cautious early in the year to being somewhat more hopeful in recent weeks.

It seems that indeed we may be at a turning point if oil prices, the US dollar, Chinese growth or global manufacturing stabilise. All of these factors could help lift investor sentiment and reduce risk premia, and we thus maintain our exposure to equities and credit. At the same time, obstacles remain and markets' enthusiasm could wane if the current market hopes are not quickly evidenced in lower oil inventories and more stable Chinese data. As a result, we think we could continue to see short term volatility and remain selective and diversified. Markets are moving fast and can overshoot, creating opportunities to step in or take profit, look at relative value opportunities and increase the use of active managers or hedge funds.

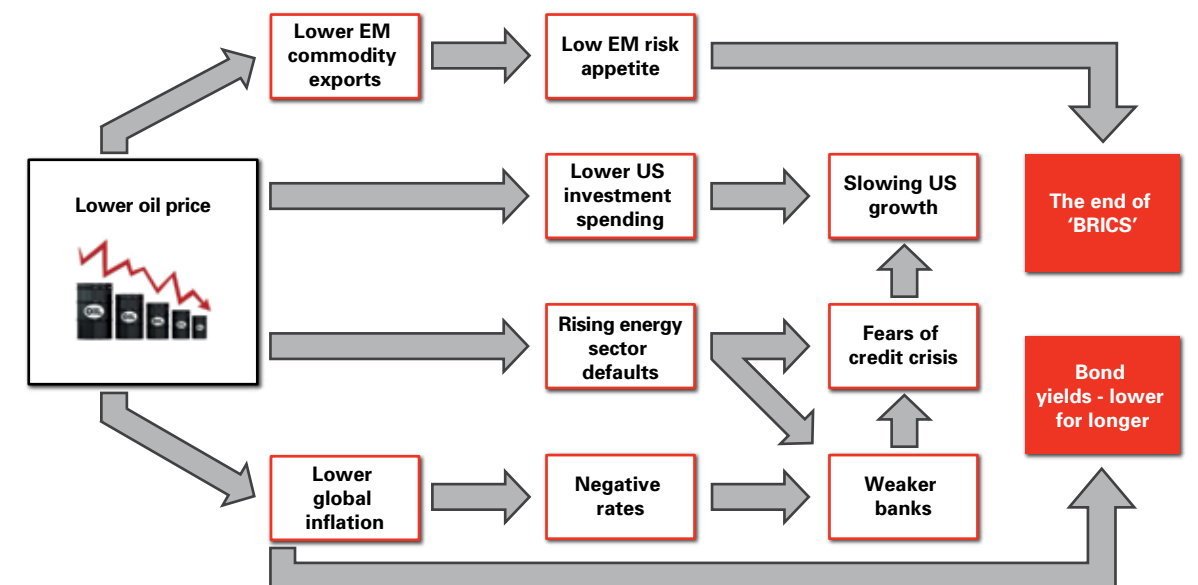
### The first six weeks of the year – Marked with irrational pessimism

Equity markets and high yield credit markets plunged early in the year, until a low was reached on 12th February 2016. The initial driver was the weakness in Chinese data, which in itself was not new. However, it quickly led to concerns over contagion to the US economy, with markets pricing in the risk of a US recession. This fear, it seems,

was overdone, as illustrated by the recent labour market and consumption data, which suggests that the US consumer is strong enough to compensate for weak trade and investment activity, thereby keeping the US out of recession. The second fear was that central banks around the world are running out of ammunition to boost inflation. This was triggered by the Bank of Japan's cut of their leading interest rate into negative territory, which had a psychological effect. We think central banks will remain very accommodative, as illustrated by the recent ECB package. But when bond markets suggested that inflation in the US, Eurozone and UK would remain below the central banks' target for more than 10 years, we thought that the pessimism had gone too far. The third overdone fear was related to credit markets, where some interpreted the widening of banks' credit spreads as a sign of a potential credit crisis. While some banks' profits are negatively affected by loan loss provisions for the energy sector or by negative interest rates earned on deposits at the ECB, we do not think that there is a stability problem in the banking sector. Capital ratios have improved in the recent years and money markets do not suggest any stress in the interbank market.

Since we disagreed with these three fears, we exploited some specific opportunities in mid-February, adding to our investment grade credit exposure, inflation-linked bonds and select commodity-related currencies (CAD, MXN, RUB).

Oil prices impact the global economy and investment fundamentals through several channels



Source: HSBC Private Bank, as at 18 March 2016

Past performance is not a reliable indicator of future performance.

From mid-February: Hopes sprung, but for how long?

Markets have been highly correlated to the oil price lately. As we show in the diagram below, lower oil prices had affected everything from emerging market growth and government deficits, to FX volatility, high yield credit spreads, bank profits and lending activity, global growth, inflation and central banks’ policies. It seems only logical, therefore, that when oil prices start to rise, the opposite effects take place, with all of these channels potentially boosting risk appetite, under the condition that such a bounce is measured in scope.

The issue, of course, is that for now, the jury is still out on the sustainability of a further appreciation of oil prices. Inventories in the US remain near record highs and are still growing, in spite of a rapid fall of drilling activity there. It seems that markets have found hope from an agreement led by Russia and Saudi-Arabia, even if it fixes production at a very high level, and from the slower than expected acceleration of Iranian production.

We envisage three scenarios for the oil price, and we believe the market is currently pricing in the first one. Stability of oil prices would be beneficial for the risk sentiment, as it would help reduce volatility and risk premia in many asset classes. Downward pressure on headline inflation would be reduced and hence markets may start to believe that negative interest rates are transitory. For some producers, however, the current oil price is below the breakeven level and therefore, deficits would remain high, leading us to remain selective in emerging markets (EM) in this scenario.

In the second scenario of gradually rising oil prices, most risk assets would benefit and oil producing emerging markets would be well placed as their deficits would shrink, reducing any credit rating pressure. Resulting currency strength could reduce inflation and allow EM central banks to slow the interest rate tightening process. However, for the Eurozone, we see a risk in this scenario, as wage growth remains low and consumption would be hurt if the windfall from low oil prices disappears.

In the last scenario of rapid production cuts, oil could go up more quickly. While positive for oil producers, the Federal Reserve would likely hike its interest rates more rapidly, creating a headwind for many economies. We do not favour this scenario and think that it is the least likely as well.

In our view, it will remain important to track oil inventories and check that market sentiment does not decouple from the fundamentals. We believe, a tentative stabilisation of oil prices calls for selective additions to emerging market credit (though not EM equities as long as Chinese growth remains challenged), while we keep an eye on the risk of an oil price spike and its potential damage to Eurozone stocks.

The UK decides on its future

Next to oil, the UK referendum on continued membership of the European Union is another potential driver of volatility. The so-called ‘Brexit’ vote will decide on the UK’s relationship with its largest trading partner, but could also lead to another Scottish referendum on independence if England and Scotland were to vote differently in the ‘Brexit’ referendum.

Markets do not opine on the benefits of being ‘in or out’ of the EU in the long term equilibrium state, and indeed the economic analysis on this point is unclear. What markets worry about is the potential damage to short term growth and inflation. We believe that growth could be halved as a result of lower investment spending and inflation could rise to 5%, as a result of a potential decline of GBP to 1.20 level.

With the polls being very tight and seemingly unreliable following the bad experience in the last UK general elections, we believe it is important to consider the exposure to GBP, as a ‘Brexit’ could lead to weakness, but continued membership could lead GBP to bounce to 1.60 level.

Investors without an exposure to GBP or to the UK markets could still be impacted through their holdings of European stocks, which we think could see some collateral damage from a ‘Brexit’, if fears of political incoherence were to rise in the EU, generally.

Asset allocation


Following the sharp bounce since mid-February, we believe equity valuations are no longer attractive, but are still fair. With continued economic growth, and relatively low earnings expectations, we think that some upside is still likely, especially for high dividend stocks, in the context of the continued search for yield.

Our overweight in equities is relatively small at 3.5%, given our muted return expectations. We believe, however, that within the asset class, there are a lot of relative value opportunities, which we exploit through our overweight position in hedge funds or through active managers. These strategies allow investors to take equity exposure without having much of the directional exposure and market risk.

From a relative perspective, we think that there is somewhat more value in credit than in equity, especially in the US. Valuations ran up significantly for US stocks in recent years, while (largely overdone) fears of Fed hikes or a credit crisis, and low liquidity put pressure on credit spreads. We continue to prefer crossover (BBB/BB ratings) over lower-rated high yield as we avoid exposure to oil-related corporate credit.

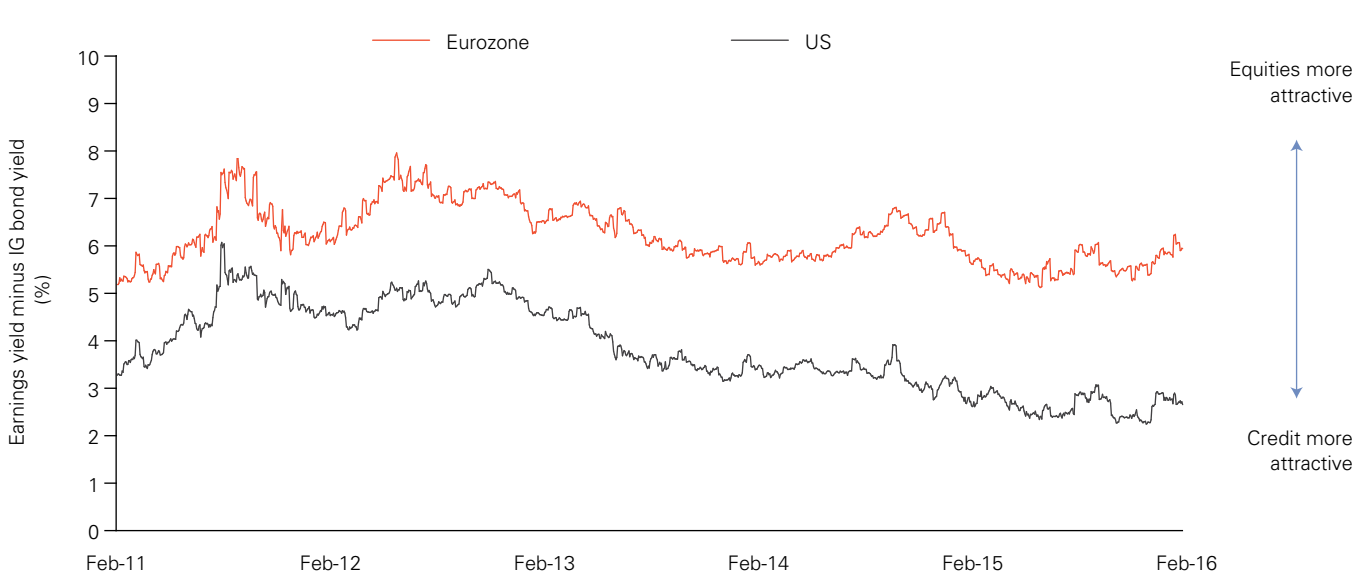
While volatility allows us to exploit tactical opportunities to exit or enter the market and take relative value positions, volatility can also be damaging. Therefore, we remain diversified and actively monitor concentration risk. We also believe that active examination of currency risk is important, not only for GBP but also for other currencies, as the right currency exposure can help boost returns and/ or help reduce the overall portfolio volatility.

Different scenarios for the oil price imply significantly different investment strategies

OIL SCENARIOS		Scenario 1 STABILITY	Scenario 2 GRADUAL SUPPORT	Scenario 3 FAST RALLY
		Slow pickup in inflation due to base effects but very accommodative monetary policy. Select rate hikes in EM to counter currency weakness	A world of no extremes: pickup in inflation, gradual Fed hikes, risk-on, EM benefits.	Faster than expected Fed hikes, risk of tapering at ECB. Benefit of higher oil price for EM is offset by rate hikes, consumer hurt
Equities	<b>Conservative</b> <b>Higher risk</b> <b>Avoid</b>	High dividend strategies, consumer staples Eurozone, China Latin America	Energy, Banks, Eurozone, China, US, Canada European consumer stocks	Energy, US, Canada, Latin America Consumer discretionary, automotive, transportation
Bonds	<b>Conservative</b> <b>Higher risk</b> <b>Avoid</b>	Inflation linked bonds, investment grade corporates Eurozone periphery, EM hard currency debt, very select local currency debt High yield energy sector	Inflation linked bonds, investment grade corporates Eurozone periphery, High yield, EM hard and local currency debt	High yield Safe haven government bonds
Currencies	<b>Conservative</b> <b>Higher risk</b> <b>Avoid</b>	CAD, NOK, EUR MXN, RUB	CAD, NOK AUD, MXN, RUB JPY	CAD BRL, MXN, RUB
Commodities	<b>Conservative</b> <b>Higher risk</b> <b>Avoid</b>	Gold Oil (contango)	Industrial metals Gold	Oil, metals Gold

Source: HSBC Private Bank, as at 18 March 2016  
Past performance is not a reliable indicator of future performance

US investment grade is more attractive than US stocks in our view, especially as fears of a credit crisis are overdone



Source: I/B/E/S Datastream, HSBC Private Bank as at 18 March 2016  
Past performance is not a reliable indicator of future performance.



## Will equities flower in the spring?

So far, 2016 has been tough for equity market investors, although some losses have been pared back recently. Most stock indices were troubled by a host of uncertainties, creating volatility or in some cases, an outright downdraft. The rout in commodity markets has slowed but prices remain weak, while in certain markets, the improved outlook for construction in the US and China has allowed stocks to catch a bid. The most visible commodity – oil – still remains weak as production remains high and inventory levels are bloated. Markets seem to want to take a constructive view on oil prices as we are writing this piece, but overproduction and high inventory levels could take a while to unwind fully.

The US and European economies continue their economic and policy divergence, which continues to create friction for investors. In China, in the meanwhile, continued policy accommodation should help buoy flagging demand and improve the outlook for equity investors. In the US, the Federal Reserve began its interest rate tightening cycle last December, but the process is likely to be slow and benign for markets, especially following the dovish March Fed meeting. Despite weakness in the energy sector and global trade, the US economy seems poised to post 2% real, non-inflationary, growth in 2016. The result is that market fears of a US recession are likely overdone, but that earnings growth should remain weak, leading us to take a defensive sector stance.

All of the above suggests that careful asset allocation and a selective approach are key. More generally, though, tepid demand, low inflation, negative interest

rates, accommodative central banks and national governments should keep the global economy out of recession in 2016. So, despite the rough start for the markets this year, we expect solid gains for the balance of the year. That said, we do not expect those gains to be painless as volatility and uncertainty are expected to remain in place. As a result, we remain focused on large cap, high quality equity investments, especially those which provide a return to shareholders. This can be accomplished through share buybacks, Mergers & Acquisitions, or dividend payments. For the balance of the year, if commodity markets find their footing or if the anticipated monetary and fiscal policy responses provide some economic stimulus, we may ponder a rotation into commodity producing nations in the world of emerging markets – but not quite yet.

### Europe

European markets remain quite intriguing for the global investors. Economic growth remains modest, and below trend, at best and the migrant crisis could hit investor sentiment if political tensions rise. Low inflation facilitated a further expansion in the ECB's quantitative easing (QE) programme, which should help banks and M&A activity, but it remains to be seen how it boosts growth in the region. Valuations in Europe remain interesting for value investors, in our view, and the outsized dividend yields are quite compelling for income investors. With a newly enhanced QE programme, lower long-term bond yields should continue to support the interest rate sensitive sectors of the economy. Therefore a careful examination of European auto sales, housing construction, and commercial

real estate is warranted. Moreover, the outbound nature of Chinese tourists and capital should continue to benefit European luxury goods and services companies.

### US

In the US, there is an expectation of renewed divergence between the short and the long end of the Treasury yield curve. The short end may see higher yields as the Fed continues the process of interest rate normalisation, albeit quite slowly. At the long end, the combination of reduced supply (due to smaller federal deficits) and global uncertainty keeps global investors buying US Treasuries. The result should be "lower for longer" on US long term interest rates. For equity investors it suggests outperformance for those sectors that stand to benefit from such fundamentals. Historically those beneficiaries have been car and truck sales, household construction, and commercial real estate. Additionally, as the housing and auto sectors continue to grow, Latin America stands to benefit as remittances should rise to Latin America. Also, strong auto and truck sales traditionally benefit the region due to production in Latin America and subsequent exports into the US. As US banks continue to recalibrate their energy exposure, it should help facilitate further consolidation in the sector, which could reduce the outsized downward pressure the sector has exerted on the US equity markets.

### Emerging markets and commodities

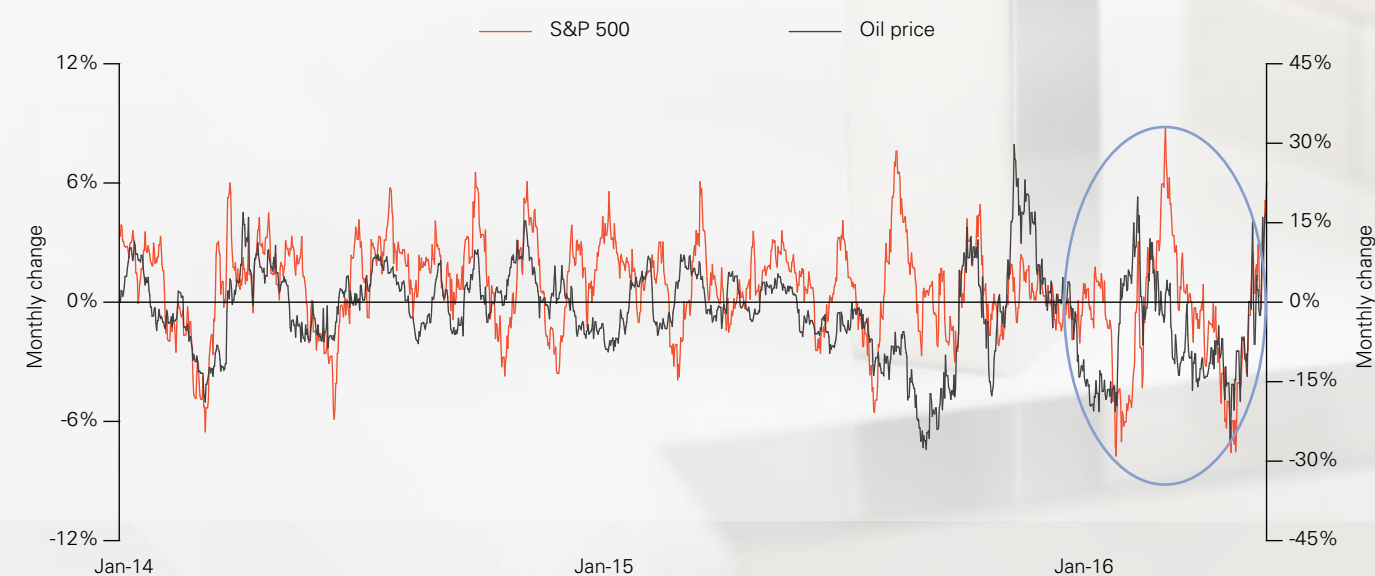
The dramatic decline in commodity markets seems to have largely run its course. However, demand remains weak relative to supply for many global commodities. The good news is that we have begun to see the rationalisation of

production in certain industries. This could be a key signal, if we are to see prices begin to turn around. As commodity prices begin to establish a floor, risk capital could begin to take a nibble in certain selective emerging markets again soon. In emerging market equities we remain focused on countries where we see solid growth and stable inflation, as well as policy reform. Our preferred markets are China and Mexico.

### China

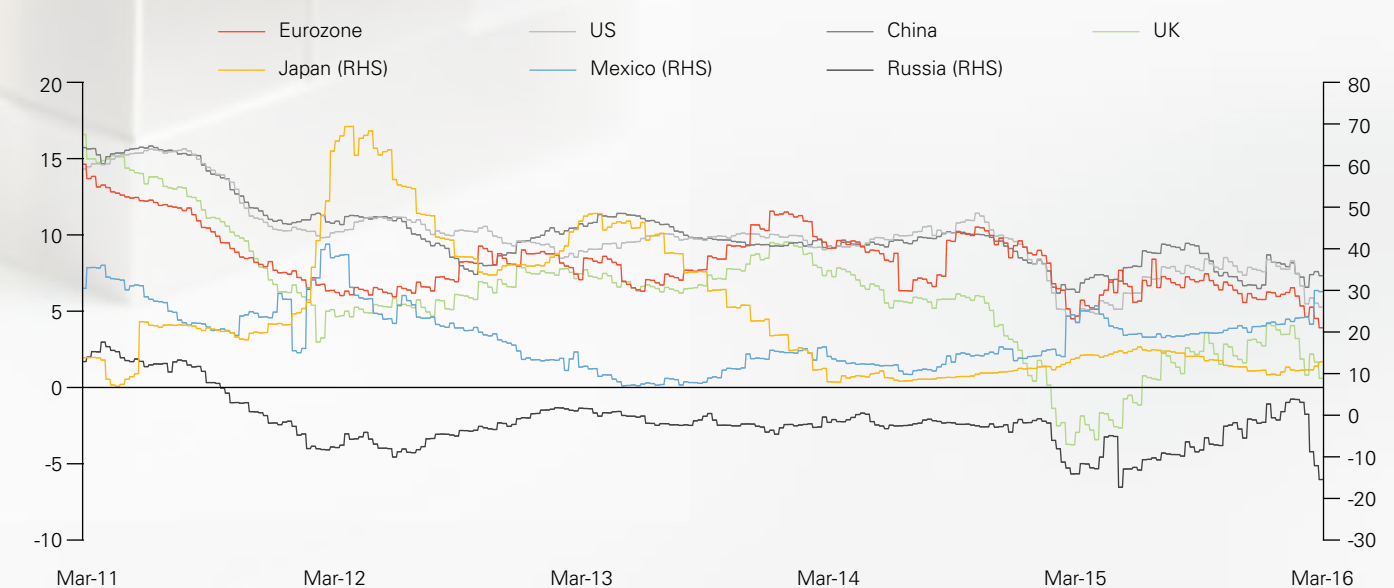
In China, pervasive weakness in manufacturing remains, while the services sector has recently also shown signs of a lackluster performance. However, equity investors continue to hang their hats on the hope of a major Chinese policy response. Throughout the balance of this year, we expect to see steady reductions in policy interest rates as well as reserve requirements for banks. Fiscal stimulus through further infrastructure investment is widely expected throughout the year, as the 'Second Wave of Urbanisation' continues to unfold. We continue to find value in Chinese H shares (quoted in Hong Kong) due to their compelling valuations. However one of the key themes which could drive growth and equity returns is the continued expansion of Chinese real estate and housing for an emerging middle class. Despite the slowing domestic growth, one theme which remains strong is that of Chinese global tourism affectionately called "Follow the Panda" by most observers. Chinese tourists, both wealthy and middle class, continue to travel abroad and many are using these trips as shopping excursions. This is a theme that should remain strong this year and evolve further in the coming years.

Stock indices have become very highly correlated to oil prices since H2 2015



Source: Bloomberg, HSBC Private Bank as at 18 March 2016. Past performance is not a reliable indicator of future performance

With the exception of Mexico, earnings expectations have been falling in most markets



Source: I/B/E/S, Datastream showing analyst consensus expectations as at 18 March 2016. Past performance is not a reliable indicator of future performance

Mind the dormant inflationary risk...

Financial market volatility and global economic uncertainty have been the key market features since the start of 2016. The main trend emanating from this backdrop was certainly one of ‘risk aversion’ with Developed Market (DM) corporate bonds generally underperforming their respective sovereign bond markets, on the back of a flight to perceived quality. Interestingly, Emerging Market (EM) debt demonstrated some resilience, despite the broader risk-off episode and volatile commodity prices. In contrast, global High Yield (HY) bonds have remained volatile amid increasing probabilities of default within oil & gas companies and continued outflows, although recently their flows have reversed. Sector-wise, an opportunity has emerged: bonds issued by financial companies underperformed non-financial corporate debt, as a result of tightened financial conditions in Europe and from negative interest rates, impairing banks’ profitability. We believe that this is overdone and see value in senior bank bonds in the US and the Eurozone.

One of the most important sources of uncertainty remains with China and its change of currency management regime announced in August 2015. While a more market-driven approach for fixing the Yuan is laudable and coherent with a policy aimed at freeing China’s capital account, the relative silence of Chinese officials on market fears of a potential short-term currency devaluation relative to the US dollar injected a great deal of price volatility into the financial markets. Ultimately, the People’s Bank of China (PBoC) Governor informed that China’s efforts to proceed with FX reforms do not imply a currency devaluation and insisted on the central bank’s new focus on fixing the Yuan level against a basket of currencies and not only against the US dollar. While we believe China should successfully free-float its currency overtime, the way of doing so will be paved with uncertainty and result in continued asset price volatility.

Tumbling oil prices have also negatively impacted the risk assets and have put downward pressure on headline inflation in most DM economies. While declining commodity prices have an obvious negative influence on fiscal balances of oil exporters and on capital expenditure from oil & gas producers, the opposite is true for private consumption. We continue to believe that positive effects of the fall in oil prices will offset the negative ones over time and be supportive of the global economic growth later this year, given typical lags between oil price shocks and their effect on consumption. Any further oil price falls should likely only have a smaller marginal effect on inflation, than what we have observed before. In conjunction with the negative base effect coming later this year and a potential decline in oil production, headline inflation may start to normalise in DM economies. This is a risk which is currently not priced in government bond yields, and as a result, we prefer inflation-linked bonds in the US and the UK over nominal Treasuries and gilts. Labour markets in the main DM countries, especially in the US, have started to tighten, pushing unemployment rates close to full employment level, a precursor of wage inflation. Central banks generally get uncomfortable when salaries expand at a rapid clip. This situation highlights the risk of higher real yields when risk appetite improves, as well as the return of monetary policy divergence between the US (and possibly the UK) versus the Eurozone and Japan.

Major central banks should remain accommodative

The Bank of Japan (BoJ) surprised market participants by lowering its interest rate to negative territory (-0.10%) earlier this year, thus joining the European, Danish, Swiss and Swedish central banks in this new phase of monetary policy accommodation. The European Central Bank (ECB) added further stimulus in March in order to fight tightening financial conditions and falling headline inflation. The already

aggressive monetary policy implemented by the ECB has played a key role in pushing Eurozone government bond yields towards sub-zero levels, with shorter maturities already in negative territory. While sovereign yields in the periphery have followed this trend, their decline was less acute and risk premia have built up to compensate for political risks.

Although US Treasury yields followed the downward path initiated in Europe, the spread between US and German 10-year yields has remained around 160bps, one of the highest levels seen over the last 25 years. As inflation and growth trends differ between the US and the Eurozone, the resulting divergence in monetary policy should keep the gap between Treasury and Bund yields wide as well.

Even if markets are not pricing in any extra interest rate hike for this year, the US Federal Reserve (Fed) is more likely to look through market volatility and declining headline inflation, focusing instead on the continuing improvement in the labour and housing markets. Hence, one can expect Fed officials to reiterate the view that the central bank is still on course to deliver further cautious tightening in 2016. This guidance is particularly important for the US dollar direction and consequently for EM economies, which have suffered from severe money outflows, currency volatility and a rise in risk premia.

Outlook

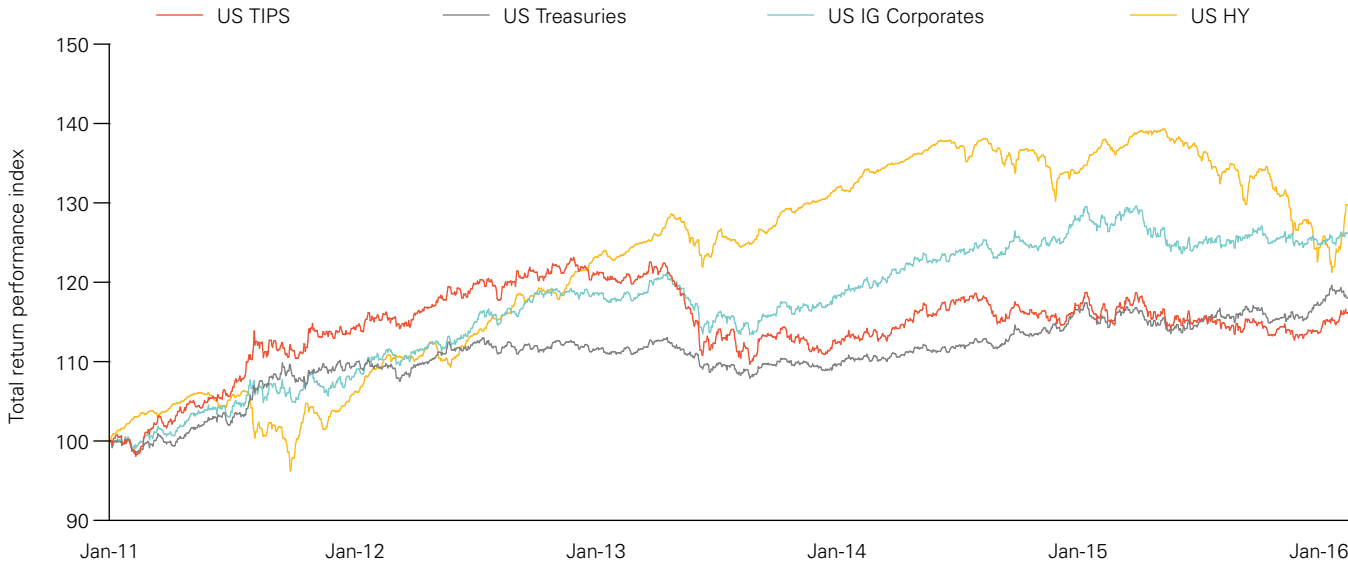
While bond yields could still fall further as a result of accommodative monetary policy, we would call for some caution on bond portfolio duration positioning and hence maintain a medium duration in our fixed income exposure. Valuations appear somewhat stretched over the short-term, as a result of the rapid rally in recent months, evidenced by negative real yields across most sovereign yield curves (negative term premiums).

Meanwhile, the more accommodative ECB policy is likely to result in tighter credit spreads among European corporate bonds, especially in Financials. In Euro-based portfolios, we maintain exposure to periphery bonds although we acknowledge that political issues might affect market sentiment negatively.

Overall, we retain a constructive stance on the credit segment, for both Developed and Emerging markets. However, we highlight rising idiosyncratic risks, which we have observed in recent months, with sometimes unexpected deterioration of fundamentals of companies, rapidly affecting their financing prospects and bond market liquidity. We understand that pressure to take risk to capture higher yields is substantial. Investors, however, should consider that the current bond credit cycle is quite mature and as such requires more selectivity and prudence. We avoid lower-rated parts of the global HY markets where default rates are supposed to escalate this year, especially in the US. Instead, we favour quality names within the investment grade or BBB/BB cross-over segment, but with still reasonable yields. In our opinion, they continue to offer the best risk/reward ratio.

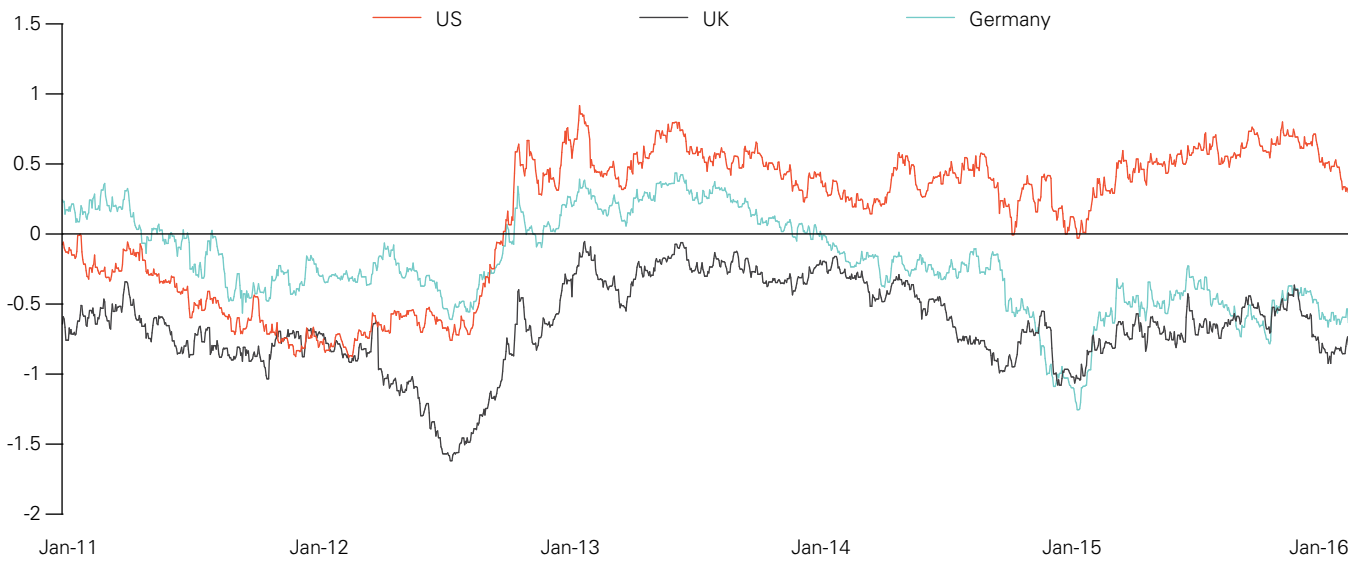
Regarding EM economies, the modest global growth environment together with specific tensions (such as the political turmoil in Brazil) remain key concerns but stabilisation in oil prices and USD should ease some of the headwinds. We like EM bonds denominated in hard currencies in order to strip out the local currency volatility, but have also gained some exposure in EM local currency bonds recently. We favour Asian and Mexican investment grade sovereign bonds and avoid investing in the debt of GCC (Gulf Cooperation Council) countries.

High yield has been very volatile due to oil prices, but this may support TIPS going forward



Source: Bloomberg, HSBC Private Bank as at 18 March 2016. Past performance is not a reliable indicator of future performance

Real yields on European safe haven bonds are negative, but not in the US



Source: Bloomberg, HSBC Private Bank as at 18 March 2016. Past performance is not a reliable indicator of future performance



## Asset class Currencies

The turbulent start to the year should be followed by some clearer trends in Q2 2016, as market participants digest the economic data and central bank monetary policy meeting results, which we think, will provide some much needed visibility and direction.

The ECB has produced a very impressive package aimed at boosting inflation, but it is not focused on capping EUR strength. On aggregate, the central banks are expected to provide support to their economies as and when needed, and confront the perception that they have run out of policy options.

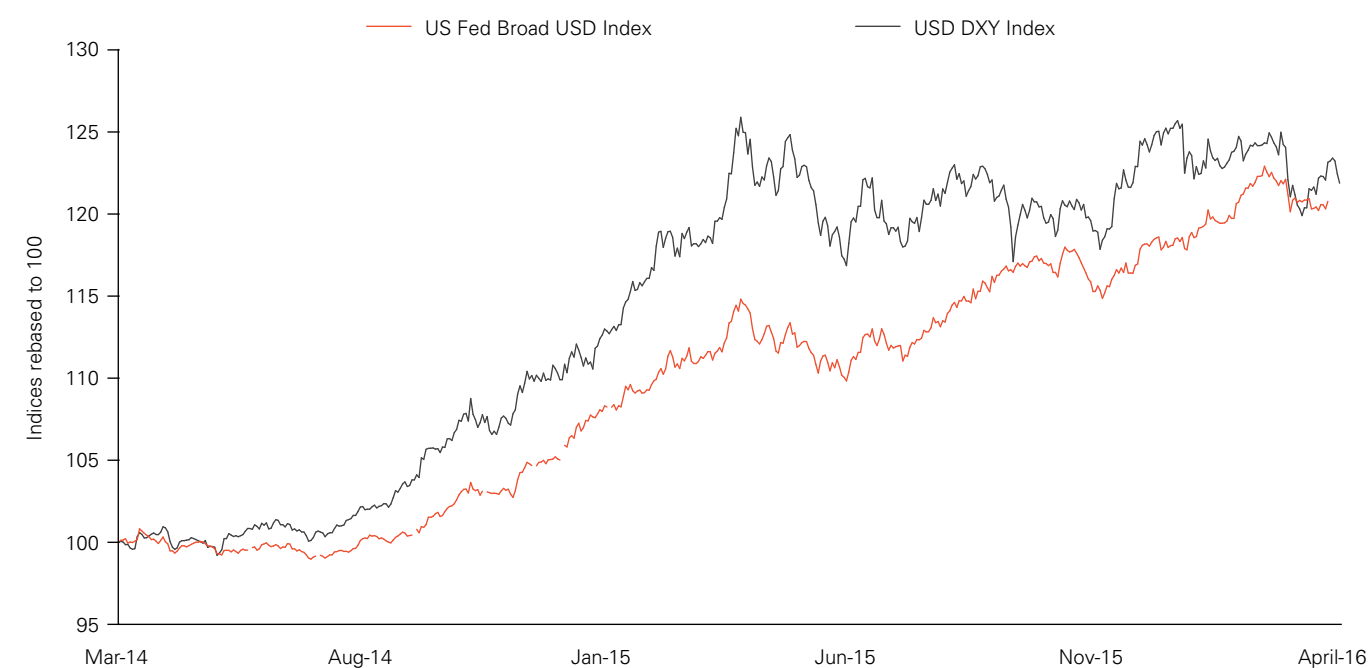
We therefore expect several trends to develop, which include a continuation of strength in key commodity currencies such as CAD and NOK, and expect MXN to also join this trend. We expect major currencies such as EUR and GBP to stage a recovery, albeit GBP may be more volatile ahead of the June 23rd EU referendum in the UK. Thus, in Q2 2016, USD should begin to move to weaker levels versus most major currencies and a select few emerging currencies.

To date, the Q1 2016 currency moves were broadly in line with our expectations. We expected strength in key commodity currencies including NOK (which gained 6.4%), CAD (+6.6%), and RUB (+7%). Additionally, our expectation of JPY strength materialised, but faster

than expected, with a sharp gain of over 7.9% versus the US dollar. EUR did not strengthen as much as we expected, but did manage to post a near 3.9% gain. GBP/USD started the year near 1.49, fell to about 1.43, climbed back to near 1.47, then fell again towards 1.38 on heightened 'Brexit' concerns, only to climb back towards 1.44. Swings of 4-5% in a matter of a few days have become common as market participants' concern about 'Brexit' seems to be ebbing and flowing with news and poll results.

For emerging market currencies, the outlook remains very mixed, but there are signs of stability and some potential strength beginning to surface in selective markets. However, for the main EM currency of our interest, CNY, we expect continued but mild weakening towards USD/CNY 6.90 by the year end, a move of about 5-6% from the current market levels. This expected CNY weakness should continue to weigh on most other Asian emerging currencies. Thus, we continue to expect most of these currencies to remain on the defensive. But not all emerging currencies are the same. While Asian emerging currencies continue to be under pressure, we find currencies more closely linked to EUR as being attractive and offering a potential upside. We expect both PLN and HUF to climb to stronger levels in the coming quarters.

USD gains are fading not just versus other developed markets but even against select emerging market currencies



Source: Bloomberg, HSBC Private Banks as at 18 March 2016. Past performance is not a reliable indicator of future performance

## Asset class Commodities

### Q2 2016 should be constructive for most commodities

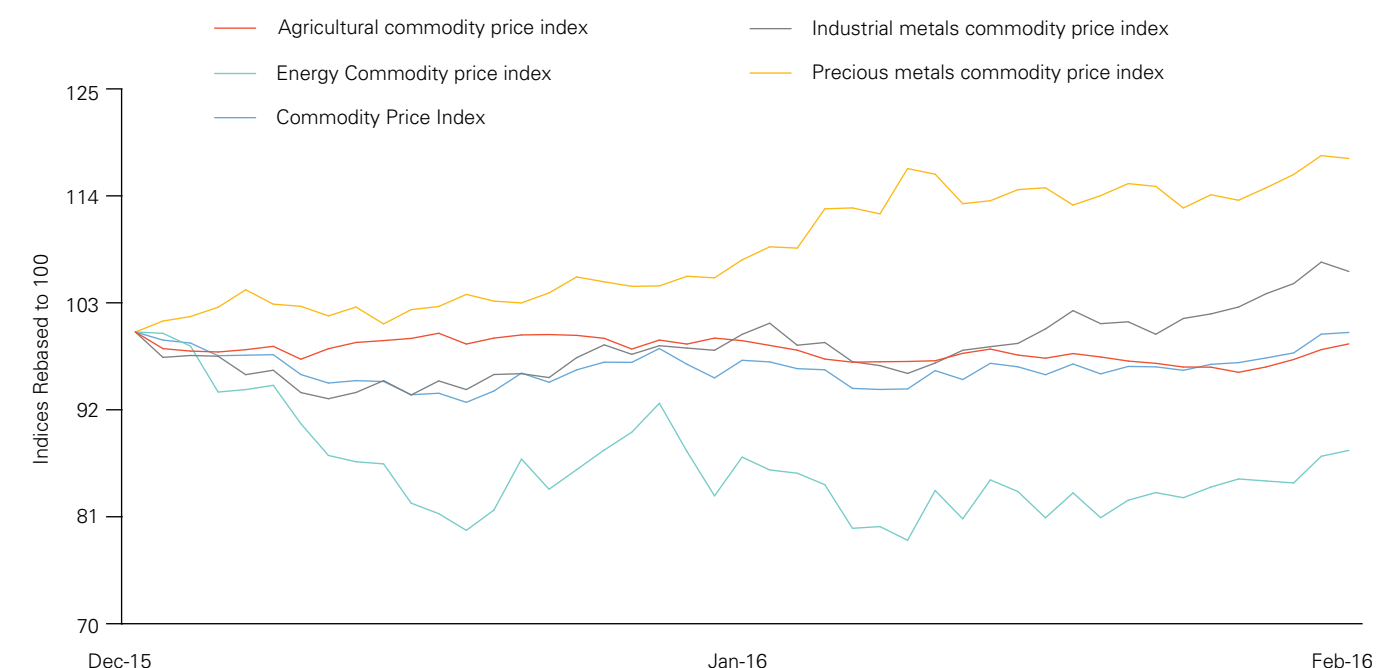
Commodity prices have broadly recovered from the lows seen early in Q1 2016, albeit with very high levels of volatility. Industrial metals, for example, experienced a 7% drop, early in the year, but later rebounded by 13%. Oil on the other hand dropped more sharply (-29%) but rebounded more than 50%. We believe that Q2 2016 should be very different from the first quarter for commodities, with less potential for a sharp drop and a better outlook for gradual support or some further price upside.

Given the favorable developments for global growth such as continued policy support from major central banks, firm economic data emanating out of the US, a clear commitment signaled by Chinese policy makers to support growth using both fiscal and monetary policy and constructive signals from key oil producers about production ceiling discussions - all set a very different and a more constructive commodity prices outlook.

The relatively constructive backdrop does not necessarily suggest any sharp rally in commodity prices during Q2, especially as oil production and inventory levels remain high and markets may remain skeptical about any improvement in the Chinese demand. The most probable scenario is

that of a more gradual price improvement for most of the commodity complex with the exception of gold price, where we believe, \$1300/oz would be the ceiling, given the improving risk backdrop. Following the strong rally in the first quarter, we believe gold is more likely to trade in a range in the second quarter of 2016.

Commodity prices normalized year-to-date performance – We believe the worst is over for most commodities



Source: Bloomberg, HSBC Private Bank as at 18 March 2016. Past performance is not a reliable indicator of future performance

## Asset class Hedge funds

We maintain a constructive outlook for hedge funds for the rest of the year. Over the last twenty four months there have been several challenging periods for hedge fund managers i.e. during March / April 2014, October 2015, and January / February 2016. Rotational shifts and technically driven markets, caused by asset re-pricing, due to the market's concern over global growth, deflationary probabilities and portfolio de-risking, particularly impacted hedge fund managers' performance for the first six weeks of this year. This led to a considerable dispersion in performance between strategies in January and early February. We believe that dispersion is normalising again and should create a more positive environment for hedge funds in the coming months.

Coming into 2016, Equity Long/Short managers concentrated their portfolios consistent with the concentration of equity market performance in the prior policy-supported period. This, in addition to the strong shift in momentum, caused difficulties. We continue to favour managers driving returns from their stock picking, rather than through greatly varying levels of market exposure.

Discretionary Market Neutral strategies were similarly negatively affected by the strong momentum shifts, de-risking pricing effects and sector rebalancing. By comparison, quantitative market neutral managers were impacted to a lesser extent. The risk-off tone of markets combined with the general dominant net long bias, position level concentration and sector concentration in Speciality Pharma, Energy, Materials and Financials however damaged the start of the year for many Event Driven managers. Hard catalyst event managers held up best in the event space as risk arbitrage spreads sold-off, but in many cases came back in by the end of the month. The closing of the Shell/BG deal despite a material reduction in the oil price was a positive for the risk-arbitrage spread market, for example. The opportunity set remains encouraging as healthy spreads are available for more complex deals that require deep fundamental analysis and risk arbitrage experience.

Macro managers entered the year positioned in-line with the December Fed rate hike, being long Equities and short rates, with in some cases steeping curve trades on, and long dollar positioning, but have generally brought risk down until the opportunity set is clearer. The 'Managed Futures' strategy has been the strongest of the variable bias strategies for the year, where medium to long term models have successfully captured trends in long bonds, short term interest rates, in addition to shorts in the energy complex, while small losses were recorded in long equities.

Overall, we believe that hedge funds will continue to play a key role in multi-asset portfolios in 2016. Helped by their approach to risk management, and diverse nature of drivers of underlying risk, multi-strategy hedge fund portfolios in most market environments have historically realised annualised volatility levels close to those of benchmark bond indices, with the ability to capture the upside in benign markets. As the markets begin to trade more on fundamentals and less on technicals and macro newsflow, we expect a good environment for hedge fund managers. As medium term equity and bond return expectations fall, we think it is increasingly important to attempt to add value in portfolios through relative value and tactical trading, which is an area where hedge funds can distinguish themselves.

## Asset class Private equity

### Gearing up for lower leverage

Last year, prices paid for buyouts in the US declined from the all-time highs reached in 2014. This coincided with an increased focus on limiting debt financing from banks, and we do not think it is a mere coincidence.

In 2013, the US government began issuing guidance to banks to limit the level of bank debt in leveraged transactions. The main requirement of this guidance was for total debt to be no more than six times EBITDA (i.e. earnings before interest, tax, depreciation and amortization) when financing a buyout. Last year this started being enforced.

By using leverage, equity investors magnify their risk as well as returns. Amongst the various sources of capital, bank debt is often the cheapest in the capital structure (and, consequently, the most senior claimant in the case of liquidation).

Using more expensive sources of financing, makes deals more costly, as well as less certain for private equity firms.

Increasing the cost of financing has one of two consequences: lower entry prices or lower returns. The proportion of a purchase financed by equity can be increased, which lowers the expected future returns; alternatively, the total purchase price can be reduced to keep return targets unchanged.

In the volatile and uncertain economic conditions of 2015, we saw disciplined buyout firms take a step back in pricing, resulting in lower valuation multiples and in effect a better risk-reward profile for investors.

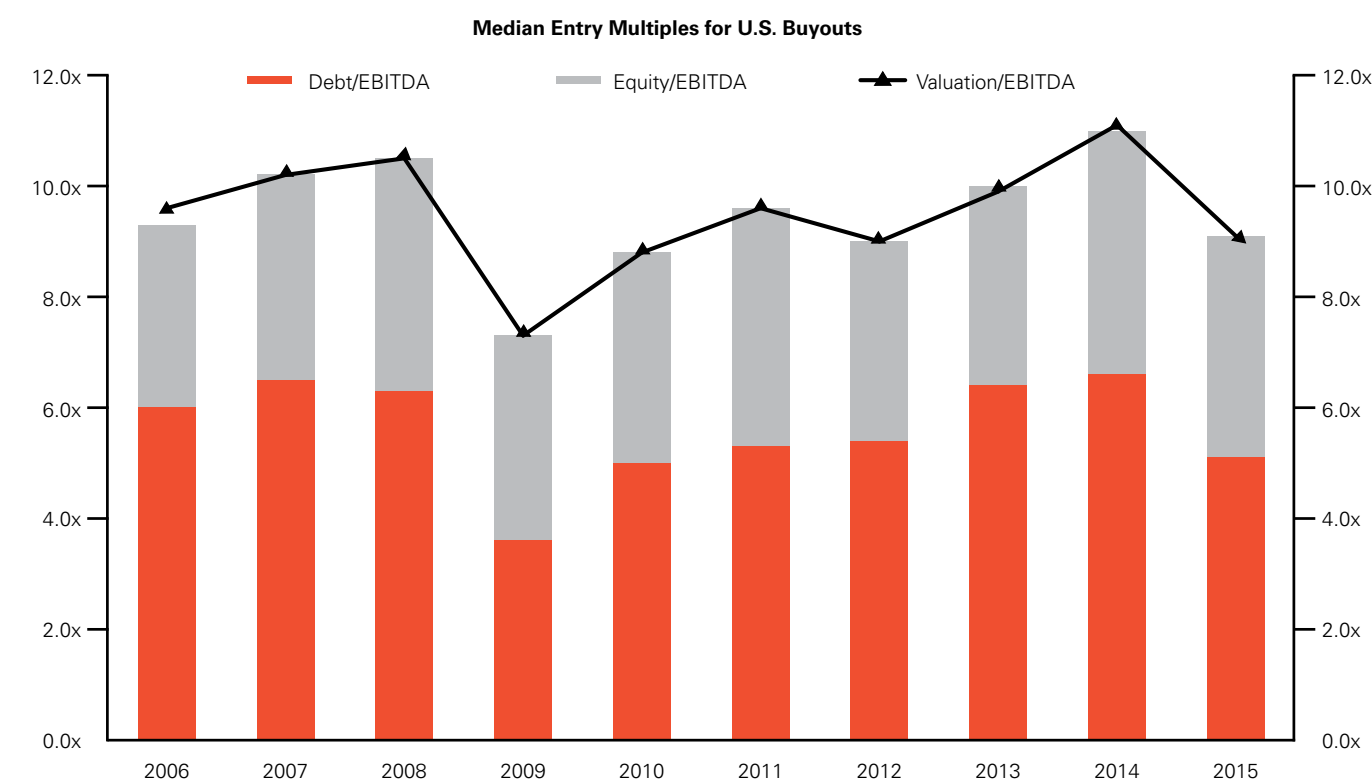
High entry multiples are a cause of concern. For instance, companies bought in 2014 cannot rely on being sold at a higher valuation today unless they have seen rapid deleveraging or earnings growth during 2015.

In theory, companies bought in 2010 could on the other hand have been held for four years and sold at a higher valuation multiple without any growth or debt pay-down (Fig XX).

Following many years of rising valuation multiples and record-making transactions that benefitted sellers, 2015 saw a moderation in prices and a greater emphasis on smaller and medium sized transactions (which are easier to finance). We expect this trend to continue through 2016.

This is good news for investors. Whilst we always recommend a multi-year approach to private equity investing, a downward pressure on debt and the resulting valuations should be attractive for buyouts in the US this year. And as the dominant part of the private equity universe, US buyouts will continue to influence long term private equity returns.

Lower debt levels should lead to lower prices



Source: HSBC Private Bank, as at 18 March 2016. Past performance is not a reliable indicator of future performance



## Asset class

### Real estate

The volatility we have seen across financial markets during the first quarter of this year has served to dampen down, rather than reverse, some of the wider growth trends seen in major real estate markets globally. Risk perception is again manifest and mutes the earlier expectation of a gradual global recovery. The edge has been taken off the appetite of international buyers in many markets: uncertainty in China's economy, substantial currency volatility, commodity price deflation and a perception of "uncomfortable" real estate asset pricing in prime markets have all contributed to this "risk on, risk off" approach.

From a strategic perspective, it is our view that Europe may be the most interesting beneficiary if this asset pricing persists, in many cases, at attractive levels and some distress means that the medium-term buying opportunity may continue to be strong. Commercial real estate yields look attractive compared to the risk free rate and barring any dramatic, prolonged economic shocks, should present a sustainable high yielding investment case. Whilst the Eurozone is not anticipated to grow strongly, the economy is improving relative to its performance over the last three years and therefore provides a constructive backdrop.

Renewed risk aversion amongst investors is likely to see them favouring higher-quality assets denominated in the currencies of countries that are expected to perform well. We believe that understanding and managing actual, rather than perceived, risks will provide an opportunity

to re-position "risk" assets for the core investment market whilst generating attractive cashflow. This is something a number of well-connected and experienced operators are managing to do successfully.

The traditional group of emerging markets are moving along markedly different trajectories with China's challenges being well documented, India and Mexico continuing to improve and Brazil moving further into recession. Emerging markets therefore offer a combination of distress and growth, albeit with much greater variability across markets and sectors.

More generally we see property being fairly valued relative to historical interest rates and inflation expectations. Any moderate increases in interest rates should be absorbed by commercial real estate values. The ability of assets to absorb future inflationary pressures will depend on local market conditions and their ability to provide rental growth and occupancy gains in order to offset the impact of higher interest rates. As ever a highly selective approach to asset and market selection remains critical to ensure preservation of capital and sustainability of returns.



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Glossary of terms

Absolute return – The nominal return on an investment irrespective of any given specific benchmark.

Alternative investments – Non-traditional investments with low correlations to traditional assets which are typically used to improve portfolio diversification.

Annualised return – The yearly increase (or decrease) in the value of an investment, including the effects of compounding.

Annualised volatility – The estimated spread of returns of an asset on an annual basis. Volatility is usually used as a measure of risk, as a highly volatile asset may offer large negative as well as large positive returns.

Asset allocation – The apportioning of investment assets between different asset classes such as equities, fixed income, liquid assets (cash), real estate, etc.

Asset class – Assets are aggregated into groups that share similar characteristics. Asset classes include ‘Equity,’ ‘Fixed income,’ ‘Liquid assets,’ ‘Real Estate’ and ‘Commodities’.

Benchmark – A single or a weighted collection of indices used as a reference or comparison of investment performance.

Credit risk – The risk of loss to your investment arising from a counterparty (e.g. a bond issuer or a bank) which does not, or cannot, make the required payments as promised or agreed on in a contract.

Cumulative return – Actual (non-annualised) performance over a given period of time.

Derivatives – Instruments such as futures, options and swaps that derive their value from the movement in the price of an underlying asset.

Diversification – The process of spreading a portfolio’s holdings over a range of securities and asset classes with the aim of reducing volatility.

Duration – The weighted average maturity of a bond’s cash flows or of any series of linked cash flows.

Expected return – The weighted average of a probability distribution of possible rates of return.

Fund of funds – A fund whose purpose is to invest in other funds. Applicable to all asset classes.

Hedge – A transaction made with the intent of reducing investment risk, for example using options or forwards.

Hedge fund – An unregulated fund which is allowed to use strategies that are unavailable to the majority of unit and investment trusts. Hedge funds can be exempt from many of the rules and regulations governing traditional funds. Usually considered as an ‘Alternative’ asset class.

High yield – Corporate bonds that are rated below investment grade (defined as BBB and below).

Hold – Maintain a current level of investment in a particular asset class, market, sector, security, or investment vehicle.

Illiquid asset – An investment that cannot be realised at short notice.

Inflation – Rising prices of individual or a basket of goods and services.

Long duration – A fixed income security that has a modified duration that is longer than 7 years.

Long term – An investment time horizon of five years or greater.

Market capitalisation – Refers to the total value of a company or stock exchange. Usually calculated by multiplying the number of shares outstanding for a company or a stock exchange by the value of a single share.

Market risk – The risk that the value of your investment can fall as well as rise by taking exposure to a particular market. Market risk cannot be diversified away from by increasing holdings of similar securities.

Medium duration – A fixed income security that has a modified duration between 3 and 7 years.

Medium term – An investment time horizon of between three and five years.

Neutral – A portfolio position that is the same as the benchmark would suggest.

Overweight – A portfolio position that is higher than the benchmark would suggest.

Private equity – Securities of unlisted companies which are generally illiquid and are therefore held for longer periods of time than more traditional securities.

Relative return – The return that an asset achieves over a period of time compared to a benchmark.

Short duration – A fixed income security that has a modified duration between one and three years.

Short term – An investment time horizon of between one and three years, or a tactical view of less than six months.

Strategic asset allocation – The proportional mix of asset classes which should meet an investor’s risk and return objectives over a seven to ten year time horizon.

Tactical asset allocation – An active management strategy that deviates from the long-term strategic asset allocation in order to take advantage of current market views.

Total return – A measure of the return over a stated period that incorporates both the return from price appreciation and investment income, such as coupons and dividends.

Traditional investments – Equities, bonds, and cash.

Underweight – A portfolio position that is lower than the benchmark would suggest.



**Risk disclosure**

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**Risks of investment in fixed income**

There are several key issues that one should consider before making an investment into fixed income. The risk specific to this type of investment may include, but are not limited to:

**Credit risk**

Investor is subject to the credit risk of the issuer. Investor is also subject to the credit risk of the government and/or the appointed trustee for debts that are guaranteed by the government.

**Risks associated with high yield fixed income instruments**

High yield fixed income instruments are typically rated below investment grade or are unrated and as such are often subject to a higher risk of issuer default. The net asset value of a high-yield bond fund may decline or be negatively affected if there is a default of any of the high yield bonds that it invests in or if interest rates change. The special features and risks of high-yield bond funds may also include the following:

- Capital growth risk - some high-yield bond funds may have fees and/ or dividends paid out of capital. As a result, the capital that the fund has available for investment in the future and capital growth may be reduced; and

- Dividend distributions - some high-yield bond funds may not distribute dividends, but instead reinvest the dividends into the fund or alternatively, the investment manager may have discretion on whether or not to make any distribution out of income and/ or capital of the fund. Also, a high distribution yield does not imply a positive or high return on the total investment.

- Vulnerability to economic cycles - during economic downturns such instruments may typically fall more in value than investment grade bonds as (i) investors become more risk averse and (ii) default risk rises.

**Risks associated with subordinated debentures, perpetual debentures, and contingent convertible or bail-in debentures**

- Subordinated debentures - subordinated debentures will bear higher risks than holders of senior debentures of the issuer due to a lower priority of claim in the event of the issuer’s liquidation.

- Perpetual debentures - perpetual debentures often are callable, do not have maturity dates and are subordinated. Investors may incur reinvestment and subordination risks. Investors may lose all their invested principal in certain circumstances. Interest payments may be variable, deferred or canceled. Investors may face uncertainties over when and how much they can receive such payments.

- Contingent convertible or bail-in debentures - Contingent convertible and bail-in debentures are hybrid debt-equity instruments that may be written off or converted to common stock on the occurrence of a trigger event.

Contingent convertible debentures refer to debentures that contain a clause requiring them to be written off or converted to common stock on the occurrence of a trigger event. These debentures generally absorb losses while the issuer remains a going concern (i.e. in advance of the point of non-viability). “Bail-in” generally refers to (a) contractual mechanisms (i.e. contractual bail-in) under which debentures contain a clause requiring them to be written off or converted to common stock on the occurrence of a trigger event, or (b) statutory mechanisms (i.e. statutory bail-in) whereby a national resolution authority writes down or converts debentures under specified conditions to common stock. Bail-in debentures generally absorb losses at the point of non-viability. These features can introduce notable risks to investors who may lose all their invested principal.

**Changes in legislation and/or regulation**

Changes in legislation and/or regulation could affect the performance, prices and mark-to-market valuation on the investment.

**Nationalization risk**

The uncertainty as to the coupons and principal will be paid on schedule and/or that the risk on the ranking of the bond seniority would be compromised following nationalization.

**Reinvestment risk**

A decline in interest rate would affect investors as coupons received and any return of principal may be reinvested at a lower rate.

Changes in interest rate, volatility, credit spread, rating agencies actions, liquidity and market conditions may significantly affect the prices and mark-to-market valuation.

**Risk disclosure on Dim Sum Bonds**

Although sovereign bonds may be guaranteed by the China Central Government, investors should note that unless otherwise specified, other renminbi bonds will not be guaranteed by the China Central Government.

Renminbi bonds are settled in renminbi, changes in exchange rates may have an adverse effect on the value of that investment. You may not get back the same amount of Hong Kong Dollars upon maturity of the bond.

There may not be active secondary market available even if a renminbi bond is listed. Therefore, you need to face a certain degree of liquidity risk.

Renminbi is subject to foreign exchange control. Renminbi is not freely convertible in Hong Kong. Should the China Central Government tighten the control, the liquidity of renminbi or even renminbi bonds in Hong Kong will be affected and you may be exposed to higher liquidity risks. Investors should be prepared that you may need to hold a renminbi bond until maturity.

**Risk Disclosure on CoCo Bonds**

- This instrument is highly complex in nature. Do not invest in it unless you fully understand and are willing to assume the risks associated with it. If you are in doubt about the risks involved in the product, you may clarify with the intermediary or seek independent professional advice. Strong/prior experience in investing similar instruments and good understanding on the underlying mechanism of CoCo is required.

- In the worst case scenario, you may lose all of your invested principal in the event of (1) permanent principal write-down, (2) the equity value drops to zero after auto-conversion and/ or (3) default, insolvency and/or bankruptcy of the relevant issuer (as the case may be), coupon payment is at the discretion of the issuer and subject to the approval of the regulator and can therefore be variable, deferred or cancelled.

- Each CoCo instrument is unique and can differ from the main outlines listed here as well as in sections 2 and 3 below. Specific country requirements may apply. Please read the risk factors and consider all the terms and conditions governing the relevant investment(s) including without limitation the Prospectus for each CoCo you invest in.

- Extremely limited liquidity can occur under adverse market conditions as evidenced from what had happened on almost all of the banks’ subordinated debt instruments in the last financial crisis in 2008.

- This CoCo is a perpetual debenture. It may be callable, not have a maturity date and subordinated. You may incur reinvestment and subordination risks, on top of the worst case scenario risks listed above.

**Risk disclosure on Emerging Markets**

Investment in emerging markets may involve certain, additional risks which may not be typically associated with investing in more established economies and/or securities markets. Such risks include (a) the risk of nationalization or expropriation of assets; (b) economic and political uncertainty; (c) less liquidity in so far of securities markets; (d) fluctuations in currency exchange rate; (e) higher rates of inflation; (f) less oversight by a regulator of local securities market; (g) longer settlement periods in so far as securities transactions and (h) less stringent laws in so far the duties of company officers and protection of Investors.

**Risk disclosure on FX Margin**

The price fluctuation of FX could be substantial under certain market conditions and/ or occurrence of certain events, news or developments and this could pose significant risk to the Customer. Leveraged FX trading carry a high degree of risk and the Customer may suffer losses exceeding their initial margin funds. Market conditions may make it impossible to square/close-out FX contracts/options. Customers could face substantial margin calls and therefore liquidity problems if the relevant price of the currency goes against them.

**Currency risk – where product relates to other currencies**

When an investment is denominated in a currency other than your local or reporting currency, changes in exchange rates may have a negative effect on your investment.

**Chinese Yuan (“CNY”) risks**

There is a liquidity risk associated with CNY products, especially if such investments do not have an active secondary market and their prices have large bid/offer spreads.

CNY is currently not freely convertible and conversion of CNY through banks in Hong Kong and Singapore is subject to certain restrictions. CNY products are denominated and settled in CNY deliverable in Hong Kong and Singapore,

which represents a market which is different from that of CNY deliverable in Mainland China.

There is a possibility of not receiving the full amount in CNY upon settlement, if the Bank is not able to obtain sufficient amount of CNY in a timely manner due to the exchange controls and restrictions applicable to the currency.

**Illiquid markets/products**

In the case of investments for which there is no recognised market, it may be difficult for investors to sell their investments or to obtain reliable information about their value or the extent of the risk to which they are exposed.

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