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EVERBRIGHT SUN HUNG KAI

[For immediate release]

EBSHK expects 2022 markets to be driven by China/U.S. inflation and global monetary policy, with the nations' pandemic and recovery progress as key factor

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Four major themes: ESG as investment trends, Asian assets, short-term bonds and healthcare sector

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HSI target: 27,500

Themes for HK stocks: 1) Domestic consumption for stable economic growth 2) Selected financial stocks against inflation and 3) Clean-energy stocks with supportive policies

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FX: Further upside for USD with catch-up of commodity currencies

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Overview:

- EBSHK expects the 2022 asset market performance to be driven by factors such as the containment levels of pandemic, changes in inflation expectations and the U.S.-China relation. The world's GDP growth may slowly return to close to pre-pandemic levels. Surging crude oil and commodities prices may drive inflation higher
- Investors may diversify their portfolio for a well-balanced strategy amidst the post-pandemic uncertainties and buy low for risky assets such as equities to minimize risks and enhance potential returns, together with short duration bonds. Four major themes are recommended including 1. ESG as a major investment trend, 2. Asian assets look set to shine, 3. Diversify risks by short-term bonds allocation, and 4. Healthcare sector with well-balanced nature
- HK equities may play a catch-up, and HSI may target at 27,500, the targets for HSCEI at 10,000 and Shanghai Composite at 3,800
- HK equities' three major themes: 1) domestic consumption for stable economic growth, 2) selected financial stocks against inflation and 3) clean-energy stocks with supportive policies
- FX: Further upside for USD with catch-up of commodity currencies

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Hong Kong, December 9, 2021 – Everbright Sun Hung Kai Company Limited ("Everbright Sun Hung Kai", "EBSHK" or the "Company") believes that the performance of asset markets in 2022 may still be driven by factors such as the containment levels of pandemic, changes in inflation expectations and the U.S.-China relation. With fading pandemic impacts on business activity, the global economy may improve and the policy may gradually tend to normalize. The world's GDP growth may slowly return to close to the pre-pandemic levels. For inflation, price levels have been driven higher by surging crude oil and commodities prices as well as the pandemic-led impacts on supply-chains. In the post-pandemic era, nations have to overcome challenges on how to bring people's livelihood and economic activities back on track during the unpredictable pandemic. For example, too early or too late rate hikes may pose risks for the U.S. economy and it is crucial for the Federal Reserve to communicate with markets effectively and manage investor anticipations in 2022.

Kenny Wen, EBSHK Wealth Management Strategist, says, "In the face of certain uncertainties in 2022, investors are suggested to diversify their portfolio by just buying at a low for risk assets including equities, waiting for each price correction to build their positioning to minimize risks and enhance potential returns, together with short duration bonds. Strategically, investors may consider the four major themes including 1. ESG as a major investment trend, 2. Asian assets look set to shine, 3. Diversify risks by short-term bonds allocation, and 4. Healthcare sector with well-balanced nature."

1. <u>ESG as major investment trend</u>

With investors' growing awareness of sustainable development concept amidst the post-pandemic era, portfolio managers also consider ESG (Environment, Social and Governance) and climate issues as the key factors for long-term growth in the portfolio-planning process. Share prices of companies with higher ESG ratings tend to outperform peers over the past year. As of late October 2021, MSCI ESG Leaders Indexes returned ~3ppt higher than MSCI World Index.

2. <u>Asian assets look set to shine</u>

Looking forward in 2022, the Asian economy may stabilize on fading impacts led by the pandemic and supply chains concerns, which may further support corporate operations. EBSHK expects Asian corporates to achieve over 10% earnings growth in 2022, making it as one of the positive catalysts for share prices. MSCI Asia Index may be well positioned to climb further given that it is trading at a reasonable price level of estimated P/E below 15x. In addition to equities, it is also worth taking a look at Asian bonds which seem to provide attractive yields with generally lower risks compared with corporate bonds in emerging markets. A moderate allocation of Asian bonds could be seen as a good option for investment diversification. On the other hand, investors may also have to pay attention to the movements of USD and U.S. bond yields as Asian assets may turn volatile if both of them rise in 2022, and the strategy of "waiting for a buy-low chance and avoid chasing high" for Asian equities is preferred.

3. <u>Diversify risks by short-term bonds allocation</u>

The QE measures seem to have tightened after Federal Reserve confirmed to start tapering bond purchases with market anticipations on the U.S. rate hike as soon as in mid-2022. The U.S. 10-year bond yield has further upside potential in H1 2022. Compared with the long-term bonds, shorter-duration bonds may tend to be less sensitive to interest rates, and their interest-rate risk may be lower in the rate-hike period. Meanwhile, the gradual improvement of global economy and lower default rates of high-yield bonds in Europe and the U.S. (even lower than the pre-pandemic era) may imply that allocation to global USD corporate bonds (with high yield rates and lower duration) may enhance portfolio returns and diversify risks.

4. <u>Healthcare sector with well-balanced nature</u>

The global healthcare sector delivered solid performance in 2021. MSCI World Health Care Index has seen positive growth in the year, but the P/E is down to 24x, roughly 13% lower compared to the beginning of 2021, mainly driven by the earnings growth. The healthcare sector is expected to maintain stable earnings-per-share growth with persistent support for the share prices. With an in-depth analysis, it could be seen that the sector has some well-balanced companies with both defensive and offensive nature, which may provide further support to the overall sector performance. For the offensive nature, the digital transformation of healthcare and changes of medical pattern would speed up in the pandemic, which may bring significant growth potential for the sector with contributions of life science and biotechnology firms.

HK stocks: potential for catch-up in 2022

In December 2020, EBSHK pointed out that valuation re-rating would become the main theme for Hong Kong stocks as the low interest rate was the core factor for HSI to strengthen in a volatile trade in 2021. On the back of economic recovery, HSI once touched a high of around 31,200 this year but the uptrend could not sustain in H2, mainly because China's launch of regulatory measures has weakened anticipations on the sectors' valuation rerating. In the H2 2021, HSI rallied and hit a high at ~29,400, which is more than 1,000 points below our estimates six months ago.

EBSHK Securities Strategist Kenny Ng, says, "HK equities could not fully benefit from economic recovery and it has been falling further behind major peers around the world, giving much room for a catch-up in 2022. With the corporate earnings' sharp rebound from its low in 2021, the earnings growth seems likely to stabilize in 2022, which may further support HSI valuation. Compared with 2021, some key changes for HK equities may come from the expectation that the low interest rate environment will be facing an inflection point, which may bring challenges to liquidity in capital markets, largely depending on the external economy's sustainable recovery and the growth stability of Chinese sectors. Some sectors may underperform under such circumstances, especially for those heavily relying on capital as well as cyclical sectors with significant uptrend in 2021. On the other hand, some sectors benefiting from supportive policies and rising interest rates may deliver strong performance.

Low valuation as the core factor. HSI targets at 27,500 in 2022

HK equities' further substantial downside may be limited due to the low valuation of several blue chip stocks, but market uncertainties may still come from some external markets since they are trading in a high range within the rate hike environment. Based on the EBSHK's internal valuation models, the HSI may test higher at 27,500 again in 2022, with the targets for HSCEI at 10,000 and Shanghai Composite at 3,800.

In H2 2021, EBSHK has delivered solid performance for its recommended four major investment themes and eight stock picks. Despite over 10% slump of HSI in the period, the returns of the selected eight stocks remained satisfactory, helping investors cushion against the bearish market in H2. For the sector selection in 2022, investor may further consider "domestic consumption with stable economy", "selected financial stocks against inflation" and "clean-energy stocks with supportive policies" based on the above expectations.

FX: Further upside for USD with catch-up of commodity currencies

In respect of FX market trends in 2021, the U.S. Dollar Index was in a narrow trading range in the first half of the year before gaining the momentum to hit fresh highs in H2 2021, which also put non-U.S. currencies under pressure in the year.

Kirk Wong, Forex Strategist of EBSHK, says, "The U.S. Dollar Index and even the FX markets turned volatile in H2 2021, mainly driven by the monetary policy shifts by central banks. In the post-pandemic era, the global economic data has gradually improved amidst easing of quarantine restrictions around the globe. With monetary tightening among major central banks, the Federal Reserve also announced in November that it would scale back asset purchases by US$15bn on a monthly basis. The persistent high inflation may also trigger market anticipations that the Fed would lift the federal funds rate sooner, which may result in sustained widening of U.S. bond yield rate differences compared with other regions. The Dollar Index is expected to remain high in early 2022 and may test the resistance at around 98 with the support at 92. The Dollar Index strength is expected to change after the Fed's first rate hike, with possible catch-up among major foreign currencies, especially for high-yield commodity currencies."

Since the performance of commodity currencies is in line with estimates and they outperformed peers in the second half, their competitive edge is expected to remain intact for the year 2022.

With the pace of economic recovery derailed by the pandemic, Australia has been a laggard in tightening the monetary policy compared with major central banks. The AUD also underperformed and its performance has been dragged down by the pullback of iron ore prices in 2021. On the other hand, the Australian economy is expected to see stable growth in 2022 due to rapid growth of vaccination rate and the easing of lockdown restrictions in Q4 2021. Accordingly, the Reserve Bank of Australia may have difficulty in maintaining monetary loosening for a sustained long period of time next year, which implies a catch-up of AUD amidst an accelerated pace of monetary tightening in the future. The AUD/USD may face resistance at US78 cents with the support level at around US68 cents.

The Reserve Bank of New Zealand has become the first major central bank to announce rate hike since the pandemic due to its rapid economic recovery after easing lockdown measures. New Zealand may see a slowing rate hike in 1H 2022, but NZD may still enjoy an edge in rate difference to be an attractive currency in FX carry trade, making it more likely to return to the level of US75 cents with the support level at around US65 cents.

The Bank of Canada had already announced to end its quantitative easing program in October and proposed to reinvest the matured bonds in markets. The central bank's policy stance seems to have turned hawkish since Governor Tiff Macklem even believed the rate hike could come much sooner with the accelerated time schedule of April to September 2022. Meanwhile, the crude oil demand is driven up by the sustainable global recovery, which may prompt CAD to stay strong with USD/CAD's resistance at around 1.30 and the pair may further test the low at 1.2.

RMB still managed to remain stable despite the USD strength, in line with our estimates. With the upcoming Regional Comprehensive Economic Partnership (RCEP), (including China) effective in January 2022, the RCEP is likely to ease concerns of exports slowdown in China. Since China is the largest regional economy, it will be more effective to use RMB as a trade currency, making it more likely to accelerate RMB internationalization. RMB performance would also be supported by easing tensions between China and the U.S., providing further upside potential for RMB, and hence USD/RMB is expected to move within the range of 6.2-6.6.

Photo caption: (from left) Kenny Ng, Kenny Wen, and Kirk Wong share their views on 2022 market outlook.

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About Everbright Sun Hung Kai Company Limited

Everbright Sun Hung Kai Company Limited ("EBSHKCL") is a leading wealth management institution with five key business segments: Wealth Management, Corporate Finance & Capital Markets, Institutional Business, Asset Management, Investment & Financing, serving individual, corporate and institutional clients in Hong Kong, Macau, Mainland China and the United Kingdom.

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Backed by China Everbright Group and Everbright Securities, coupled with its heritage in the financial industry beginning in 1969, EBSHKCL has emerged to be a full-fledged financial platform providing excellent global financial services with Moody's "Baa3" long-term issuer and "Prime-3" short-term issuer credit ratings. The customer assets of EBSHKCL and its associated companies are currently about HK$124billion. For more information, please visit www.ebshk.com.

^ *This refers to EBSHKCL, China Everbright Securities International Limited and their respective subsidiaries and affiliated companies.*

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For enquiries:

Juliana Chan	+852 3920 2511	juliana.chan@ebshk.com
Maggie Chan	+852 3920 2513	maggie.chan@ebshk.com
Kit Chan	+852 3920 1863	kit.chan@ebshk.com