Emerging Markets Investment Guide
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After a year of ups and downs in 2016, the global economy in 2017 has proved positive for financial markets all over the world. Low unemployment rates, low interest rates, low inflation and steady GDP growth have all combined to create a so-called ‘Goldilocks’ economy, one that (like the porridge in the story of Goldilocks), is ‘neither too hot nor too cold, but just right’.

This positive environment, which has seen good performances from equities and bonds worldwide, has arisen despite a background of rocky political moments, such as those arising from heightened tensions on the Korean peninsula and in US domestic politics.

In the light of the current environment, many investors have found Emerging Markets (EMs) increasingly appealing. Their enormous investment potential has arisen mainly due to improving infrastructure and rapid economic growth in the regions. One of the first questions that many potential investors ask is, “how can I start to invest in EM assets?”

This booklet is designed to answer that question and other related ones, including:

• What are EMs, and how have they developed?

• What kinds of opportunities are EM equities and bonds opening up?

• Why is it a good idea to adopt a multi-asset strategy for EM investment?
HSBC Global Asset Management

We commit ourselves to connecting our customers with investment opportunities with experience, professionalism, and a boundless global network.

Adopts various strategies

Investment Platform

Including EM equity/EM bond/EM multi-asset

USD 461.5 billion

Assets under Management

Source: HSBC Global Asset Management, as at 30 September 2017.
Chapter 1: Market review and outlook
1.1 Global review in 2017

The global ‘Goldilocks’ economy in 2017 was characterised by low unemployment rates, interest rates and inflation, along with steady GDP growth. Markets were stable and most asset classes performed steadily, with many outperforming 2016.

Good economic fundamentals in economies across the globe supported strong corporate performances, and this was reflected in the equity markets, with global equities performing consistently strongly across the year. EM equities in particular delivered impressive returns, with US equities underperforming by comparison.

In the fixed income markets, global government bonds continued to offer relatively low returns, while returns from global corporate bonds also softened in 2017. Here again, EM bonds performed well during the year, comfortably outperforming other bonds.

The incoming Trump regime in the US raised the prospects of reflationary trade, with expectations of rises in economic growth and inflation following from the new government’s policies. At the level of international political confrontation, escalating tensions on the Korean peninsula, including concerns about the possibility of war between the US and North Korea, unsettled the picture and raised prospects of armed conflict in the near future. Despite these potential flashpoints, though, markets to date have remained steady.

Performance of key indices in 2017 (%)
1.2 Opportunities in 2018

In 2017, synchronised growth in all the major regions of the globe together with sustained low inflation and strong corporate earnings all served to boost the performance of asset prices. These positive factors are set to continue into 2018.

The policies of both the world’s central banks and its governments are expected to continue to support growth. Although some central banks are starting to raise interest rates, it is believed that any tightening of monetary policy will proceed at a very slow pace. Meanwhile, sustained low inflation is enabling most central banks to remain accommodative in their monetary policy.

These macro-factors are set to support earnings by creating a positive business environment for corporations. Such an economic and market environment is generally beneficial for risk assets. Consequently, we continue to see EM as one of the most attractive investment options across the globe, for both equities and bonds.
Current developments in major emerging markets countries

**Brazil**
- Improving economic activities
- Easing of inflation
- Accommodative monetary policy, and further rate cut expected

**Russia**
- Oil price plunged from late 2014 to early 2016, leading to recession
- The economy saw a strong turnaround in 2017
- Accommodative monetary policy expected to offer further boost

**India**
- New government committed to reform
- Easing inflation and interest rates
- More accommodative measures expected from the government, boosting growth

**China**
- Growth stabilising
- Strong earnings in 2017 1H
- Supply side reform in full swing, covering the steel, coal, aluminium, petrochemical and pharmaceutical sectors

Source: HSBC Global Asset Management, as at October 2017. The above views are expressed in the course of preparing the information and are subject to change without notice. For illustrative purposes only.
Chapter 2:
What are emerging markets?
2.1 What are emerging markets?

The International Monetary Fund (“IMF”) classifies countries into ‘advanced economies’ and ‘emerging markets and developing economies’ based on per capita income levels, export diversification and degree of integration into the global financial system.

These two types of economies are also referred to as Developed Markets (DM) and Emerging Markets (EM). A total of 24 countries are currently included in the MSCI Emerging Markets Index, representing a very diverse group in terms of geographical location and population size.

MSCI Emerging Markets Index Allocation

<table>
<thead>
<tr>
<th>MSCI Emerging Markets Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emerging markets</td>
</tr>
<tr>
<td>Americas</td>
</tr>
<tr>
<td>Brazil</td>
</tr>
<tr>
<td>Chile</td>
</tr>
<tr>
<td>Colombia</td>
</tr>
<tr>
<td>Mexico</td>
</tr>
<tr>
<td>Peru</td>
</tr>
<tr>
<td></td>
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</tbody>
</table>

As can be seen, EM are not necessarily small markets. In fact, the combined population of the EM countries makes up approximately 70% of the total global population. Furthermore, many EM economies are very large, and these economies are continuing to grow at a fast pace. When the economies of the top 7 DM and EM countries are compared (i.e. G7 vs. E7), rapid changes can be seen to be currently taking place in the balance of global economic power.
Global economic power will shift to the E7 economies

In 1995, E7 was half the size of G7.

By 2015, E7 were around the same size as G7.

And in just 25 years (2040), E7 could be double the size of G7.

G7: US, UK, France, Germany, Japan, Canada and Italy
E7: China, India, Indonesia, Brazil, Russia, Mexico and Turkey

Sources: IMF for historical GDP, PricewaterhouseCoopers analysis for “The World in 2050” projections
This rapid growth in the size and importance of EM economies is not accidental. Although these EM countries are very diverse, they tend to share certain key characteristics that foster strong growth. These include large and youthful populations, often with rapidly increasing education levels, which provide these countries with large workforces, boost levels of consumption, and increase local spending power. Governments in EM countries also typically invest heavily in local infrastructure. These characteristics have led to explosive development and remarkable economic growth in many EM countries in recent years.
2.2 Development of emerging markets

- **Late 1970s**
  - Global economic difficulties lead to defaults
  - Skyrocketing oil prices
  - Double digit inflation

- **1970**
  - Multinational banks in the US and Europe actively lend to developing markets

- **1975**

- **1980**

- **1985**

- **1990**
  - Market growth begins to outpace the legal and economic infrastructure of emerging countries

- **1994**
  - Mexican devaluation

- **1995**

- **1997-1998**
  - Asian financial crisis
    - Currency depreciated
    - Growth declined
    - Requested emergency financial support from IMF

- **2007**

- **2008**
  - Brazil raised to investment grade
  - Ecuador default

- **2009**
  - Dubai debt crisis

- **2010**
  - Euro debt crisis

- **2013**
  - US Federal Reserve announces quantitative easing

- **2016**
  - Jump in the Brazil oil barrel price

- **2017**
  - MSCI announces inclusion of onshore Chinese equities in its EM index
  - Official launch of the ‘One Belt One Road’ Initiative

- **2014**
  - Rises in inflation in Russia and Latin America

- **2011**
  - Arab Spring

- **1980s**
  - Global debt and equity markets grow
    - Berlin wall comes down
    - Eastern Europe and former Soviet Union participate in global world markets

- **1984**
  - Mexican devaluation
Emerging Markets Investment Guide

HSBC Global Asset Management

Source: HSBC Global Asset Management
Though we saw in the last section that EM are characterised by strong and rapid economic growth, the progress of EM countries has not always been smooth. Many EM countries have experienced complex and at times turbulent histories. The timeline above shows some of the critical events that have taken place in the development of EM.

Volatility has therefore always been one of the defining features of EM. Three areas driving EM volatility have been political risk, economic risk, and currency risk. If EM countries have unstable governments, this can create political unrest and seriously disrupt the economy. Economic risk arises when EM countries experience high inflation, if their markets are insufficiently regulated, if monetary policies are unsound, or if there is a shortage of labour and raw materials. Currency risk arises when the value of the local currency changes significantly, causing the value of an investment potentially to drop. All these risks have historically led to economic crises in some EM countries, which has made for volatile returns for investors, and high default rates on fixed term debt.
In recent years, however, many EM economies have seen improvements in their macroeconomic stability. They have generated strong investment inflows, improved their liability management, and carried out structural reforms such as deregulation, privatisation of key industries, and reduction of trade barriers. In some cases, they have achieved outstanding economic growth as a result. The gradual flow of market capital from DM into EM means that the investment potential of EM equities and bonds should not be overlooked.
Chapter 3: Why invest in emerging markets?
3.1 Emerging markets risks are improving

In Chapter 2, we saw how EM have historically been associated with higher levels of investment risk. This situation has begun to change in recent years, however. Today, a number of EM have strong and stable financial systems in place. Their financial growth is being driven by both external and domestic factors that have enhanced stability.

On the external front, EM have been enjoying the benefits of improving world trade, stable commodity prices and rising terms of trade. Domestically, many EM enjoy favourable demographics, a growing middle class, increased urbanisation, and improving infrastructure. All these have helped boost domestic consumption and have fuelled economic growth.

Traditionally, EM default rates have been higher than those for DM. But now that many EM countries have adopted flexible exchange rates, accumulated solid reserves, and moved to issue debt in local currencies, EM default rates are not materially greater than those for DM, while sovereign debt issues have become rare and localised. In late 2017, EM corporate debt default rates were tracking at around just 0.5%, due to higher levels of domestic and export demand following from the broad, sustained growth in the global economy.
Parallel to this, the credit ratings of EM bonds have also improved due to steady economic growth and structural reforms that have made these markets less vulnerable to external shocks. Currently around half of the USD-denominated emerging market sovereign bond market index is made up of investment grade bonds, compared with little more than 10% 20 years ago.

Credit rating of the JP Morgan EMBI Global Diversified Index

Source: JP Morgan, as at 31 October 2017
3.2 Emerging markets are powering ahead

According to the International Monetary Fund, the economies of all EM countries are expected to grow faster than the US and Developed Markets averages by 2018.

In fact, about 80% of the world’s total GDP growth is expected to come from EM over the next five years. A recent forecast suggests that EM GDP growth will accelerate to 5% in 2019 from an expected 4.6% in 2018 and 4.4% in 2017, with the most significant growth occurring in India, Brazil and Russia. It is anticipated that the EM-DM growth differential will widen to 3.4% by 2019, its widest since 2013.

Source: IMF, HSBC. Any forecast, projection or target contained in this document is for information purposes only and is not guaranteed in any way. HSBC Global Asset Management accepts no liability for any failure to meet such forecasts, projections or targets. Any content contained herein is not intended to constitute advice or recommendation to buy or sell any sectors or financial instruments, nor should it be regarded as investment research.
Rapid growth in EM has attracted higher domestic and foreign investments, which in turn has led to the establishment of new industries, the creation of more jobs, and an expansion in the number of middle-class consumers. According to the McKinsey Global Institute, annual consumption in EM is anticipated to rise to USD30 trillion by 2025, compared to just USD12 trillion in 2010. During the same period, EM’s share of world consumption is expected to increase from 32% to 47%.

Another factor behind EM growth is the enormous young populations. Today’s youth are highly educated and techno-savvy, and they are instrumental in driving business innovation and helping to boost productivity and economic growth, especially in areas such as new technology and e-commerce.

One example that illustrates the growing importance of EM is smartphone use. Currently, around 2 billion people worldwide are smartphone users, but that number is estimated to rise to 4 billion by 2020, representing about 80% of all adults in the world. This growth will mainly be driven by EM, with strong growth likely in countries such as China, India, Indonesia, Russia, and Brazil.

### Top 15 countries in terms of smartphone users

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of users in millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>717.31</td>
</tr>
<tr>
<td>India</td>
<td>300.12</td>
</tr>
<tr>
<td>United States</td>
<td>226.29</td>
</tr>
<tr>
<td>Brazil</td>
<td>79.58</td>
</tr>
<tr>
<td>Russian</td>
<td>78.36</td>
</tr>
<tr>
<td>Japan</td>
<td>63.09</td>
</tr>
<tr>
<td>Germany</td>
<td>55.49</td>
</tr>
<tr>
<td>Indonesia</td>
<td>54.99</td>
</tr>
<tr>
<td>Mexico</td>
<td>52.99</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>44.95</td>
</tr>
<tr>
<td>France</td>
<td>42.40</td>
</tr>
<tr>
<td>Turkey</td>
<td>40.01</td>
</tr>
<tr>
<td>Italy</td>
<td>39.32</td>
</tr>
<tr>
<td>South Korea</td>
<td>36.26</td>
</tr>
<tr>
<td>Spain</td>
<td>30.77</td>
</tr>
</tbody>
</table>

Source: Statista.com, as at April 2017
3.3 Emerging markets equities

The EM equities returned at 11.6% in 2016, and further to approximately 30% at the end of October 2017, out performing other major stock markets. As a result, the valuation level of EM is not as “cheap” as it was in the past, but still remains near the historical low level of the past 17 years. Currently EM equities trade at a 25% discount to their developed peers.

Source: HSBC Global Asset Management, DataStream, November 2017. For illustration purposes only, Performance shown is based on historical data, and past performance is not indicative of future performance.
When discussing valuations, profitability comparisons can also be made. Compared with DM equities, EM equities offer higher returns on equity with a lower price-to-book ratio. This reflects the fact that, compared with DM, EM have profitability advantages and a lower cost of purchasing assets.

**Profitability and valuations**

EM equities have been positively impacted by a supportive environment of ample liquidity, along with other positive macroeconomic factors. For investors, economic growth has added impetus to growth in corporate earnings. EM earnings growth is expected to be around 20% for 2017, while we continue to see signs of positive earnings adjustments.

**Earnings per share of the MSCI EM Index**

<table>
<thead>
<tr>
<th>Sector</th>
<th>2016</th>
<th>2017 forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer discretionary</td>
<td>-1.5</td>
<td>16.9</td>
</tr>
<tr>
<td>Consumer staples</td>
<td>-0.4</td>
<td>12.8</td>
</tr>
<tr>
<td>Energy</td>
<td>-8.2</td>
<td>23.3</td>
</tr>
<tr>
<td>Finance</td>
<td>1.3</td>
<td>10.1</td>
</tr>
<tr>
<td>Healthcare</td>
<td>5.6</td>
<td>17.8</td>
</tr>
<tr>
<td>Industry</td>
<td>-3.6</td>
<td>29.0</td>
</tr>
<tr>
<td>Information Technology</td>
<td>12.5</td>
<td>46.8</td>
</tr>
<tr>
<td>Material</td>
<td>330.5</td>
<td>20.4</td>
</tr>
<tr>
<td>Real estate</td>
<td>11.5</td>
<td>7.9</td>
</tr>
<tr>
<td>Telecommunication</td>
<td>-9.9</td>
<td>15.8</td>
</tr>
<tr>
<td>Utility</td>
<td>-5.7</td>
<td>-7.6</td>
</tr>
<tr>
<td>EM</td>
<td><strong>7.8</strong></td>
<td><strong>20.4</strong></td>
</tr>
</tbody>
</table>

Source: Credit Suisse, MSCI, IBES Aggregates, as at 7 August 2017.
3.4 Emerging markets bonds

EM bonds are fixed income bonds issued by EM countries or by entities operating within these countries. Over recent years the size of the EM bond market has grown enormously. EM bonds are now issued by sovereign, quasi-sovereign, and corporate entities, with issuance volume over USD450 billion.

Source: BofA Merrill Lynch, as at 31 December 2016.
EM bonds are typically issued in hard currencies (mainly US dollars) or local currencies, although the bond market in local currencies is far larger than the hard currency market. Foreign exchange appreciation can add benefits to local currency denominated bonds, with stronger local currencies delivering both higher yields and price appreciation. The table gives comparable performances of the two kinds of bonds, showing that volatility is higher for local currency bonds, while in the longer term hard currency bonds appear to offer better risk adjusted returns.

<table>
<thead>
<tr>
<th></th>
<th>2017 YTD return</th>
<th>10-year annualised return</th>
<th>10-year annualised volatility</th>
</tr>
</thead>
<tbody>
<tr>
<td>EM hard currency bonds</td>
<td>8.63%</td>
<td>6.75%</td>
<td>8.94</td>
</tr>
<tr>
<td>EM local currency bonds</td>
<td>12.75%</td>
<td>4.03%</td>
<td>12.97</td>
</tr>
</tbody>
</table>

Source: HSBC Global Asset Management, data as at 30 November 2017

Unless the global growth momentum stalls or the US dollar is rapidly resurgent, EM bonds hold good potential for investors. In addition, many EM currencies strengthened substantially against the USD in 2017, and this has boosted the performance of EM local currency bonds.

Currencies against the dollar
% increase from 30 December 2016 to 30 November 2017

Source: Bloomberg
While certain EM countries have enjoyed rising credit ratings in recent years, the yield premium for EM bonds has remained high compared with DM bonds due to the still-developing political and economic environments in EM. As at 31 August 2017, DM bond yield stood at 1.33% while EM bond yield was 6.8%, with a spread of up to 547 basis points. In other words, yields from EM bond investments are about 5.47% higher than for DM bond investments, which is fairly attractive for income seekers.

**EM bond yields more attractive than DM bond yields**

Comparison of government bond yields (%)

Source: HSBC Global Asset Management, DataStream, August 2017. Performance shown is based on historical data, and past performance is not indicative of future performance.
Chapter 4: Multi-asset strategy
4.1 Why diversify?

The most basic reason to diversify is simple: no single asset class ever outperforms all the others, all the time. From year to year, individual asset classes rise and fall in performance, sometimes dramatically. If you do not diversify the asset classes that you invest in, you run the risk of having an investment roller-coaster ride from year to year. And if you ‘put all your eggs in one basket’, there is a risk that they will all break.

In the world of investment, market volatility is inescapable. Market volatility is driven by many different factors, some unpredictable, including shocks in the global political environment. It is important to remember that those asset classes with higher expected returns are also those that experience the highest levels of volatility in the face of negative events. In typical cases these asset classes can take a long time to recover.
The table below breaks down the performances of 12 different asset classes over a 14-year period, and shows how each asset class ranked in terms of annual performance. It shows that the best-performing asset class tends to change from year to year. No single asset class has consistently outperformed the others. Having a diversified portfolio comprising various asset classes can thus help to reduce volatility and investment risk.

Source: HSBC Global Asset Management, Morningstar, data as at 30 November 2017. All returns in USD, total return, ranked in order of performance from best to worst. Indices used: BofMAL USD LIBOR 3 Mon CM (cash), Citi WGBI USD (Global government bond), BofAML Global Corporate Total Return Index (Global investment grade bond), BofAML Global High Yield Total Return Index (Global high yield bond), JPM EMBI Global Total Return Index (Hard currency EM bond), JPM GBI-EM Diversified Composite Total Return Index (Local currency EM bond), BofAML Asian Dollar Total Return Index (Asian bond), BofAML Asian Dollar High Yield Total Return Index (Asian high yield), MSCI World Gross Return Index (World equity), MSCI EM Gross Return Index (EM equity), MSCI AC Asia Ex Japan GR USD (Asia ex Japan equity). Past performance is no guarantee of future results. The views expressed were held at the time of preparation and are subject to change with notice.
4.2 What is a multi-asset strategy?

As its name suggests, a multi-asset strategy involves investing in many different asset classes at once to gain the benefits of diversification and to lower risk.

Some types of assets perform in a way that is closely correlated with the way other assets perform. This means that if one of these assets performs badly, it is likely that the other ones will too due to their close correlation. By contrast, when assets are not closely correlated, one asset may perform spectacularly while another performs poorly. Holding both kinds of assets can thus help smooth out market volatility.

For example, one fundamental approach to asset allocation recognises that stock prices and bond prices are negatively correlated, so when stock markets fall, bond prices typically rise. A multi-asset strategy uses this correlation to create a portfolio to balance risk, by broadening investors’ portfolios across different asset classes that are not highly correlated. This means that if one or more asset classes underperform, it is possible that this will be more than offset by a strong performance by another asset class.

Multi-asset strategies typically do not guarantee the highest absolute returns, but they do smooth out market volatility and are thus well-suited to long-term investments. However, operating a good multi-asset strategy requires global expertise and market awareness. For example, investors who understand that equities usually outperform other assets in times of economic expansion (when corporate earnings tend to improve) will consider adjusting their portfolio at such times to increase the proportion of equities they hold and reduce fixed income or cash holdings. Conversely, recessions or times of high market volatility may be opportunities to reduce the volatility of a portfolio by increasing fixed income investments, which are less likely to fluctuate in such conditions.
4.3 Why invest in emerging markets with a multi-asset strategy?

EM fundamentals have improved in recent years, resulting in good performances across all EM asset classes. Some concerns have been raised about the potential impact of a US rate hike on EM assets, but it can be noted that the performances of EM equities and bonds were not significantly affected during previous US rate hike cycles, and they even occasionally outperformed other asset classes during these cycles.

Source: Bloomberg, as at December 2016, with total returns in USD. Benchmark index: S&P 500 (US equities), MSCI World Index (DM equities), MSCI EM Index (EM equities), MSCI AC Asia Pacific Ex Japan (Asia Pacific equities), Barclays Capital 7-10Y US Treasury Total Return (US 10-year Treasury), Merrill Lynch US High Yield Total Return (US high yield bonds), Barclays Capital Global Aggregate Bond (DM bonds), J.P. Morgan Government Bond – Global EM Diversified Total Return (EM bonds), HSBC Asian USD Bond Total Return (prior to 31 December 2012) and Markit iBoxx USD Asian Bond (after 31 December 2012) (Asian bonds). Performance shown is based on historical data, and past performance is not indicative of future performance. Performance may fluctuate.
Although a US rate hike will not necessarily have an adverse impact on EM assets, investors should remain aware of other potential risks, such as changing global geopolitical and economic conditions. In addition, a total of 24 countries make up the EM, all with diversified asset classes and themes. Investors who only focus their investments in a single country or asset class may expose themselves to higher investment risks, and miss out other investment opportunities. For example, if investors invest solely in EM hard currency bonds, they are likely to miss out on opportunities arising from the appreciation of EM currencies.

EM equities  |  EM bonds (hard currency)  |  EM bonds (local currency)  |  EM currencies
--- | --- | --- | ---
Growth and income potential  |  Bond yields  |  Bond yields  |  Currency appreciation potential
By adopting a multi-asset strategy when investing in EM, investors not only expose themselves to a wide range of investment themes, asset classes and regions, but at the same time reduce the “single market risk” that arises from investing in a single asset class or country. Historical statistics show that holding a more diversified investment portfolio can be effective in maintaining an acceptable level of risk while providing solid investment returns.

Source: HSBC Global Asset Management, as at October 2017. Performance is calculated for the period from 27 February 2009 to 31 October 2017, monthly annualised volatility and annualised returns are calculated based on the following indices: MSCI EM Index (EM Equities), J.P. Morgan EMBI Global Investment Grade (EM Hard Currency Bonds), and J.P. Morgan EMBI Global Diversified (EM Local Currency Bonds). Performance shown is based on historical data, and past performance is not indicative of future performance.
Investing in EM by adopting a multi-asset strategy requires expertise in every asset class and local knowledge, which can be difficult for general investors. On the other hand, a fund is managed by a team of professionals with expertise in assets such as equities, bonds and currencies, who are also involved in research, investing and risk management activities. Therefore, from finding opportunities, diversifying investments, to multi-asset management, funds are in the good hands of the investment professionals.

Supported by their size, network, investment professionals and expertise, fund houses are better equipped than individual investors, and are thus well-positioned to benefit from multi-asset strategies. When it comes to fund selection, investors should not only focus on track record, but also the asset manager’s global network, as it determines how promptly fund managers can react to every move in overseas markets. In addition, prudent risk management is another vital factor to consider.
Points to note when investing in emerging markets:

Investing in EM involves a greater risk of loss than investing in more developed markets. This is due (among other factors) to greater political risks, tax risks, economic risks, foreign exchange risks, liquidity risks, settlement risks, custody risks, market volatility (such as interest rate and price volatility), and legal and regulatory risks.

High market volatility and potential settlement difficulty in some EM stock markets may lead to significant price volatility of the securities traded in those markets, and some EM securities exchanges have the right to suspend or restrict the trading of any securities in the relevant exchanges. Government bodies and regulatory bodies may also affect the policies of financial markets.

Investing in EM bonds is subject to credit risk, downgrading risk, interest rate risk, liquidity risk, volatility risk, valuation risk, credit rating risk and sovereign debt risk.
We think that global emerging markets provide an exciting opportunity for investors. Through 2017 we saw a really strong performance from EM equities, which outperformed developed market stocks by more than 10%. And there are good reasons for believing this outperformance could continue.

Despite the recent outperformance, EM stocks have the potential to rally significantly further to catch up with developed markets. We think EM equities are attractively valued, especially compared to developed market peers, against which they trade at a significant discount. Positive valuations are not limited to equities, as EM bonds also offer a large yield advantage over developed market bonds due to the associated risk.

Over the past decade, EM have become the primary driver of global GDP growth, and this strong performance from the emerging economies is expected to continue. It is being driven by several factors, including favourable demographics, technological improvements and increasing consumption by the growing middle classes. As emerging economies evolve they tend toward stronger governance, enhanced legal frameworks, and greater institutional stability. Such pro-market reforms lower the risk-premia attached to those countries, providing a tail wind for long-term investors.

An example of a country benefiting from positive structural change is Poland. Now ranked ahead of both France and Japan on the world Ease of Doing Business Index, Poland is buoyed by its exports to Europe. During 2017 we saw Polish equities rally by over 40% in US dollar terms. India is another great example of a country pushing hard for economic reform, with PM Modi’s long-term policy expected to help boost growth in India and provide jobs.

We access global emerging market investment opportunities through our Multi-Asset Income strategy, using our global reach and resources. We combine our rigorous, top-down asset allocation process with our award-winning, bottom up equity and fixed income active management expertise. The result is a true multi-asset EM vehicle with a “balanced” risk profile that we expect to reduce the volatility and risk normally associated with investing in EM, whilst allowing investors to participate in EM growth.
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