Q1 / 2019

HSBC Jade Perspectives

Shaping your investment portfolio

HSBC Jade

Together we thrive

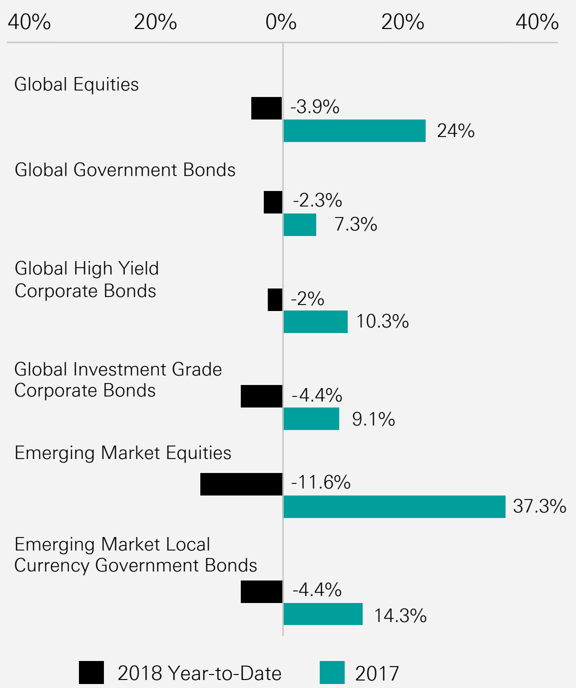
"HSBC Jade Perspectives" is a publication specifically created for our Jade clients. It explores the key global themes relevant to today's investors, while explaining their diverse implications.

Finding clarity amid the noise

Jan-Marc Fergg, CFA
Deputy Head of
Group Wealth Management
HSBC Retail Banking and
Wealth Management

Xian Chan
Global Head of
Wealth Insights
HSBC Retail Banking and
Wealth Management

Selected asset class performance



Source: Bloomberg, as of 5 December 2018. Investment involves risks. Past performance is not indicative of future performance. For illustrative purpose only.

Note: the charts show total returns of asset classes in US Dollar (USD). Asset class performance is represented by different Indices - Global Equities: MSCI ACWI Net Total Return Index; Global Government Bonds: Bloomberg Barclays Global Aggregate Treasuries Total Return Index; Global High Yield Corporate Bonds: Bloomberg Barclays Global High Yield Corporate Total Return Index; Global Investment Grade Corporate Bonds: Bloomberg Barclays Global Aggregate Corporate Total Return Index; Emerging Market Equities: MSCI Emerging Net Total Return USD Index. Emerging Market Local Currency Government Bonds: Bloomberg Barclays Emerging Market Local Currency Government Total Return Index.

Welcome to the first edition of HSBC Jade Perspectives.

In today's digitally-connected world, we are constantly bombarded by live updates on financial markets – especially when they perform badly. It can sometimes be hard to filter out the short-term "noise" and place it into perspective.

That's why we created HSBC Jade Perspectives: a quarterly publication to offer our clients the curated facts, insights and perspectives they need to help make better investment decisions.

In this first edition, we focus on how investors should position themselves going into 2019, in light of recent market volatility. At the time of writing, global equities are in negative territory for the year. Most of the weakness has come since October 2018.

In our view, volatility is to be expected at this late stage in the economic cycle. The US is in the midst of one of the longest economic expansions in history, having run for almost 10 years[1]. Given human nature, it's hardly surprising that investors are nervous and waiting for reasons to sell. Also, as Joseph Little from HSBC Global Asset Management discusses later on, volatility is still lower than long-term averages, suggesting that the low-volatility environment we have experienced is actually the anomaly.

Have we become negative on equities? No, not just yet…

Let's take stock of the facts. Economic growth remains solid globally and corporate earnings are strong. Interest rates, in spite of the upward trajectory in the US, remain low by historical standards and continue to stimulate the economy.

A recent poll of US economists indicated that a recession was more likely to happen by 2020, not 2019[2]. We share this view, reflected in our preference for equities over bonds as we move into 2019.

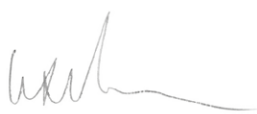
Even so, it would of course be ill-advised not to take steps to protect one's portfolio. Uncertainty in today's geopolitics – for example, Brexit or the ongoing trade tensions between the US and China – can damage sentiment and create short-term volatility, while disappointment around corporate earnings is also more likely at this late stage of the economic cycle.

However, protective measures for investors should focus on creating a diversified portfolio and selecting the right investments, rather than not investing at all.

For instance, we have upgraded our view for Emerging Market equities, given their improved valuations and improving growth prospects in 2019. We strongly favour Asian equities because of their more attractive valuations. Meanwhile, higher interest rates available on US Treasuries mean they are now more attractive. High-quality government bonds can also protect a portfolio in the event of market volatility.

We wish you a happy and productive year ahead.

Jan-Marc Fergg



Xian Chan

Source:

1. As measured by National Association for Business Economics
2. National Association for Business Economics, 28 September 2018

Contents

Some thoughts on market volatility…

Joseph Little
Global Chief Strategist
HSBC Global Asset Management

Investing in volatile markets: should I stay or should I go?

Are we expecting more volatility going into 2019? If so, what could trigger it?

After the stellar investment returns of 2017, the episodic volatility and shifts in market behaviour experienced in 2018 have felt abrupt and extreme.

However, we believe this is just a return to a more typical market environment. Recent volatility in global equities is still below the historical average, which suggests that the real anomaly was in fact the calm we enjoyed in 2017, rather than the conditions experienced in 2018.

Going forward, we are a expecting a "back to reality" macro environment, where global growth becomes more trend-like, global inflation remains subdued and economic policies, especially in the US, get closer to neutral. This backdrop should support market volatility to remain at historical average levels.

Further periods of volatility may lie ahead, as markets adjust to a new stage of the business cycle and a number of key trends interact in challenging ways. These include tightening monetary conditions, global trade disputes and heightened geopolitical risks. Meanwhile, central banks around the world are moving away from emergency levels of monetary easing, and the large US fiscal stimulus is likely to fade significantly next year.

Importantly however, our assessment is that the risk of a recession remains low for 2019.

In a typical market correction, which asset classes normally perform better?

In a market correction, government bonds like US Treasuries – which are perceived as a safe-haven asset – tend to perform well as investors flock to what they see as safer options.

This year, however, US Treasuries have disappointed, underperforming during market corrections in February and October. In February, this was principally due to fears around higher inflation, while October's underperformance followed comments from the Federal Reserve suggesting that US interest rates might rise above the so-called "neutral rate", the point at which the rate neither helps nor hurts economic growth.

Conventional safe-haven assets like gold have also performed poorly in 2018. Despite offering investors a degree of protection during October's sell-off, they have still provided a disappointing overall return over the year.

While historically, perceived safe-haven currencies like the Yen and Swiss franc have acted as good diversifiers, we believe the US dollar could now be the best place to find safety. Amid fears of higher US interest rates and signs of overheating, the dollar has performed well this year.

What strategies might investors consider in light of recent and expected volatility?

In our view, it still makes sense to be pro-risk, although admittedly this is no longer a straightforward environment for risk asset classes.

While today's market participants are focused on recession risk and growth concerns, in reality the risk of a significant growth slowdown looks low to us. The business cycle does not run on a clock, and for the moment economic and corporate fundamentals continue to look good – the earnings and profit cycle remain strong and credit defaults remain low.

However, there are many uncertainties, and how the macro and political issues play-out will have a significant impact on market action. Therefore, it is important for investors to be adaptive to changes in the environment.

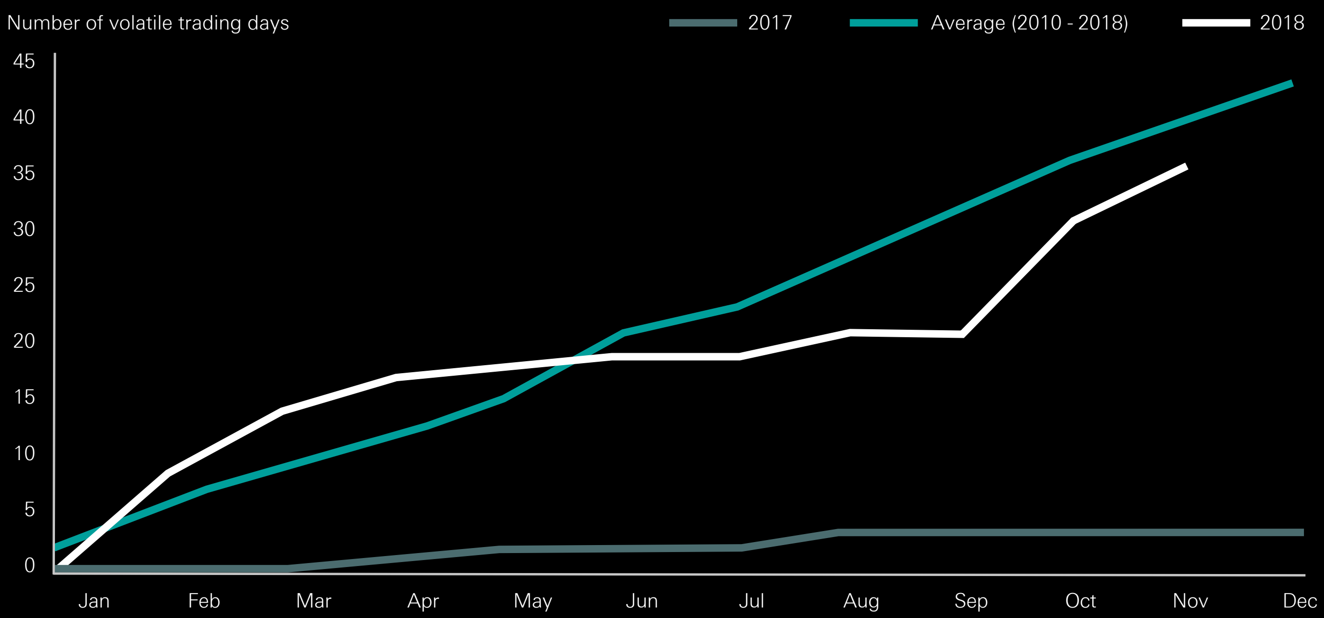
We believe there are still a number of good opportunities to "back growth", where valuations are still reasonable – a theme we refer to as "growth at a reasonable price".

We prefer to achieve this through global equities rather than global credits, although credits have become a bit more attractive during 2018. For us, current valuations suggest we should be focusing our risk budget on Asian and Emerging Market equities.

In addition, the re-pricing in US interest rates has created a role for US fixed income assets – especially short-duration government bonds and credits – as a way of building "portfolio resilience" against future rises.

However, past performance should never be seen as a guide to the future. It is therefore important for investors to be adaptive and active in building diversified multi-asset portfolios.

Global equity volatility is still below historical average

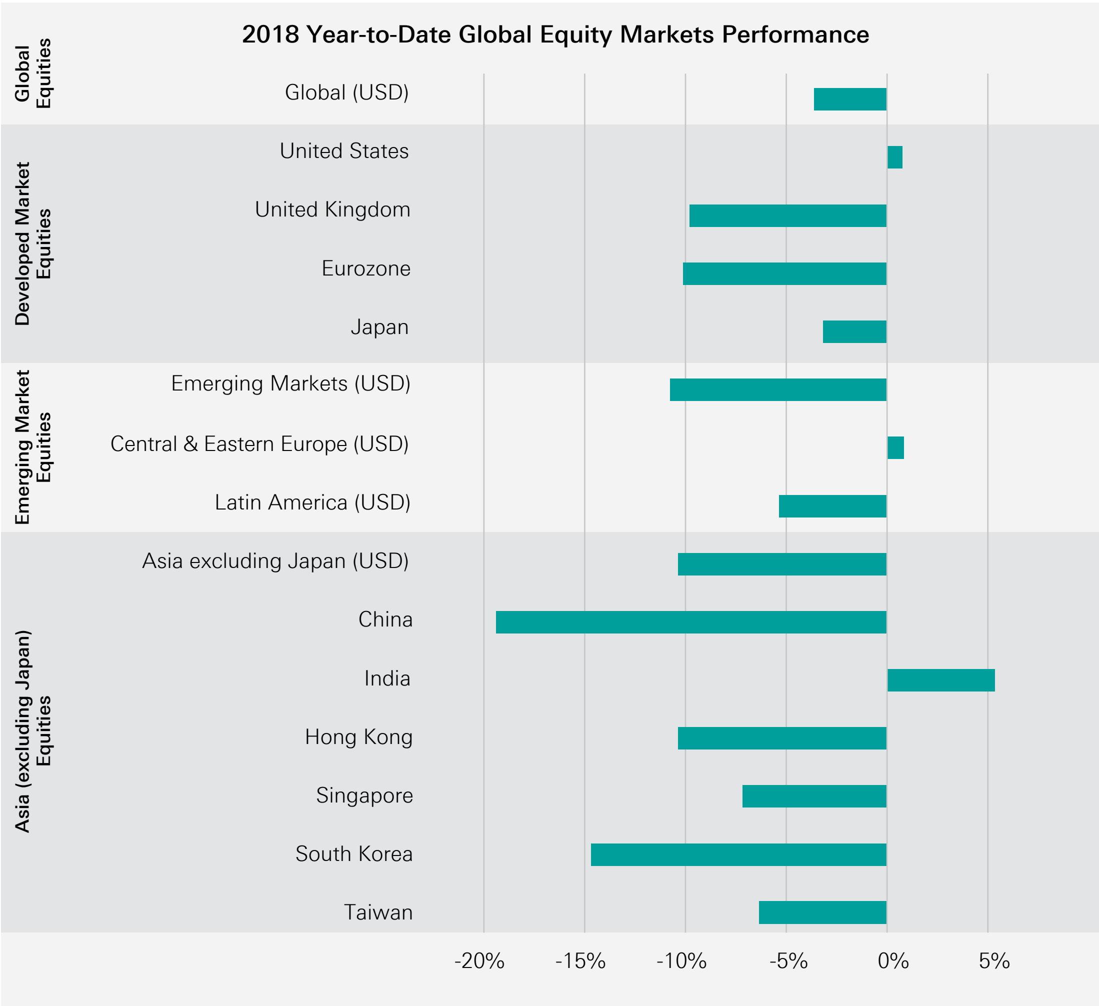


Source: Bloomberg, HSBC Global Asset Management, November 2018. Note: Global equity is represented by MSCI ACWI Net Index.
Number of volatile trading days: defined as the number of trading days of the MSCI ACWI Net Index price change larger than 1% (either up or down).

Markets review

Equities

The last quarter of the year was tricky for global equities, wiping out most gains from earlier in the year. At time of writing, global equities have fallen around 7% since the beginning of October, driven by concerns over stock market valuations, higher interest rates in the US and concerns over economic growth in 2019. This means that global equities as a whole have fallen almost 4% in 2018.



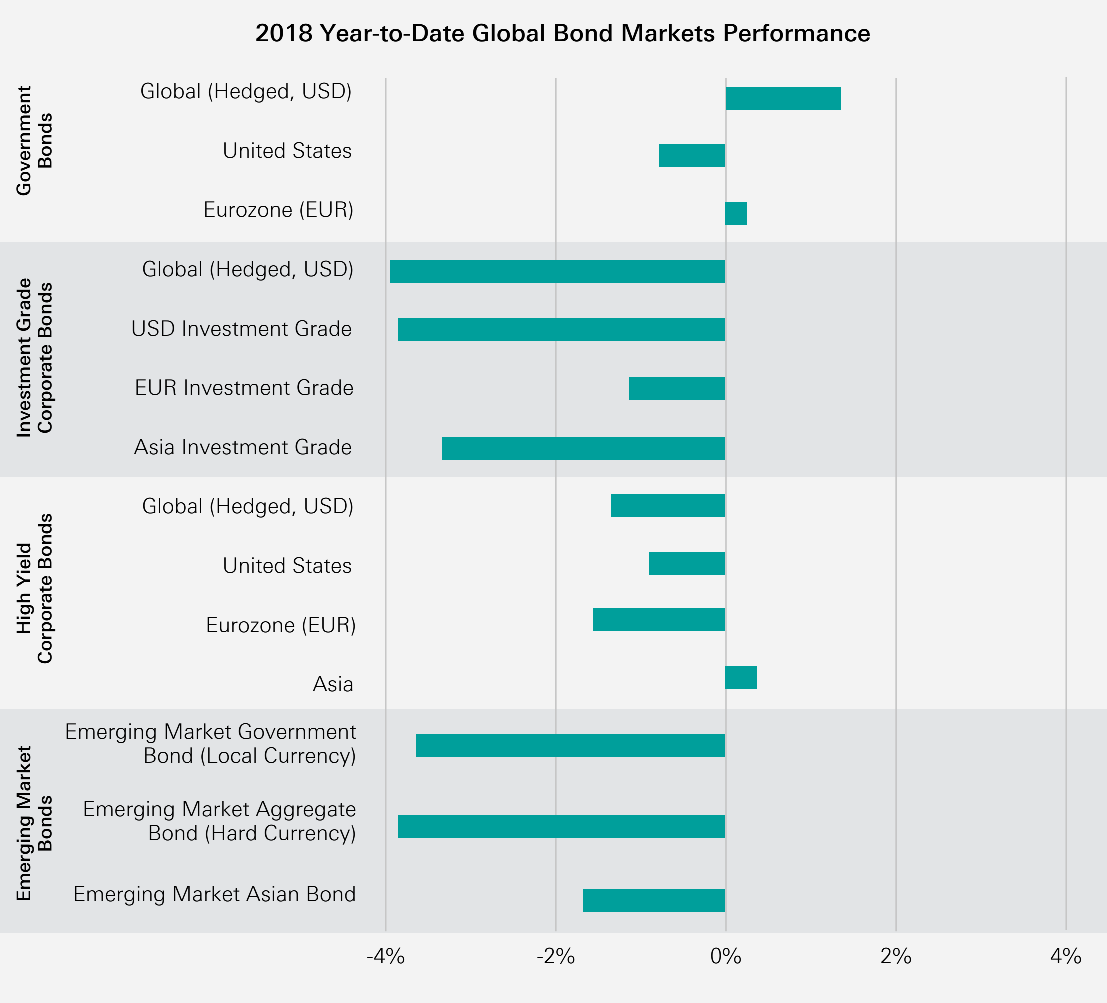
Source: Bloomberg, as of 5 December 2018. Investment involves risks. Past performance is not indicative of future performance. For illustrative purpose only.

Note: total returns of asset classes are shown in local currencies, unless otherwise stated. Equities performance is represented by different Indices – Global Equities: MSCI ACWI Net Total Return Index (USD). US Equities: S&P 500 Index (USD). UK Equities: FTSE 100 Index (GBP). Eurozone Equities: EURO STOXX 50 Index (EUR). Japan Equities: Nikkei 225 Index (JPY). Emerging Market Equities: MSCI Emerging Net Total Return Index (USD). Central & Eastern Europe Equities: MSCI Emerging Markets Eastern Europe Net Total Return Index (USD). Latin America Equities: MSCI Emerging Latin America Net Total Return Index (USD). Asia (excluding Japan) Equities: MSCI AC Asia Pacific ex Japan Net Total Return Index (USD). China Equities: Shanghai Stock Exchange Composite Index (CNY). India Equities: S&P BSE SENSEX Index (INR). Hong Kong Equities: Hang Seng Index (HKD). Singapore Equities: FTSE Straits Times Index (SGD). South Korea Equities: Korea Stock Exchange KOSPI Index (KRW). Taiwan Equities: Taiwan Stock Exchange Weighted Index (TWD).

Bonds

Yields on US government bonds (also known as Treasuries) rose on the back of strong US economic data and rising wage growth. Gains received a further boost as market expectations with regard to interest rate hikes gradually aligned with those of the Federal Reserve.

Rising Treasury yields meant that the market price of these bonds fell. So far this year, US Treasuries have received negative returns. Emerging Market government bonds in local currency declined by almost 4% year-to-date, primarily due to a stronger US dollar and poorer sentiment around Emerging Market assets in general.



Source: Bloomberg, as of 5 December 2018. Investment involves risks. Past performance is not indicative of future performance. For illustrative purpose only.

Note: total returns of asset classes are shown in US dollar (USD), unless otherwise stated. Bonds performance is represented by different Indices – Government Bonds: Global Government Bond (Hedged, USD): Bloomberg Barclays Global Aggregate Treasuries Total Return Index (Hedged, USD); US Government Bond: Bloomberg Barclays US Government Total Return Index; Eurozone Government Bond: S&P Eurozone Sovereign Bond Total Return Index (EUR); Investment Grade Corporate Bonds: Global Investment Grade Corporate Bond (Hedged, USD): Bloomberg Barclays Global Aggregate Corporate Total Return Index (Hedged, USD); USD Investment Grade Corporate Bond: Bloomberg Barclays US Corporate Total Return Index; EUR Investment Grade Corporate Bond: Bloomberg Barclays Euro Aggregate Corporate Total Return Index (EUR); Asian Investment Grade Corporate Bond: Markit iBoxx USD Asia ex-Japan Corporates Investment Grade Total Return Index. High Yield Corporate Bonds: Global High Yield Corporate Bond (Hedged, USD): Bloomberg Barclays Global High Yield Corporate Total Return Index (Hedged, USD); USD High Yield Corporate Bond: Bloomberg Barclays US Corporate High Yield Total Return Index; EUR High Yield Corporate Bond: Bloomberg Barclays Pan-European High Yield Total Return Index (EUR); Asian High Yield Corporate Bond: Markit iBoxx USD Asia excluding Japan High Yield Total Return Index. Emerging Market Bonds: Emerging Market Government Bond (Local Currency): Bloomberg Barclays Emerging Market Local Currency Government Total Return Index; Emerging Market Aggregate Bond (Hard Currency): Bloomberg Barclays Emerging Market Hard Currency Aggregate Total Return Index; Emerging Market Asian Bond: Markit iBoxx USD Asia excluding Japan Total Return Index.

Investment views Q1 2019

Latest asset class views (>12months)

- "Overweight" implies that, within the context of a well-diversified typically multi-asset portfolio, and relative to relevant internal or external benchmarks, HSBC Global Asset Management has (or would have) a positive tilt towards the asset class.
- "Underweight" implies that, within the context of a well-diversified typically multi-asset portfolio, and relative to relevant internal or external benchmarks, HSBC Global Asset Management has (or would have) a negative tilt towards the asset class.
- "Neutral" implies that, within the context of a well-diversified typically multi-asset portfolio, and relative to relevant internal or external benchmarks, HSBC Global Asset Management has (or would have) neither a particularly negative or positive tilt towards the asset class.

Government bonds

Developed Markets

Low yields overall mean prospective returns remain unattractive. However, "safe-haven" government bonds with high credit ratings can still offer diversification benefits in a portfolio.

Government bonds

Emerging Markets, local currency

We view most countries' prospective returns as attractive, boosted by the potential for Emerging Market currency gains.

Corporate bonds

Global Investment Grade

The economic environment remains supportive for corporate bonds, leading us to expect better returns.

Corporate bonds

Global High Yield

Corporate fundamentals are solid and defaults are low. We favour higher-quality High Yield bonds.

Global equities

Global growth remains on trend, making equities more attractive compared to government bonds.

Commodities

Commodity futures can help investors diversify their portfolios, although prospective returns are currently poor.

Source: HSBC Global Asset Management, as of December 2018

Note: views are produced by a range of groups, including regional HSBC Global Asset Management Asset Allocation meetings held throughout November 2018, HSBC Global Asset Management's long- term expected return forecasts generated as at 31 October 2018, and our portfolio optimisation process and actual portfolio positions. These views are not to be taken as investment advice, a recommendation to buy or sell investments or a guarantee of returns, and are subject to change without prior notice. Please refer to the latest Investment Monthly or your Relationship Manager for more long-term asset class views.

Regional equity views (>12months)

"Overweight" implies that, within the context of a well-diversified typically multi-asset portfolio, and relative to relevant internal or external benchmarks, HSBC Global Asset Management has (or would have) a positive tilt towards the asset class.

"Underweight" implies that, within the context of a well-diversified typically multi-asset portfolio, and relative to relevant internal or external benchmarks, HSBC Global Asset Management has (or would) have a negative tilt towards the asset class.

"Neutral" implies that, within the context of a well-diversified typically multi-asset portfolio, and relative to relevant internal or external benchmarks HSBC Global Asset Management has (or would have) neither a particularly negative or positive tilt towards the asset class.

United States

The US economy is strong, and should support good stock market performance. However, risks may be posed by expensive valuations, higher US interest rates and the possibility of lower corporate margins.

Eurozone

Eurozone equities offer attractive returns, supported by improved earnings news and ultra-low interest rates.

Japan

Japanese equities remain cheap while government policy is supportive of the stock market.

Emerging Markets (EM)

Valuations are attractive following recent market corrections. We currently prefer Asia EMs over other regions (for example, Latin America) due to their relatively robust economic growth.

Source: HSBC Global Asset Management, as of December 2018

Note: views are produced by a range of groups, including regional HSBC Global Asset Management Asset Allocation meetings held throughout November 2018, HSBC Global Asset Management's long- term expected return forecasts generated as at 31 October 2018, and our portfolio optimisation process and actual portfolio positions. These views are not to be taken as investment advice, a recommendation to buy or sell investments or a guarantee of returns, and are subject to change without prior notice. Please refer to the latest Investment Monthly or your Relationship Manager for more long-term asset class views.

▶ United Kingdom

Prospective returns on UK equities are less attractive compared to other markets. Brexit uncertainty remains a risk.

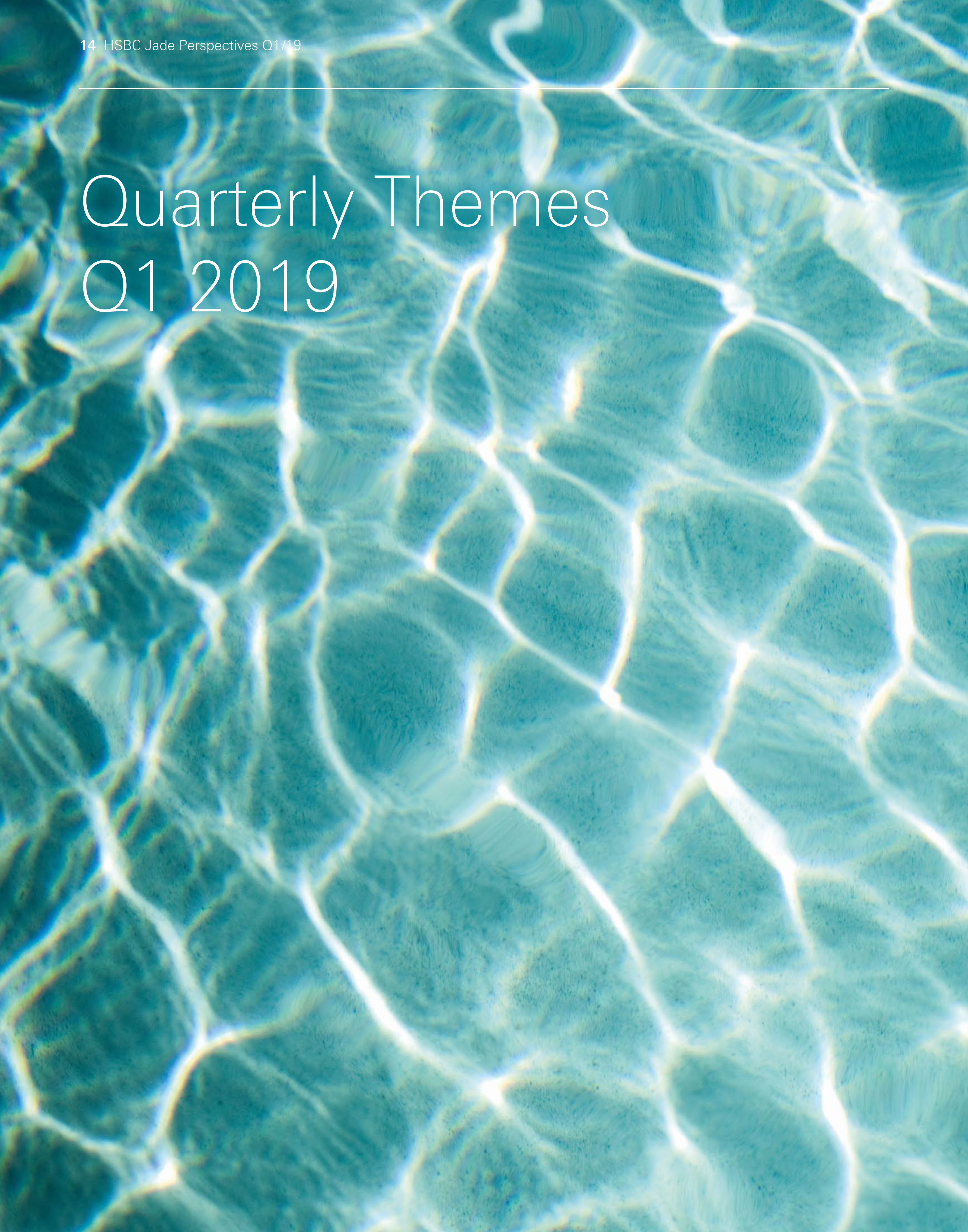
▶ Central & Eastern Europe and Latin America

Brazil and Mexico have lost economic growth momentum in 2018, while Poland, Russia and Hungary offer more appealing valuations.

▲ Asia (excluding Japan)

Valuations are attractive, corporate earnings remain strong and economic growth has been relatively solid.

Quarterly Themes Q1 2019



How to position your portfolio for the start of 2019

We are probably witnessing the “late” stage of the current economic cycle. The US stock market has had a historic bull run, US unemployment is at its lowest level in nearly half a century and the Federal Reserve is raising interest rates. Markets have been more volatile of late, prompting investors to ask if a recession may be on the horizon.

The answer is probably not – at least not for 2019. Despite poor market sentiment recently, the economy is expected to continue expanding, with the IMF (International Monetary Fund) estimating 3.7% global growth for 2018. Further economic outperformance in the US seems likely on the back of fiscal stimulus, which our analysis suggests will continue to boost the US economy in the first half of 2019.

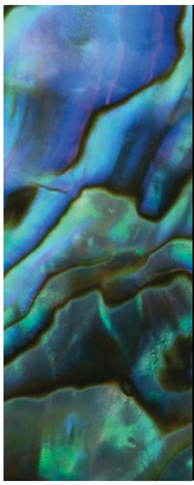
That’s why we still believe in global equities as a broad asset class. In our view, this is still the best way to take advantage of global growth. Based on current valuations, we prefer Eurozone, Asian and Emerging Market equities where prospective returns also look attractive.

However, as the end of the cycle approaches, it makes sense for investors to be selective in their investment decisions and adaptive to the changing environment. Geopolitical turmoil and trade issues could spark volatility and cast doubts on future economic performance, while faster-than-expected US interest rate hikes could also hit sentiment.

So how should investors position their portfolios going forward?

Diversification is key. Allocating some capital to “safe-haven” assets like high-quality government bonds could provide a buffer for portfolios in the event of a correction. In a time of rising interest rates, short-duration bonds, which are less sensitive to rate spikes, could help to mitigate any investment losses.

There is a lot to process in today’s complex market environment. We’ve therefore identified four key investment themes to help clients navigate the sometimes murky world of financial markets and position their portfolios for 2019.



Growth

Stay invested in equities

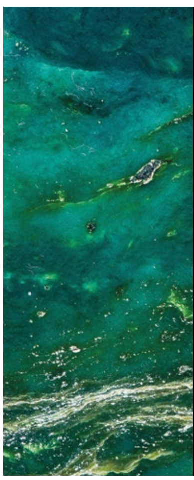
Global economic growth remains solid, and marginally above its five-year average. The economic environment continues to support strong corporate earnings and fundamentals. In our view, equities remain the best way to access global growth.

Valuations

Favour markets with attractive valuations

Following recent volatility, equity valuations in some geographies are cheap and offer decent prospective returns. We particularly favour Eurozone, Asian and Emerging Market equities.

In the case of bonds, Emerging Market local currency debt continues to offer appealing returns.



Volatility

Diversify your portfolio to protect against volatility

Geopolitical turmoil and trade tensions could create volatility in the coming year. A split US Congress creates uncertainty regarding US policy, while global trade tensions could also dampen the economic outlook. In particular, investors should consider short-dated, high-quality bonds as potential diversifiers in a multi-asset portfolio.

Interest Rates

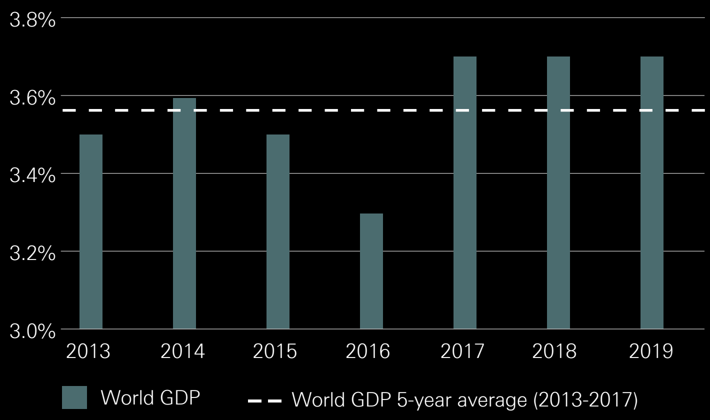
Favour short-dated, high-quality bonds

Rising interest rates could have a negative impact on bond prices, and short-duration bonds are one way of protecting your portfolio against this risk.

Growth

World GDP (Annual percent change)

Economic growth in 2019 is expected to remain above trend



Source: International Monetary Fund (IMF), World Economic Outlook, October 2018

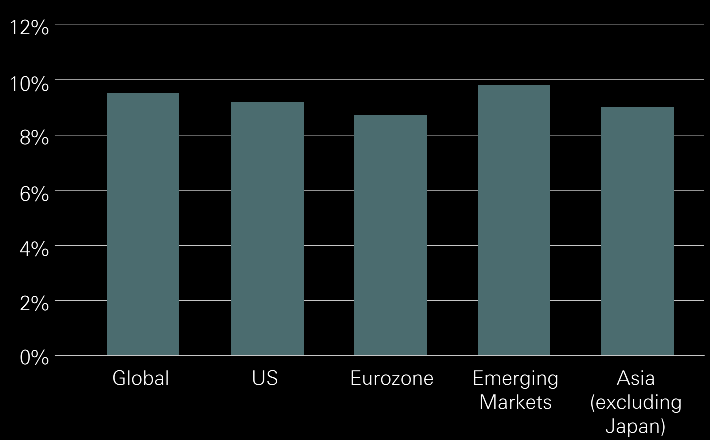
Economic fundamentals are strong.

In our view, the risk of recession is low for 2019. According to the IMF projections, the global economy is on track to grow at a healthy rate of 3.7% in 2018 and 2019[1].

On the back of fiscal stimulus, further US economic outperformance is likely, and should continue to boost the economy in the first half of 2019. Our analysis indicates a 1% increase in US economic growth[2] for the year.

The forward 12-month Earnings per Share growth estimate for major equity market regions

Global corporate earnings remain solid



Source: Thomson Reuters I/B/E/S, as of 5 December 2018.

Investment involves risks. Past performance is not indicative of future performance. For illustrative purpose only.

Note: Equity markets are represented in different indices in US dollar (USD) – Global Equities: MSCI ACWI Index. US Equities: S&P 500 Index. Eurozone Equities: EURO STOXX 50 Index. Emerging Market Equities: MSCI Emerging Markets Index. Asia (excluding Japan) Equities: MSCI AC Asia ex Japan Index.

Stay invested in equities.

At a global level, strong economic growth continues to support corporate earnings and fundamentals. Global equities, in our view, still offer attractive returns.

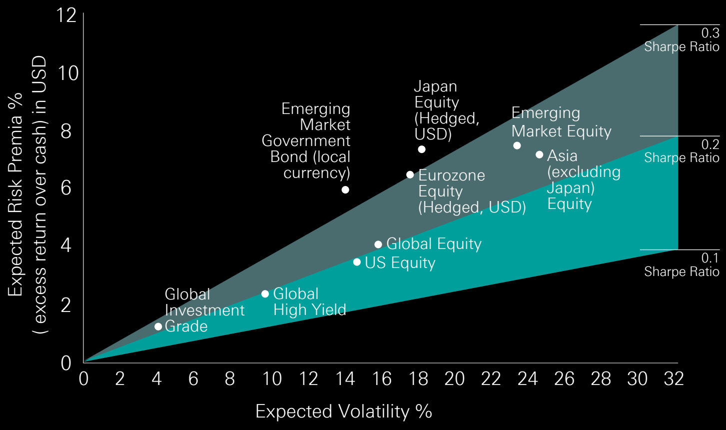
Corporate earnings are growing globally at a healthy rate, while corporate default rates remain on a downward trend. While the emerging economic outlook may look challenging because of trade disputes and interest rate hikes in the US, many Asian economies remain resilient. According to the IMF's predictions, Asia will continue to drive the global economy[3].

Source: 1. International Monetary Fund (IMF), World Economic Outlook, October 2018 2. HSBC Global Asset Management, Bloomberg, as of October 2018 3. International Monetary Fund (IMF), Regional Economic Outlook: Asia Pacific, October 2018

Valuations

Expected Risk and Return of Asset Classes

Equities are more attractive than bonds currently



Source: HSBC Global Asset Management, Bloomberg, as of November 2018.

Investment involves risks. Past performance is not indicative of future performance. For illustrative purpose only.

Note: Asset class returns are shown in unhedged terms, unless otherwise stated. Sharpe Ratio measures risk adjusted performance. Broadly speaking, asset classes towards the top of the wedge appear to be attractively valued and offer attractive returns relative to their risk. Asset classes towards the bottom indicate unattractive valuations.

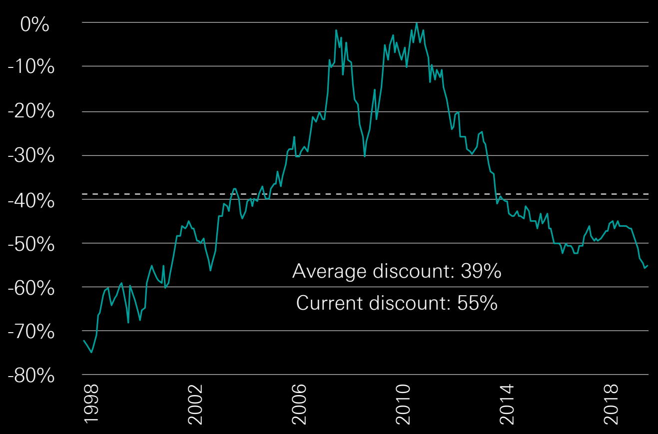
Favour markets with attractive valuations.

Valuations are cheap after the recent market sell-off, having fallen to below-average levels. Right now, equities appear more appealing than bonds.

Based on current valuations, Eurozone, Asian and Emerging Market equities are most attractive. Emerging Market local currency debt, in our view, continues to provide appealing prospective returns.

How much cheaper are Asian Equities compared to US stocks?

Asian Equities are trading significantly cheaper than US stocks



Source: Bloomberg, as of 5 December 2018

Investment involves risks. Past performance is not indicative of future performance. For illustrative purpose only.

Note: Discount to US stocks is calculated using Price-to-Book valuation ratio.
Index – Asian Equities: MSCI AC Asia ex Japan Index (USD).
US Equities: MSCI USA Price Return USD Index (USD).

Look to Asia for income and yields.

Asian equities continue to offer attractive potential returns, while Asian bonds are less vulnerable to US interest rate hikes because they have shorter maturities.

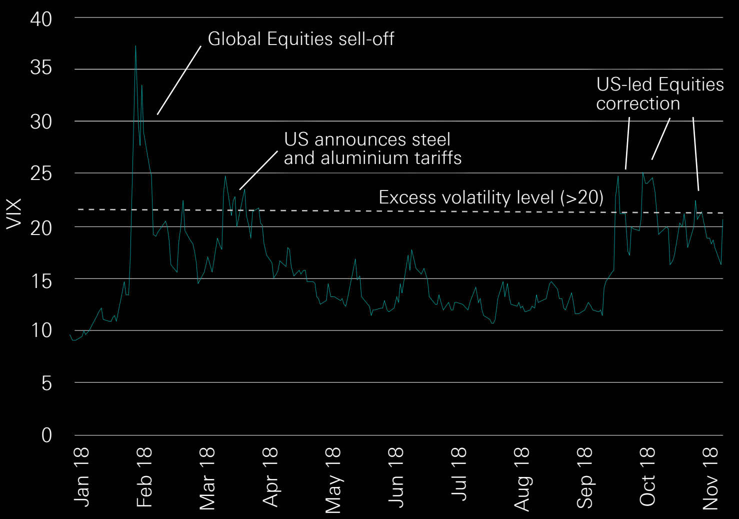
Although growth in Emerging Markets has lost momentum this year, Asian economies remain resilient. Corporate earnings are expected to grow in Asia (excluding Japan) by a healthy 9% for the coming 12 months[1].

Source: 1. Thomson Reuters I/B/E/S, as of 5 December 2018

Volatility

The Volatility Index (VIX)

Geopolitical events can trigger short-term volatility



Source: Bloomberg, as of 5 December 2018.

Investment involves risks. Past performance is not indicative of future performance. For illustrative purpose only.

Note: the volatility index (VIX) is represented by Chicago Board Options Exchange S&P 500 Volatility Index in US dollar (USD).

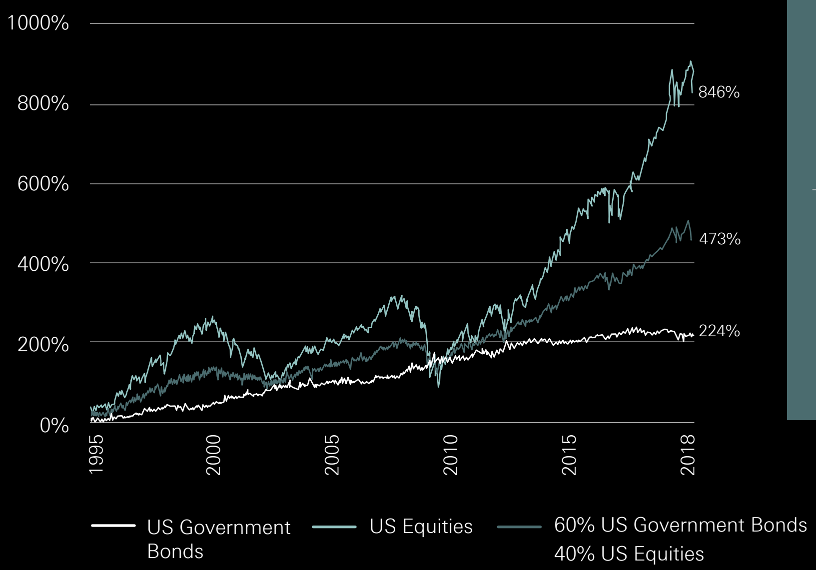
Diversify your portfolio to protect against volatility.

Geopolitical events, trade wars and policy surprises can trigger short-term volatility, meaning that portfolio diversification is key.

Unexpected developments stemming from politics and trade wars may inject additional volatility into markets. At time of writing, the US and China have agreed a "truce" to their ongoing trade-war. However, tensions still remain and a prolonged calm is far from certain. A multi-asset approach that incorporates bonds, equities and other asset classes may offer investors a smoother ride in the event of a correction.

Cumulative return for US Government Bonds, Equities and a 60/40 Portfolio

A diversified portfolio would have had a smoother ride



Source: Bloomberg, as of 28 November 2018. Total return in local currency. Asset class performance is represented by different indices - US Government Bonds: Bloomberg US Government Bond Index. US Equities: S&P 500 Index.

The benefits of a multi-asset approach.

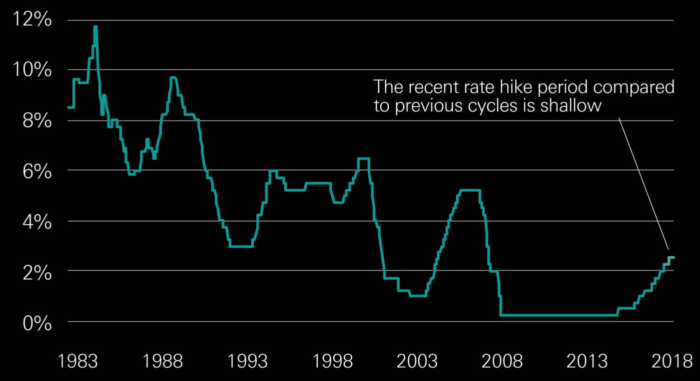
Because of their low volatility profile compared to equities, government and investment grade corporate bonds can be a good way to diversify.

In particular, higher US interest rates mean that US government bonds are now more attractive. Projected returns for corporate bonds have improved this year, and we also see short-duration, high-quality bonds as being slightly more attractive.

Interest Rates

The US Fed Funds Rate

Gradual pace of rate hikes by the Fed



Source: US Federal Reserve, Bloomberg, as of 28 November 2018

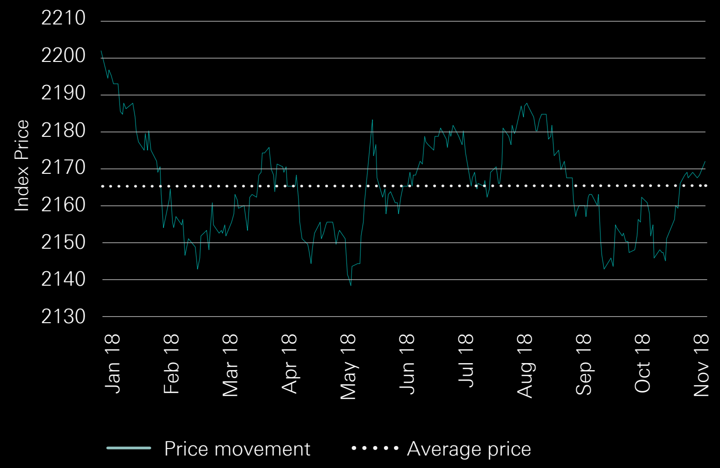
Favour short-dated bonds to cushion against interest rate risks.

The US Federal Reserve is expected to continue gradually raising interest rates, while any inflation shock could incite it to do so further and faster.

US core inflation has risen this year and is now around target, while the economy is growing faster than its historical trend. In response, the Fed has raised interest rates three times in 2018. Based on its own projections, one more rate hike is expected in December, and three more during 2019.

US government bond price movement

US government bonds are now more attractive and are useful diversifiers



Source: Bloomberg, 30 November 2018.

Investment involves risks. Past performance is not indicative of future performance. For illustrative purpose only.

Note: US government bond is represented by Bloomberg Barclays US Government Total Return Index in US dollar (USD).

Be selective in your bond allocation.

Higher interest rates in the US have led to the price of US government bonds (also known as Treasuries) now being lower, making them more attractive.

While bond prices suffer when interest rates increase, lower duration bonds are on the whole less sensitive to interest rate risks.

Because of this, short-dated, high-quality bonds can be a useful way of protecting a diversified portfolio against rising rates.

HSBC Perspective
Liquid alternatives and their value in a diversified portfolio

Xian Chan
Global Head
of Wealth Insights
HSBC Retail Banking and
Wealth Management

Lane Prenevost, CFA
Global Head of Investments
HSBC Retail Banking and
Wealth Management

Traditional investing typically involves some combination of government bonds, corporate bonds and equities from a range of different geographies. The term "alternative investments", therefore, simply refers to any investment that doesn't fall into the traditional bond or equity categories. This term is so broad that it even includes "passion" asset classes like fine wine, art and classic cars – all of which have an active market.

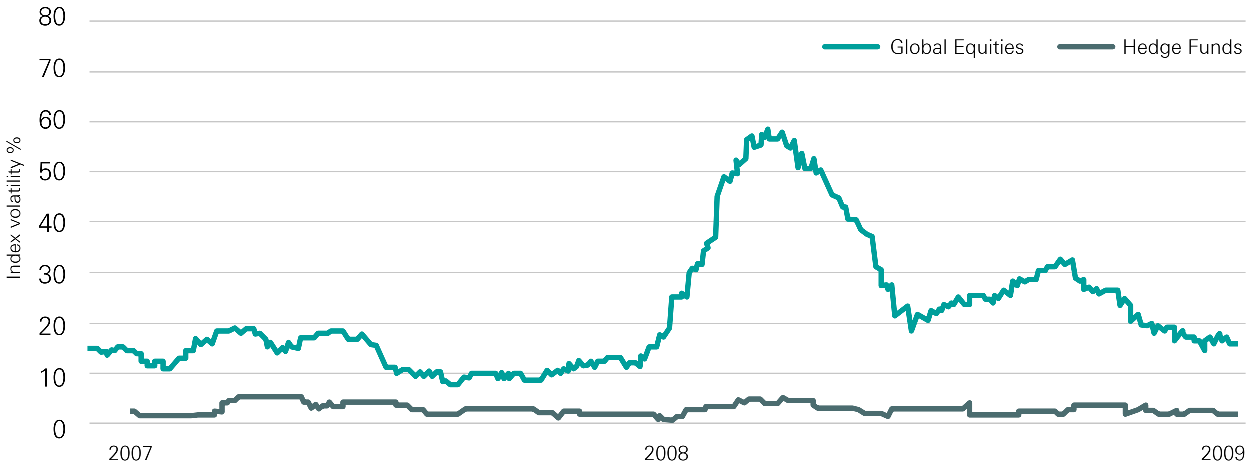
In a more conventional financial context, "alternative investments" generally refer to hedge funds, private equity, property and infrastructure strategies. A characteristic shared by all these investments is their lower correlation with equity and bond markets.

In theory, this means that in the event of a market crash in equities, these alternative investments would generally exhibit their own behaviour and not simply decrease in value as well. In other words, they are more likely to deliver an "absolute return", decoupled from equity or bond market performance.

Traditionally though, the entry barriers for alternative investments have been high, making them difficult for individual investors to access. When compared to traditional mutual and exchange traded funds, hedge fund and private equity strategies require high minimum investments (around USD 500k- USD1m) and are more costly to maintain (annual fees of 2% and a 20% performance fee for hedge funds).

Average volatility during the Financial Crisis (2007-2009)

Hedge funds have been less volatile than global equities in a market downturn



Source: Bloomberg. Investment involves risks. Past performance is not indicative of future performance. For illustrative purpose only.

Note: Financial crisis indicates the period from December 2007 to June 2009. Asset class is represented by different indices in US dollar (USD) - Global Equities: MSCI ACWI Total Return Index. Hedge Funds: HFRX Absolute Return Index.

Liquidity, or the ability for an investor to access their funds quickly and without penalty, is another barrier. Hedge funds only allow investors to access their funds at monthly or less frequent intervals. Private equity strategies, meanwhile, require investors to be “locked-in” for multi-year periods, meaning they are not able to withdraw early without significant penalties.

Most importantly, alternative investments like hedge funds and private equity tend to be inaccessible to individual investors because of their complex, non-regulated nature. This has changed to some degree, however, with the introduction of liquid alternatives.

Liquid alternatives offer a similar “alternative” strategy, but delivered through a regulated mutual fund that allows investors to withdraw on a daily or weekly basis. Because these are regulated investments, they generally offer enhanced governance and transparency compared to their non-regulated counterparts. Liquid alternatives may also have lower fees.

Different types of liquid alternative strategies include:

- **Long-short equity:** this involves investing in both equity securities and derivatives to achieve positive returns whether markets go up (Long) or down (Short). The balance of Long to Short positions typically depends on the manager’s macro-economic view.
- **Non-traditional bond strategies**: these use bond investments to achieve returns uncorrelated with the bond market. Often known as “unconstrained bond funds”, they have the flexibility to invest in different bond instruments across a very broad universe (for example, investments like frontier market debt or more illiquid loans) depending on their view.

For individual investors, the inclusion of liquid alternatives in a diversified portfolio could lower overall portfolio risk, as measured by volatility. Thanks to the lower correlation of these strategies relative to traditional equities and bonds, liquid alternatives can provide a buffer, in the event of a downturn in equity and bond markets, as well as some degree of portfolio protection.

We believe these investments offer useful diversification benefits, without compromising the core client requirements of governance, transparency and ability to access funds on demand.

External Perspective

Using alternative investments to manage portfolio volatility

Anton Pil
Managing Partner of
J.P. Morgan Global
Alternatives

Shawn Khazzam
Managing Director,
J.P. Morgan Global
Alternatives,
Asia Pacific

Investors are increasingly turning to alternative investments as a way of managing volatility. What's behind this trend?

In the last decade we've seen interest in alternative investments grow steadily among professional investors around the world. This isn't surprising, considering their track record of superior relative returns.

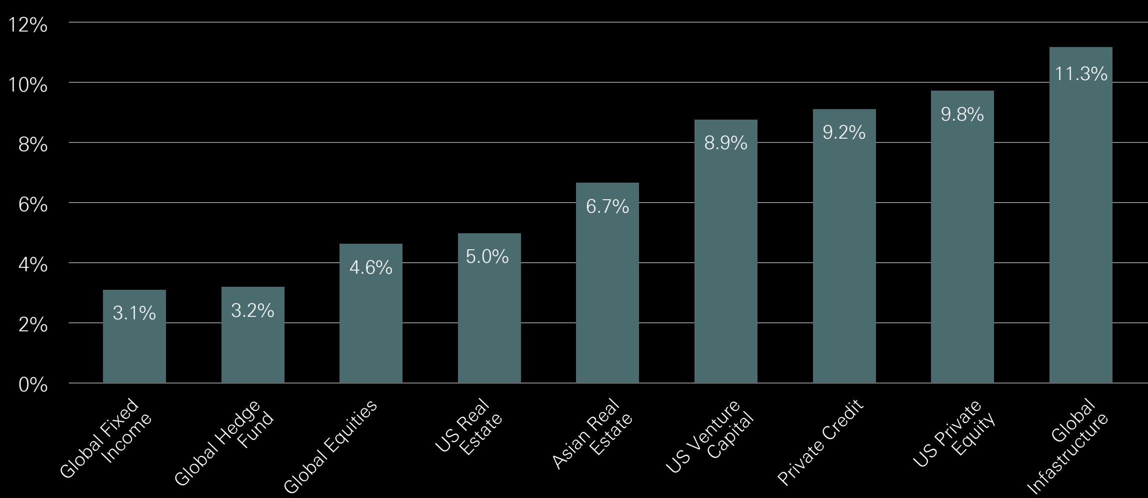
What's more, at a late stage of the economic cycle there may be countless other reasons for investors to consider alternative investments - particularly as a way of addressing the following challenges, all of which prevail today:

- Volatility has returned to public markets
- Interest rates, while rising, are still low, leaving limited options for yield
- Inflation is expected to rise over the medium term
- High valuations in some equity markets have prompted a search for alternate sources of return

Alternative investments offer investors a means of diversifying their portfolios while also providing enhanced returns, thereby helping to protect against these challenges.

We believe investors are approaching an asset allocation "tipping point", where alternative investments will play an increasingly prominent and important role in portfolio selection.

Annualized return by asset class, 2008 to 2017



Source: MSCI, Bloomberg Barclays, HFRI, J.P. Morgan Asset Management. Global Fixed Income returns reflect the Bloomberg Barclays Global Aggregate Index. Hedge Fund Agg: HFRI FW Index. Global Equity returns reflect the MSCI AC World Index. U.S. Core Real Estate (US Core RE): NCREIF Fund Index –Open End Diversified Core Equity Index. Asia Pacific Core Real Estate (APAC Core RE): IPD Global Property Fund Index –Asia-Pacific. U.S. Venture Capital (US VC): Cambridge Associates U.S. Venture Capital Index. Private Credit: Cliffwater Direct Lending Index. U.S. Private Equity (US PE): Cambridge Associates U.S. Private Equity Index. Global Infrastructure: MSCI Global Quarterly Infrastructure Asset Index.

Going into 2019, how might investors use alternative investments to navigate the financial markets? What will be the key themes?

Alternative investments will be a key asset class for 2019, providing investors with a way to mitigate volatility, protect against inflation, enhance returns and deliver relatively high, predictable levels of income. We believe the focus will be on hedge funds, private credit and real assets.

- **Mitigating volatility:** When public markets are volatile, real assets and hedge funds play an important role in maintaining portfolio stability (over the last 20 years, real assets have experienced half the volatility of global equity markets). While hedge funds cushion volatility, many strategies such as "Long/Short" and "Relative Value" (especially Quantitative Statistical Arbitrage) can also benefit from (1) the dispersion that usually comes with higher volatility and (2) higher interest rates. Generally, hedge funds have performed best when the CBOE Volatility Index (VIX) is at around 20-25, approximately the level it has reached today.
- **Income:** With global bonds currently yielding just over 2%, private credit offers an alternative source of income. Floating rate yields in direct lending strategies grow as rates rise. Transportation income strategies lease backbone assets (maritime, aviation, etc) to high-quality counterparties and capitalise on the illiquidity premium to generate yields of 9%.
- **Protection from inflation:** Few asset classes can protect portfolios from inflation. From 1971 to 1985, the last period of significantly high prices, real assets (including real estate and infrastructure) were the only asset class to outperform inflation. Returns from utilities and real estate leases also derive benefit from higher inflation.
- **Enhanced returns:** Investors with sufficiently long-term investment horizons will look to private equity and private credit as a way to achieve enhanced returns by harvesting, amongst other things, an illiquidity premium.

Finally, not all alternative investments require long capital lockups of 10 years. Many investment strategies are offered through open-ended funds that focus on diversification, income generation and protection against inflation while paying regular dividends with lockups of four years or less. In addition, for investors seeking more liquidity, there are a number of "liquid alternative" strategies available in daily dealing funds.

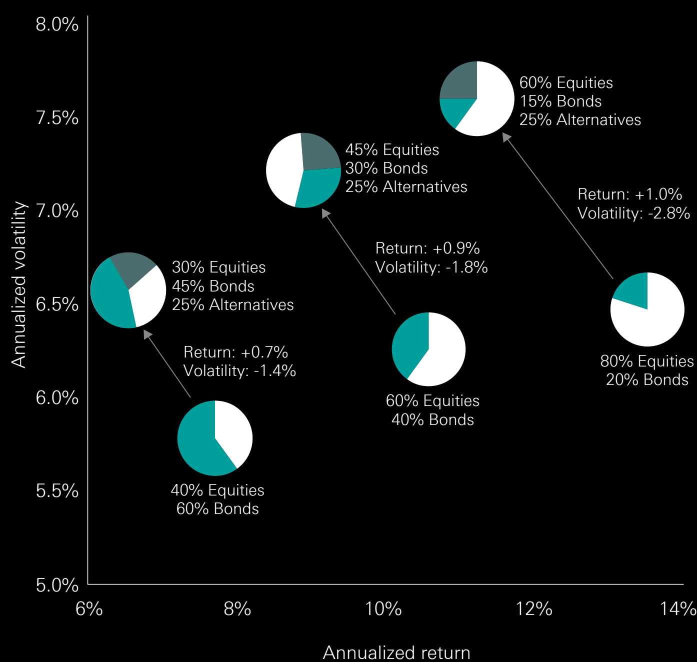
What are the risks of alternative investments? Are they riskier than traditional investments?

Alternative investments are susceptible to illiquidity, currency, regulatory, political and executional risk – though illiquidity tends to be top of mind when contemplating this particular asset class.

The best way to mitigate illiquidity risk is to include alternative investments in a broad, diversified portfolio of equities and bonds. The addition of a 25% core-plus alternative investments allocation to a traditional portfolio of stocks and bonds can reduce volatility by nearly 300 basis points while enhancing returns (see chart below).

Whatever benefits they seek, from mitigating volatility to enhanced returns, income generation or protection against inflation, professional investors with long-term horizons should consider a strategic allocation of alternative investments to meet their objectives – especially late in the cycle.

Annualized volatility and returns, 1998 to 2017



Source: J.P. Morgan Asset Management. The data is as of 13 August 2018. Illustrative 20-year analysis using asset class data from 1998 to 2017. Volatility is calculated using historical annual 1998-2017 standard deviation of historical returns. The portfolios assume annual rebalancing. Alternative investments portfolio includes global real estate, infrastructure and transport, private credit, liquid alternatives, and private equity.

Key Economic Events

Dec 2018	**18-19 Dec:** US Federal Open Market Committee (FOMC) meeting **19-20 Dec:** Bank of Japan meeting **20 Dec:** Bank of England meeting
Jan 2019	**22-23 Jan:** Bank of Japan meeting **22-25 Jan:** World Economic Forum Annual Meeting **24 Jan:** European Central Bank (ECB) meeting **29-30 Jan:** US FOMC meeting
Feb 2019	**7 Feb:** Bank of England meeting
Mar 2019	**7 Mar:** European Central Bank (ECB) meeting **14-15 Mar:** Bank of Japan meeting **19-20 Mar:** US FOMC meeting **21 Mar:** Bank of England meeting **21 Mar:** General Council meeting of the ECB **29 Mar:** Brexit day

Things we are watching

Central Bank Policy

- Statement by key Central Bank members
- Economic activity data

Geopolitics

- US - China trade tensions
- United States - Mexico - Canada Agreement (USMCA)
- Brexit negotiation
- Italy government budget challenges

Glossary

Asset class: a group of securities that show similar characteristics, behave similarly in the marketplace, and are subject to the same laws and regulations. The main asset classes are equities, fixed income, and commodities.

Asset allocation: the allocation of funds, based on an investor's objectives, to various categories of assets such as equities, bonds and others.

Duration: the sensitivity of a fixed-income investment's price (the value of principal) to a change in interest rates. The longer a fund's average duration, the more sensitive the portfolio is to interest rate shifts. Duration is expressed as a number of years.

Company fundamentals: the intrinsic value of a company as analysed by looking at its revenue, expenses, assets, liabilities and other financial indicators.

Diversification: often referred to as "not putting all your eggs in one basket", diversification means investing in a variety of different markets, products and securities to spread the risk of loss.

Fiscal policy: the use of government spending and tax policies to influence macroeconomic conditions such as aggregate demand, employment, inflation and economic growth.

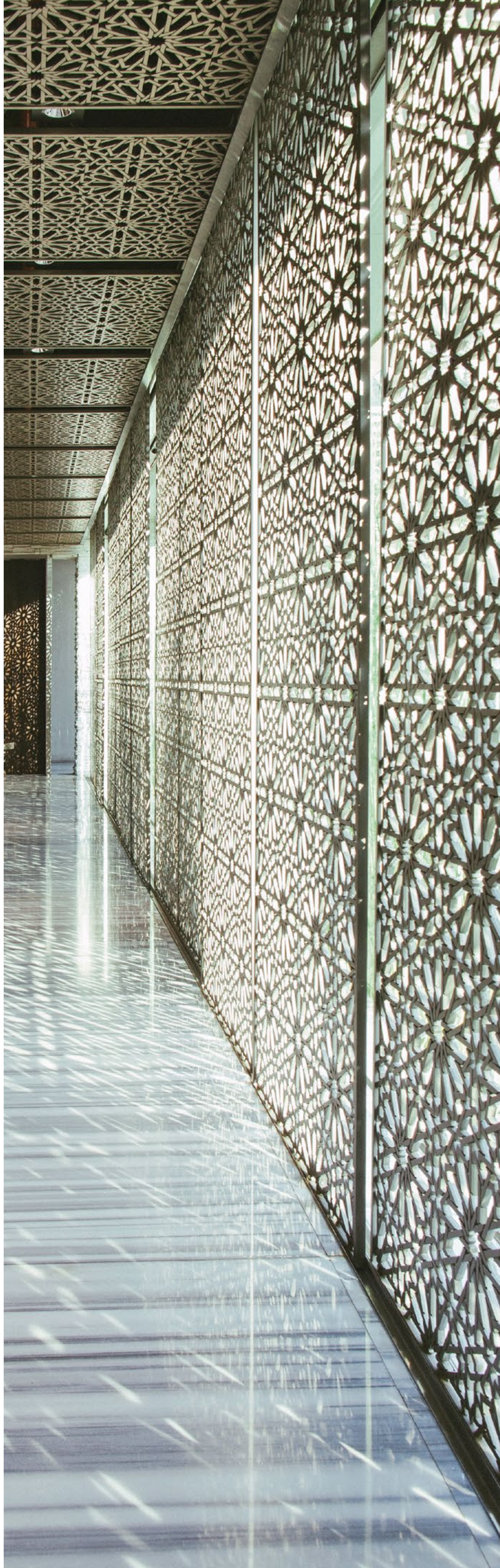
Investment strategy: the internal guidelines that a fund follows in investing the money received from its investors.

Maturity: the date when the issuer of a bond or debt obligation repays the principal (the original amount invested).

Monetary policy: process by which the authorities of a country control the supply of money. This often involves targeting a rate of interest for the purpose of promoting economic growth and stability.

Inflation: the rise in the general price levels of goods and services in an economy over a period of time.

Volatility: a term for the fluctuation in price of financial instruments over time.



Contributors

Jan-Marc Fergg, CFA

Deputy Head of Group Wealth Management, HSBC Retail Banking and Wealth Management

With many years' experience in investment banking, wealth management and financial markets, Jan-Marc has an in-depth perspective on all aspects of the industry. As Deputy Head of Group Wealth Management, he currently leads the development of our investment products, financial planning, and research & insights strategy. He is also responsible for the evolution of HSBC's wealth advisory process.

Xian Chan

Global Head of Wealth Insights, HSBC Retail Banking and Wealth Management

Xian is responsible for developing thought leadership and communicating HSBC investment views for our retail banking and wealth management clients. In particular, he specializes in delivering actionable insights on the world's fast-moving financial markets. Previously, Xian was a multi-asset class fund manager at various private banks and asset managers, including HSBC Global Asset Management.

Lane Prenevost, CFA

Global Head of Investments, HSBC Retail Banking and Wealth Management

Lane is responsible for the HSBC Global Wealth investments proposition, including mutual funds, discretionary accounts, managed solutions, asset allocation services, and alternative investments. Previously, he was with HSBC Global Asset Management leading the HSBC Multimanager business and investment capability in the Americas, and was Global Head of Wealth and Multimanager Product. Prior to HSBC he held senior investment roles at TD Asset Management based out of Toronto, Canada.

Simin Zhuo

Insights and Research Analyst, HSBC Retail Banking and Wealth Management

As the editor of this publication, Simin focuses on helping clients understand global markets to support their investment decision-making. She also leads the production of insights and research for our retail banking and wealth management clients worldwide, ranging from investment strategy to thought leadership.

Guest Contributors

Joseph Little

Global Chief Strategist, HSBC Global Asset Management

Joe heads the Global Investment Strategy team within HSBC Global Asset Management, with lead responsibility for macroeconomic and multi-asset research, as well as for developing our investment views on asset allocation and portfolio construction. Previously, he was Chief Strategist for Strategic Asset Allocation and a portfolio manager for HSBC's Absolute Return Global Macro Fund.

Anton Pil

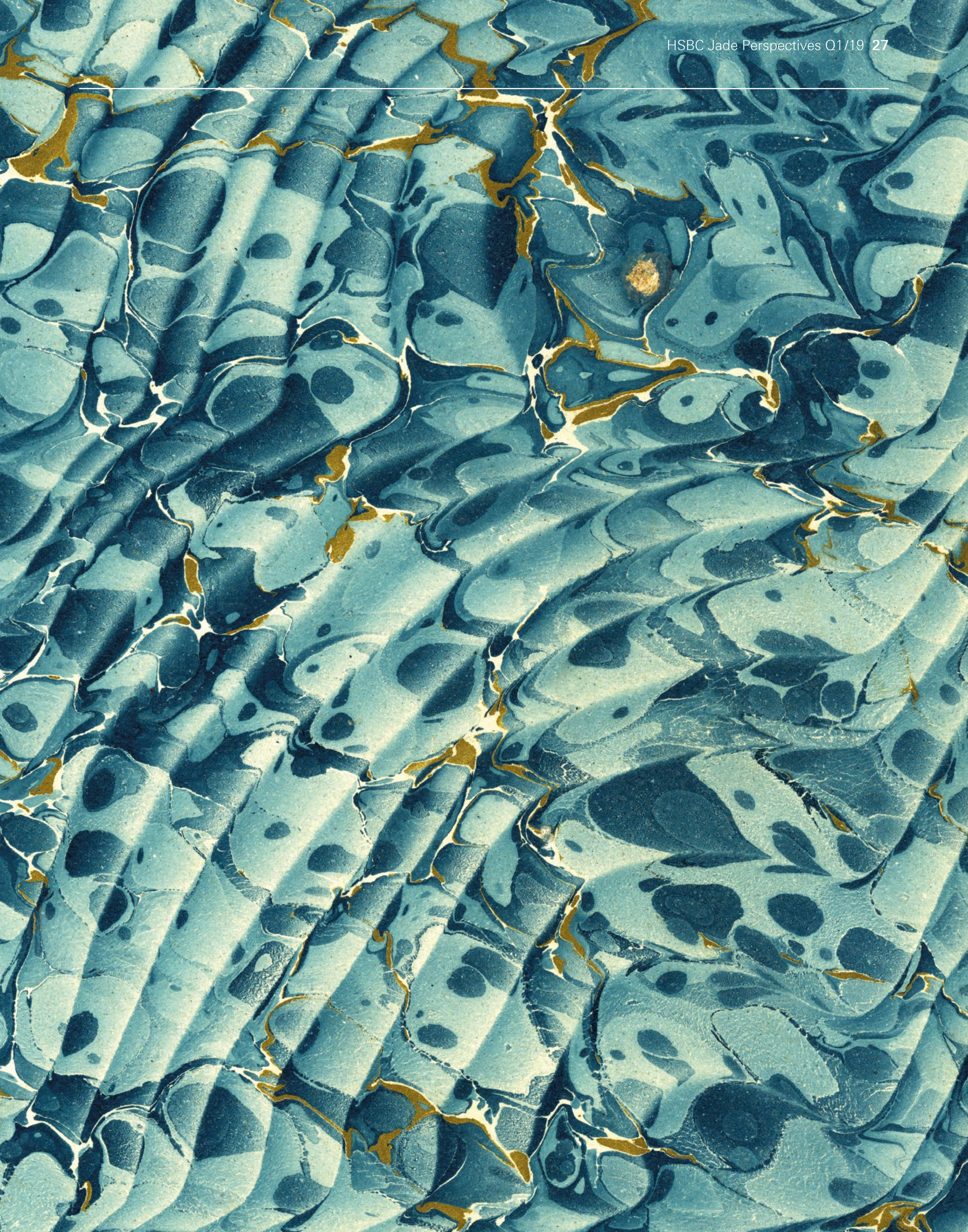
Managing Partner of J.P. Morgan Global Alternatives

With over $130 billion in alternative assets under management, Anton's team manages investments across real estate, private equity, infrastructure, hedge funds and liquid alternatives. Anton has held a variety of leadership roles at J.P. Morgan over the last two decades. He was most recently head of the Private Bank's Global Investment Opportunities Group (GIO), working with the firm's most sophisticated clients interested in opportunistic absolute return investing across public and private markets. Prior to becoming Head of GIO in 2008, Anton was Head of Fixed Income, Currencies, and Commodities for J.P. Morgan Wealth Management.

Shawn Khazzam

Managing Director, J.P. Morgan Global Alternatives, Asia Pacific

Shawn leads the positioning of hedge funds, infrastructure, private credit, private equity, real estate, transportation, and multi–alternative portfolios for institutions and individuals across Asia Pacific. Prior to this, he was Head of Product Strategy & Development for the region, where he also oversaw Sustainable Investing and ESG initiatives. Shawn has also held positions in Investment and Consumer banking in New York and London.



This document is prepared by The Hongkong and Shanghai Banking Corporation Limited ('HBAP'), 1 Queen's Road Central, Hong Kong. HBAP is incorporated in Hong Kong and is part of the HSBC Group. This document is distributed by HSBC Bank Canada (including its subsidiaries HSBC Investment Funds (Canada) Inc., HSBC Private Wealth Services (Canada) Inc., and the HSBC InvestDirect division within HSBC Securities (Canada) Inc.), HSBC Bank (China) Company Limited, HSBC France, HBAP and HSBC Bank (Singapore) Limited (collectively, the "Distributors") to their respective clients. This document is for general circulation and information purposes only.

The contents of this document may not be reproduced or further distributed to any person or entity, whether in whole or in part, for any purpose. This document must not be distributed in any jurisdiction where its distribution is unlawful. All non-authorised reproduction or use of this document will be the responsibility of the user and may lead to legal proceedings. The material contained in this document is for general information purposes only and does not constitute investment research or advice or a recommendation to buy or sell investments. Some of the statements contained in this document may be considered forward looking statements which provide current expectations or forecasts of future events. Such forward looking statements are not guarantees of future performance or events and involve risks and uncertainties. Actual results may differ materially from those described in such forward-looking statements as a result of various factors. HBAP and the Distributors do not undertake any obligation to update the forward-looking statements contained herein, or to update the reasons why actual results could differ from those projected in the forward-looking statements. This document has no contractual value and is not by any means intended as a solicitation, nor a recommendation for the purchase or sale of any financial instrument in any jurisdiction in which such an offer is not lawful. The views and opinions expressed herein have been sourced from HSBC Global Asset Management at the time of preparation, and are subject to change at any time. These views may not necessarily indicate HSBC Global Asset Management's current portfolios' composition. Individual portfolios managed by HSBC Global Asset Management primarily reflect individual clients' objectives, risk preferences, time horizon, and market liquidity.

The value of investments and the income from them can go down as well as up and investors may not get back the amount originally invested. Past performance contained in this document is not a reliable indicator of future performance whilst any forecasts, projections and simulations contained herein should not be relied upon as an indication of future results. Where overseas investments are held the rate of currency exchange may cause the value of such investments to go down as well as up. Investments in emerging markets are by their nature higher risk and potentially more volatile than those inherent in some established markets. Economies in emerging markets generally are heavily dependent upon international trade and, accordingly, have been and may continue to be affected adversely by trade barriers, exchange controls, managed adjustments in relative currency values and other protectionist measures imposed or negotiated by the countries with which they trade. These economies also have been and may continue to be affected adversely by economic conditions in the countries in which they trade. [Mutual fund][1] investments are subject to market risks, read all investment related documents carefully.

This document provides a high level overview of the recent economic environment and has been prepared for information purposes only. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of its dissemination. It is not intended to provide and should not be relied on for accounting, legal or tax advice. Before you make any investment decision, you may wish to consult a financial adviser. In the event that you choose not to seek advice from a financial adviser, you should carefully consider whether the investment product is suitable for you. You are advised to obtain appropriate professional advice where necessary.

We accept no responsibility for the accuracy and/or completeness of any third party information obtained from sources we believe to be reliable but which have not been independently verified.

THE CONTENTS OF THIS DOCUMENT HAVE NOT BEEN REVIEWED BY ANY REGULATORY AUTHORITY IN HONG KONG OR ANY OTHER JURISDICTION. YOU ARE ADVISED TO EXERCISE CAUTION IN RELATION TO THE INVESTMENT AND THIS DOCUMENT. IF YOU ARE IN DOUBT ABOUTANY OF THE CONTENTS OF THIS DOCUMENT, YOU SHOULD OBTAIN INDEPENDENT PROFESSIONAL ADVICE.