Highlight

In 2016, a slow recovery pace of the US economy will not only keep the Fed staying relatively dovish but also keep ECB, BOJ and PBOC continuing/expanding current easing programs. Looking ahead the Fed statement and China’s economic indicators would continue to drive the global risk appetite, and the indication of US economic strength and dollar direction are likely to result in EM volatility again.

Global equities

Low DM inflation and a mild global growth remain in the scene for 2016 for investors to favor fund flows to DM equities. Our preferred DM market remains European equities, as the additional monetary policy easing will be an important driver of returns in the Stoxx, while corporate profitability improvement is likely to be another catalyst moving into this year. The other focus market will be Japanese stocks.

HK/China

On HK/China, since the central government is proactive in reducing obsolete capacities and de-leveraging, it is unlikely to boost investment or expand the balance sheets of local governments. During stock selection, investors should focus on the outperformers related to the new economies.

Fixed Income Markets

On credit market, US high yield has been suffering in 2015, with liquidity/redemption risk continuing to pressure the prices, whereas Asia bond market was relatively resilient. Investors who look for a stable income and yield could continue to expose in Asian USD bonds.

Forex Markets

On FX, USD is on track to strengthen further in 2016, although the magnitude of USD appreciation might not be as dramatic as we have seen in 2015. Our top FX idea in 1Q16 is to short CAD. We think Canada’s Central Bank may need to cut interest rates further to cushion against the oil shock and stimulate the sluggish economy. Our 1Q16 target for USDCAD is 1.42.
Executive Summary

Equities

US
Emerging Markets (EM)
Europe
Japan
China / Hong Kong

Global Bond Market

Currencies

NZD
AUD
CAD
EUR
GBP
EXECUTIVE SUMMARY

Investment Analysis

<table>
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<tr>
<th>Asset Class</th>
<th>1Q 2016</th>
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<tr>
<td>US equities</td>
<td>=</td>
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<tr>
<td>European equities</td>
<td>+</td>
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<tr>
<td>Japanese equities</td>
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<td>Hong Kong China equities</td>
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<tr>
<td>Emerging market equities</td>
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<td>DM Corporate Bonds</td>
<td>+/-</td>
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<td>EM Sovereign bonds</td>
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<td>Asian bonds</td>
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<tr>
<td>Commodity currencies</td>
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<td>Gold</td>
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*Red* means changes have been made recently

Symbol representation:

+=/+ Neutral with a Positive bias

=+ Neutral with a Negative bias

+ Positive

- Negative

= Neutral

In 2016, a slow recovery pace of US economy will not only keep the Fed staying relatively dovish but also keep ECB, BOJ and PBOC continuing/expanding current easing programs.

Low DM inflation and a mild global growth remain in the scene for investors to favour fund flows to DM equities. Our preferred DM market remains European equities, and the other focus market will be Japanese stocks.

On HK/China, since the central government is proactive in reducing obsolete capacities and de-leveraging, it is unlikely to boost investment or expand the balance sheets of local governments. During stock selection, investors should focus on the outperformers related to the new economies.

On credit market, US high yield has been suffering in 2015, with liquidity/redemption risk continuing to pressure the prices, whereas Asia bond market was relatively resilient. Investors who look for a stable income and yield could continue to expose in Asian USD bonds.

On FX, USD is on track to strengthen further in 2016, although the magnitude of USD appreciation might not as dramatic as we have seen in 2015. Our top FX idea in 1Q16 is to short CAD and our target for USDCAD is 1.42.

Global equities hit their troughs at the end of 3Q15 and rebounded sharply in October, thanks to a more dovish than expected statement from Fed. As US has finally hiked the Fed Funds Rate in Dec 2015, the market seemed to react so calmly that neither the US dollar nor the long term Treasury yield has had much obvious movement since. We viewed this as the best case scenario for the global markets, as a not-too-hot and not-too-cold economic temperature should continue to support global asset prices. A slow recovery of US economy will not only keep the Fed stay relatively dovish but also keep ECB, BOJ and PBOC continue their current easing program. Going forward, Fed statement and China’s economic indicators would continue to drive the global risk appetite, and the indication of US economic strength and dollar direction are likely to result in EM volatility again.

On the other hand, low DM inflation and a mild global growth remain in the scene for 2016 for investors to favor fund flows to DM equities, in our view. Our preferred DM market remains European equities, as the additional monetary policy easing will be an important driver of returns in the Stoxx, while corporate profitability improvement is likely to be another catalyst moving into this year. The other focus market will be Japanese stocks, although the case of BOJ easing and Yen weakness does not look as strong as that in Europe in 2016. In this quarter, we downgraded US
equities, as we expect US stock market to show another year of range trading. Concerns on rising labor cost and profit margin sustainability would likely emerge this year, and we would like to focus on a few key sectors such as consumption related technology and healthcare stocks as they are the major beneficiaries of further strength in US consumer spending.

On Asia, all eyes are still on China growth slowdown and government’s reform agenda. Economic growth is likely to face further downward pressure going into 1Q16, and it is widely anticipated that more aggressive policy supports are needed to prevent a hard-landing. In 2016, we expect consumer and service sectors to perform relatively better than the industrial sector, as the former is supported by policy makers and the latter still faces the overcapacity and restructuring challenges. With de-capacity and de-leverage in sight, China is not likely to rejuvenate its investment spending and expand local government balance sheet in the coming years. Investors should focus on winners emerging from the new economy.

On credit market, US high yield has been suffering in 2015, with liquidity/redemption risk continuing to pressure the prices, whereas Asia bond market was relatively resilient thanks to its undemanding valuation and investors’ risk averse attitude toward Asia’s more volatile equities price performance. Chinese property sector USD high yield bonds have outperformed the market expectation thanks to policy support to allow developers to issue onshore bonds with lower costs, as well as the loosening of controls on property purchase restrictions. Investors who look for a stable income and yield could continue to expose in Asian USD bonds. On the other hand, a weakened RMB exchange rate has dampened the sentiment toward offshore RMB Dim Sum bonds. The market consensus is for RMB to weaken further going into 2016. We expect the short tenor high yield Dim Sum bonds remain supportive thanks to the limited supply and the spill-over effect from onshore RMB bond market to the offshore.

On FX, USD is on track to strengthen further in 2016, although the magnitude of USD appreciation might not be as dramatic as we have seen in 2015. Our top FX idea in 1Q16 is to short CAD. Canadian economy grew only 1% in 3Q15 after a technical recession in the first two quarters of 2015. The weak oil prices and sector spending cut would continue to dampen the Canadian economy going forward. The outlook for oil price remains pessimistic due to supply demand imbalance. We think the Canada’s Central Bank may need to cut interest rates further to cushion against the oil shock and stimulate the sluggish economy. Our 1Q16 target for USDCAD is 1.42.
1Q 2016 Investment Outlook 7 Jan 2016

UNITED STATES

INVESTMENT SUMMARY
- U.S. equity markets surged by 7.3% in 4Q15 and 3% for the year of 2015.
- U.S. economic backdrop remains healthy.
- Earnings season kicking off in January will be in focus.
- Dollar strength and oil prices hold the key.
- An aging bull market, but not turning into bearish yet.
- Valuations of U.S. equities are not cheap.

U.S. equity markets (S&P 500) surged by 7.3% in 4Q15 and 3% for the year of 2015. U.S. equities saw wild swings on global growth concerns, interest rate hike uncertainty and oil prices slump and strong dollar affecting manufacturers.

U.S. economic backdrop remains healthy. The Federal Reserve also raised its policy rate by 25 bp for the first time in ten years, supported by healthy economic backdrop of strong labor market, easy credit conditions and improving consumer spending, although overall wage pressures remain subdued. Low oil prices and the strong dollar are also factors holding back headline inflation. The latter is unlikely to exceed the Fed’s 2% target before the end of 2016.

Earnings season kicking off in January will be in focus. Affected by strong dollar, U.S. corporates revised downward their revenue and earnings forecast. According to Factset’s earnings insight, the estimated earnings for 4Q15 are expected to decline by 4.5%, which would mark the first time of declines in U.S. corporate earnings since 2009.

Dollar strength and oil prices hold the key. A key determinant of the pace at which the Fed continues to raise rates is likely to center around the U.S. dollar strength and oil prices. A stronger dollar acts as a drag on the U.S. economy, and hurts corporate earnings and commodity prices. Suppressed oil prices drag down inflation outlook. Therefore, continued dollar strength and low oil prices would likely slow the pace of the Fed’s rate increases. On the other hand, counter moves in the dollar and rebound in commodity prices or inflation could trigger a faster pace of rate increases.

An aging bull market, but not turning into bearish yet. Looking into 2016, we remain positive on U.S. equities, given its healthier economic backdrop than other countries and regions. Stronger dollar and better fundamentals would allow the country to be more appealing than the others. But we also note that entering its seventh year, which is now in its 82nd month (versus the 50-year average of 54 months), the ageing US equity bull market looks vulnerable. Taking history as reference, U.S. equities tend to underperform the global benchmark on average after the start of the first rate hike. Monetary divergence would make Eurozone and Japan to be more attractive than the U.S markets.
Valuations of U.S. equities are not cheap. The S&P 500 is trading at 16x forward 2016 earnings, which is above its 5-year historical average of 15.8x. We therefore expect U.S. equity markets to be volatile in narrow trading ranges heading into 1Q16. We recommend investors to focus on sectors like financial and information technology, and favor stocks with high U.S sales exposure, strong balance sheets and strong fundamentals.

Sector Outlooks

Technology (Overweight) The sector performed well in 2015. Having broken through 5000, Nasdaq Index might come due for some profit taking. But we believe the innovation and entrepreneurial spirit driving the technology sector still pervade. Technologies that offer consumer-related or business-oriented services are appealing to investors. Positive factors for technology sector include increased investment, M&A, and strong balance sheets. Sector-wise, big data, cloud computing, internet of things, mobile internet and social media will be the areas for future growth.

Healthcare (Overweight) The long-term growth story of healthcare/biotechnology is still intact. The health care sector covers two industry groups, 1) companies that make healthcare equipment and provide healthcare services, and 2) those that are involved in pharmaceuticals and biotechnology. While the latter group has been outperforming the market for a while and valuations appear fair, we prefer more of the first group, which are still benefiting from numerous provisions of the Affordable Care Act and valuations are not over-stretched yet.

Consumer Discretionary (Overweight) Consumer sentiment in the U.S. is improving, as strengthening job market and money saved from lower energy prices boosted spending power. Among consumer discretionary sub-sectors, we favor travelling and tourism related businesses, benefit from higher demand in travelling and entertainment not only from Americans but also from other developed and emerging economies.

Risk Considerations: 1) uneven economic growth in Europe and the BRIC nations, 2) economic trends in China, 3) oil price volatility and 4) geopolitical threats in Europe and the Middle East. 5) a global low inflation environment that could turn deflationary.
Fed starts the interest rate normalization

The FOMC moved to raise the target range for the Fed funds rate in the December 2015 meeting, the first time since December 2008. Market expects Fed to raise rates by another 50-100bps in the year 2016. Financial conditions of some emerging markets could be under pressure with higher levels of US dollar denominated debt with the backdrop of rising interest rates and a strengthening value in US Dollar. However, given that emerging markets have fewer dollar-denominated debts than they did in the past decades, it makes them less vulnerable than before. On the other hand, since Fed’s taper tantrum in 2013, emerging markets currencies have suffered significant devaluations. We believe that the EM currency values have already been reflecting any potential Fed rate hikes in the near future. The cheaper currency also makes emerging markets’ products look more attractive; eventually boosting exports and improving economic growth.

With US economic improvements, we believe the exports of emerging market will finally pick up in the second half of 2016.

China’s economic slowdown and devaluation of Yuan

China’s continued slowdown poses a serious headwind for the emerging markets. For years, the world’s second largest economy had been a major importer of raw materials from around the world. As China posted the weakest economic growth data since 2009, increasing concerns are felt around the global market. China’s currency, the Renminbi also saw its value fall by 4% in 2015, posting a four and a half year low. Both the economic slowdown and currency devaluation could have detrimental effects on the emerging market’s weakening, export-reliant economy. As People’s Bank of China engages in the easing of monetary policies, central banks of the emerging markets would also devalue their own currency to preserve their competitive advantage in international trade. We believe that China remains a key risk component for the emerging market economies.

Oil price slumps further

Nymex crude oil closed at $37.04 a barrel which translates to a loss of about 30% in 2015. Down for two straight years, Nymex crude has suffered a total loss of more than 60% of its value since its record high in 2013. Oil-exporting nations have undoubtedly suffered from reducing government revenues and weaker currencies. For example, Russia’s 2016 budget was calculated on the basis oil prices at $50 per barrel. Currently the oil price at around $37 would create financial difficulties for Russian government to meets it fiscal and monetary budget goals. On the other hand, Russia’s Central Bank predicts that if oil prices remain at current levels, GDP could shrink by as much as 2% in 2016. OPEC reveals that, the oversupply of oil market would not see any reversal until the 3Q of 2016.
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Expect EM to pick up in 2nd Half The headwinds that have been battering emerging markets still exist in 2016 making any attempts of reversal in 2016 a difficult task, but the hope is that some countries will begin to turn the corner. The cheap valuation is beginning to attract the attention of investors. We believe the fund flows to emerging markets will start picking up in the second half of this year.

Market Outlook

Indonesia (Overweight) Indonesia’s inflation rate posted in December fell to the lowest figure in the last 6 years. Inflation rate went down to 3.35% in December, from 4.89% in November, paving the way for the central bank to further ease monetary policy as early as the 1st quarter. The low inflation rate allows for total rate cuts of 75 bps this year, shifting from contractionary to stimulatory monetary policy. Along with seven economic packages announced by Indonesian government, we expect the domestic demand could continue to improve. We think Indonesia could outperform among its emerging market counterparts.

Korea (Overweight) The economic slowdown of China, the largest trading partner of Korea, would continue to put pressure on Korea's export growth. While Korea's external demand is expected to remain sluggish, an improvement in domestic demand could help to alleviate its weak exports. The unemployment condition remains stably low at 3.4% in recent months despite the slowdown in external demand. The rise in home prices and low interest rate environment are also likely to boost domestic consumption. With cheap valuation, we believe Korea can outperform its emerging market rivals.

Taiwan (Neutral) Taiwan's export and industrial production in November went down by 16.9% and down by 4.94% year-on-year respectively. Continued weakness in Chinese and emerging markets’ demand will exert further headwinds on Taiwan's exports. Also, Taiwan's main opposition, the Democratic Progressive Party, being the front runner of the upcoming presidential election in January may lead to a potential shift in the government’s bias towards Pro-China economic policies. We see this change as a risk and hence rate Taiwan as neutral.

Russia (Neutral) Oil price began falling in the summer of 2014 from over $110 per barrel to just above $35 per barrel today. Russia's economy relies heavily on its oil related industry. The fall in oil price drives Russia towards another year of recession. However, the terrorist attacks on the Russian civil airplane in Egypt and Paris may lead to broad coalition between Russia and Western countries, even though the EU extended the sanctions for another 6 months in December. We believe that continued cooperation between Russia and the West in the Syrian crisis gives Russia a genuine opportunity to revert away from its economic and political isolation. We rate Russia stock market as neutral.

India (Underweight) The total washout of Parliament's winter session was a big disappointment and largely a repeat of the Monsoon Session. Investors started to raise questions on the ability of Modi-led government in pushing ahead with its reform agenda in the aftermath of a massive defeat BJP suffered in Bihar polls. The failure to pass critical economic reforms such as Goods and Services Tax (GST) Bill could put immense pressure on the government’s effort to assure concerned investors. Indian stocks are
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trading at 30% premium compared to its Asian peers, we believe the gap would reduce over time and hence Indian stock market is expected to underperform in 2016.

Brazil (Underweight) Brazil's economy is expected to contract by 3.5% in 2015 and again in 2016, due to growing unemployment, budget deficit as large as 9.5% of GDP and political uncertainty remaining elevated. Finance Minister Levy resigned in December as he felt a lack of proper conditions for him to carry on with reforms. The increasing tension in the Congress significantly undermined the ability of government to implement austerity measures. Last but not least, the lower house of Congress will likely decide by March on whether to recommend for the impeachment of President Rousseff. We believe that Brazil will be facing difficult economic and political challenges in the coming quarter.

Risk Considerations:
1) Political, liquidity, and currency risks, 2) further downside on oil / commodity prices, 3) Further slowdown in China or U.S, 4) unexpected tightening on Fed funds rate
1Q 2016 Investment Outlook

EUROPE

INVESTMENT SUMMARY

- The Stoxx 600 Price Index recorded gain in 4Q15
- Eurozone’s economic growth is expected to remain solid in 2016
- Growth not only found in Germany but also in peripheral countries
- Consumer spending leads the recovery.
- We are still positive on European equities.

The Stoxx 600 Price Index recovered in 4Q15 from previous quarter’s loss. Europe was the most outperforming developed market, recording 10.3% gain last year. European equities were volatile due to Greek debt crisis, migrant crisis, terrorism, fear of slowdown in China, depreciation of emerging market currencies, and uncertainty of U.S. interest rate hike. Volkswagen emissions scandal and Glencore debt-related worries added on the selling pressure. But European shares managed to recover well after every correction.

Eurozone’s economic growth is expected to remain solid in 2016. The Eurozone economy improved in 2015 although at a modest pace of 1.6%. The gradual recovery is expected to continue in 2016, supported by solid domestic demand, low oil prices and the continuation of the region’s accommodative monetary policy. However, slow inflation is still a concern triggering the risk of deflation. So we believe ECB, though not adding more, will still maintain and extend its quantitative easing program to support economic growth in 2016.

Growth not only found in Germany but also in peripheral countries. Despite the Greek debt crisis, migrant crisis and the terrorists’ attack, economic growth in Europe has been resilient, led by the strength in Germany. We believe going into 2016, recovery will be more broad-based from other Eurozone countries. The Organization for Economic Cooperation and Development’s leading indicators for the Eurozone economy suggested that the region will continue to grow modestly in coming months, accelerating in France and Italy while remaining stable in Germany.

Consumer spending leads the recovery. Even though economic weakness in emerging markets has hurt exports, consumer spending has been the leading driver for the Eurozone recovery. Boosted by lower energy prices, Eurozone consumers are encouraged with higher disposable income. An improving labor market with falling unemployment also boosted consumer confidence. We expect consumer spending to continue to play its part in driving growth in the region.

We are still positive on European equities. We think that the outlook for European stocks seems favorable, due to a combination of positive growth, low inflation and the ECB’s continued monetary stimulus in 2016. Fiscal spending is likely to get a boost from spending on immigrants and defense, while low oil prices, weak currencies and credit growth should also bolster economic expansion. With a prospective P/E level of 14.7x, the valuation of Stoxx Europe 600 Price Index is still lower than its latest 5 years’ averages of 17.5x.
Germany (Overweight) The German economy has proven remarkably robust over the past two years, supported by private and public consumption (though smaller contribution from the latter). Even though sluggish exports and shrinking investment were a drag on growth, a strong labor market (unemployment was at record-lows in October and November) and expansionary monetary policy are all supporting private consumption. Consumer sentiment was resilient in 4Q15 and is expected to continue to drive growth. Public spending will likely also lift growth, partly due to increased spending related to heightened immigration.

U.K. (Neutral) UK economy is slowing, which is partially attributed to downside risk in sterling against the euro. Sterling pound is now close to a 20-year high relative to the euro. U.K. calling for a referendum on the country’s membership of the European Union would likely pose a political risk. A vote to leave would bring significant political uncertainty which could affect confidence of investment in the country. Trading at 15x prospective PE, the valuations of UK equities (FTSE 100 Index) are not overstretched but also not as attractive as other Eurozone countries. The index’s high exposure to financial and energy sectors might also cap the market’s near-term upside.

France (Neutral) The French economy tends to be less volatile than other Eurozone economies, because the substantial weight of government expenditures stabilizes growth while the share of exports is relatively low. In 1Q16, we expect consumption growth to remain solid but somewhat less dynamic than in 2015 after the terrorist’s attack. Notably, labor market conditions remain challenging as unemployment is still rising.

Italy (Overweight) Italian growth has remained on a gradually accelerating path during the past year, thanks to improving labor market conditions, lower oil prices, accommodative monetary policy and some progress on administrative reforms. We expect the acceleration in consumption growth to continue in 2016, as the mentioned drivers remain in place and fiscal policy becomes less restrictive. Consumer confidence has climbed to an all-time high; unemployment has edged down from elevated levels and nominal wage growth has accelerated. However, investment growth has so far remained more subdued.

Spain (Neutral) Given still high leverage in the economy, Spain is one of the prime beneficiaries of the improving financing conditions induced by various ECB measures. Debt servicing costs have fallen significantly due to lower rate. Low energy and moderate inflation have continued to support the country’s domestic demand. However, the results of a fragmented parliament following the 20th Dec 2015 election will set the stage for weeks of political uncertainty in 1Q16, which will be a short-term headwind to the country.

Risk Considerations: 1) Challenge of low inflation; 2) Political stresses related to the refugee crisis, Spanish election, and UK referendum; 3) Resurgence of tension with Russia; 4) Slowdown in emerging markets, especially China, or weaker-than-expected demand in major emerging markets; 5) Failures to act timely by the ECB on stimulus program; 6) Slump in oil prices which further adds pressure on inflation.
12-Month Performance

Nikkei 225 Index Data

- Market cap (JPY) 349.3 million
- 52-week Hi / Lo 20,868/16,796
- 3-Mth Total Return 9.6%
- Y-T-D Total Return 11%
- 50 / 250 Mov.Avg. 19,233/19,175
- 2015 Est. Yield 1.7%
- 2015 Estimated P/E 19.8x
- 2016 Estimated P/E 17.1x
- 2015 Estimated P/B 1.7x

Source: Bloomberg L.P.
As of 12/31/2015

INVESTMENT SUMMARY

- The Japanese Nikkei 225 Stock Index advanced 9.6% in 4Q15 and maintained positive up 11% in 2015.
- The BoJ has kept monetary policy on hold.
- Abe focuses on domestic economic policy.
- Improving corporate earnings and governance
- Japan in crucial phase to build solid base for sustained growth.
- We maintain our positive view on Japan

The Japanese Nikkei 225 Stock Index advanced 9.6% in 4Q15 and maintained positive up 11% in 2015. Despite the yen showed modest strength at 117-121 levels most of the time, investors re-entered the Japanese equity markets after the heavy sell-off in 3Q15.

The BoJ has kept monetary policy on hold. On 18 Dec 2015, the Bank of Japan (BoJ) kept its main target for monetary stimulus unchanged, but at the same time, it announced a new program for buying exchange-traded funds and decided to extend the average remaining maturity of its Japanese government bond purchases. At the 30 Oct 2015, the BoJ pushed back the time frame for reaching its ambitious 2% inflation target to late 2016. However, most market participants doubt that inflation will hit 2% next year as forecast, due to global disinflationary environment, no further support from JPY depreciation, and modest wage growth. However, rising CPI and a tight labor market are positive factors to keep the BoJ on hold over the next few months. But with core inflation measures leveling off at 0.9%, pressure on the BoJ to show a policy reaction could mount again in the course of 2016.

Abe focuses on domestic economic policy. On 5th Oct 2015, the Trans-Pacific Partnership (TPP) negotiations have finally come to an agreement, which encompasses 12 countries and roughly 40% of global GDP. The government said it expects the TPP trade pact to boost GDP by ¥13.6 trillion or 2.59% from fiscal 2014 in its first estimate. Consequently, the potential benefits of the TPP is believed to improve Japan’s productivity and mid-term growth potentials, which include increasing the attractiveness of foreign direct investment in Japan, and also increase the competition in the country’s domestic-oriented sectors that suffer from low productivity.

Improving corporate earnings and governance. Japanese companies’ earnings have been growing at a solid pace. On a corporate front, the introduction of Corporate Governance Code last year added to positive development in Japan. The pressure exerted by shareholders on management is beginning to see pay off, as increased dividends and share buybacks by Japanese companies.

Japan in crucial phase to build solid base for sustained growth. We think that Japan will be in a crucial phase to build a solid base for extended economic growth over a medium-to-long-term horizon. From the market’s point of view, sector selection in equities will also be important according to the policy theme under the growth strategy. As the feasibility of these policy measures increases, we expect upside potential for stocks exposed to domestic demand over the longer term.
We maintain our positive view on Japan. Although economic data from Japan present a mixed picture on the country's growth, the overall trend for Japanese economy remains positive. In an environment of low growth and low inflation, Japanese equity markets are supported by firm corporate earnings growth and growing returns to shareholders. Furthermore, valuations of Japanese equities are reasonable, with the Nikkei and Topix Indexes trading at prospective earnings of 17.5 and 14.6 respectively. On corporate levels, positive news from M&As, capex, dividend payout and share buybacks will continue to serve as short-term catalysts. We expect Nikkei to trade between the ranges of 17500-20000.

Risk Considerations: 1) Inability to implement structural and other economic reforms; 2) Yen appreciation due to global risk-off sentiment; 3) significant surge in JGB yield 4) fiscal deficits caused by delayed sales taxes increase; 5) BOJ fails to enact further easing in order to boost inflation; 6) China's slow-down, as China is Japan's second largest trading partner.
CHINA / HONG KONG

INVESTMENT SUMMARY
- We expect to see a mild recovery in China’s economy in 2016 amid greater visibility in the global outlook after the US rate hike.
- Policy support for the property sector and financial reform will be the highlights in 2016
- We prefer China insurance, China brokerage, China property, TMT, pharmaceutical and infrastructure

Greater visibility in the global economic outlook in 2016 Going into 2016, we expect higher visibility in the outlook of the global economy than in 2015, since the US Fed has initiated the rate hike cycle on December 17. With this major uncertainty removed, the capital flight situation in the EM should be relieved. First, the Federal Reserve is likely to keep the monetary environment loose during the presidential election year. Second, the US dollar is unlikely to be so strong as to hurt the U.S. economy. In fact, the US dollar index barely exceeded the 100 level on November 30, and it later weakened to 97-98 by end of December. Against this backdrop, we believe China will see a mild recovery in its economic activities in 2016.

Expects more supportive policies for the property sector China has stated its five economic goals for 2016 in the Central Economic Work Conference: to cut excessive inventory, to reduce obsolete capacities, to de-leverage, to cut costs and to provide remedy for the poor regions. Among these goals, the most important is destocking in the property sector. The wide range of policies, both existing and under proposal (such as lower installment rate for first time home buyers), suggests the Chinese government is relying on the property market for reviving the economy. We expect more effective policies (possibly tax deduction with mortgage interests) to be rolled out and see it as a major theme in 2016.

Financial reform continues to unfold With the successful inclusion of RMB into SDR, the market anticipates Shenzhen-HK Stock Connect will be the next to come. Along with it, the quota for Shanghai-HK Stock Connect is likely to be expanded, and hence the launch should be positive to the HK stock market. Separately, a number of U.S.-listed China concept stocks were included in the MSCI China index back in November. Thus, it is natural to expect that A shares would be included in the MSCI Index in the foreseeable future, or possibly in 2016. Other important measures include the reform of the IPO registration system and mutual recognition of HK/China funds. Overall, the financial reform continues to unfold quickly and it will be a key driver on the HK/China markets in 2016. We raise our year-end target for CSI 300 Index from 4,200 to 4,400.

Sentiment on HK market should improve in 2016 We continue to favor the HK market as a means to gain China exposure because valuation is more attractive than the A-shares (HSI trading at 11x vs. CSI 300 at 15x). Currently, the HK market is oversold, as foreign investors fear there might be a hard landing in China when a soft landing is more likely in our view. Given lower earnings estimate, we lower our year-end targets for HSI and HSCEI from 25,000 and 12,000 to 24,000 and 11,000 respectively.

Risk Considerations: 1) deflation; 2) policy undershoot; 3) slowdown in demand growth 4) faster than expected rate hike 5) RMB depreciation risks.
China Sector Snapshot

China insurance (maintain Overweight) Insurance penetration (insurance premium per GDP) and insurance density (insurance premium per capita) are still low, comparing to Western countries. There is still large room for premium growth. On the other hand, government has introduced some supportive policies to boost industry development. Recently, it launched trial program of individual income tax reduction on commercial healthcare insurance in 31 cities. It is expected that tax reduction policy will be also introduced in pension insurance which would be one of the catalysts. Moreover, we expect government to further relax the investment restriction of insurance company’s portfolio which can enhance their investment yield and diversify investment risk.

China brokerage (maintain Overweight) Trading volume for A-shares picked up with an average daily trading turnover of Rmb1,065bn in Nov vs Rmb890bn in Oct. Margin finance balance also increased from Rmb1.1tn in Oct to Rmb1.2tn. That indicates strong momentum supported by increasing turnover. Looking forward, China brokerage sector still has many catalysts in 2016. The registration-based IPO system will be implemented as soon as 1 March 2016 which will gradually apply to over 700 companies in the pipeline. Such policy will improve the transparency and price-mechanism of the IPO system, which will favour brokers with ibank business. The opening of Shenzhen-Hong Kong Stock Connect and fine-tuning of Shanghai-Hong Kong Stock Connect will attract global investors for A and H shares, moreover. The inclusion of A shares in MSCI index will introduce more institutional investors in the market. Mutual fund recognition will provide more choices for investors. We expect more reforms will be released in order to re-consolidate the confidence of investors. The sector currently trades at 9.1x PE, which is undemanding, thanks to industry policy release, loose monetary policy and lack of investment vehicles in China.

China property (maintain Overweight) According to China Index Academy, CREIS China Residential HPI-100 Index in Dec was up 4.15% yoy to RMB 10,980/sq m. Meanwhile, national property sales value continued to grow 20.2% yoy in Nov (vs 12.4% yoy in Oct), supporting YTD sales growth of 15.6% yoy. We believe policy will remain positive and supportive for China property sector in 2016. Apart from credit loosening, discussions are under way on a personal tax deduction for mortgage interest, a further down-payment cut for first-home purchases, more flexible use of the Housing Provident Fund, and local government subsidies (eg, Puyang in Henan province subsidises CNY150/sqm to rural citizens buying their first home). More importantly, President Xi and many government officials emphasize many times the importance of de-stocking of property, which means government encourages developers to increase inventory turnover, and thus stimulate related consumption and real estate investment in the economy. As such, China property sector will continue to outperform in 2016, whereas large players will take competitive advantages for comprehensive landbank, lower finance costs, and synergy.

Technology, Media & Telecommunications (maintain Overweight) Driven by faster speed and better network coverage, 3G/4G penetration has ramped up to 60.2% as at end-Nov 2015, comparing with 46.7% as at end-2014. In Oct 2015, average monthly data usage per user was around 362MB. It is expected that 2G users will likely direct upgrade to 4G network. As data usage of 4G user is much higher than 3G and 2G, fast growing 4G
user base will boost data service revenue of China telcos, offsetting the negative impact from “data roll-over”.

We expect the 4G migration will also benefit the internet and software names which could monetize on the scalable ecosystems in the mobile internet. Under 13th Five Year Plan, “Internet +” would be one of the key policies. Government will encourage more sector upgrades by applying internet technology which could boost new replacement demand. On the back of solid balance sheet and strong cashflow, technology giants could expand its business horizontally and vertically.

**Pharmaceutical (maintain Overweight)** China healthcare reform (started in 2009) will make structural change in the whole healthcare industry. We expect it will be challenging in downstream and most resources (such as doctors) are still dominated by public hospitals. Yet, restructuring in upstream (manufacturers and distributors) could be more straightforward, and will be the government’s main focus in near term.

China pharma manufacturing sector is fragmented. In 2014, top 100 drug manufacturers contributed only 45.8% drug sales in China. Market expects industry consolidation will result in the top 100 players reaching ~52% in 2020E. Domestic pharma leaders will continue consolidating market share from the exiting of domestic manufacturers with inferior quality products and weak R&D abilities and MNCs with lower price flexibility, less understanding of tenders and lower penetration ability to lower tier markets. Drug manufacturers with strong R&D capabilities are still likely to outperform.

For distributors, top 5 players contributed 37.4% market share in 2014, compared with +90% in US. It is believed that tight regulations with government committed enforcement should reaccelerate distributor consolidation over the next 3-5 yrs. Market estimates ~70% distributors will be eliminated in the next 5 years due to failure to pass the new Good Supply Practice (GSP), unfavourable tendering rules/business environment, falling along with “shadow distributors” in the government's ongoing anti-bribery/VAT tax pursuit. As such, market will favour big distributors.

**Infrastructure (maintain Overweight)** The value of new railway contracts surged 28% yoy in 3Q15 (vs -33% in 1H15) and many new projects were approved. Media reports that many new potential overseas railway projects will be launched. Market expects railway investment will rise 1% yoy, with railway infrastructure investment staying flat and railway equipment investment increasing 7% yoy in 2016E. According to the NDRC, there are 34 potential PPP railway projects, with required total investments amounting to Rmb236.9bn. At present, China is expanding its overseas market for the railway sector, which includes Thailand, Indonesia, Eastern Europe, US, UK and so forth. It is expected that new overseas railway contracts in the next three to six months might exceed US$20bn, this estimate includes China-Laos, Thailand, and Jakarta-Bandung contracts. Better still, China’s policy banks and commercial banks, four new financial institutions have been established to finance “One Belt, One Road” (OBOR) projects. These include the Silk Road Foundation (SRF), the Asian Infrastructure Investment Bank (AIIB), the China Investment Corporation Capital (CIC Capital) and the New Development Bank. Market expects they could provide US$2tn in funding. Thus, we are still bullish for the sector thanks to both strong demands from domestic and overseas markets.
### 1Q 2016 Investment Outlook  
7 Jan 2016

<table>
<thead>
<tr>
<th>Rating</th>
<th>Sectors</th>
<th>Comments</th>
</tr>
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<tbody>
<tr>
<td><strong>Overweight</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Insurance</td>
<td>Strong insurance premium growth and policies support, such as tax benefit</td>
</tr>
<tr>
<td></td>
<td>Brokerage</td>
<td>Shenzhen-HK Stock Connect to boost market sentiment and turnover</td>
</tr>
<tr>
<td></td>
<td>China property</td>
<td>Destocking policy and strong inelastic demand</td>
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<tr>
<td></td>
<td>Pharmaceutical</td>
<td>Consolidation of the small players and positive policy support</td>
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<tr>
<td></td>
<td>TMT</td>
<td>Ramp up of 4G will boost data usage; benefit from “internet +” policy</td>
</tr>
<tr>
<td></td>
<td>Infrastructure</td>
<td>Strong demand from domestic and overseas markets, policy support and AIIB commence operation</td>
</tr>
<tr>
<td><strong>Neutral</strong></td>
<td></td>
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<tr>
<td></td>
<td>China banks</td>
<td>Undemanding valuations, but fall in NIM, sluggish loan growth and rising NPL</td>
</tr>
<tr>
<td></td>
<td>Consumer</td>
<td>Positive from Two-Child policy and rising disposable income but keen competition</td>
</tr>
<tr>
<td></td>
<td>Macau gaming</td>
<td>Low base effect and new properties will launch but anti-corruption measures go on</td>
</tr>
<tr>
<td></td>
<td>Gas</td>
<td>Government's supportive policy but low crude oil prices will squeeze gas demand</td>
</tr>
<tr>
<td></td>
<td>New energy</td>
<td>Government's supportive policy but low crude oil prices will squeeze demand</td>
</tr>
<tr>
<td></td>
<td>HK banks</td>
<td>Benefit from US rate hike but weak loan demand from China and weak mortgage demand</td>
</tr>
<tr>
<td></td>
<td>HK property</td>
<td>Developers provide incentive programs for marketing, strong balance sheet, higher inventory turnover</td>
</tr>
<tr>
<td><strong>Underweight</strong></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Basic materials</td>
<td>Weak demand and oversupply</td>
</tr>
<tr>
<td></td>
<td>Energy</td>
<td>Weak demand and oversupply</td>
</tr>
<tr>
<td></td>
<td>Utilities</td>
<td>Sensitive to US interest rate and expensive valuation</td>
</tr>
</tbody>
</table>
US Treasury 2 Year Yield

Federal Open Market Committee (FOMC) has lifted its policy rate by 25 basis points in December 2015, which was the first hike since June 2006. While this move may be small for now, market consensus expects the next rate hike to occur in the 2nd Quarter of 2016. This expectation will be reflected in short-dated US Treasury market, providing an upward momentum for short-dated US Treasury yield to reach new highs in the future. However, long-dated US Treasury market is in a more complicated situation. Further quantitative easing in Europe, Japan and China will not only provide a strong headwind for aggressive rate hikes in US, but also attract further foreign demand to look for higher yields in Treasuries, pressuring yields down. Therefore, longer-dated US Treasury yields are expected to remain capped.

High quality credits to outperform high yield credits

FOMC Meeting in December suggested that US household spending was solid, the labor market was strong and the underutilization of layout resources has diminished appreciably in 2015. This provides strong evidence that the US domestic economy is undergoing a modest recovery. On the other hand, China and emerging markets’ economy continues to suffer from an ongoing slowdown. Persistent oversupply in key commodity markets will continue to exert downward pressure on commodities prices which will further damage the economic outlook for countries reliant on the export of resources such as Russia, Brazil, Chile and South Africa. This will have an adverse impact on the emerging market economies as corporates profit margins reduce in these countries. Credit conditions are expected to be worsening too. This is the reason why high quality credits from developed countries performed generally better than the high yield credits from emerging market countries at the end of 2015. This trend is expected to carry on towards 2016. US high yield bonds comprised primarily of resources-related companies and this sector faces similar problems as high yield bonds from emerging market countries. They are expected to remain under pressure in 2016.

Stay focus in Chinese property, technology and consumer staples sectors

China’s policymakers held their annual Central Economic Work Conference last month, laying out key tasks in economic policies for 2016, the year of initiation for the 13th “Five-Year Plan”. These tasks address the main structural problems in the economy (overcapacity, high debt, and the evolving financial risk) and new sources of growth. Market expects it would lead to further cut in interest rates and Reserve Requirement Ratio, reformation of the Hukou policy, subsidizing home purchases for migrant workers, and promotion of high-tech and servicing industries. Looking forward, we believe that the creditability in domestic properties, technology and retail sectors will improve due to the favorable policy invoked. In contrast, sectors such as natural resources, oil and industrials are less favorable and investors should remain vigilant.
CNY depreciation kept offshore CNY bonds under pressure

CNY depreciation played a strong role in the performance of the offshore CNY bonds in 2015 and the effects are expected to continue in 2016. The successful inclusion of CNY into IMF’s Special Drawing Rights basket caused some concerns as the opening up of the capital account would induce more capital outflows due to the loss of confidence on China’s slowing economy and the turmoil faced in China’s stock markets last summer. Sell-off in offshore CNY bonds occurred as CNY depreciation reduced investors’ return. However, The Chinese government has been reiterating that the recent devaluation in CNY is merely a correction and that further depreciation would be limited. China’s rates are also expected to be reduced, thus stabilizing the performance on offshore CNY bonds. In addition, since issuers can sell CNY bonds with a lower coupon in the domestic market, new issuances of offshore CNY bonds are expected to maintain at lower level in 2016. This will reduce the supply of offshore CNY bond in the market. As of the demand side, domestic investors continue to look for ways to maximize their CNY investment returns, including increasing their positions in offshore CNY bonds which would provide a stabilizing force in the market. We expect high quality names with attractive yields and short tenors to maintain its attractiveness to investors.

Risk Considerations:

i) Unexpected and aggressive rate hike in US;
ii) Deterioration of US and Chinese economy;
iii) Prolonged global recession;
iv) Unexpected global deflation;
Sharp decline in asset prices.
INVESTMENT SUMMARY
- Dairy prices gradually stabilized
- Possibility of RBNZ deferring rate cut may help NZD rebound

Dairy prices gradually stabilized
Last year, the international dairy prices have fallen sharply until signs of stabilization occurred this month. But still, it remained weak overall. Since dairy products accounted for about thirty percent of New Zealand’s exports, a price decline will hurt its export earnings and harm its economic development. From the demand side, China announced a relaxation of “Two-Child Policy” during the Fifth Plenary Session. In theory, it should boost China’s import demand for dairy products and support dairy prices in long-term, but in mid-short term, the effect is not significant. Also, the implementation of policies to encourage fertility may result far less than expected impact when China is experiencing slowdown in economic growth.

Mainland government had implemented the “Standalone Two Child” policy in 2013, but until the end of last year, applications from qualified “Standalone” couple were far below expectation. From the supply perspective, the current US corn bumper harvest and tariff relaxation on Argentina agricultural exports will increase corn output, causing downward pressure on corn prices and drop of cost of animal husbandry, and is not favorable to milk price trend. We expect the international dairy price will begin to stabilize after it has fallen sharply last year, but the imbalance of supply and demand will still limit its upside.

Possibility of RBNZ deferring rate cut may help NZD rebound
From a fundamental perspective, New Zealand’s economy slowed down and the inflation rate remained well below the lower limit of RBNZ’s target range of 1-3% last year. The recent sharp decline of oil prices will increase the risk of inflation slowdown. RBNZ stated that rising exchange rate will have no benefit, and a further depreciation of NZD would be appropriate. Still, RBNZ had cut interest rate for four times already, returning to the historic low of 2.5%. The RBNZ governor Wheeler raised the 2016 1Q economic growth forecast and stated that an interest rate of 2.5% can stimulate the inflation rate this year to within the target range set by RBNZ, along with a weak NZD currency. The implication seems to imply that a temporary easing of monetary policy is no longer necessary. In addition, New Zealand’s housing prices remain high and will increase risks to financial stability. As there were no clues of further rate hike of Fed in short term, NZD may have a rebound as RBNZ’s rate cut has made the currency drop sharply last year. We expect NZD/USD to be traded in range in 1Q with year-end target at 0.6900.
AUD / USD

INVESTMENT SUMMARY
- Commodity weakness, China's economic slowdown and tightening U.S. monetary policy weigh on Australian dollar

Commodity weakness weighs on AUD
The declining price of main commodities has remained a limiting factor for the Australian dollar because of Australia’s excessive reliance on the resources sector. Iron ore price has dropped by more than 40% last year and it is not expected to resume its rising trend with supply continuing to outstrip demand.

China’s economic slowdown is likely to continue in 2016
As Australia’s biggest trading partner, any kind of slowdown in China could have a serious impact on Australia’s export sector. Australia’s widening trade deficit will keep adding downward pressure to the Australian dollar. Moreover, the U.S. Federal Reserve is forecasting gradual rate hikes in 2016, while the Reserve Bank of Australia could conduct further easing of monetary policy to boost its economy. A combination of US policy changes and struggling commodity prices is likely to weigh on the outlook for the Australian dollar. We remain cautious on AUD/USD in 1Q with year-end target at 0.7300.

USD / CAD

INVESTMENT SUMMARY
- Global oil glut may worsen
- Canada’s economy is expected to remain on a slower growth path

Global oil glut may worsen
With the slump in oil prices, The Organization of the Petroleum Exporting Countries (OPEC) has no plan to cut oil production targets, resulting in market disappointment. Most of the OPEC’s countries, leading by Saudi Arabia, have been reluctant to reduce productions armed with the fact that their costs of extraction are one of the world’s lowest. Iran is set to rejoin the world’s crude market this year, US has lifted 40-year ban on crude oil exports and Russia have spoken about increasing energy production in order to battle competitors. The lack of an agreement between these parties is estimated to cause even higher levels of crude supply. With global economic growth expected to be modest this year, the demand for oil is also set to slow. Increasing oil surplus will put further pressure on the crude price.

Canada’s economy growth remains slow
Energy companies are being forced to scale back expenditure plans in face of sharply falling revenues. This resulted in a drop in investment and also layoffs. Moreover, the falling oil price hurt exports and Canada has marked monthly trade deficit for over a year. We expect Canada’s economy to remain on a slower growth path in 2016. If conditions get worse, Canada’s central bank may need to cut interest rates further to cushion against the oil shock and stimulate the sluggish economy. We remain bullish on USD/CAD with 2016 year-end target at 1.4500.
EUR/USD
12-Month Performance

<table>
<thead>
<tr>
<th>ECB Main Refinancing Rate</th>
<th>0.05%</th>
</tr>
</thead>
<tbody>
<tr>
<td>52-week Hi / Lo</td>
<td>1.2104 / 1.0496</td>
</tr>
<tr>
<td>12-Mth Change</td>
<td>-10.26%</td>
</tr>
</tbody>
</table>

Source: Bloomberg L.P.
As of 31/12/2015

GBP/USD
12-Month Performance

<table>
<thead>
<tr>
<th>BoE Benchmark Interest Rate</th>
<th>0.05%</th>
</tr>
</thead>
<tbody>
<tr>
<td>52-week Hi / Lo</td>
<td>1.5883 / 1.4632</td>
</tr>
<tr>
<td>12-Mth Change</td>
<td>-5.45%</td>
</tr>
</tbody>
</table>

Source: Bloomberg L.P.
As of 31/12/2015

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INVESTMENT SUMMARY
- Eurozone recovery increasingly supported by domestic demand
- Fed’s gradual hike may relieve pressure off Euro

Domestic demand continues to drive Eurozone growth
Supported by the impact of lower oil prices, consumer spending has been the main driver of the economic recovery in the Eurozone last year. And the recently extended quantitative easing program by the European Central Bank to extend bond purchases and cut the deposit rate could boost capital investment and help drive employment and wage growth. Recent macro statistics in the Eurozone were better than expected and inflation showed a tentative recovery. The damage of the Paris attacks and Volkswagen’s emission scandal is limited. And the rising manufacturing activity signals a weaker euro is benefiting the region’s exporters. The Eurozone is set to continue its gradual recovery this year. But still, the region faces headwinds from refugee problem and a general global slowdown particularly on the back of slowing growth in China and other emerging markets.

Fed’s gradual hike may relieve pressure off Euro
The euro had hovered near the lows before the Fed’s first rate hike. Yet it is believed that the policy divergence between Fed and ECB has been fully priced in by currency markets and the pressure on euro would be relieved by the Fed’s promise of slow rate rises. We expect EUR/USD to trade within range in 1Q with year-end target at 1.1200.

GBP/USD
INVESTMENT SUMMARY
- UK economy is expected to expand steady this year
- Eurozone economic recovery supports UK’s export

Consumer-driven growth continues with economy expanding steadily
The British pound has been in decline with weakness being driven by the shift in tone at the Bank of England concerning the timing of UK interest rate rises. Yet recent economic performance of the country has been stable. Unemployment has come down to about 5% and consumer-driven growth continues. After the Federal Reserve raises interest rates for the first time in nearly a decade, we expect the UK won’t be long behind.

Eurozone economic outlook is improving
Meanwhile, with an improving performance of the European economy, UK’s major export market, worries that the pound will be excessively strong if the BoE raises interest rates are likely to be a much less significant factor this year. This also supports higher UK interest rates. It is expected that the pound could face headwinds in short term from a strong dollar and “Brexit” challenges. But the outlook of the currency remains positive. We remain cautious on GBP/USD in 1Q due to the uncertainty of “Brexit” with year-end target at 1.5200.
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