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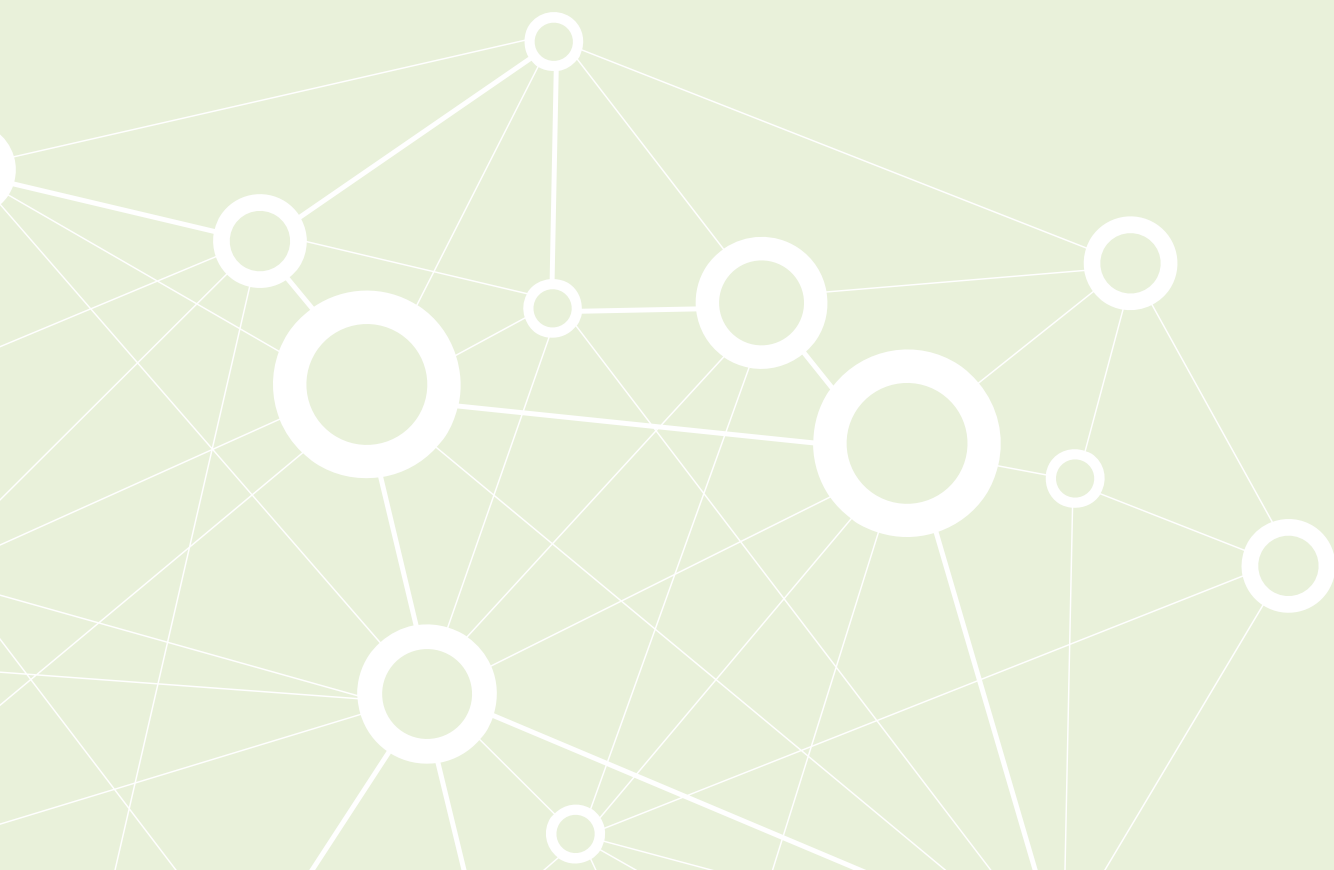
THOUGHTS FOR 2018

DECEMBER 2017

> After years of sustained global growth and buoyant asset prices, investors face a number of significant potential turning points in 2018. We share our thoughts on some of the major investment themes and the opportunities and challenges they present.

Following years of sustained growth the global economic expansion accelerated in 2017, buoying sentiment and global asset prices. Markets proved resilient, largely shrugging off political uncertainty, interest rate rises in the US and UK, and significant changes to major central bank policy on quantitative easing.

Against this backdrop, we examine some of the major themes which our investment specialists and clients are pondering. Is the current rate of growth sustainable? Can wage growth remain so low? What are the implications for financial markets? We examine these questions and other major trends that face investors in 2018.



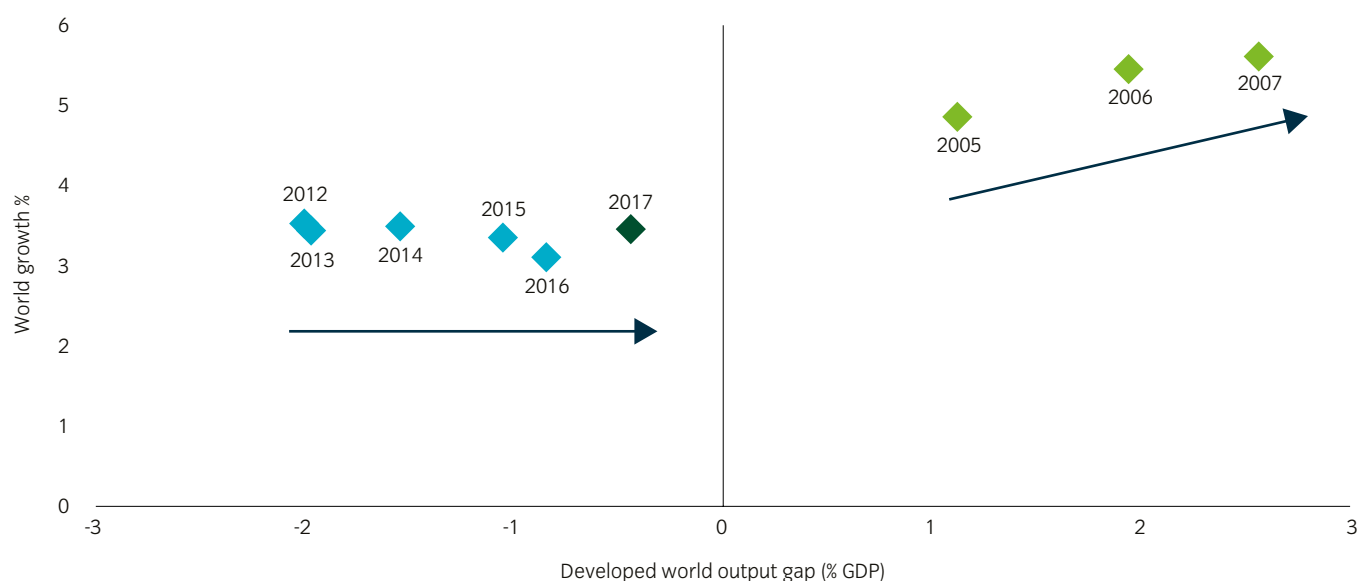
HOW SUSTAINABLE IS THE GLOBAL EXPANSION?

GLOBAL INVESTOR SENTIMENT IMPROVED IN 2017 AS ECONOMIC GROWTH BECAME MORE BROAD-BASED RATHER THAN FOCUSED ON THE US. UNEMPLOYMENT DECLINED IN DEVELOPED MARKETS AND MANY EQUITY MARKETS REACHED NEW HIGHS.

Compared to levels before the financial crisis, the global economy is expanding at a steady pace, and developed markets continue to have some spare capacity. This stands in contrast to 2005-2007 when developed markets were already operating beyond full capacity – leading to an increase in imported goods and services from emerging markets – which in hindsight was clearly unsustainable.

The current rate of growth looks more stable, and could arguably have some years to run, though risks remain – including the potential for political developments to change the economic outlook. This backdrop is broadly supportive for credit and riskier assets such as emerging markets.

World growth versus developed world output gap



Source: IMF, as at 30 November 2017. 2017 data is a forecast.

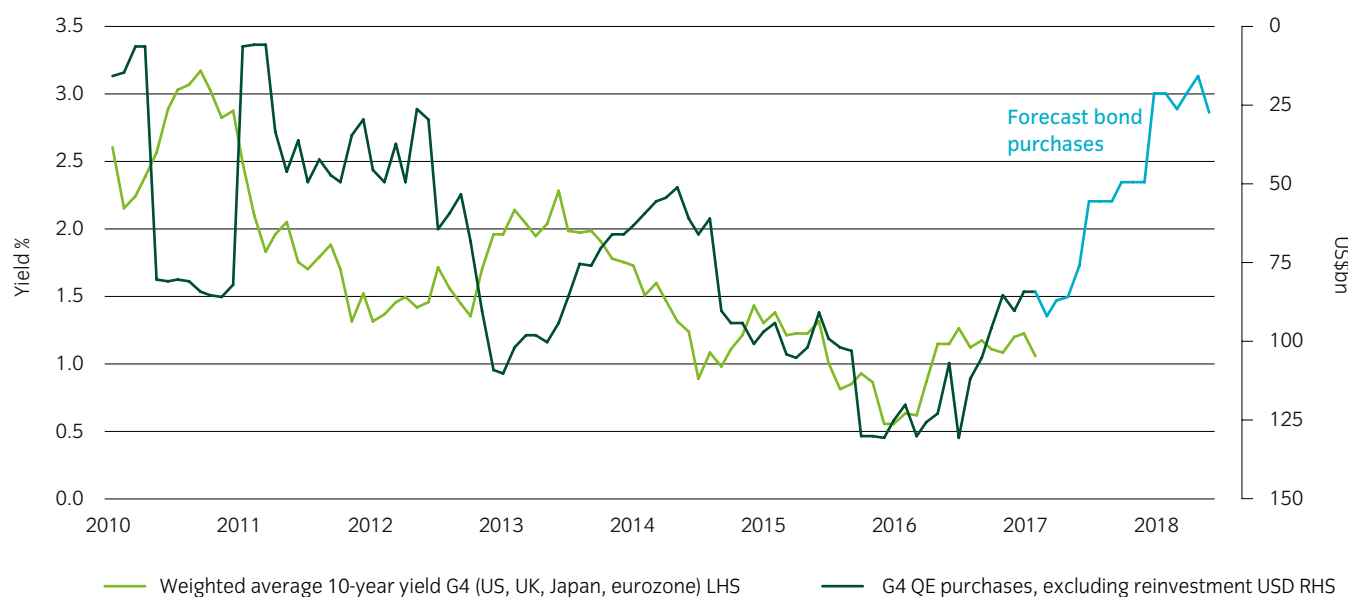
QUANTITATIVE TIGHTENING TO COME?

THE EUROPEAN CENTRAL BANK (ECB) HAS STATED THAT IT WILL REDUCE THE PACE OF ITS MONTHLY BOND PURCHASES FROM €60BN TO €30BN FROM JANUARY 2018, WHILE THE US FEDERAL RESERVE HAS STARTED TO REDUCE ITS BALANCE SHEET BY \$10BN PER MONTH, INCREASING BY \$10BN EVERY THREE MONTHS UNTIL THE MONTHLY REDUCTION REACHES \$50BN.

For now, the Bank of Japan is expected to continue with its current programme through 2018, which it believes will allow the Japanese economy to achieve the Bank's 2% inflation target by 2019. By Q4 2018 the overall monthly pace of asset purchases by major central banks will be very low, as purchases in Europe and Japan are nearly outweighed by the expected \$50bn monthly balance sheet reduction in the US.

With over \$8trn in fixed income assets still at negative yields, the market reaction in 2018 to continued gradual policy normalisation will be a key factor to watch. Central banks will want any rise in yields, if it occurs, to be gradual in order to reduce the risk of financial market disruption.

Weighted average 10-year G4 bond yield versus G4 monthly bond purchases



Source: Bloomberg, BNP Paribas, data to end August 2017 and forecast for remaining period.

CONSIDERABLE DIVERGENCE IN EMERGING MARKETS

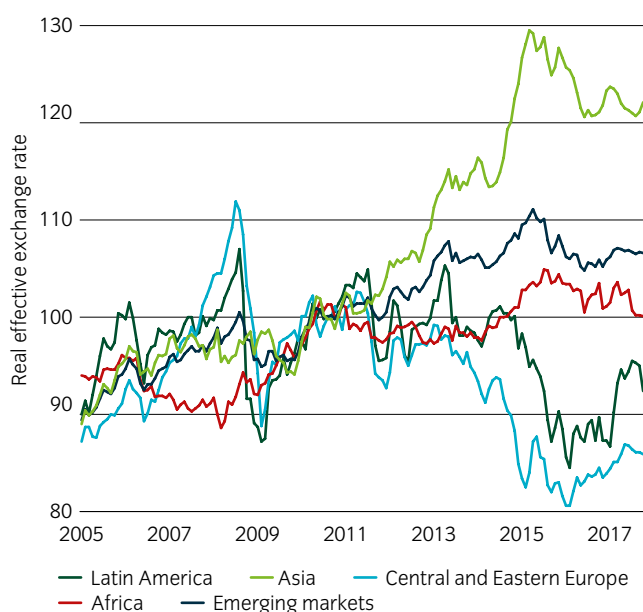
THE OUTLOOK FOR THE GLOBAL ECONOMY HAS IMPROVED, WITH A BROAD-BASED PICKUP IN GROWTH, AND THIS IS GENERALLY SUPPORTIVE FOR EMERGING MARKET ASSETS. DESPITE THIS, VALUATIONS IN EMERGING MARKET ASSETS VARY CONSIDERABLY BY MARKET AND REGION.

The next few years could be a major opportunity for emerging markets, which are generally more sensitive to the global economic cycle due to exposure to exports and commodity prices. Yields are also attractive relative to developed markets, both for local government debt and corporate debt issued in hard currencies. However, regional and market divergence within

emerging market assets is high, with headline index values encompassing a range of valuations.

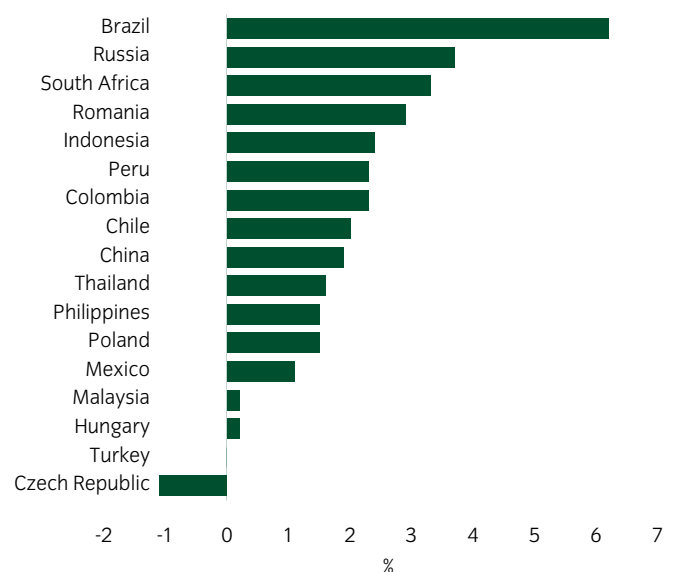
This divergence, combined with political risks, both at a domestic level in certain countries and emanating from broader global risks, will make a flexible approach to investment an important factor in 2018.

Real effective exchange rates



Source: JP Morgan, Bloomberg, as at 31 October 2017.

Real yields



Source: JP Morgan, Bloomberg, as at 31 October 2017.

HIGH YIELD IS BENEFITING FROM THE GLOBAL UPSWING

RISING STARS ARE ISSUERS UPGRADED FROM HIGH YIELD TO INVESTMENT GRADE, AND FALLEN ANGELS ARE ISSUERS DOWNGRADED TO HIGH YIELD. THE NUMBER OF RISING STARS IS NOW HIGHER THAN THE NUMBER OF FALLEN ANGELS FOR THE FIRST TIME SINCE 2014.

When global growth strengthens, credit dynamics generally improve, especially for those most sensitive to the economic cycle. For high yield investors this creates an important investment theme, as established companies get upgraded, causing the spreads of their debt relative to government bonds to tighten; while positive sentiment allows new issuers to enter the market, presenting new opportunities. In 2015 and 2016, companies in the oil and gas, and mining, sectors were affected particularly badly, but this turned around as commodity prices

stabilised and then started to rise. Companies that controlled costs and paid down debt have since benefited. For example, Anglo American – one of the world's largest mining companies – was faced with a credit rating downgrade in 2016, only to be upgraded once again in 2017.

If the momentum in the global economy continues into 2018, then this powerful technical dynamic within the high yield market should continue.

Global rising stars versus fallen angels



Source: Bloomberg, S&P.

SEARCHING FOR VALUE – SECURED FINANCE?

IN THE MINDS OF MANY INVESTORS, ASSET-BACKED SECURITIES (ABS) CONTINUE TO BE TAINTED BY THEIR ASSOCIATION TO THE FINANCIAL CRISIS. BECAUSE OF THIS, THE VALUE OFFERED IN THE MARKET CAN OFTEN SURPRISE INVESTORS.

UK residential mortgage-backed securities (RMBS), for example, have never defaulted at the higher end of the capital structure, even during the height of the financial crisis. According to analysis from JP Morgan, senior UK RMBS investments offer investors enough protection to withstand 56 times the maximum losses experienced in the largest UK housing crisis in memory during the early 1990s. Despite this, many ABS markets – including UK RMBS, global collateralised loan obligations, and more innovative

opportunities in the private lending markets – offer considerable credit spread premiums over comparably-rated corporate credit markets, reflecting the relatively complexity of the assets. This spread divergence widened over 2017.

This provides a compelling opportunity for investors to source attractive risk-adjusted returns in a low yield and narrow credit spread environment without having to take additional credit risks.

Residential mortgage-backed securities spread versus comparably-rated corporate credit spread



Source: JP Morgan, Bank of America Merrill Lynch, as at 31 October 2017.

ESG IS GROWING IN IMPORTANCE FOR INVESTORS GLOBALLY

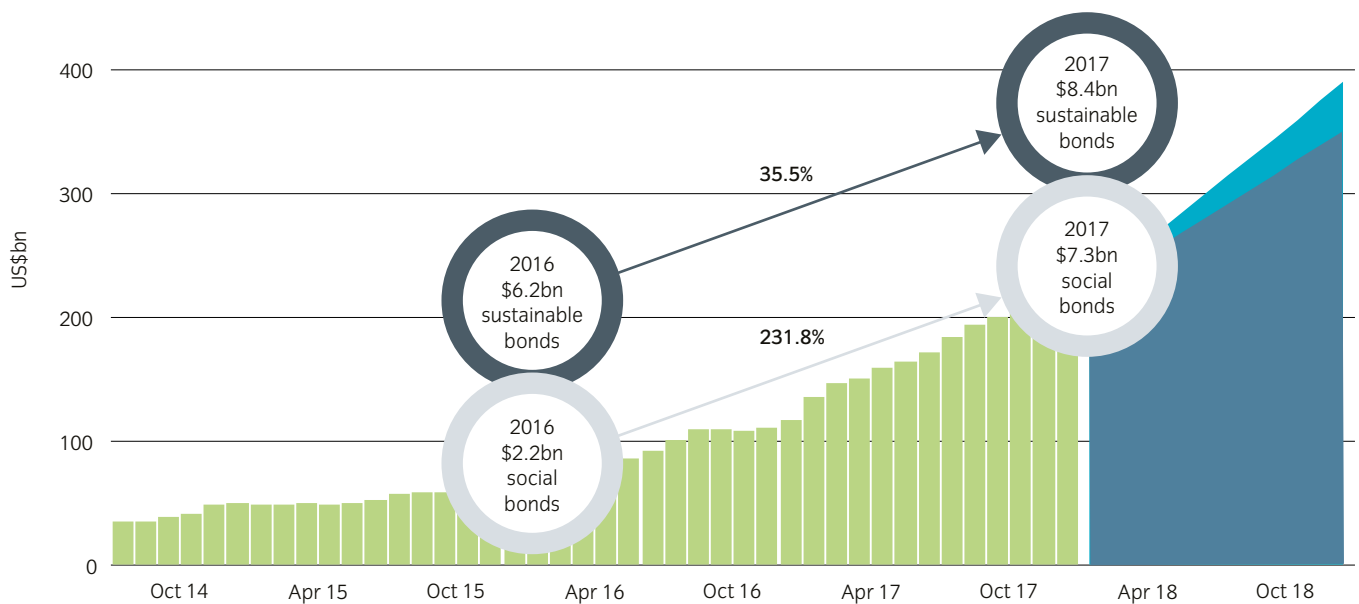
ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) ISSUES ARE INCREASINGLY IMPORTANT FOR INVESTORS AND WE BELIEVE THAT THIS TREND WILL CONTINUE.

Issuance of specialist sustainability bonds, such as green bonds, is growing rapidly and investment managers need to incorporate ESG into their investment processes. The first gender equality bond was issued in 2017 with orders of more than 20 times the issuance amount. Euro and US dollar new issue green bonds received orders averaging more than twice the issue size during 2016 and the first half of 2017. In a poll by YouGov, commissioned by the UK Sustainable Investment and Finance Association, 57% of

UK adults with a pension believed that investment management companies have a responsibility to ensure that the companies they invest in are managed in a way that is positive for society and the environment.

We expect further innovations in the impact bond market in 2018 as awareness grows and investors increasingly look to align both financial and non-financial goals.

Size of green bond market



Source: S&P Green Bond Index, HSBC, as at 31 October 2017, assumes zero new issuance in November/December 2017.



IMPORTANT INFORMATION

RISK DISCLOSURES

Past performance is not indicative of future results. Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.

The performance results shown, whether net or gross of investment management fees, reflect the reinvestment of dividends and/or income and other earnings. Any gross of fees performance does not include fees and charges and these can have a material detrimental effect on the performance of an investment.

Any target performance aims are not a guarantee, may not be achieved and a capital loss may occur. Funds which have a higher performance aim generally take more risk to achieve this and so have a greater potential for the returns to be significantly different than expected.

Portfolio holdings are subject to change, for information only and are not investment recommendations.

ASSOCIATED INVESTMENT RISKS

Where the portfolio holds over 35% of its net asset value in securities of one governmental issuer, the value of the portfolio may be profoundly affected if one or more of these issuers fails to meet its obligations or suffers a ratings downgrade.

A credit default swap (CDS) provides a measure of protection against defaults of debt issuers but there is no assurance their use will be effective or will have the desired result.

The issuer of a debt security may not pay income or repay capital to the bondholder when due.

Derivatives may be used to generate returns as well as to reduce costs and/or the overall risk of the portfolio. Using derivatives can involve a higher level of risk. A small movement in the price of an underlying investment may result in a disproportionately large movement in the price of the derivative investment.

Investments in emerging markets can be less liquid and riskier than more developed markets and difficulties in accounting, dealing, settlement and custody may arise.

Investments in bonds are affected by interest rates and inflation trends which may affect the value of the portfolio.

Where high yield instruments are held, their low credit rating indicates a greater risk of default, which would affect the value of the portfolio.

The investment manager may invest in instruments which can be difficult to sell when markets are stressed.

Where leverage is used as part of the management of the portfolio through the use of swaps and other derivative instruments, this can increase the overall volatility. While leverage presents opportunities for increasing total returns, it has the effect of potentially increasing losses as well. Any event that adversely affects the value of an investment would be magnified to the extent that leverage is employed by the portfolio. Any losses would therefore be greater than if leverage were not employed.

While efforts will be made to eliminate potential inequalities between shareholders in a pooled fund through the performance fee calculation methodology, there may be occasions where a shareholder may pay a performance fee for which they have not received a commensurate benefit.

The specific collateral used to secure a loan may decline in value or become illiquid, which would adversely affect the loan's value. Also, many loans are not actively traded, which may impair the ability of the portfolio to realise full value in the event of the need to liquidate such assets.

Property assets are inherently less liquid and more difficult to sell than other assets. The valuation of physical property is a matter of the valuer's judgement rather than fact.

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