News release

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HSBC GLOBAL ASSET MANAGEMENT SUGGESTS FOUR KEY MACRO THEMES FOR 2017

****Dynamic asset allocation focusing on valuation to capture opportunities****

****Emerging market equities including Asia look attractive****

**** Higher oil and commodity prices have helped improve Malaysia's terms of trade and provide more fiscal space****

HSBC Global Asset Management ("HSBC") opined that "Trumponomics", the cooperation of fiscal and monetary policy, improving global economic activity and continuing low interest rates, will be four key themes shaping the macro environment in 2017.

"Trumponomics" – market perceptions of risk have shifted towards the scenario of a "strong demand recovery", driven by expectations that Trump will try and implement more growth-friendly policies. The era of "deflation dominance" is likely over.

Cooperation of fiscal and monetary policy – the world is moving toward an "end of austerity" with fiscal authorities shifting to greater coordination with central bankers. Yet various monetary measures including negative rates and QE programmes still mean that global liquidity conditions will remain highly supportive for growth.

Improving global activity – While Asia remains a dynamic region in the world and continues to be a key driver for global growth, there are also clear signals that growth momentum is picking up across major economies including the US, the UK, Japan and the Eurozone area.

Continuing low interest rates – Despite the Fed's signal of a rate hike cycle in 2017, investors are likely to continue to face a low interest rate environment with any increases being uber-gradual.

Focus on Malaysia by HSBC

Higher oil and commodity prices have helped improve Malaysia's terms of trade and provide more fiscal space. This coupled with a competitive currency, infrastructure/railway-related investment, and support from China (relatively stable and resilient Chinese economic growth in the near term and pivot to Chinese FDI, etc.) should help the Malaysian economy. Meanwhile, tourism is picking up, with a significant increase in Chinese tourist arrivals. Malaysia has made progress in tax/fiscal reform, i.e. GST and subsidy reforms. The financial markets are deep and liquid with a strong domestic investor base as well.

However, downside risks from US/global protectionist policies, tighter financial conditions and consumer headwinds remain. A mild export recovery may not be sufficient to offset domestic growth headwinds. The cash hand-outs for current and retired civil servants and possible election-related policy spending could potentially lift consumption temporarily, but consumer demand is constrained by high household debt and labour market softness. Companies have seen their margins eroded amid soft demand and rising (imported) input costs, curbing private capex.

The policy option to boost growth appears limited, amid the need for fiscal consolidation, although the government can also use off-budget measures to support growth, such as public investment through government linked entities. The country's external vulnerabilities amid volatile capital flows and higher inflation have raised the hurdle for monetary easing.

Although we expect Malaysia's current account balance to improve this year vs. 2016 on the back of higher commodity prices, we remain concerned about potential ringgit volatility due to Fed rate hikes, any positioning adjustments given the high foreign ownership in local debt, the country's relatively low FX reserves, and uncertainty over its FX policies (for example, the recent tightening of regulations on the offshore FX market). The ringgit is one among the emerging Asian currencies most sensitive to higher US rates.

Bill Maldonado, Chief Investment Officer, Asia Pacific, HSBC Global Asset Management, said: "While we remain constructive on the outlook for 2017, there are clearly risks and uncertainties and episodic volatility will continue to be a feature. Active management, based on a robust valuation discipline and incorporating dynamic asset allocation will be key in successfully navigating the market to capture opportunities across asset classes."

From an asset allocation perspective, HSBC continues to prefer global equities and select emerging market equities and debts, while maintaining a structural underweight in global government bonds.

Equities continue to look undervalued relative to bonds, particularly government bonds. The equity risk premium is still attractive and the asset class presents opportunities in both developed and emerging market equities. Selective emerging market assets also look attractively priced. The prospect of pro-cyclical fiscal policy has increased the odds of reflation which could harm the bond market but may benefit equities.

Investors also need to be cautious as political uncertainty remains elevated and the prospect of a more protectionist US has the potential to spill over to corporate fundamentals globally. A strengthening US dollar could also be a negative on emerging markets but this should be balanced by stronger US and global growth.

<u>Asia ex-Japan equities</u>
Asia ex-Japan GDP growth should continue to outpace that of developed markets. HSBC believes consumption demand is a key driver for the region's equities where sectors such as technology, consumer staples and discretionary, financials (especially insurance), and telecom will allow investors to tap the consumption theme.

Economic fundamentals and the policy environment continue to be supportive for Asian equities. Importantly, the reform agenda in Asia, which is key to the sustainable growth in the region including China, India and Indonesia continues to evolve, providing a positive backdrop for Asian equities in the medium to long term.

Another supportive factor for Asian equities is their still inexpensive valuations relative to their level of profitability, amongst the most attractive on that basis around the world. Rising consumption, stable commodity prices and supportive monetary policy in the region could help drive up corporate earnings.

In China, proactive fiscal policy expansion, alongside implementation of further supply side and SOE reforms, and a further opening up of capital markets, are supportive of the market. Within Chinese equities, HSBC continues to prefer H-shares over A-shares due to their favourable valuation and attractive dividend profile. Following the launch of the Stock Connect programme between the mainland and Hong Kong, HSBC expects to see stronger southbound fund flows which is a positive catalyst for the offshore Chinese equity market, especially in the mid-cap space.

<u>Asian bonds</u>
Fixed income market volatility is expected to increase in 2017 versus 2016 amid expectations on further US rate hikes. Asian bonds may face a difficult start in 2017 but their attractive relative

valuations and favourable technicals should limit the downside. HSBC remains constructive on the outlook for credit, and expects high yield to perform better than investment grade bonds.

Upon settling down of recent market volatility of RMB performance, the opening up of the China onshore bond market will gradually attract more foreign participation, and will gain international importance as more foreign investors choose to diversify into this market. Both the onshore and offshore bond markets could offer some good attractive yield carry opportunities when compared to other global markets.

Cecilia Chan, Chief Investment Officer of Fixed Income, Asia Pacific, HSBC Global Asset Management, said: "With its strong fundamentals and favourable supply and demand dynamics, we expect the Asian credit bond market to continue to show resilience in 2017. In view of increased volatility in the US Treasury market, we are prepared to employ more dynamic duration strategy management while continuing to take a prudent approach in credit selection. For instance, we will focus on investing in selective shorter-dated corporate bonds as strategic holdings for yield carry purposes and purchasing some long-dated Asian sovereign bonds as tactical exposure for potential capital gains."

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Notes to editors:

HSBC Global Asset Management

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