



IEAC ANNUAL REPORT

2019-2020

April 10, 2020

IEAC Annual Work Group Members include:

UBS Asset Management

BNP Paribas Asset Management

Colombia Threadneedle Investments

Insurance Asset Management Association of China

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Message

Dear IEAC members,

These are extraordinary times as COVID-19 continues to spread rapidly around the world, straining healthcare systems, impacting economies and creating a humanitarian tragedy.

This IEAC Annual Report was based on the survey feedback we collected several weeks before the COVID-19 crisis exacerbated and the IEAC will provide a separate follow-up on the impact of this. When we met back in May 2019, we had a vision of how we would tackle our four work plans (Annual Report, Policy Research, ESG Study, Education & Training) and issues that we have defined in the annual meeting. However, we now have to adapt to the evolving situation and so have decided to conduct our education and training online. We are confident that by doing so, we will still be able to meet the ongoing needs of our members in these challenging times.

While previous economic growth projections are clearly no longer valid, it is too early to forecast the impact in the months and years ahead and will depend very much on how long it takes for the current situation to be contained and resolved. One thing is certain, going forward in 2020, robust risk management will continue to be critically important in helping to navigate through this difficult time. On behalf of IEAC and the Annual Report working group, I hope you find the report valuable and would like to express our thanks to our members for all of their input.

Stay safe and healthy,

Nasreen Kasenally.

Chair of IEAC

Executive Summary

The IEAC Annual Report ("Report") aims to provide local investors with a consolidated view towards global asset allocation and investment management in 2020 from a foreign asset manager's perspective, by summarizing insights from the IEAC members. A Work Group, including UBS Asset Management, BNP Paribas Asset Management and Colombia Threadneedle Investments, has been formed to work with the IEAC Secretariat to drive this initiative.

The Work Group received feedback from 22 members of foreign asset managers from around the world. Out of the 22 respondents, 50% are from the United States; 36% are from Europe; and 14% are from Australia. All are top global asset managers in terms of AuM.

As of 3Q19¹, there are 14% respondents with AuM less than USD100bn; 62% respondents with AuM between USD100bn to USD1trn; and 24% respondents with AuM of more than USD1trn. Of the respondents, 67% of them have set up a Wholly Foreign Owned Enterprise ("WFOE") in China². Only 19% of them have a Private Fund Management ("PFM") license.

This survey was conducted between 27 December 2019 and 13 January 2020, weeks before the outbreak of coronavirus (COVID-19). Therefore, COVID-19 is out of the scope of this survey. The survey sent to IEAC members included 35 questions, covering three topics, 1) 2019 overview, 2) 2020 Global Market Outlook, and 3) 2020 Mainland China Market Outlook.

2019 Overview: Despite the China-US trade war, the majority of the respondents think it had little impact on China's economy. In fact, they are of the view that China's economy will become stronger in the long run. Half of the respondents think that Japanese and UK equities were undervalued in 2019, while US equities were overvalued.

2020 Global Market Outlook: The respondents do show slightly increased concerns around economic growth and market performance globally. Emerging Markets are still most

¹ One company did not provide AuM data, total responses received are 21.

² One company did not provide their status of WFOE and PFM set up in China, total responses received are 21.

managers' favorite, in both equities and fixed income, while the managers showed little confidence in Developed Markets. One interesting observation is that NO ONE "firmly" believes that Donald Trump will lose the election. 57% believe that he will have his second term and the rest think "It's hard to tell".

2020 Mainland China Market Outlook: Most of the respondents expect to see slower economic growth in China in 2020. In response to weaker growth, the Chinese government is expected to cut interest rates in order to support the local economy. The majority of respondents are still optimistic on the onshore equity market, especially the consumer sector. Many respondents are hoping to expand outbound channels and widen the investment scope for local insurance companies. Transparency of regulations is of great concern for foreign asset managers.

Given that COVID-19 has had a material impact on both Chinese and global markets, four representatives of IEAC (i.e. UBS AM, JP Morgan AM, BNP Paribas AM and Columbia Threadneedle Investments) were invited to offer further insights into trends in the global economy and financial market. It is hoped that their latest views help readers to learn more about the influence caused by COVID-19.

Part One 2019 Overview

Comments on the 2019 Overview

2019 was an eventful year due to the US-China trade war, Brexit, Fed rate cuts and many more factors.

The high stakes geopolitical tussle between US and China overshadowed Asian equity markets in 2019 and continue to be an ongoing risk in 2020. Although the trade war dispute in 2019 meant China and the US imposed tariffs on hundreds of billions of dollars-worth of one another's goods, the majority of the group felt it had little impact on China's economy. In fact, the group were of the view that China's economy will become stronger in the long run.

In 2019, the Federal Reserve cut US interest rates three times as the US economy slowed amid trade disputes. About 60% of the group felt this will not have a big impact on global economy in 2020 and growth will continue to grow by over 2%. Almost a third view that growth be sluggish and grow at 1-2% globally.

More than 82% of surveyed respondents thought that the pound will likely have a moderate appreciation or remain flat post Brexit, with around 18% holding the view that the pound will have a moderate depreciation.

In terms of views on the most undervalued and overvalued asset classes in 2019, 46% of respondents thought Japanese equities and UK equities were most undervalued, followed closely by Asian ex-Japan equities.

In terms of the most overvalued asset class, half the respondents polled thought US equities was the most overvalued asset class, followed by investment grade bonds (32%).

Specifically, on Asia ex-Japan equities, roughly half felt that the asset class was undervalued, and the other half felt that it was fair to overvalued.

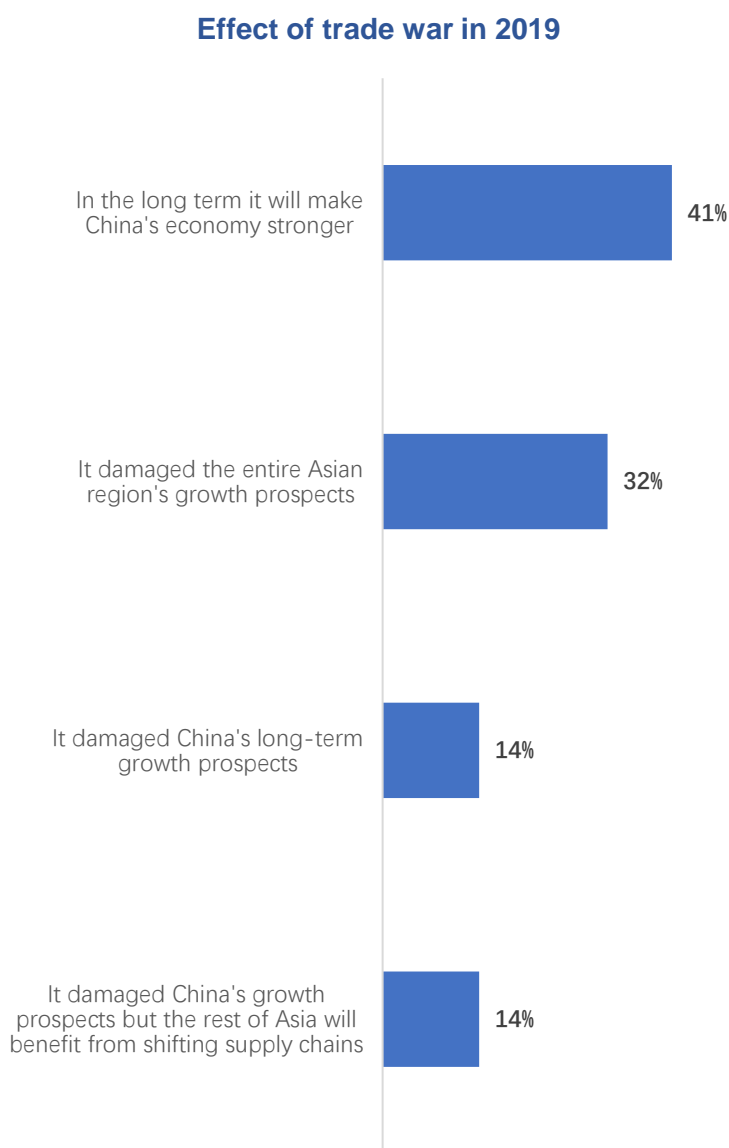
More than one third of the respondents picked private equity as their favourite alternative asset class in 2019. 24% favour private debt and 24% favour private equity and the rest favour hedge funds. No one picked venture capital.

Detailed survey data of the 2019 Overview

Majority of the group felt that effect of the trade war in 2019 will have little impact on the economy of China in the long run.

More than 40% of the respondents felt that the trade war will have little impact on the Chinese economy in the long run. In fact, they thought that China's economy will be stronger in the long term. About one third felt that the trade war damaged the Asian region's growth prospects. The rest were split equally with the views that it will either damage China's long-term growth prospects or make China's economy grow stronger.

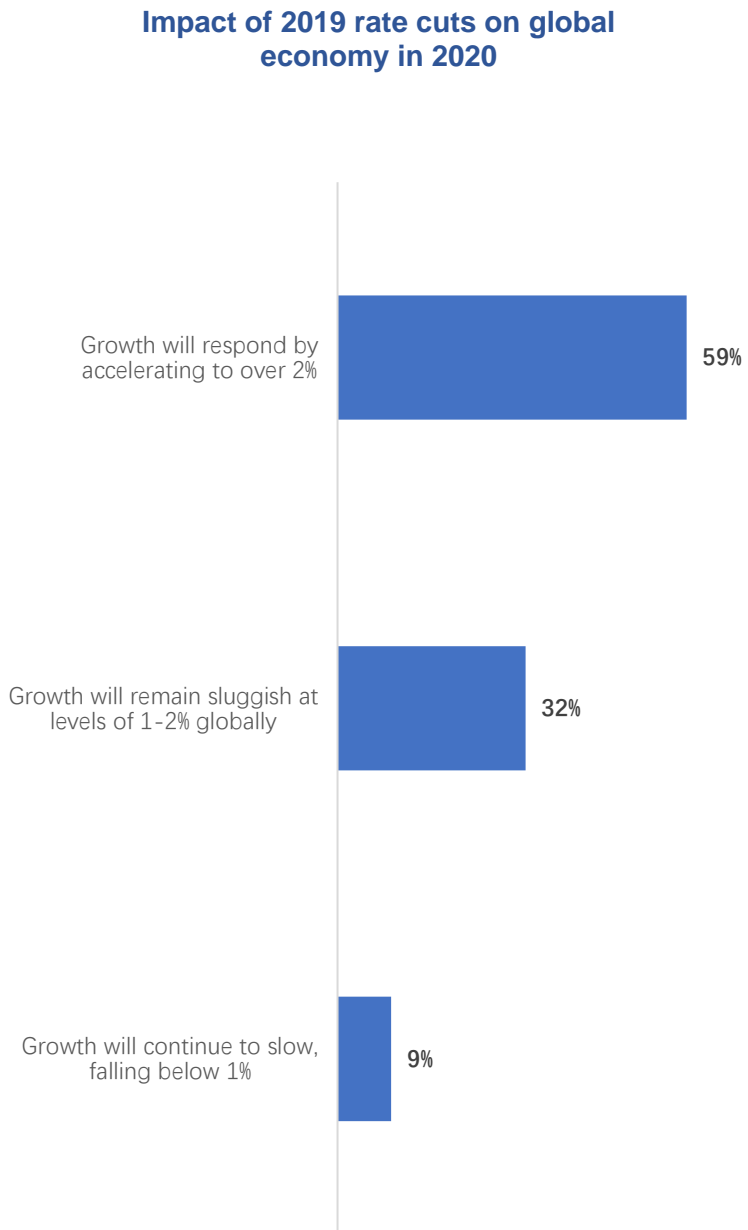
Fig 1



Majority of the group felt that the 2019 Fed rate cuts will not have a big impact on global economy in 2020 and growth will continue to grow by over 2%.

Majority felt that the global economy will continue to grow in 2020. Almost 60% felt that the growth rate will be over 2% while one third felt it will remain sluggish at 1-2%. A minority thought growth will continue to slow.

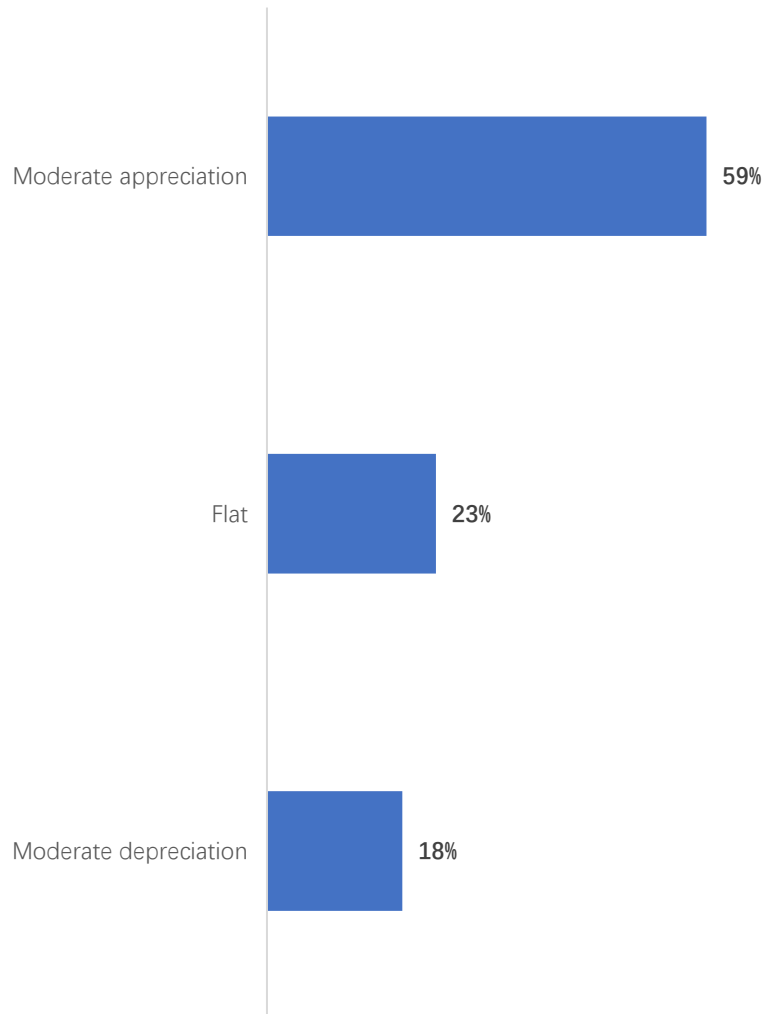
Fig 2



Most respondents hold the view that the pound will have moderate appreciation after 2019's Brexit developments.

Fig 3

Impact of 2019's Brexit development on pound

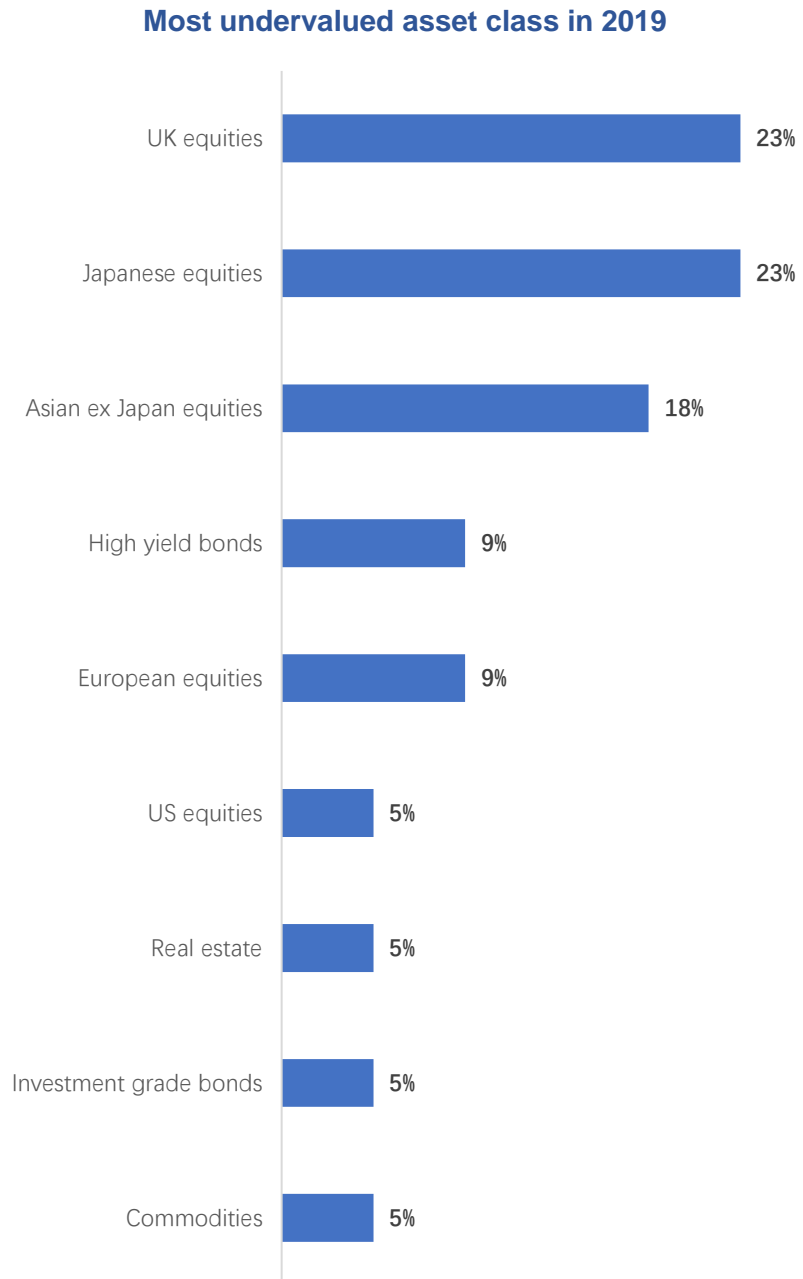


Most felt that the pound will likely have a moderate appreciation or remain flat post Brexit, with around 18% holding the view that the pound will have a moderate depreciation.

Almost half the respondents felt Japanese equities and UK equities were the two most undervalued asset classes, followed closely by Asian ex Japan equities.

A very diverse range of selection from the respondents have been observed. The two asset classes which respondents thought were most undervalued were Japanese equities and UK equities, followed closely by Asian ex Japan equities. The question is - will these asset classes remain undervalued in 2020?

Fig 4

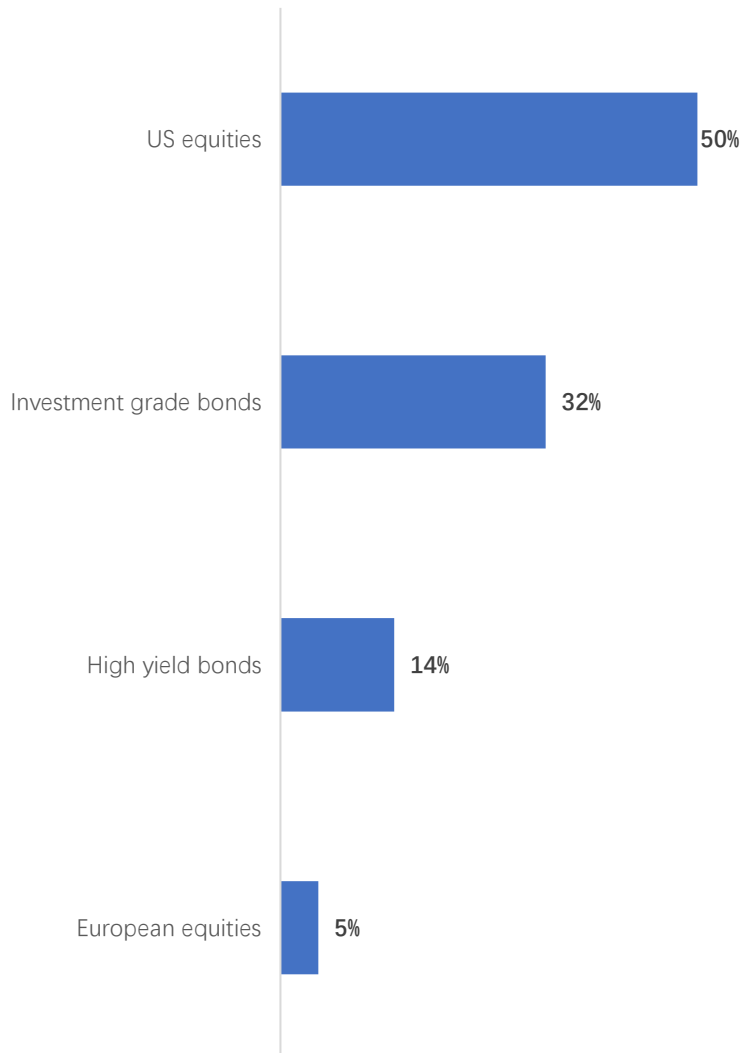


Majority indicated that US equities was the most overvalued asset class.

US equities (50%) was singled out as the most overvalued asset class, followed by investment grade bonds (32%). However, will these remain overvalued? Where will investors put their money in 2020?

Fig 5

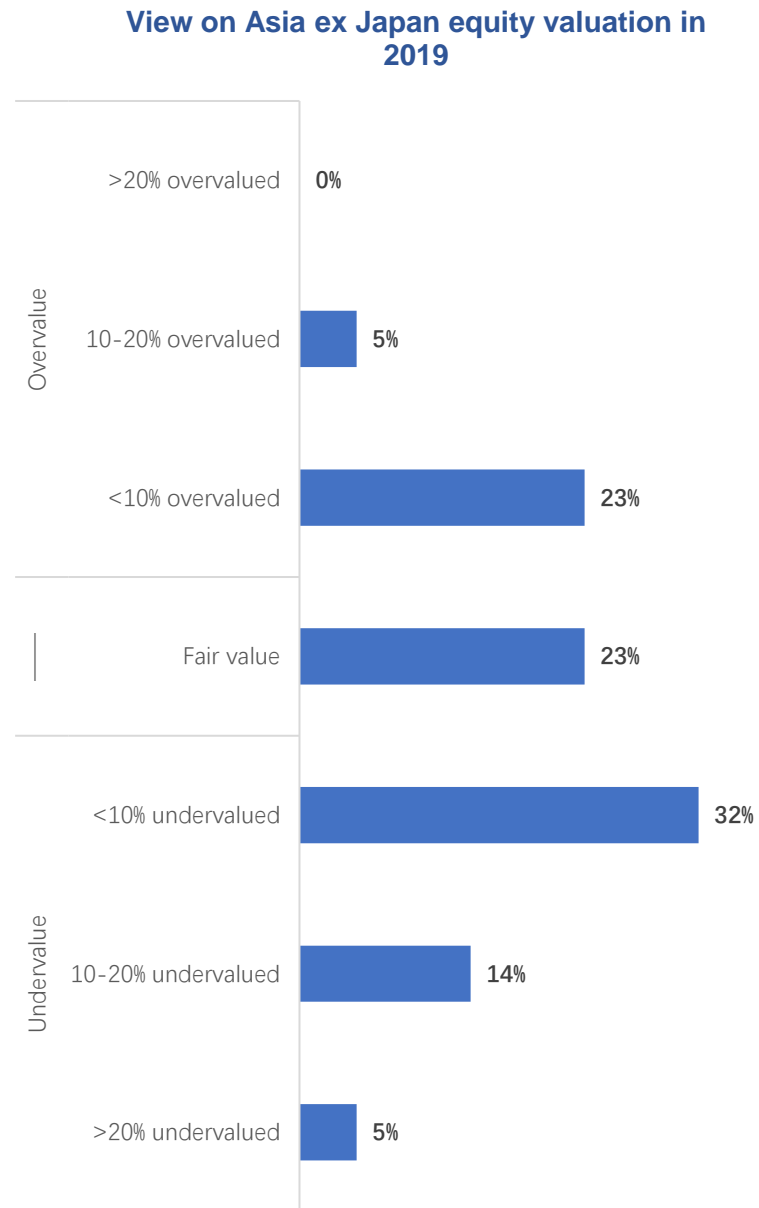
Most overvalued asset class in 2019



About half felt that Asian ex-Japan equities are undervalued, and the other half felt that the asset class is fair to overvalued.

About 50% of the respondents felt that Asian ex Japan equities are undervalued and the other half felt that the asset class is fair to overvalued.

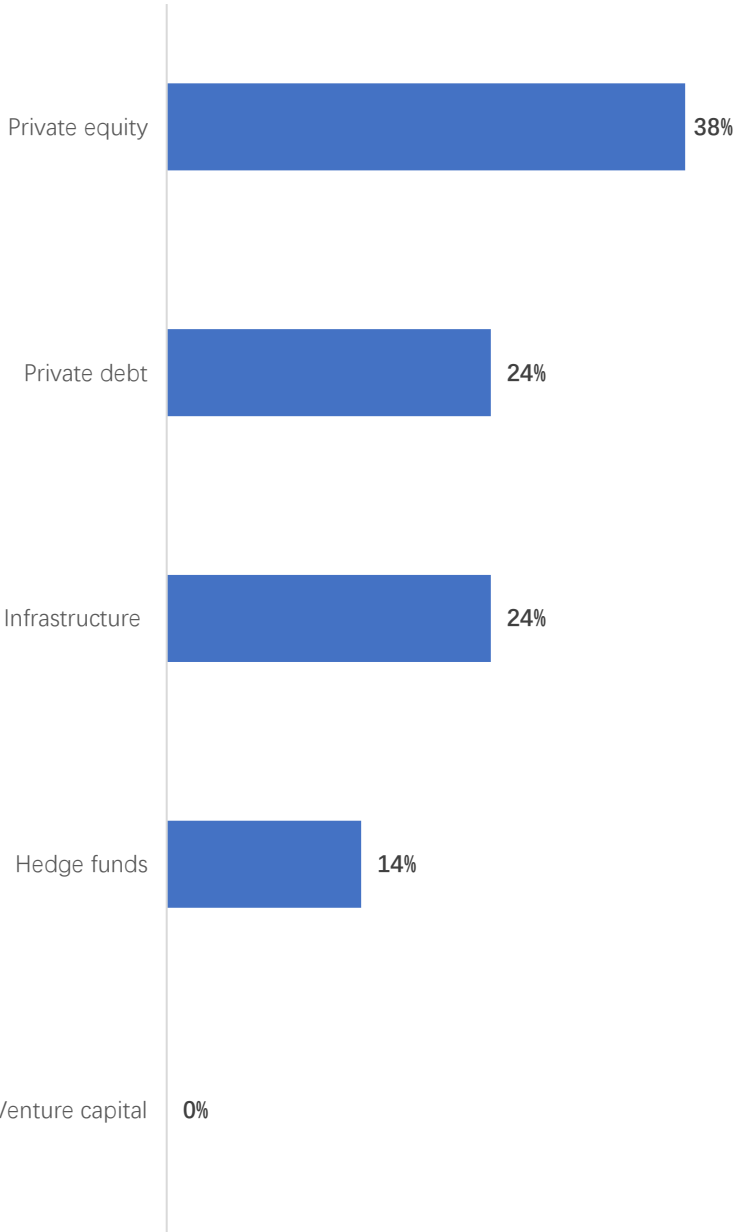
Fig 6



The most favoured alternative class in 2019 was Private Equity.

Fig 7

Most favoured alternative asset class in 2019



More than one third of the respondents picked private equity as their favourite alternative asset class in 2019. 24% favour private debt and 24% favour private equity and the rest favour hedge funds. No one picked venture capital.

Part Two 2020 Outlook for Global Market

Comments on the 2020 Outlook for Global Market

In this section we collect feedback from various global asset managers about their economic views, including GDP, inflation and currency, as well as their outlooks of asset classes and markets. There are also interesting projections on critical events in the coming year.

In general, the collective views of the survey participants are consistent with the market momentum in the past few years, i.e. there are no dramatic or extreme movements on either macro or markets. However, the results do show a slightly increased concern of uncertainties of economy growth and market performance globally. It is understandable given that in the developed markets, the US has experienced one of its longest bull markets and an adjustment has been anticipated for years, while in the developing markets volatility has remained an issue .

The results show that GDP growth rate, inflation, Fed policy and currency movements are expected to be flat in general, but the USD is expected to depreciate against EUR and the Pound will appreciate against EUR. 2020 is the election year for the US so the main theme would be stabilizing the inflation and market.

In terms of the views on markets and asset classes, Emerging Markets are still most managers' favorite, in both equities and fixed income classes, while the managers show little confidence on Developed Markets. According to the survey, the best and worst performing indices are CSI 300 and Nifty 50, respectively, and the best and worst performing assets are EM equities and DM fixed income/Hedge Funds.

The top critical event, not surprisingly, is the China-US relationship in the context of trade conflict. Many of the managers believe that the tension will persist in 2020 which is also one of the main sources of volatilities of the asset prices.

One last interesting observation is that NO ONE "firmly" believes that Donald Trump will lose the election. 57% believe that he will have his second term and the rest think "It's hard to tell".

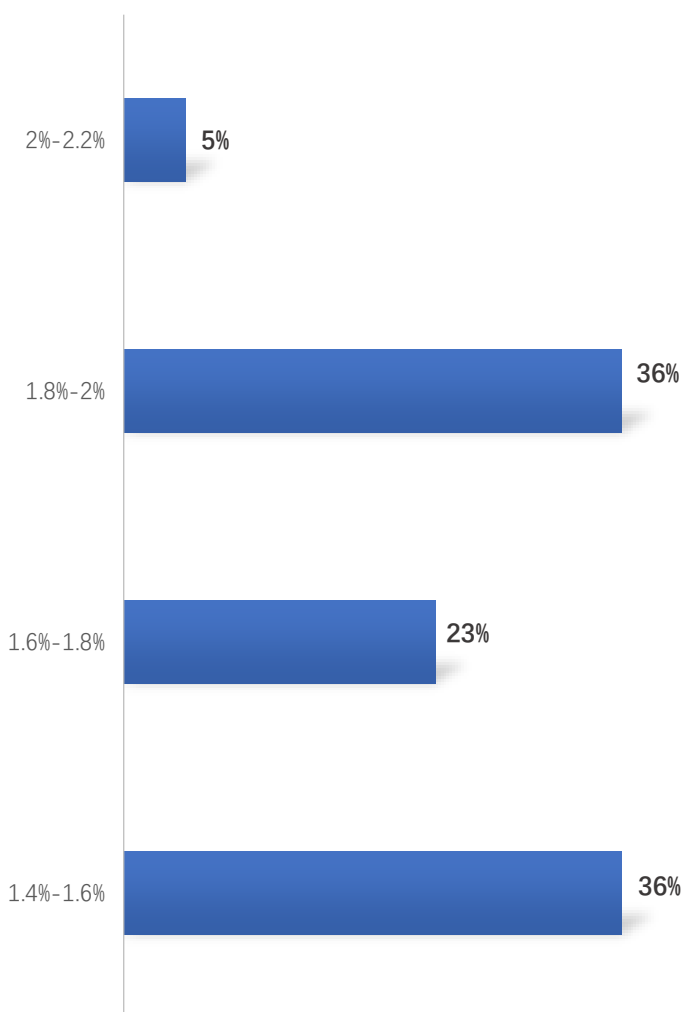
Detailed survey data of the 2020 Global Market Outlook

Global managers tend to be conservative on GDP growth in advanced economies in 2020

The survey shows that the outlook for advanced economies in 2020 is a mix of optimism and pessimism although with a slight skew towards pessimistic. It could be a reflection of the diverse views which tend to be conservative when facing increasing uncertainty.

Fig 8

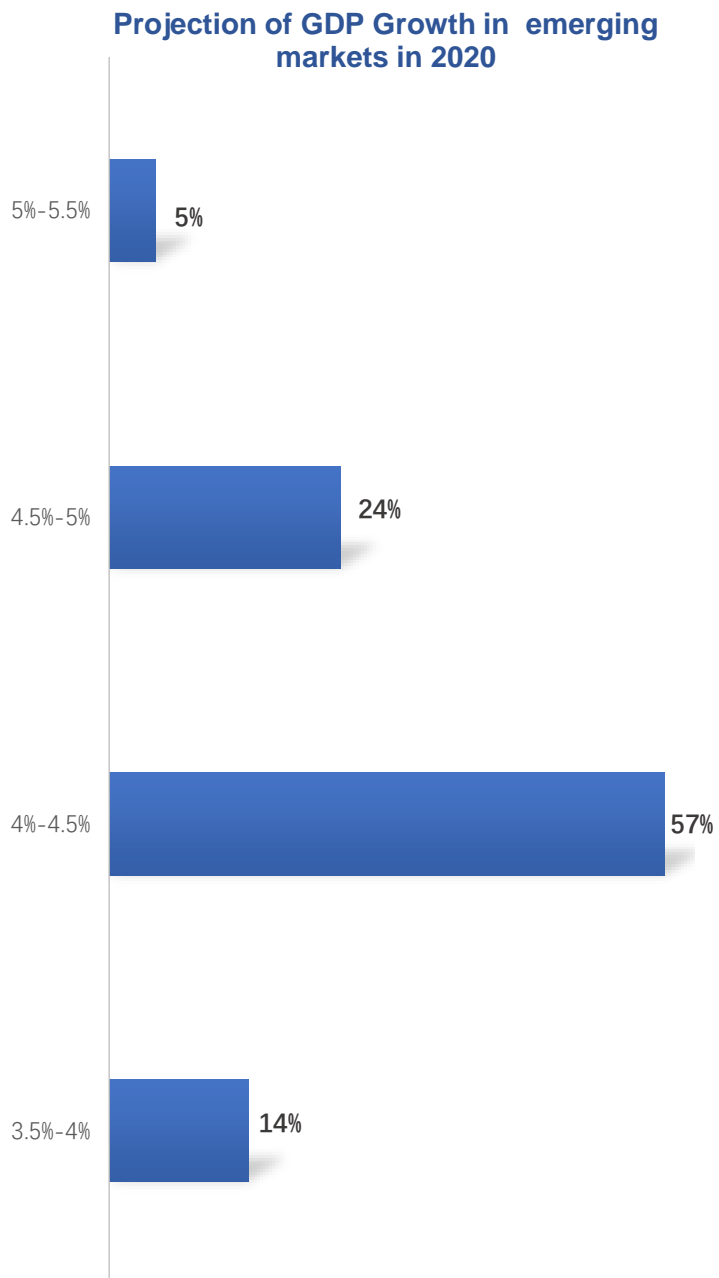
Projection of GDP Growth in advanced economies in 2020



Majority of our respondents project 4%-4.5% GDP growth in emerging markets in 2020

Majority of the opinions are relatively conservative which is flat compare to the GDP growth rate in the past few years. There is no clear sign of a strong economy growth driver across the globe so it is reasonable to be neutral about expectations.

Fig 9

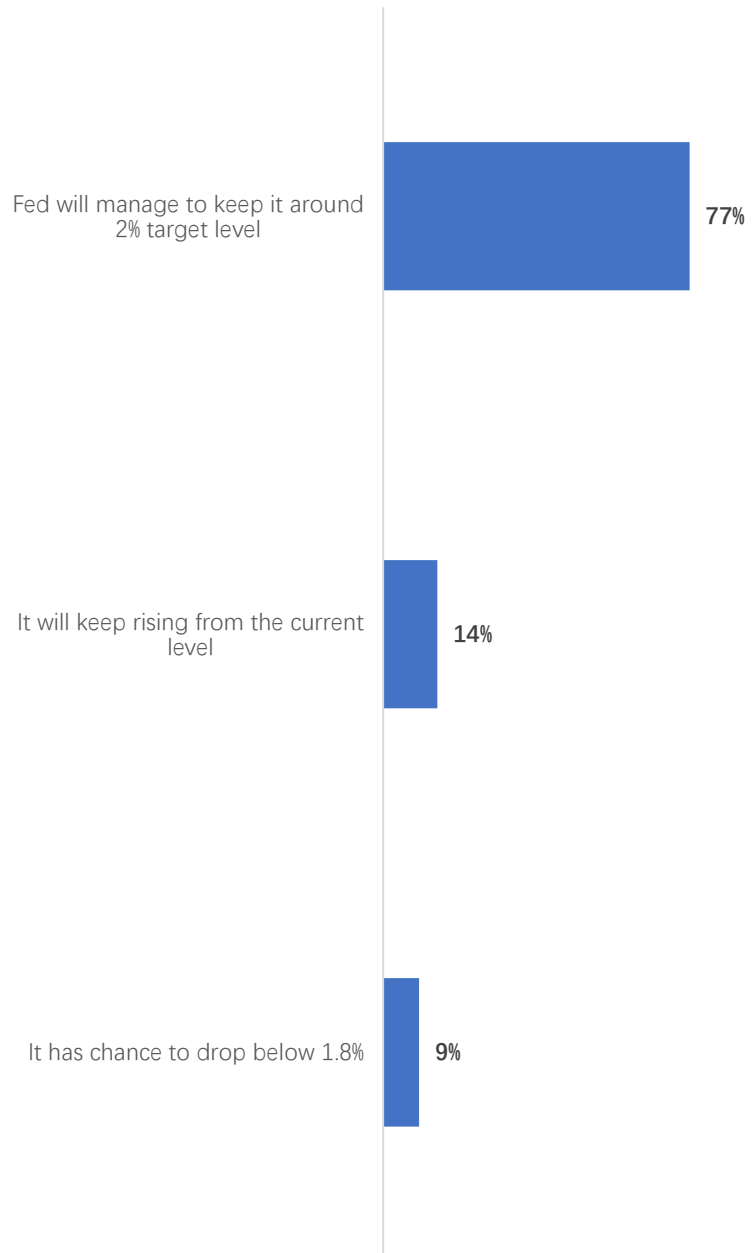


Most of the managers believe the Fed will keep the inflation rate around 2%

Inflation rate has been on current level for a few years and market believes that Fed has managed to maintain a balanced policy to keep it on track in 2020.

Fig 10

Projection of US inflation movement in 2020

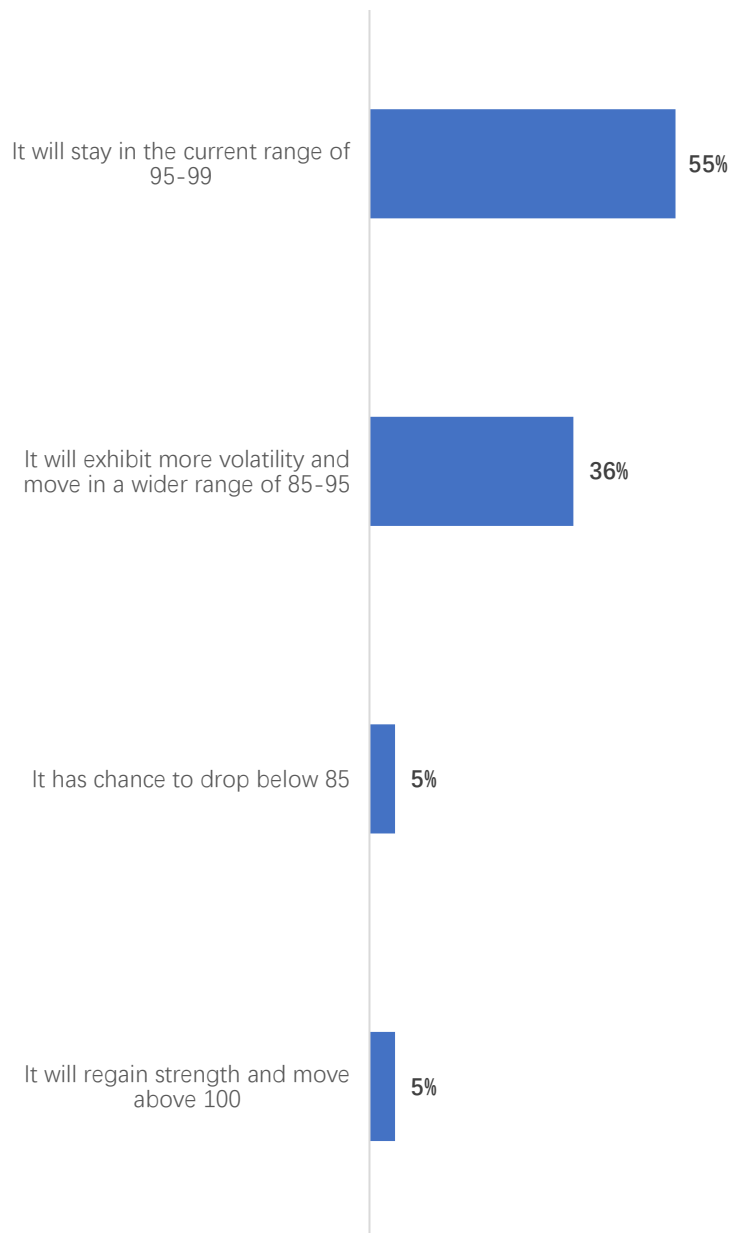


40% of our interviewees believe USD will exhibit more volatility in 2020

Half of the opinions are confident with the stability of USD while the other half expects more volatility. This is in line with outlooks on other indicators such as inflation rate or stock market performance. Momentum plays a role here so the outlooks can be stable but still there are doubts.

Fig 11

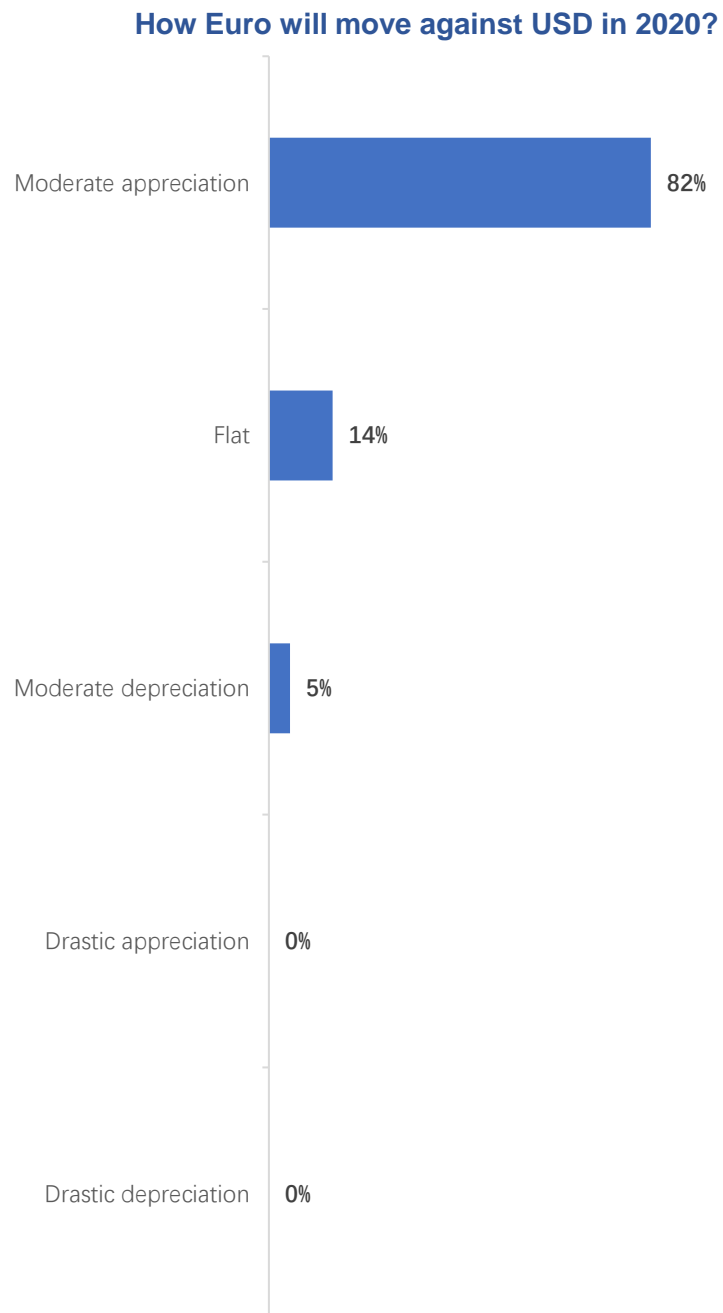
Projection of US dollar index movement in 2020



The majority believes Euro will have moderate appreciation against USD in 2020

Stability is the consensus as no one expects drastic movement and majority believes that EUR will appreciate against USD, moderately. This is also in line with the outlook on USD index where nearly half believes that USD weakening possibility of increasing.

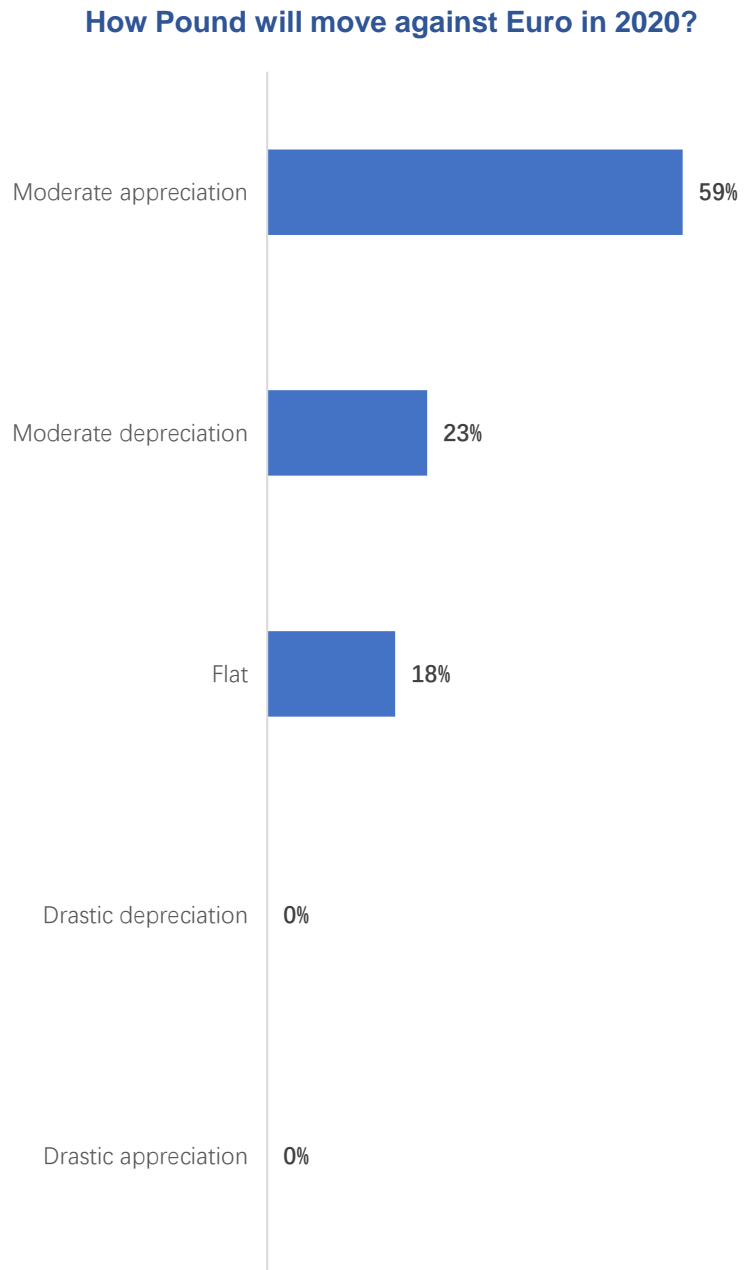
Fig 12



Divergence on Pound against Euro with 62% believing a moderate appreciation while 24% projecting moderate depreciation

Almost the same expectation as EUR only a bit more people believe that Pound could depreciate against USD. This reflects the view of possibility of weakening USD as well as the uncertain consequences of Brexit.

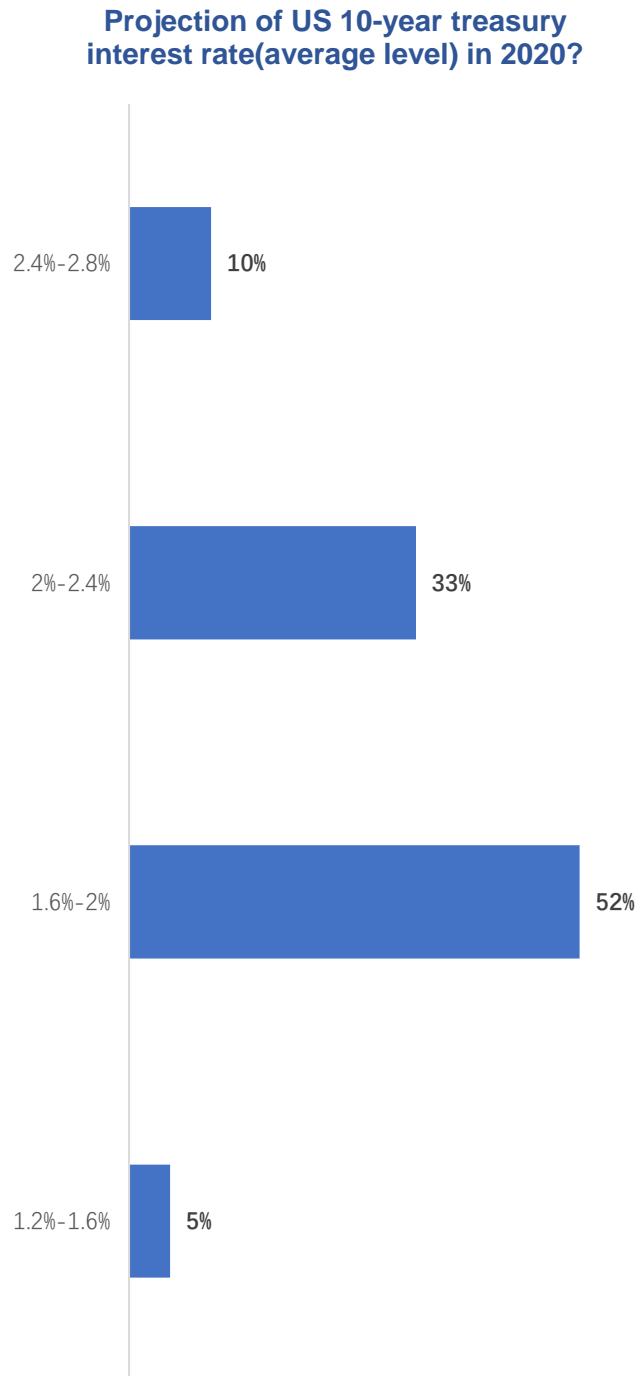
Fig 13



Half of interviewees expect 10-year treasury to stand at 1.6%-2%

Half believes that demand for this asset may stay stable in 2020 while many also believe that the demand may decrease. This outlook is a bit contradict to the outlook of USD value which many expect stable to weakening.

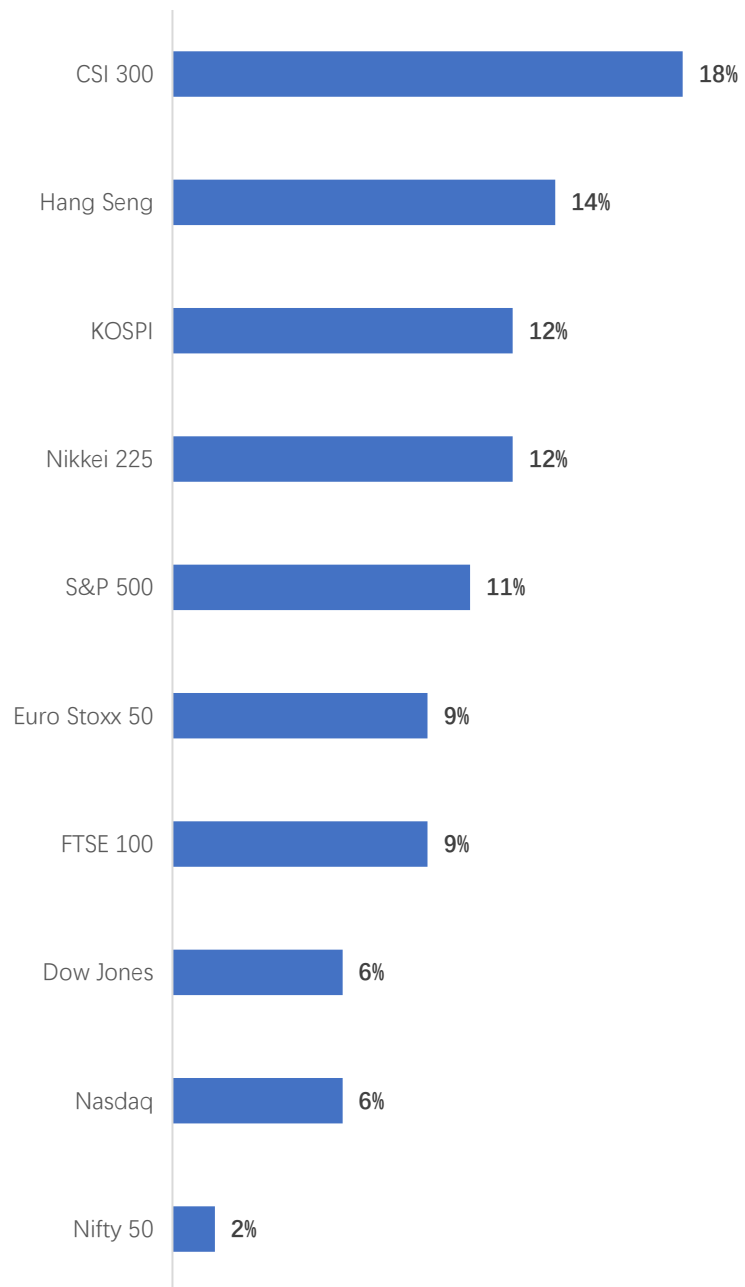
Fig 14



CSI 300 beats other indices to become most promising asset class by managers in 2020

Fig 15

Anticipation on the outperforming indices in 2020

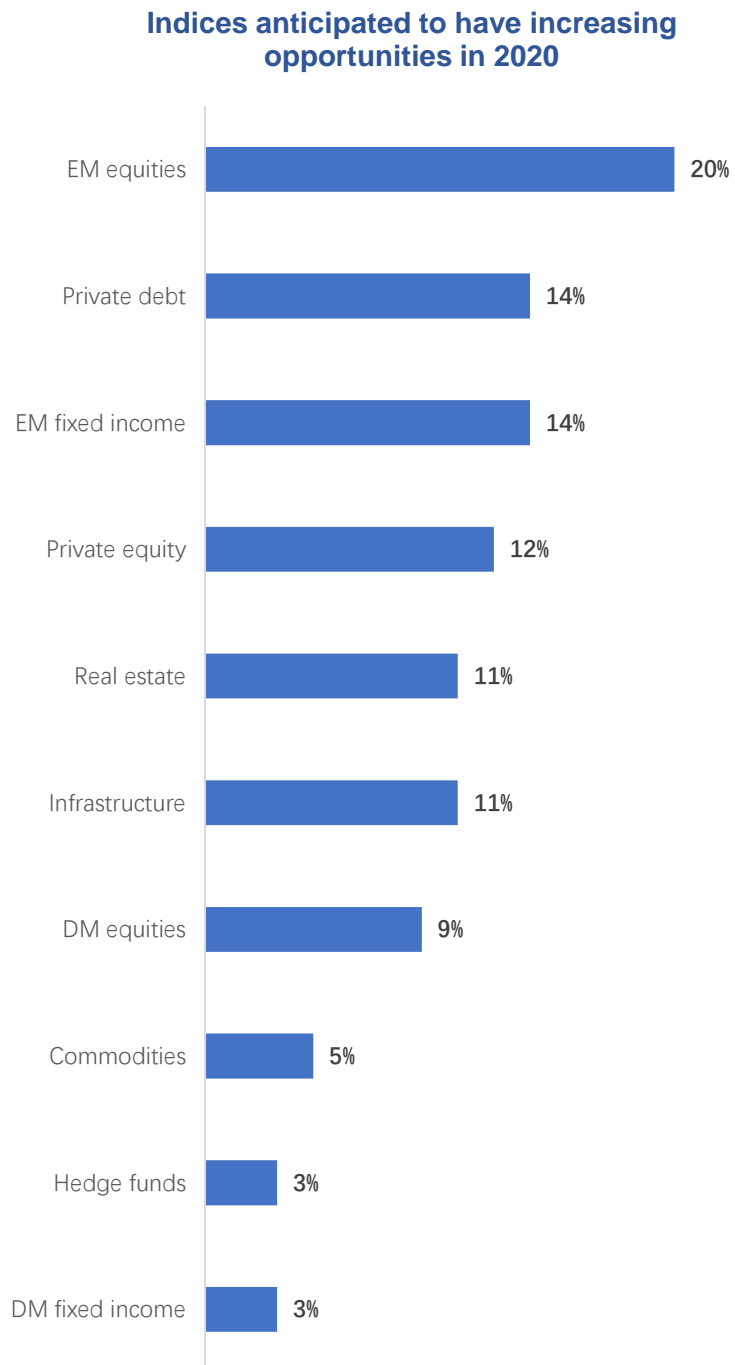


All emerging markets are favorable with China being the most promising market and US market is at the bottom range.

Managers anticipate EM and Private assets have better opportunities

Emerging market and Private market and Real Assets are becoming more and more popular than before.

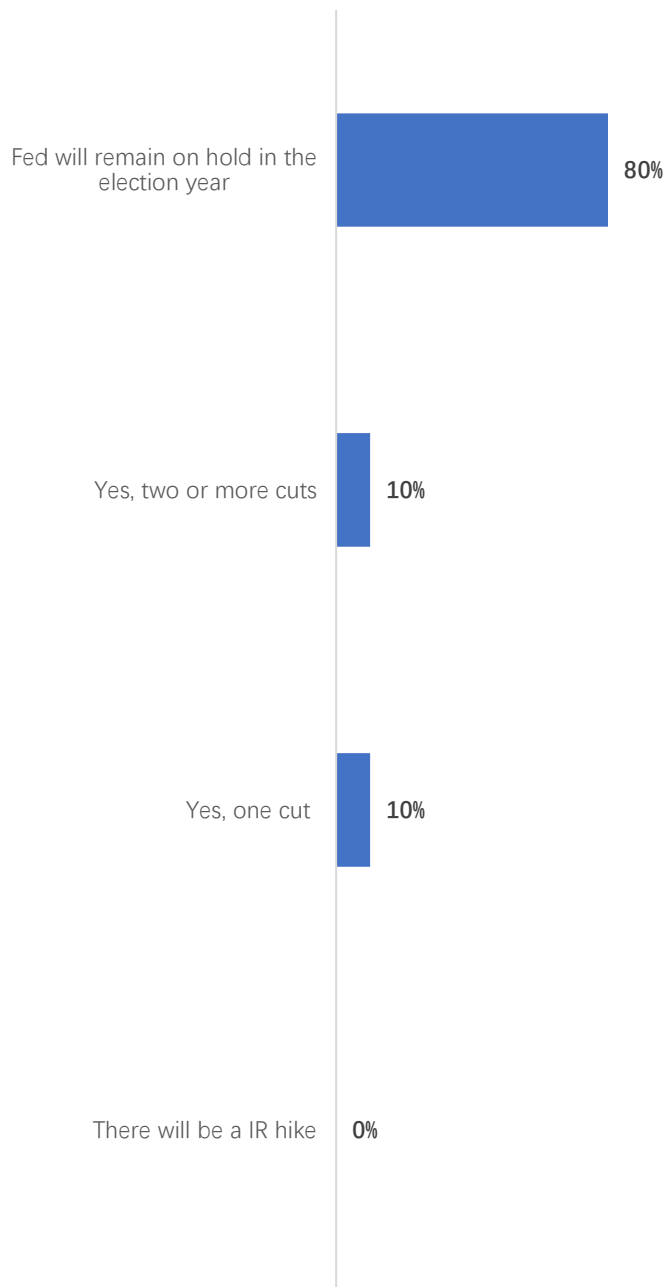
Fig 16



Majority expects no actions on rates in 2020.

Fig 17

Do you anticipate Fed to cut interest rate in 2020?

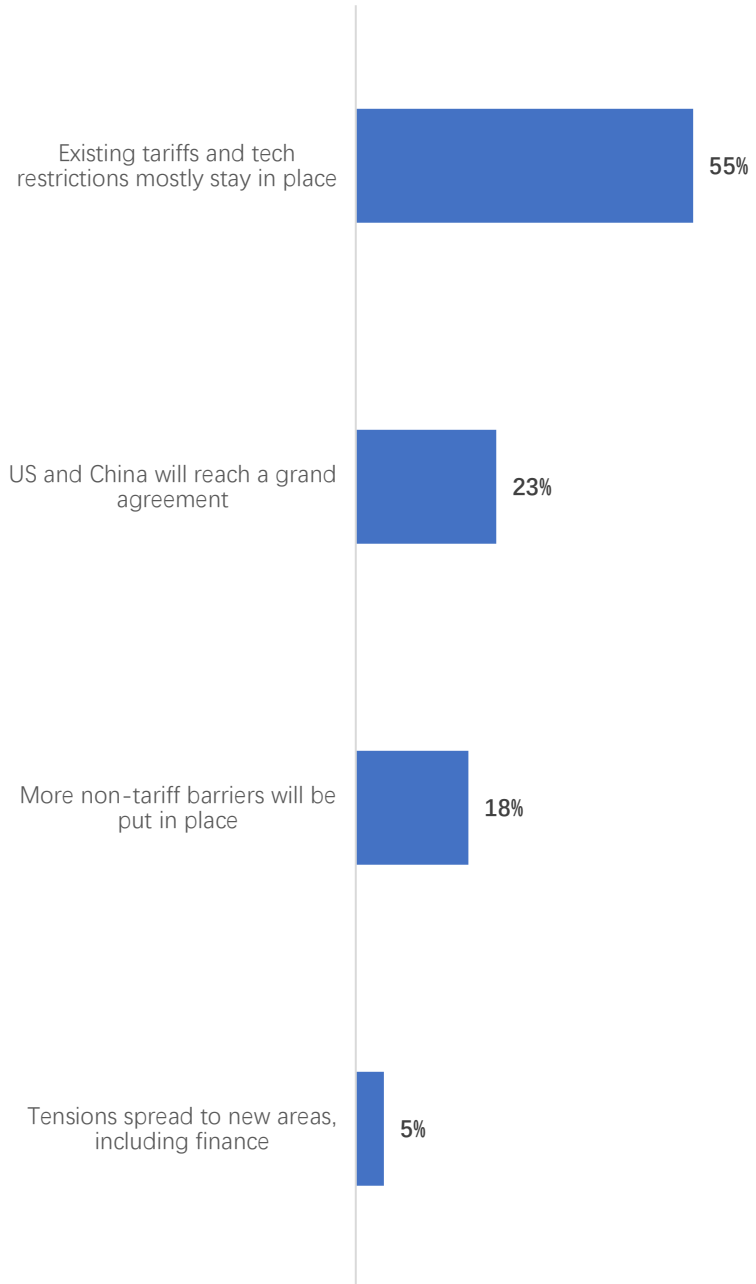


Majority expects no actions on rates in 2020.

Half of interviewees believe tariffs and tech restrictions still in place

Fig 18

How will the Trade war evolve in 2020?



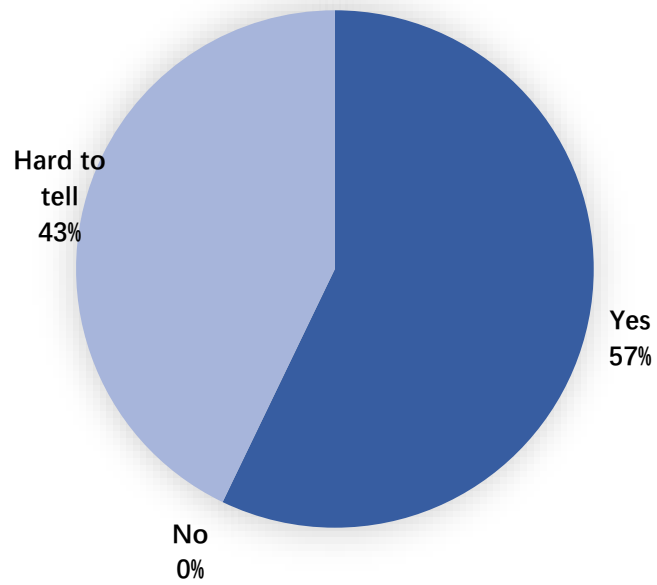
55% of the global managers interviewed think existing tariffs and tech restrictions will remain in place in 2020

43% of managers think there is uncertainty over the US presidential election

Fig 19

Donald Trump will win the reelection of president in 2020?

43% managers think there is uncertainty over presidential reelection

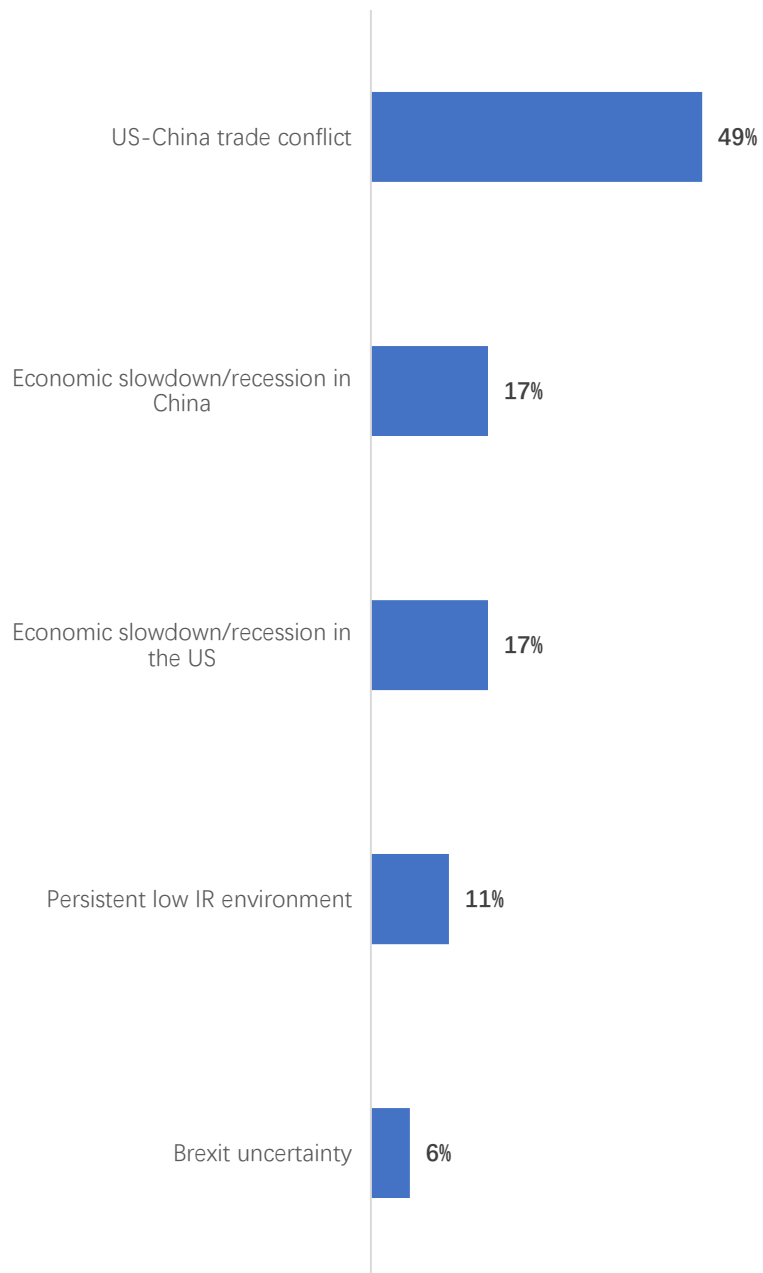


Trade war still the biggest macro risk concerning global investment managers

This concern shows how much the relationship between No. 1 and No. 2 economies may impact the world because together they ARE representing the macro environment for every economy. This also shows that voters are not very optimistic on the ease of the trade conflict between China and US.

Fig 20

The most serious macro risk anticipated by investors in 2020

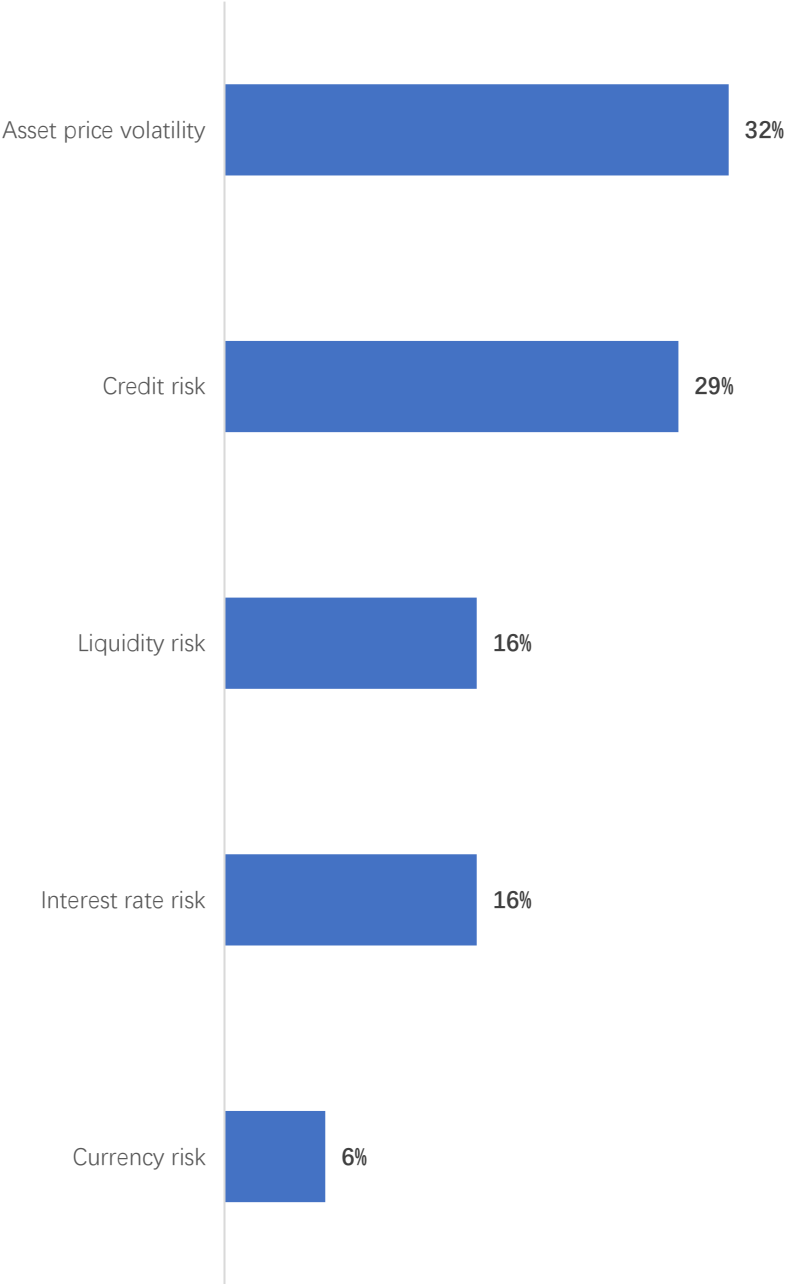


Volatility and credit top the market risk list

Other than the volatility concern brought by the uncertainties, credit risk ranks #2 among all the risks. QE and economy slowing down have both contributed to the development of credit risk across the globe.

Fig 21

The most serious market risk anticipated by investors in 2020



Part Three 2020 Outlook for Mainland China Market

Comments on the 2020 Outlook for Mainland China Market

Stepping into 2020, the confidence of the interviewees towards onshore economic growth has shaken a little amid the uncertain environment. Most of the respondents expect to see Chinese economic growth slow down this year, likely because of the events mentioned in part 2. In response to weaker growth, many respondents anticipate the Chinese government will cut interest rates in order to support the local economy. Meanwhile, nearly two third of them expect China's CPI in 2020 will rise to between 3% and 4%.

With regard to the onshore equity market, the majority of interviewees are still sanguine, especially the consumer sector. On the other hand, although the respondents hold different views on the credit spreads trend in China, nearly half of them believe it will widen in 2020. Within the onshore debt markets, investment grade corporate bonds are preferred, especially with shorter maturity.

For ESG integration, most of the respondents are riding on this global trend and gradually adopting it into their investment processes. To promote the awareness of ESG investing in onshore market, they believe more interaction with onshore asset managers as well as involvement from local regulatory bodies are key to success, though the "Governance" factor is the most difficult one to monitor and analyze.

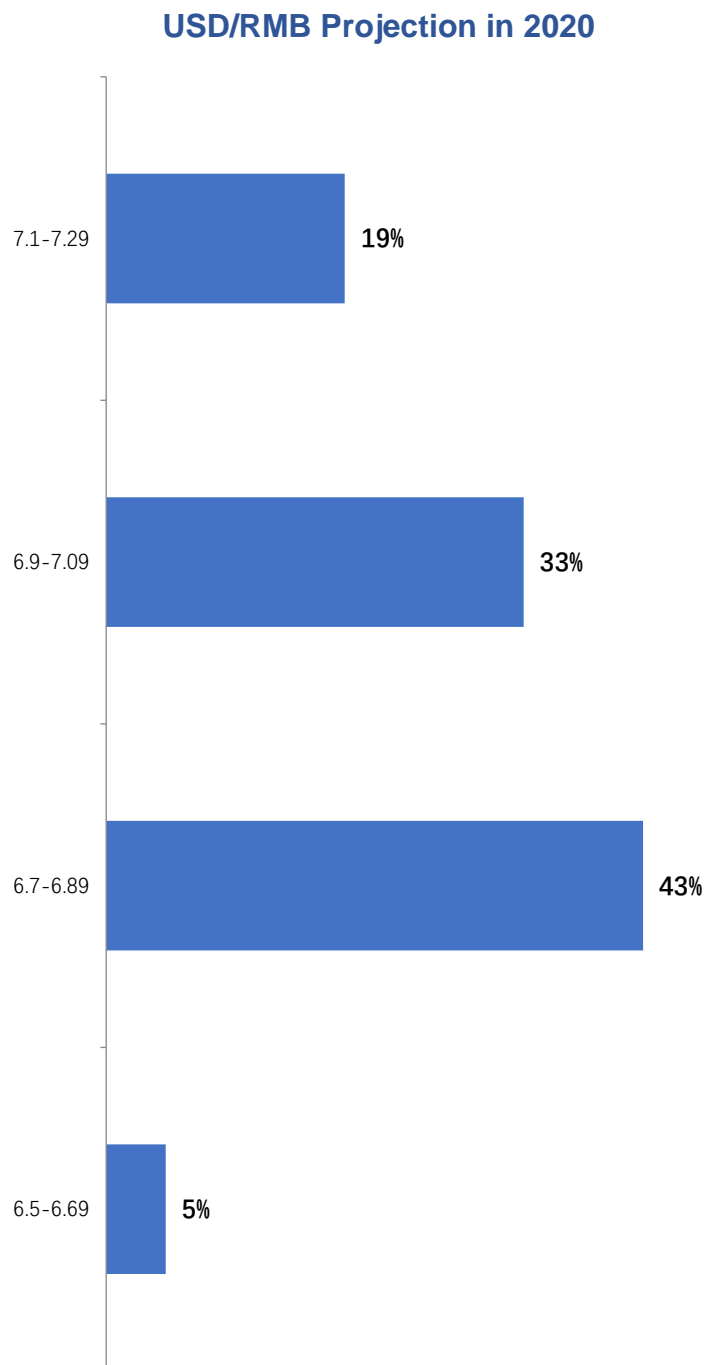
When it comes to policy reform in China, many respondents would like to see an expansion of both outbound channels and investment scope for insurance companies. Not all of the respondents have a WFOE set up in China yet, but many have shared the same thoughts of lacking transparency in regulations while expanding their business in China.

Detailed survey data of the 2020 Outlook for Mainland China Market

Majority believes USD/RMB will trade between 6.7 – 6.9 in 2020.

Compared with 6.99 on 31 Dec 2019, over 95% of the respondents believe that USD/RMB will be above 6.7 in 2020; while 40% plus of them believe it will sit at the range of 6.7 to 6.89 in 2020. But majority believes USDRMB will trade between 6.7 – 6.9 in 2020.

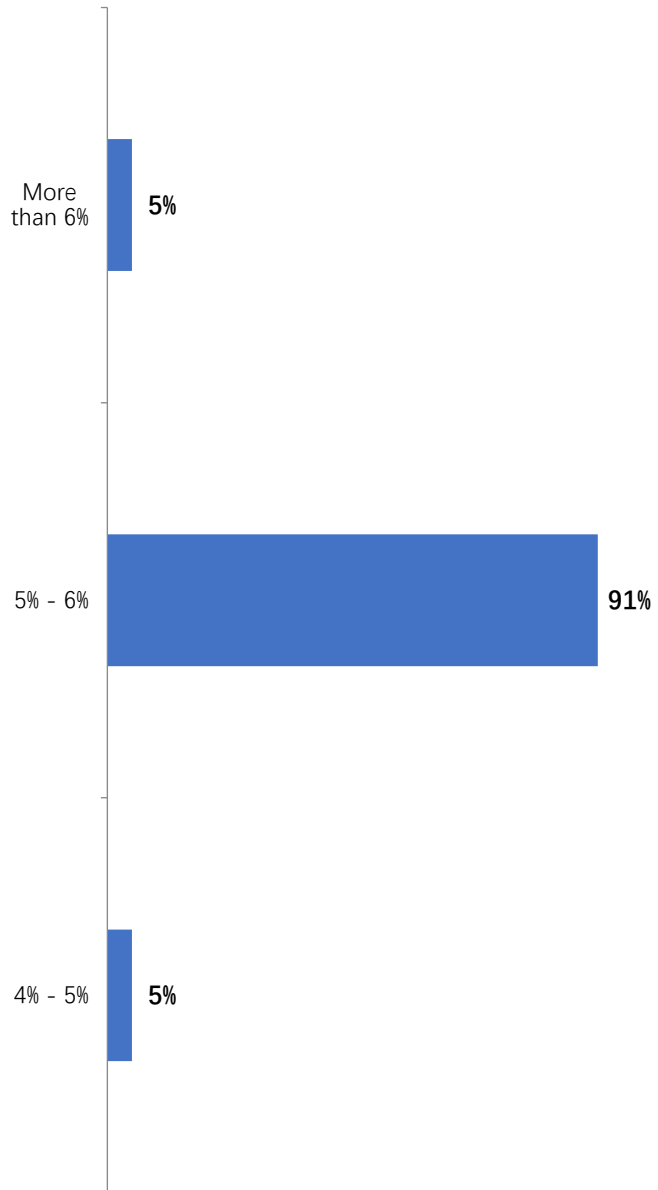
Fig 22



Most asset managers expect a slowdown in China's GDP growth in 2020.

Fig 23

China's GDP Growth Projection in 2020

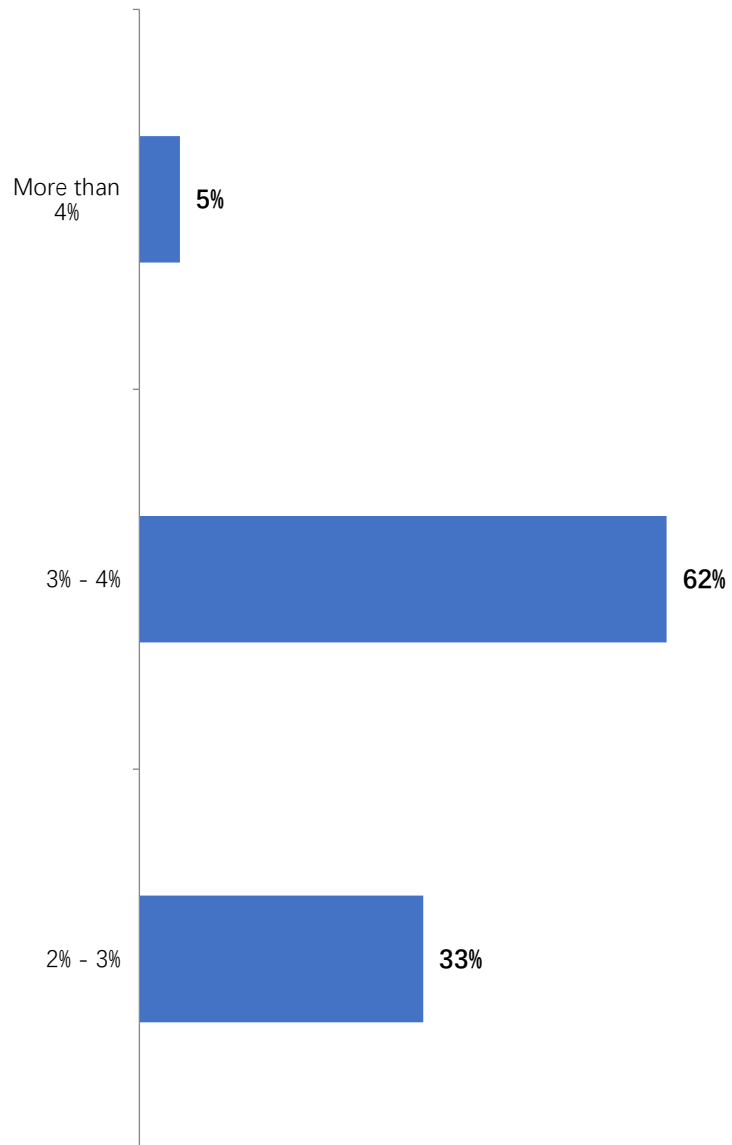


Compared with 6.1% growth in 2019, over 90% of the respondents expect the China's economic growth would further slow down to 5% to 6% in 2020 amid the uncertain environment.

Two third of the foreign asset managers believe China's CPI will rise to between 3% and 4% in 2020.

Fig 24

China's CPI Projection in 2020

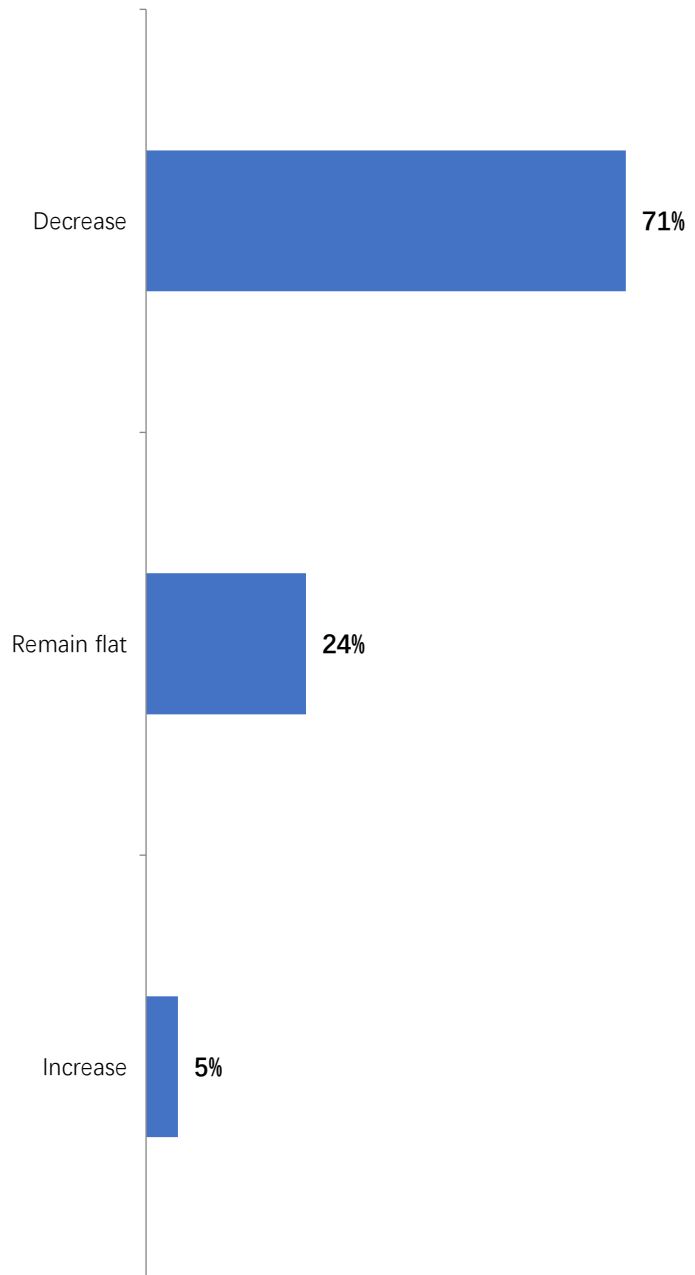


Compared with 2.9% in 2019, nearly two third of the respondents expect the CPI of China in 2020 will rise to between 3% and 4%; while one third of them expect to remain at current level - between 2% to 3%.

Rate cut is expected by most asset managers in 2020.

Fig 25

China's Interest Rate Projection in 2020

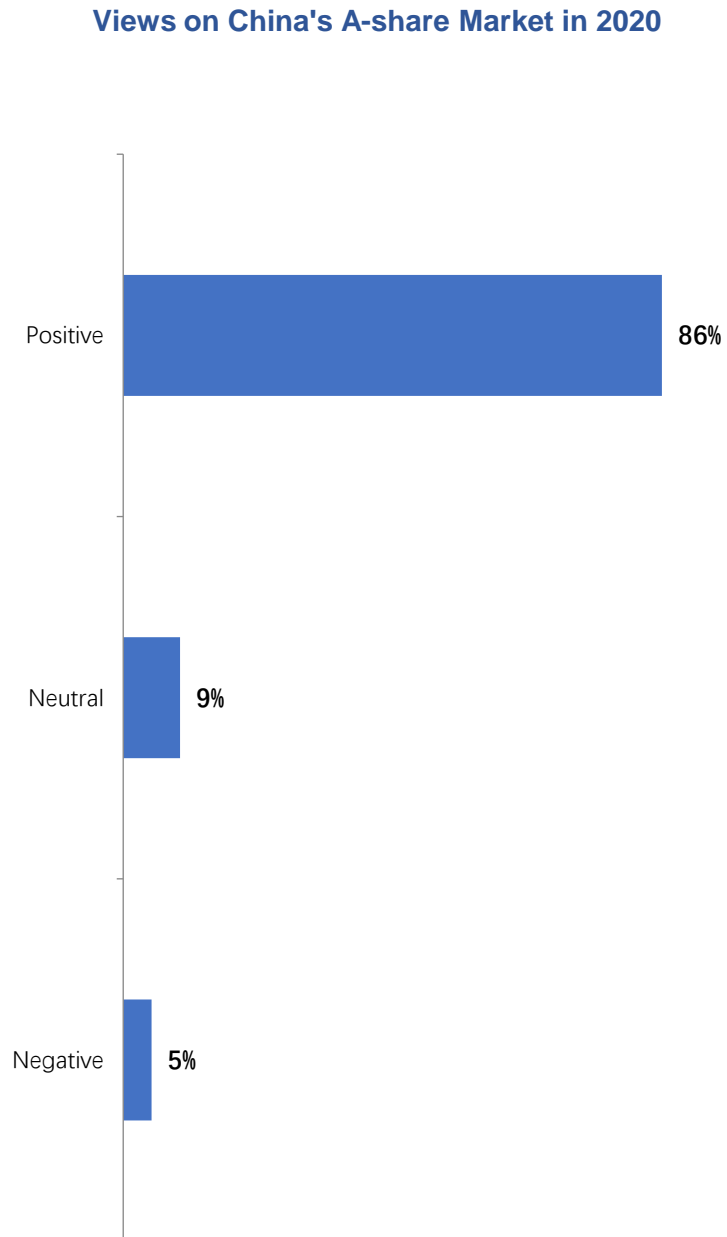


Echoing the slowing down expectation on the economy in Q26, over 70% of respondents anticipate that China's will cut interest rates in 2020.

Foreign asset managers in general remain bullish about China's A-share market in 2020.

After the robust performance in 2019 by returning 22.3% (SSE), most of the asset managers remain a positive trend towards the China's A-share market in 2020. That said, it is interesting to note that although most respondents think that the Chinese economy will slow down in 2020, the majority still has a positive outlook on the stock market.

Fig 26

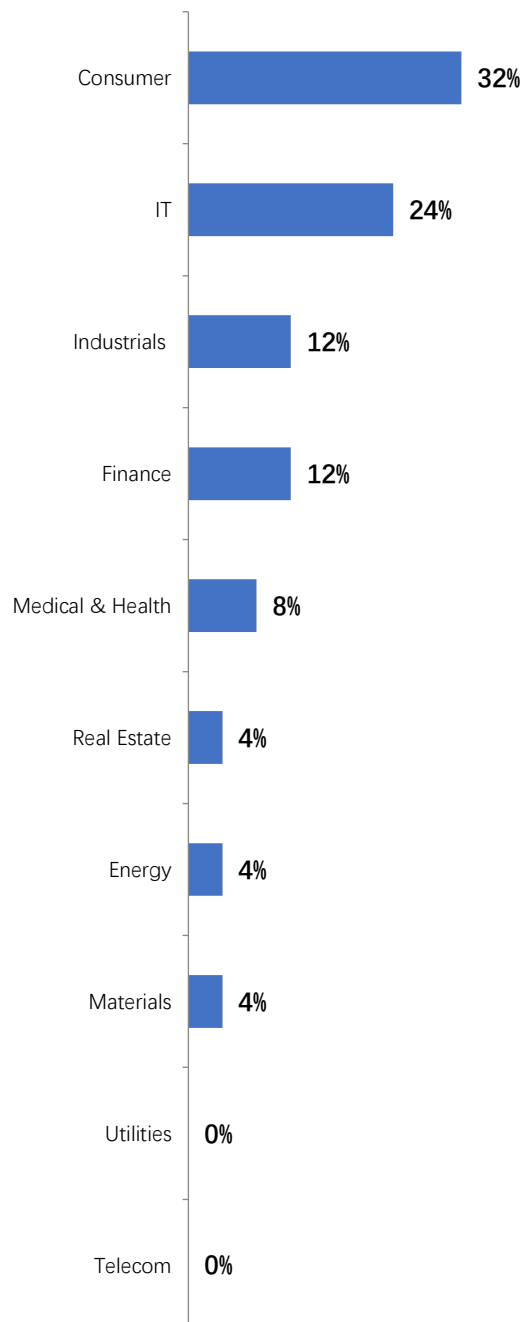


*None of the participants is either highly positive or highly negative towards China's A-share market in 2020.

Domestic consumption sector is expected to outperform this year.

Fig 27

A-share sectors that asset managers most prefer in 2020

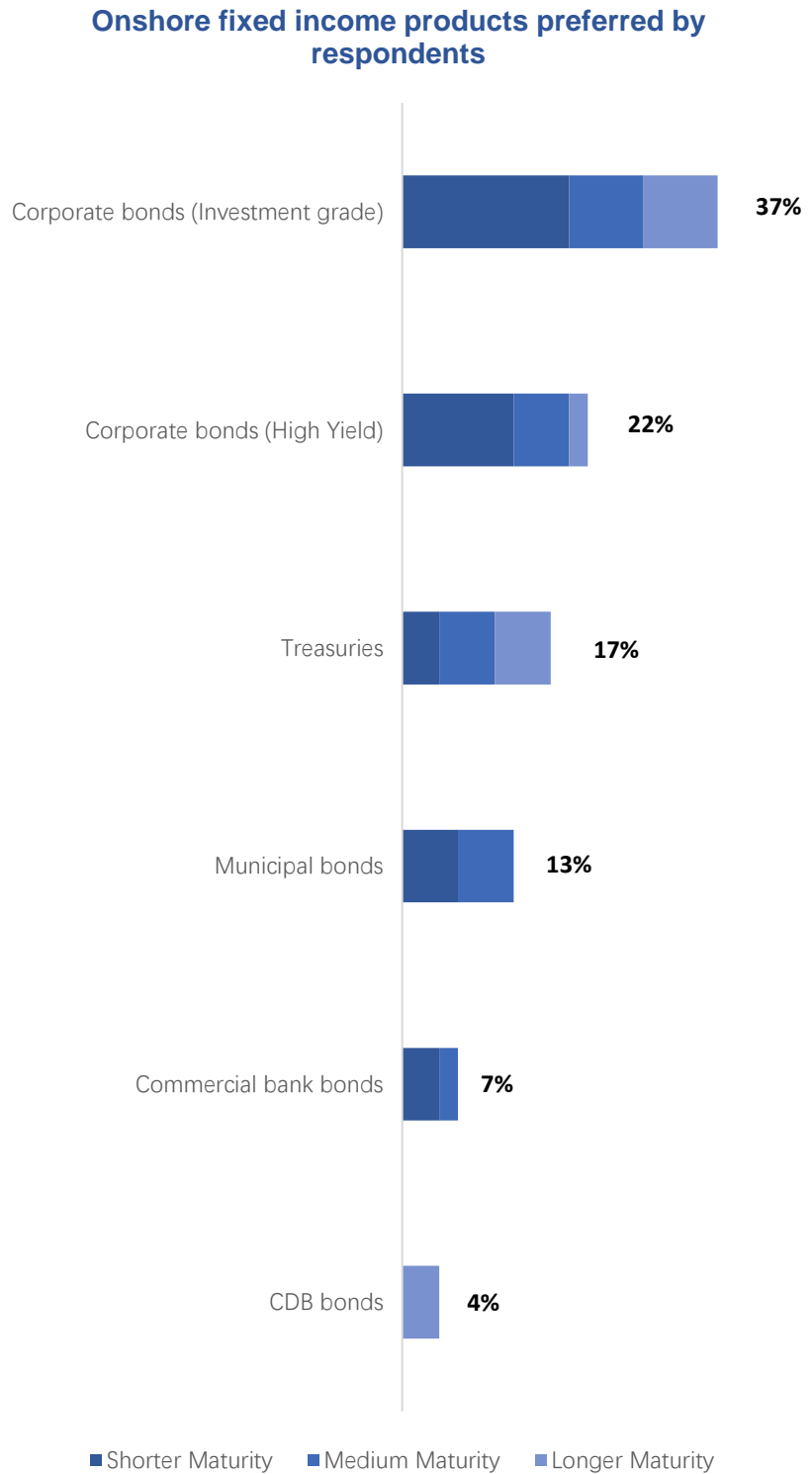


In contrast to the performance in 2019, consumer is the most preferred sector among asset managers, while the IT is only the second preferred sector, implying that domestic demand is believed to be the key in 2020.

Among onshore debt, foreign asset managers prefer investment grade corporate bonds, especially with shorter maturity.

Overall, investment grade corporate bonds are the most popular among asset managers, the one with shorter maturity in particular. On the contrary, they are least interested in CDB bonds. Other than corporate bonds with investment grade, foreign asset managers, in general, prefer products with short to medium maturity.

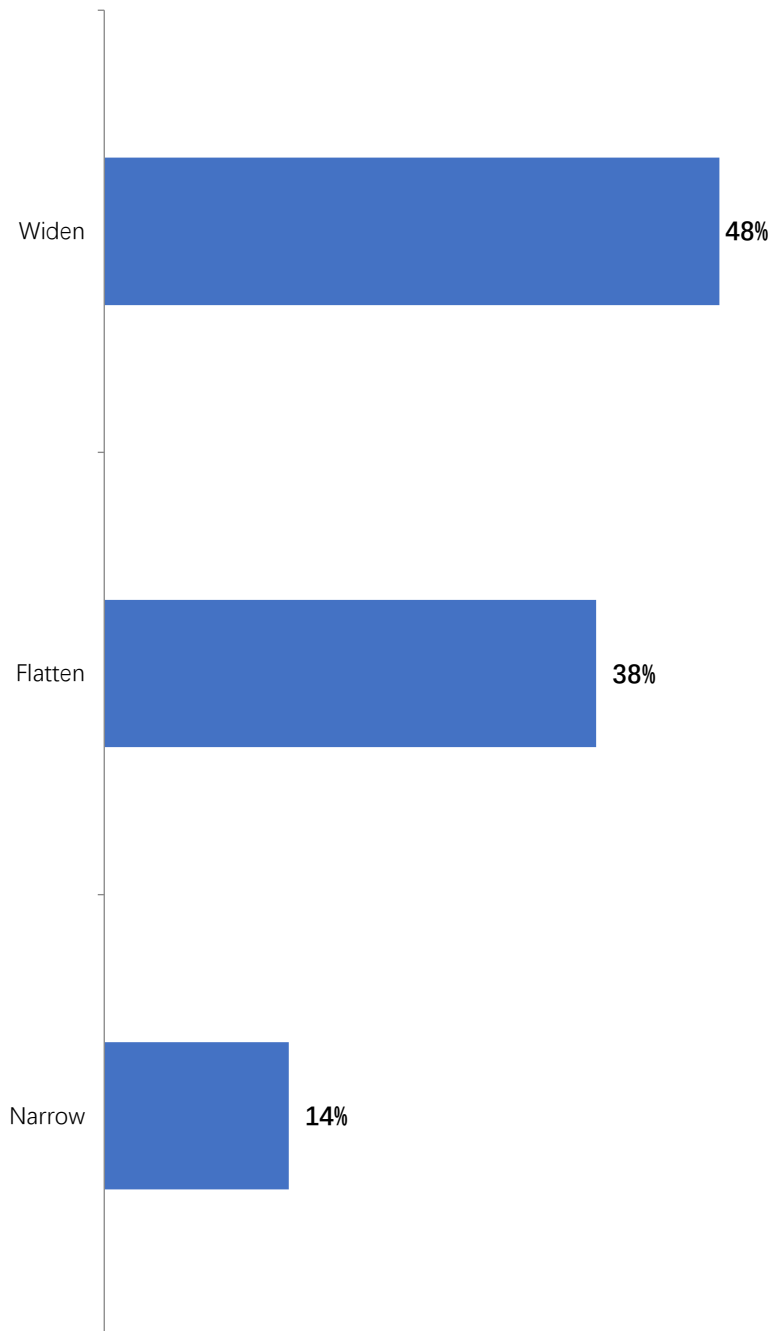
Fig 28



Diverse views on onshore credit spread movement in 2020.

Fig 29

China's Credit Spread Projection in 2020

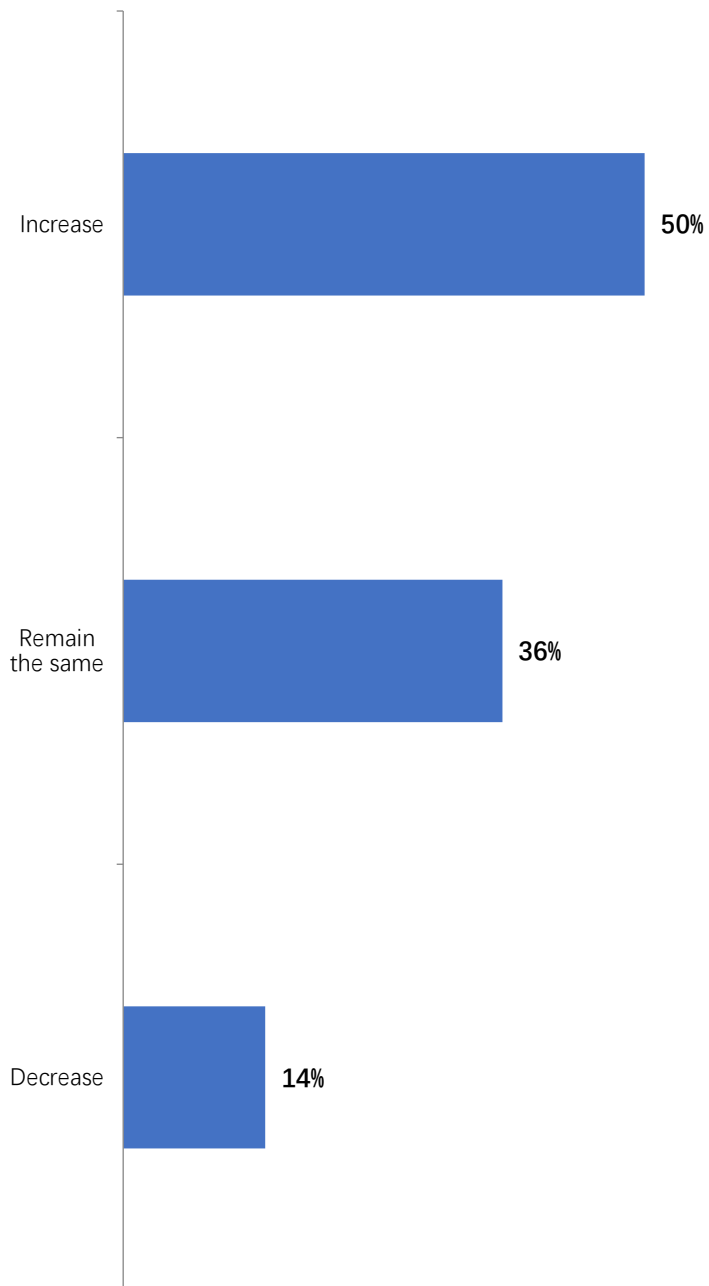


Foreign asset managers hold different views on credit spreads in China in 2020. However, nearly half of them believe they will widen in 2020.

Heightened default rates in China will continue to be a concern among asset managers.

Fig 30

China's Default Rates Projection in 2020

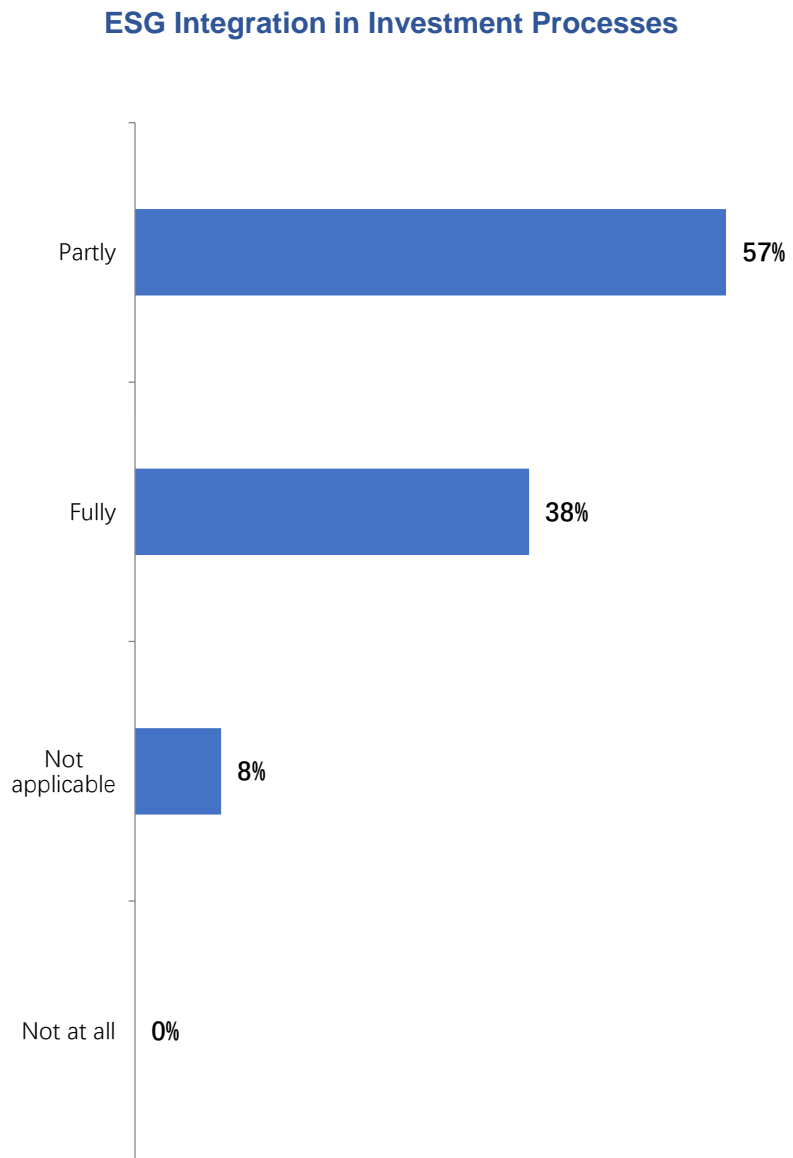


Half of the asset managers expect to see an increase in the default rates in China in 2020. This echoes Fig 28 that investment grade credit is more preferred other others. Only a minority of them believe that onshore default rates will drop.

ESG is a global trend and gradually being integrated into foreign asset managers' investment process.

With ESG being the hot topic among asset managers, over 95% of the them are either partly or fully integrating ESG into their investment process. It indicates that responsible investment has become the focus over the years, especially in offshore markets.

Fig 31



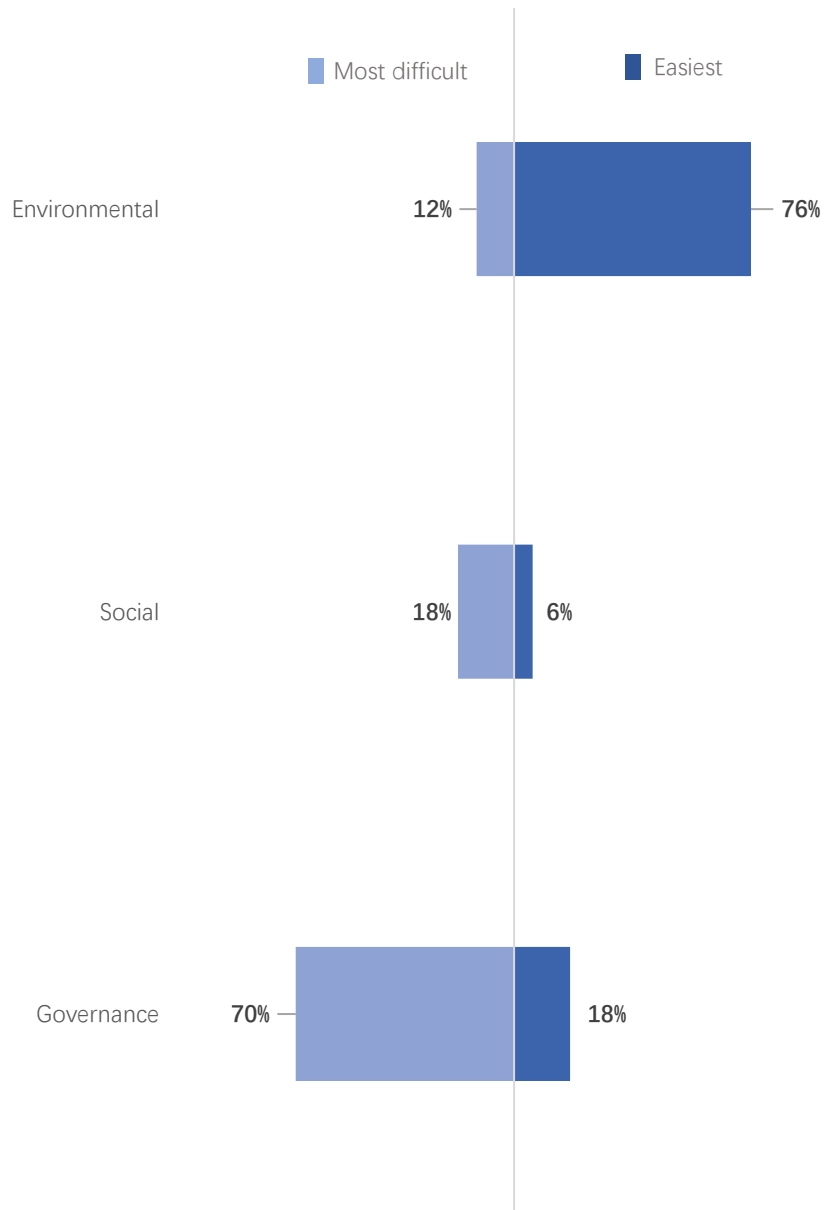
*A total of 21 asset managers provided their feedback. One respondent chose "not applicable" for this question.

Among the three components in ESG, foreign asset managers find "Governance" the most challenging to be monitored and analyzed in China; while "Environmental" is relatively easier to implement.

Among environmental, social and governance, most of the asset managers think that the "environmental" factor is the easiest to be monitored and analyzed likely because related measurements or tools are in place; while most of them believe "Governance" is the hardest to be monitored in onshore market.

Fig 32

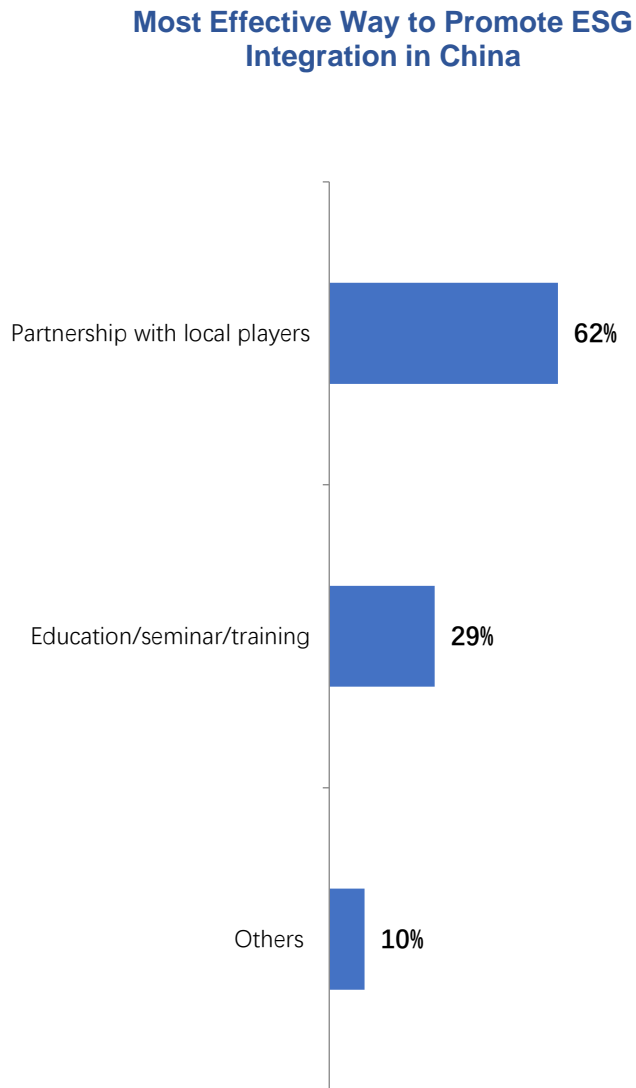
Which ESG factors is the easiest and most difficult to be monitored and analysed in China?



Partnering with local players is instrumental to encourage ESG integration in onshore market.

Most of the offshore asset managers think that partnering with local firms will be the most effective way to promote ESG integration in the onshore market. Some of them also suggested that Chinese government and regulatory bodies could play a part in it as China is a policy directed market compared to other offshore markets.

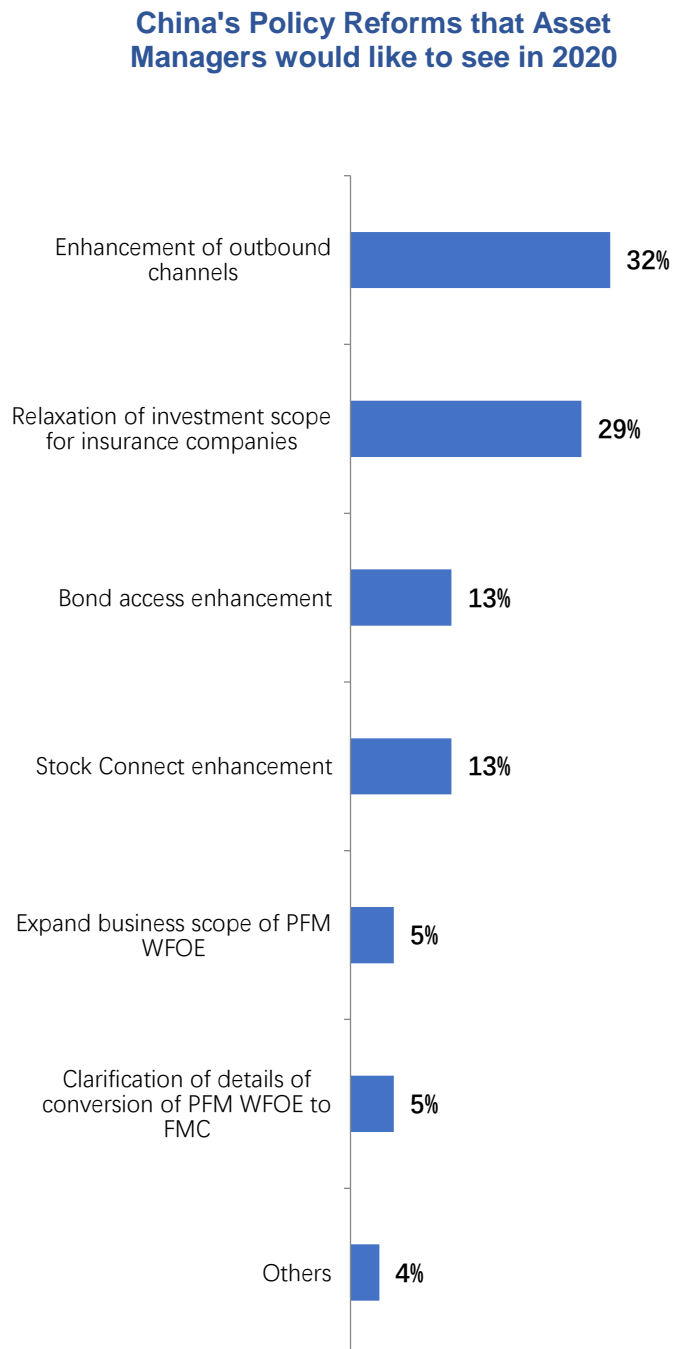
Fig 33



Enhancement of outbound channels as well as relaxation of investment scope for insurance companies are preferred by foreign asset managers.

The top policy reform that offshore asset managers would like to see in 2020 are enhancement of outbound channels. Many see that there is still room to expand the outbound channels. It could be either expanding the quotas or widening the number of channels. They also hope for a relaxation of investment scope for insurance companies. Due to the policy constraint, the investment universe of onshore investment companies is limited at the moment, thus impacting their investment's risk/return profile. Offshore managers would also like to see an opening up of wider range of risk-management tools for offshore asset managers.

Fig 34

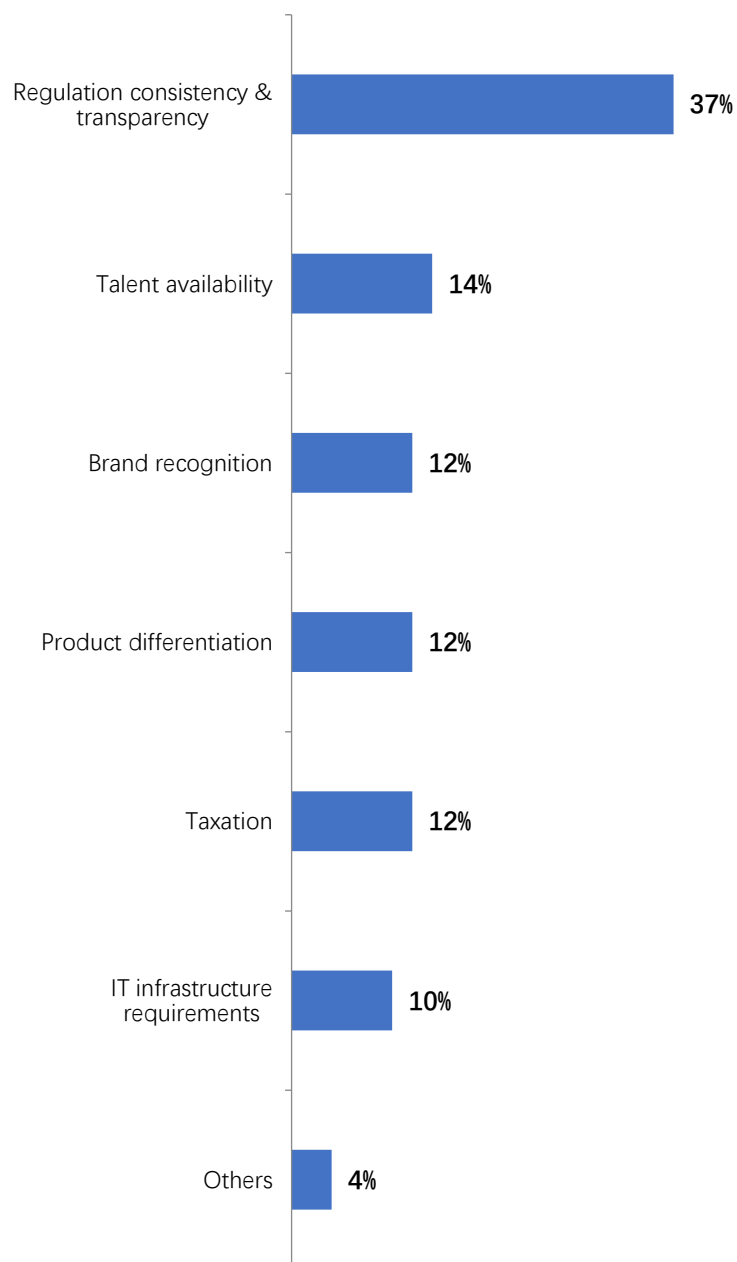


Regulation inconsistency is the main obstacle in expanding business in China

Over one third of the offshore asset managers has experienced a difficulty in entering China market due to regulation inconsistency and lack of transparency. Some of them also find it hard to acquire talent in onshore market. Other issues they have encountered are the weak brand recognition, insufficient product differentiation compared to onshore companies, as well as taxation issue and IT infrastructure requirements.

Fig 35

Risks/barriers Asset Managers Encountered When Entering China Market



CORONAVIRUS AND EMERGING MARKETS: EARS-TO-THE GROUND

UBS Asset Management | **Emerging Markets and Asia Equity team**

Key takeaways

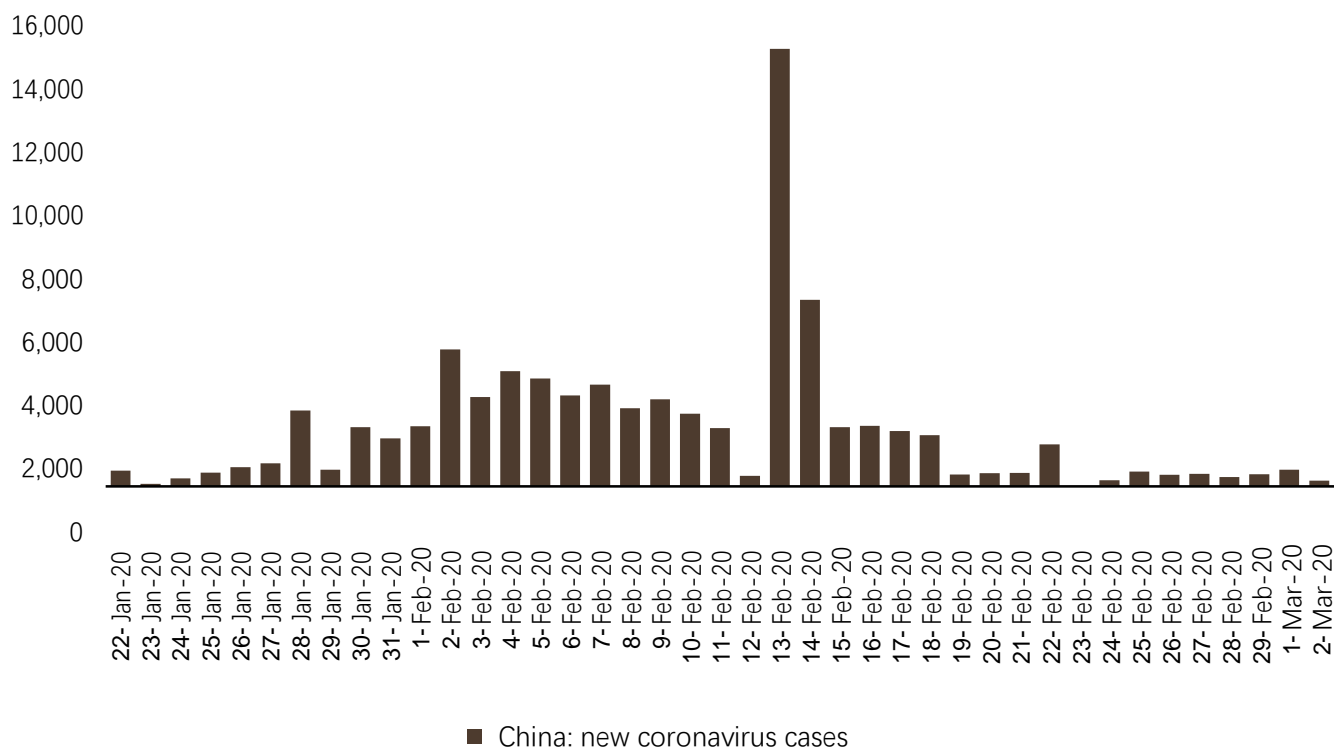
- The coronavirus outbreak will have a clear short-term economic impact on both China and economies throughout the Asia region;
- The extent and duration of the impact will depend on containing the spread in Asia and around the world, as well as the extent of policy support. China, Singapore and Hong Kong are already rolling out support measures;
- Global markets have only recently reacted negatively and could remain volatile in the near term; however,
- In China, the outbreak is accelerating a series of trends, including:
 - **Ongoing industry consolidation:** many smaller firms are finding it difficult to cope and will likely go out of business. Stronger and larger players are likely to benefit by growing market share.
 - **An offline-to-online shift across business segments:** more pronounced in industries such as after-school tutoring, banking, and healthcare diagnosis; offline-only businesses are likely to lose market share;
 - **Investment in R&D and innovation:** driven by growing demand for automated solutions, AI-driven technology, high-quality healthcare, as well as online entertainment and communication services;
 - **Supply chain shifts:** coronavirus provides additional impetus to diversify, and favored destinations are South-East Asia and India and reshoring, especially to North America, South Korea or Japan.
- We remain confident in fundamental, long-term changes playing out in emerging markets and our strategies are focused on quality companies associated with them.
- Despite market resilience in the wake of the coronavirus outbreak, we had remained cautious, thinking that investors may be too sanguine about the economic and earnings impact of the coronavirus.

Short-term impact significant, but stimulus measures are in the pipeline

The short-term impact of coronavirus on China's economy could be significant, largely because of the considerable precautions taken, like travel restrictions and factory closures.

However, the growth rate of new cases has slowed markedly in China while picking up pace elsewhere in the world.

China: new coronavirus cases, Jan 23rd, 2020-March 2nd, 2020



Source: Johns Hopkins CSSE, March 2nd, 2020

In China, many large companies and state-owned enterprises have resumed work, but smaller companies face more of a struggle. Depending on the sector and progression of the situation, it is estimated that the impact of work disruptions could last for one to two quarters.

Government efforts to support China's economy have been considerable, including cuts to interest rates, cuts to selected banks' required reserve holdings (RRR), support for small-and-medium enterprises, and relaxation of home purchase restrictions in some parts of China.

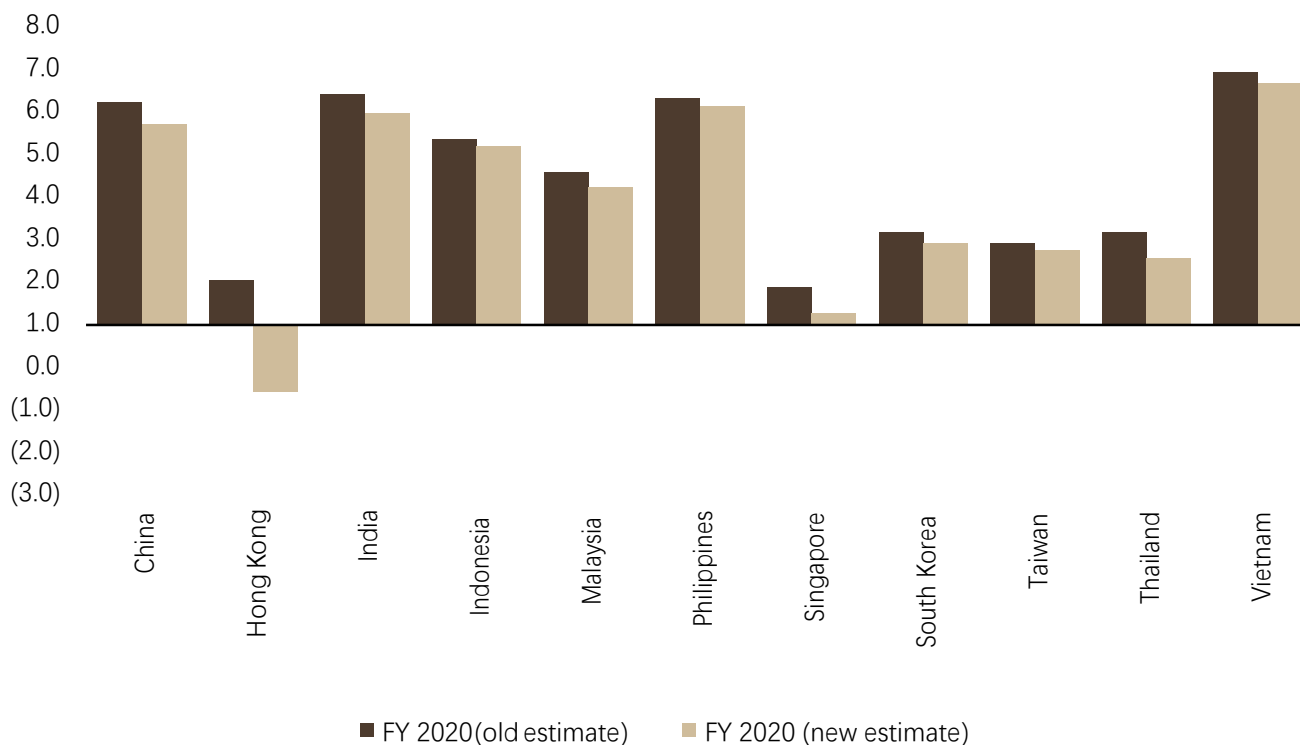
In Asia, there will likely be spillover effects, with the heaviest impact on countries dependent on tourism, commodity exports and trade flows.

Taking Asian tourism as an example, Chinese tourists account for a large portion of tourist spending. In Thailand, tourist spending accounts for about 12% of GDP, and approximately 28% comes from Chinese tourists. Other Asian countries significantly exposed to Chinese tourism include Hong Kong, Singapore, and Malaysia.

However, we are beginning to see support measures across the region, including stimulus measures in Singapore and Hong Kong, infrastructure spending in China. Furthermore, there is a rising likelihood of further interest

rate cuts.

FY2020: GDP Forecasts Across Asia: Old vs New



Source: UBS, December 20, 2019 & February 28, 2020

Supply chain restoration underway; companies are relocating out of China, but they are not rushing

In the shorter term, many industries across the world with parts of their supply chain linked to China will likely face supply constraints in Q1 and possibly Q2. The rest of Asia also has significant supply chain exposure to China.

On average, China accounts for 20% of imports in the rest of Asia. But the restoration of supply is now underway. For example, logistics companies who were operating at 15% capacity at the trough are now at about 80% capacity.

Large companies and SOEs have much higher work resumption rates, while small companies face more of a struggle. Coal mining, steel, food manufacturing have seen a faster pace of work resumption.

Restoration is slower in the auto sector, which is currently estimated to be at 30% capacity due partly to low expected demand.

Overall, there are downside risks with the virus now going global.

Even prior to Covid-19, the move to reduce dependence on the China supply chain had started, driven by rising costs in China and rising automation reducing labor cost differentials, the trade conflict and tariffs, and a general desire to diversify China's supply risk. Covid-19 provides an additional impetus to diversify from the China supply chain

This diversification is widespread across industries, but is a slow process.. Many companies are looking at a China plus one strategy, hence China will continue to be an important production base for companies.

Favored destinations are South-East Asia (with Vietnam the top destination), India and reshoring to North America, Korea or Japan.

Restructuring the supply chain is often accompanied by automation, benefitting factory automation companies. Selected companies in South-East Asia and India should also benefit, but the impact is more diffuse.

Our views across sectors

Consumer: expect a slowdown, but the extent of the impact will vary

China's consumer sector will see a near-term growth slowdown, but the extent of the impact and the time of recovery will vary by each consumer sub-segment.

Enforced closures mean sub-sectors like restaurants, sportswear and spirits & beer are most exposed to the slowdown.

For example, Yum China¹ announced that it had closed 30% of its restaurants in China and other chains have also announced temporary closures.

Additionally, China's auto sector will likely see a significant drop in sales and production in the near-term: we're currently seeing 30%-50% utilization across the supply chain, and only 20%-30% of dealerships open in mainland.

It is highly likely that China's government will apply support policies, potentially in the form of cuts to purchase taxes, continued subsidies for electric vehicles, and increased license quotas.

Aside from hoarding of essential items, supermarkets and consumer staple sectors aren't likely to see meaningful long-term impact. Retailers with O2O (offline/online to online/offline) support will be less impacted than pure offline players.

Consumer: potential winners are online education, large restaurant chains and sports apparel sectors

Online after-school tutoring companies are seeing a surge in demand amid closures of offline classes, and we see this as an opportunity for leading online companies in the sector to take market share.

Leaders in the restaurant sector may benefit if, as we expect, smaller players are forced out of the market. Larger players can exploit the situation by securing good locations with favorable rental terms.

Organized and established players may also benefit in the long term if consumers put more emphasis on hygiene and health considerations when selecting restaurants. For the same reason, the food manufacturing sector may also see consolidation.

We expect more emphasis within China on sport and exercise since coronavirus has hit those already in poor health especially hard. Given high entry barriers, China's leading sports apparel companies, , may see stronger sales coming from a heightened focus on staying healthy.

¹ Marketwatch, February 2020 (<https://www.marketwatch.com/story/yum-china-closes-30-of-stores-due-to-coronavirus-2020-02-05>)

Internet: increased demand for virtual economy services

Online travel and on-demand food delivery have been adversely affected by travel & work restrictions in China as well as a shift toward home-dining and self-cooking amid restaurant closures and hygiene concerns.

The impact on e-commerce and online advertising in China has been relatively neutral.

For e-commerce, reduced sales of apparel and home appliances have been balanced by increased sales of health products and groceries. For online advertisers, ad spending from online games and education companies has been strong, but other advertisers have canceled their marketing budgets.

Virtual economy subsectors have benefited the most.

Take online gaming for example, user traffic grew between 30% and 50% during the Chinese New Year period. Social video providers have seen increases in daily time spent, and online diagnosis services like Alihealth, Alibaba's online healthcare platform, and DXY (Ding xiang yuan), an online healthcare community site, have seen significant increases in demand.

Finally, software-as-a-service (SAAS) companies have seen a notable shift in demand. The most downloaded apps in Apple's China iOS store include work communication apps

Healthcare: expect big changes in China's health system; four key categories will likely benefit

In the short-term, patients are avoiding hospital visits which may adversely impact sales of treatments or drugs that have to be administered in hospitals.

At the industry level, the surge in cases highlighted vulnerabilities within China's primary healthcare institutions. As a remedy, we expect a concerted effort by the government to improve health services, which will likely boost demand for companies operating in the following areas:

- Testing equipment: such as polymerase chain reaction (PCR) testing and computerized tomography (CT) tools for lung imaging. China's National Medical Products Administration (NPMA) approved seven rapid-testing kits in late-January.
- Diagnosis: hospitals using a multi-department team (MDT) model that relied on cooperation between different departments were able to reduce the severity rate of the coronavirus cases in mainland China. We believe this would likely become a trend or working practice, which could boost investment in technologies that promote cooperation across regions.
- Treatment: including development of anti-viral drugs, improvement of blood plasma self-sufficiency, and establishment of critical care medicine and intensive care units (ICU). Demand is high for devices and materials to enhance basic ICU infrastructure, like defibrillators, ECGs, blood purifiers, and biochemistry analyzers. Most of these devices are imported and we believe that domestic players will strengthen product innovation and design capabilities to meet higher demand.
- Preventative solutions: such as high-quality vaccines.

Financials: slower environment in 1H20, digital offerings will be key differentiator

The biggest short-term impact from coronavirus will be on business segments driven by face-to-face interaction, like insurance and wealth management. This is especially so in China and the most affected parts of certain Asian cities.

In China, movement restrictions and the shut down of commercial activities have hurt loan demand. Asset quality pressure is growing amid weaker cashflow, but this is being offset to some degree by government efforts to boost liquidity and bank steps to relax payment terms.

In the rest of Asia, so far the impact of coronavirus has been minimal because official responses have been less draconian and the disease has spread more slowly compared to China. However, the virus is gradually affecting economic activity through reduced tourism, social gatherings and delayed supply chains. We expect government support measures, including liquidity support for small-and-medium enterprises, cash handouts, and relaxed recognition of non-performing loans to ensure lending lines continue. A slower business environment is expected in 1H20, but most companies predict a fast rebound in 2H20 if the spread of the virus abates.

The virus outbreak will accelerate the push into digital banking, as well as increase scrutiny on banks' digital capabilities. Those having done the best job are in line to benefit.

Online lending

In China's online lending industry, loan volumes are down significantly y-o-y, partly due to lower demand but also due to lenders' tighter policies, which have lowered approval rates and favored only existing borrowers.

Management are seeing asset quality pressure and higher delinquencies are likely. Currently, loan collection teams have returned to 80% of the normal capacity.

Banks and financial institutions are hungry for high-quality assets as they are required to provide more lending but there is a lack of high-quality borrowers in the market. The large online lending platforms, acting as the loan facilitator, may be a potential source of assets for them.

Semiconductors: short-term supply challenges, increased long-term demand for connectivity

End demand will slow in the short-term. On the supply-side, companies will likely have to with falling end demand, securing sufficient upstream components; managing the return and safety of workers coming back into the production line for those with manufacturing facilities in China

Looking longer-term, this current crisis may lead to greater demand for devices that facilitate offsite work and interaction. Such devices require better connectivity, mobility, bandwidth and so on, so greater investment in networks and datacenters is likely.

On the supply side, this crisis may highlight the risk of concentrating production in one country or region and may accelerate the relocation of some manufacturing facilities away from China. Investment in automation may also pick up pace.

Industrials:
automation and
surveillance long-
term winners; oil
industry
consolidation afoot

China's government will pressure utility companies to cut prices and power plants (coal-fired and nuclear) and sewage treatment companies will be most impacted. Gas distributors enjoy a degree of pricing power due to their quasi-monopoly status and should be less affected.

Within industrials, subsectors exposed to long and complicated supply chains are most exposed such as auto glass providers and construction companies.

However, automation and surveillance companies may be long-term winners. Demand for robotics systems and surveillance, such as in warehouses, has the potential to rise. Additionally, surveillance technology with infra-red thermometers or AI, was widely used to help detect, monitor and track patients and quarantined individuals.

Oil refineries are seeing much slower demand, with some estimates putting the shortfall at 20%-30% of global oil consumption. On the supply side, large state-owned refineries have cut run rates by 10% to 13% while private entities have cut less.

Small, 'tea-pot' refineries have cut run rates by 40%-50%, the lowest level in the past five years. If the current situation continues, industry consolidation may accelerate, which may be positive for private integrated refineries with lower cash cost levels.

Looking regionally, there's further potential downside for refineries. Mainland China will likely see an inventory build-up, which may mean increased exports in 2Q20 and margin pressure for regional refineries. Furthermore, the recent global spike in cases will probably drive a further decrease in demand, thus forcing run rate cuts for regional refineries.

Real estate: sales will
slow, industry
consolidation to
accelerate

Sales and construction in China will take at least a month or two to ramp up. Developers are unlikely to launch projects until late-March and the slow return of migrant workers will weigh on project builds. .

An imminent liquidity crisis is unlikely, but smaller developers will continue to face difficulties – media are reporting 80 bankruptcies for small developers YTD, compared to 400+ in FY 2019.

Weak sentiment and tight financing will likely drive consolidation, with state-owned enterprises and larger developers likely to gain market share.

Retail landlords in general will be more negatively impacted. They need to assist tenants because of lost sales. Moreover, the shift of purchasing behavior from offline to online will quicken, potentially resulting in long term loss of business for retail landlords.

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BNPP AM

CHINA IN CORONAVIRUS CRISIS: AN UPDATED ASSESSMENT

When written in Chinese, the word 'crisis' is composed of two characters. One represents danger and the other represents opportunity.

John F. Kennedy

The coronavirus outbreak in China is still unfolding. There are noises and inaccurate reports circulating around. Let us try to assess the situation rationally.

Beijing's reaction

The government's attitude towards handling the current health crisis is entirely different from SARS in 2003, with faster reaction and higher degree of transparency this time. Medical services in China are more sophisticated than 17 years ago. Communication is better, knowledge of viral outbreaks and ability to deal with them are also better.

Within three weeks of the first case of coronavirus, Beijing declared an outbreak in Wuhan by the end of December. Two weeks later, on 15 January 2020, Beijing already identified the sequence of the genome and published it online for worldwide analysis. President Xi Jinping also declared that any official trying to cover up infections would be marked as "a sinner for eternity" and liable for severe punishment. City lockdowns and warnings against travelling to Wuhan are unprecedented moves.

China's growth under attack

Due to the draconian measures implemented to control the outbreak, first quarter GDP growth will be hit hard, by as much as 4ppts, according to some bearish estimate. Beijing's decision to extend the Lunar New Year (LNY) holiday by between three days to a week will result in loss of production by as much as 2ppts of overall outputs in 1Q.

Complete locked down of Hubei province (which accounts for 4.5% of national GDP) until at least the end of February could cut national GDP by 1.5ppts. Meanwhile, policies to restrict tourism and transportation will have adverse impact on other industries (retail, catering and cultural services etc.), and are estimated to cost 0.4ppts of GDP.

As I argued recently¹, SARS had a sharp but only transitory impact on GDP growth in 2003. The virus did not dent Chinese GDP growth, which rose from

9.1% YoY in 2002 to 10.0% in 2003 and 10.1% in 2004, thanks to aggressive policy easing by Beijing.

This may well be the case this time around because the policy goal of doubling China's real GDP this year from 2010 is very important and rigid, in my view. And GDP needs to grow by about 6% this year to achieve that. The revision to the GDP data recently does not change this picture much.

So there is no downside flexibility for GDP growth from a policy perspective. Any threat to drag down GDP growth significantly below 6%, given a tough macroeconomic environment, would trigger aggressive policy easing to protect the implicit growth target.

Thus, growth could likely rebound sharply after the crisis has peaked. It is too early to change my growth forecast of 6.1% YoY for full year 2020 at this point.

Policy will ease aggressively if needed

It is noteworthy that China's growth was robust during the SARS period and Beijing was generous with policy easing. Growth momentum today is weak on the back of a trade war with the US. Consumption and the service sector are much bigger now, implying that the growth drag by the hard-hit sectors would be bigger than during SARS. Barring an economic hard-landing, there will not be massive easing.

On a positive note, the trade-war risk is stabilising. China's weakest economic links – the electronics and auto sectors – are recovering, with economic green shoots emerging in other sectors too. The doubling-of-GDP- growth policy goal would pressure Beijing to increase easing. Beijing has indeed shown policy flexibility in balancing sustaining GDP growth with deleveraging to contain financial risk.

In my view, in case of emergency, there will likely be more aggressive RRR and interest rate cuts, bigger infrastructure and fiscal spending, and even policy easing to boost the property market to ensure steady GDP growth.

Market implications

Industries and sectors to be hit hard in 1Q & 2Q: Retail sales, transportation and leisure and cultural sectors (tourism, hotel, catering services, entertainment and social service).

Industries and sectors to benefit: E-commerce, online video, PC/mobile games, packaged food and food retailers (as people avoid interactions and outdoor activities), and healthcare due to increased demand for

vaccines/health check-ups

Meanwhile, commodity prices are pricing in aggressively a virus-hit China cutting global demand. Global growth may drop by about 0.2ppt in 1H20, depending on the virus development. But this would imply a dovish global policy environment this year.

Chi Lo, Senior Economist
BNPP AM

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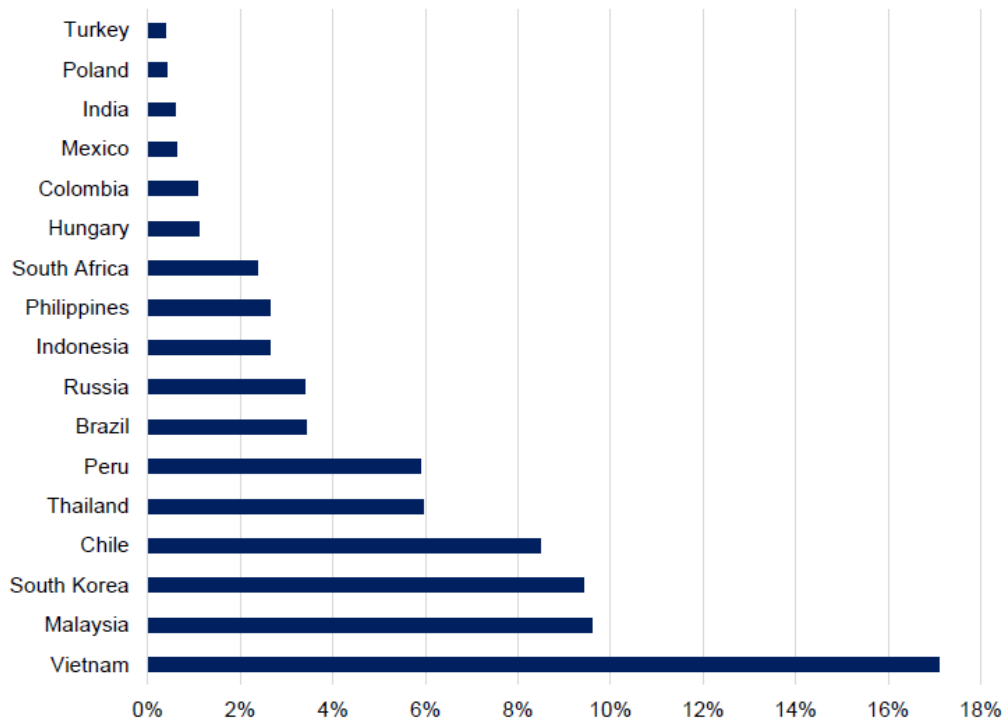
CTI

CORONAVIRUS AND THE OUTLOOK FOR EMERGING MARKETS

The impact of a coronavirus-based economic slowdown is a global GDP story, but over the last week, there was a particular emphasis on the expected impact for China and emerging markets. The MSCI EM Index pulled back 5.1% for the week ended January 31 (vs. 2.5% for the MSCI ACWI) on reduced appetite for risk, as the number of reported cases more than tripled. It now stands at more than 20,000, with the first death outside of China reported in the Philippines. The current coronavirus outbreak is more contagious but less deadly than SARS, and we are in the acceleration phase of infections, which is what has markets so spooked.

Relative to when SARS hit in 2003, China is a much larger portion of global GDP (16% now v. 4% then), its debt to GDP is twice as large, and its GDP growth is lower (6% now v. 10% then). Among emerging markets economies, exposure to China varies widely. Stock markets in Taiwan and South Korea, which are heavily reliant on China, were down 6% and 9%, respectively, from January 20 through January 31 (the S&P 500 is down 3% for the same period). The impact on Indonesia's GDP from the outbreak is expected to be much more limited than on Thailand's given less reliance on Chinese tourism. Approximately 4% of Indonesia's GDP came from tourism and China accounted for about 13% of all inbound tourist traffic versus Thailand's 11% tourism GDP share and 30% Chinese inbound traffic. The South-East Asian Nations Travel Association believes Thailand and Vietnam are the most at risk given their reliance on tourism.

Exhibit 1: Exports to China as a share of local GDP



Source: Columbia Threadneedle Investments. Data as of 12/31/2018

In the SARS outbreak, the annual impact on Chinese GDP is estimated to have been 1% for 2003. The composition of the Chinese economy is very different now, however, with consumer spending accounting for nearly 70% of GDP growth. As a result, the impact on the Chinese economy, and those reliant on Chinese consumers, may be longer-lasting. That said, the impact of the outbreak while a short-term negative, is not expected to derail the longer-term drivers of the asset class.

We expect an economic impact, but a transitory one, with a quick rebound in growth once the virus is contained. Our expectation is that the market will look through any earning misses or reduced guidance once containment is in sight. Given the quarantine in Hubei province (the epicenter of the outbreak), we are watching the rate of new infections outside of Hubei. When this rate reverts to linear rather than exponential growth, we will be more comfortable calling a market bottom.

Weather and central banks both matter in the coming months. Like flu season, the SARS and MERS coronavirus infections ebbed as the weather warmed, and warming trends in March and early April may help limit the spread of the current virus. In the face of higher volatility and weaker global growth we expect to see central bankers in China and globally bring liquidity to the system,

helping to buffer any market downturns. The central bank of China has already announced that it will inject 1.2 trillion yuan (US\$173 billion) into markets and pledged its commitment to use monetary policy tools to ensure liquidity remains ample and supportive of firms affected by the virus.

While we expect volatility to continue, we remain constructive about the outlook for emerging markets and China. Having said that, we had been taking profits in China even before the outbreak, given the rapid rise in some portfolio holdings over the past couple months as the risk/reward profile became less attractive and valuations more full on a shorter term basis post the U.S.-China phase one trade agreement. Fundamentally, our emerging markets portfolios have minimal exposure to areas which suffered the most in previous outbreaks (e.g., tourism, catering services, transportation, and retail). In areas where there may be some exposure to the corona virus, we own the highest quality companies that have ways to mitigate the impact of the outbreak.

Going forward, given our adjustments over the last few months, we have ample dry powder to deploy should the sell-off become more pronounced, and we are actively looking for top-tier companies/franchises that we may be able to buy for a discount. E-commerce and online entertainment (game play and streaming) are obvious beneficiaries as much of the country is on lockdown. Once we see containment, we also expect to see a sharp acceleration in modern retail as the government cracks down on older, unhygienic wet markets where it is believed this (and other) viruses originated. Tutoring companies, which were starting to transition students from offline in-person tutoring to digitally-enabled online platforms should also see an acceleration of this transition in the current environment. A focus on quality of health care and the need for insurance (areas we focus on in our portfolio) will likely be reinforced by this outbreak.

DARA WHITE

Head of Global Emerging Markets Equity

Sources for this article include: MSCI; New York Times; Bloomberg; Trading Economics; CNBC; Wall Street Journal; Reuters; Standard and Poor's; and Columbia Threadneedle Investments

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J.P. Morgan

积极寻找配置机会，应对疫情压力测试

China's authority is paying high attention and carrying out a national mobilization to control the fast and wide transmission of COVID-19. Thanks to the potent and effective measures, the virus spreading has been put under control outside of Hubei Province since late February, and the situation is improving inside Hubei. Therefore, the policy priority is shifting to economic growth from pandemic control, and production resumption is gradually pushed forward, which might foreshadow a normalization of economic activities around end-March outside of Hubei. On this basis, the economic impacts of the pandemic might be concentrated in the first quarter of 2020, while major economic indicators are likely to recover in the second quarter and thereafter. Based on such prospect, domestic investors are taking a forward-looking investment approach, eyeing on the growth outlook after the pandemic, while tending to omit the short-term shock. This has driven a sustained A-share rally after a transient market sell-off after Lunar New Year.

The pandemic is a stress test for various sectors and listed companies. It also provides an opportunity for investors to identify new economic growth engines and long-term investment themes. During this hard time of virus outbreak, leaders in sectors including 5G, internet services, and healthcare, have demonstrated advantages to achieve long term growth. In traditional sectors such as consumer and financial services, leading companies are adopting cutting-edge technologies to upgrade their services and management systems. Meanwhile, these areas are becoming the highlights of an upgraded infrastructure investment plan, and will receive strong policy supports. In terms of asset allocation, these areas are preferred as long-term themes for global investors.

The slowdown in the first quarter will be a dragger to whole-year growth record for 2020. Therefore, fiscal measures including tax reduction and infrastructure investment will be escalated as economic stabilizers, meanwhile a moderate monetary easing will be adopted to support small- and medium-sized enterprises and investment in the real economic sectors. It is noteworthy that uncertainties still exist for a large-scale virus outbreak in the rest of the world. To support the economy, the US Fed and other central banks have taken actions to lower interest rate, however, monetary easing might not be an effective tool to counter the shocks simultaneously on supply and demand sides. As a result, in order to deal with the uncertainties, it is critical to adopt a diversified and flexible portfolio strategy across regions, asset classes and sectors. Meanwhile, we continue to overweight the long-term investment themes in Chinese market.

Chaoping ZHU
Global Market Strategist based in Shanghai

Disclaimer:

The below insights provide data and commentary on China markets without reference to products. Designed as a tool to help clients understand the markets, the insights explore the implications of current economic data and changing market conditions.

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