Top Trends and High Conviction Themes

Q1 2022

Investing in a Changing World

HSBC

Global Private Banking

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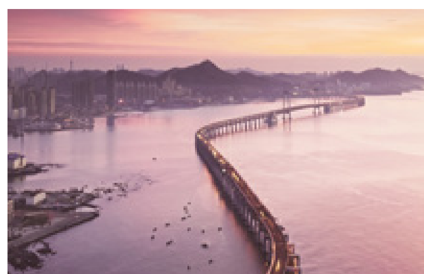

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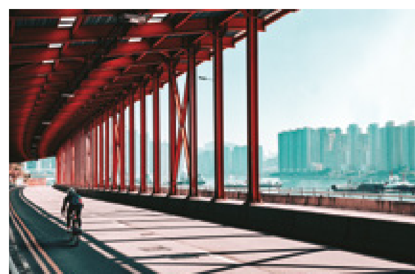

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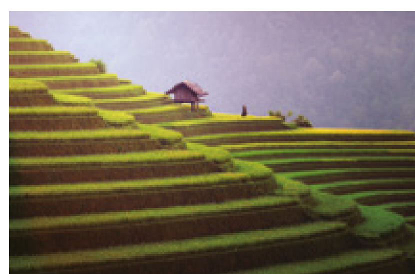

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Welcome

Willem Sels,
Global Chief
Investment Officer
January 2022

Dear client
Financial market news is often overly focused on the daily economic data and events flow, which can be erratic, focused on the short term or even backward-looking. And when economists comment on what's going on, they tend to cover concepts such as interest rates, money flow and deficits, which fail to excite investors.

By comparison, a thematic approach is often more accessible, and it is no surprise that it is now a common feature in people's investment strategy and that asset managers have developed a very wide range of thematic funds and ETFs. Typically, thematic investments are added as satellites to a well-diversified multi-asset core portfolio, and in this publication, we will present a series of such interesting High Conviction Themes.

But the big trends that drive the themes can also help drive our asset allocation strategy, because they help us better understand the world. For example, the excess savings of the growing middle classes in the emerging markets not only drive our theme of Asia's consumer revival; and increased computer power and mobility do not just help drive our theme of Automation & AI. Taken together, these trends should also help bring down inflation and keep rates low, and they therefore cause us to be overweight on carry strategies in our core portfolio.

The real benefits of a thematic approach are that it 'speaks' more to investors than economists' abstract concepts, and that many of the trends are more durable. For example, Asia is remaking its future in response to the pandemic and the sometimes difficult US-China relationship, but also to take advantage of its growing wealth and increased technological expertise. This new economic model creates many opportunities for investors for years to come. Another key trend is the sustainability revolution, which is underpinned by the global effort to address climate change, and this broad long-term commitment gives a solid foundation to this theme as well. And thirdly, we believe the digital transformation cannot be halted. The combination of artificial intelligence, virtual reality, mobility and increased digital literacy creates a wide variety of opportunities that go well beyond the activities of the well-known US and Chinese behemoths.

The thematics under our fourth Top Trend ('Policy support for mid-cycle growth') are not as long-term in nature, but nevertheless are linked to the start of a gradual tightening cycle by central banks, and the need for some fiscal tightening, which can take a number of years. While this trend may be more of a gradual transition, the three other trends are clear illustrations of "The Big Reset" we discussed in our Investment Outlook.

We hope that this publication will provide a good summary of our thematic view of the world, and help you identify the investable opportunities linked to durable and exciting macro trends.

Our Thematic View of the World

How the pandemic has changed the world

The pandemic was not just a health crisis, but it has also had a profound influence on the world we live in. Many of us were forced to work from home, and to become much more literate in anything related to the digital world, from participating in zoom or team calls, to buying food and entertainment online. Some of these work and consumption patterns will remain with us, be it because of the convenience for the consumer or because of the multiplication of the online offering. And businesses have discovered that employees may be as productive when they work from home as when they are in the office, but generate lower real estate related costs.

Of course, not everyone was able to work from home, and the unemployment rate spiked. It appears that many employees who lost their jobs may have switched to other companies and industries. This created labour shortages and wage inflation in the hospitality sector for example, while benefiting job growth in more innovative businesses. And while factories remained closed or operated at lower capacity during the pandemic, inventories ran down, creating supply chain issues, which also boosted inflation. As we discussed in our Investment Outlook, rising wages and supply chain issues may keep inflation elevated for at least 6 months, and above the typical 2% target for developed market central banks throughout 2022.

The pandemic has also added to governments' debt load, as they tried to help businesses bridge a difficult period, and provided unemployment support or handouts to households. Nevertheless, income and wealth inequality rose further as lower income households, ethnic minorities, poorer nations and women were generally hit harder by the economic and health crisis than the global average.

On the positive side, the health crisis made many people stand still and recognise the link between the pandemic and the natural world. It clearly illustrated that our reckless relationship with the natural world can have negative consequences, not just for the planet and biodiversity, but also for ourselves. We believe this combined with the flooding and fires last year to create a big jump in ESG awareness.

One area where this increased ESG awareness is particularly prevalent is Asia. China's net-zero emissions target by 2050 is crucial, as it is the world's largest GHG emitter. At COP26, other Asian nations joined with ambitious targets. But Asia's growth model changed in other respects as well. Some households find it difficult to cope with the cost of housing, education and healthcare, giving rise to China's "Common Prosperity" goal. And the global supply chain issues contributed to the policy of tech self-sufficiency and further regional integration.

A range of triggers contribute to our four Top Trends for investors

Source: HSBC Global Private Banking, December 2021.

So, it is clear that the past two years have had a lasting impact on the world we live in.

How the pandemic crisis added to pre-existing trends

While the pandemic was a big shock to our system, it would be wrong to say that everything reversed course. In fact, many of the trends (or seeds thereof) were already in place.

Western governments were already indebted, but the cost of that debt had been held low by the global savings surplus, and by ageing populations who like to put their money in safe bonds. And companies had managed to hold wages low due to global labour market competition and automation, keeping inflation and policy rates low. These fundamentals are still largely in place, but it is clear that the current spike in inflation and the new record debt levels are forcing a transition in fiscal and monetary policy. Still, policy makers will try to tighten as little as possible, to help support continued mid-cycle growth. In the following chapters, we will present a number of thematic ideas linked to this notion of gradual policy change, where interest rates are still low but start to normalise, governments keep spending but more selectively on their key priorities, and economies keep growing.

The latest changes to Asia's chosen growth path are also not completely new, but an extension of long term trends that were already in place. The sometimes difficult US-China relationship was already leading to more regional integration of supply chains. And the industrial upgrading – a logical consequence of rising GDP and higher value added products – leads to the need for more technological components, which need to be secured locally or regionally. As populations grow wealthier, the quality and stability of growth is increasingly important to them. This shows in their increased demand for upgraded consumer services, digital consumption and healthcare. It also drives them to attach more importance to ESG aspects, which are a pre-requisite for quality growth. In fact, some Asian investors are now more interested in environmental issues such as climate change, carbon emissions, air and water pollution than the European average.

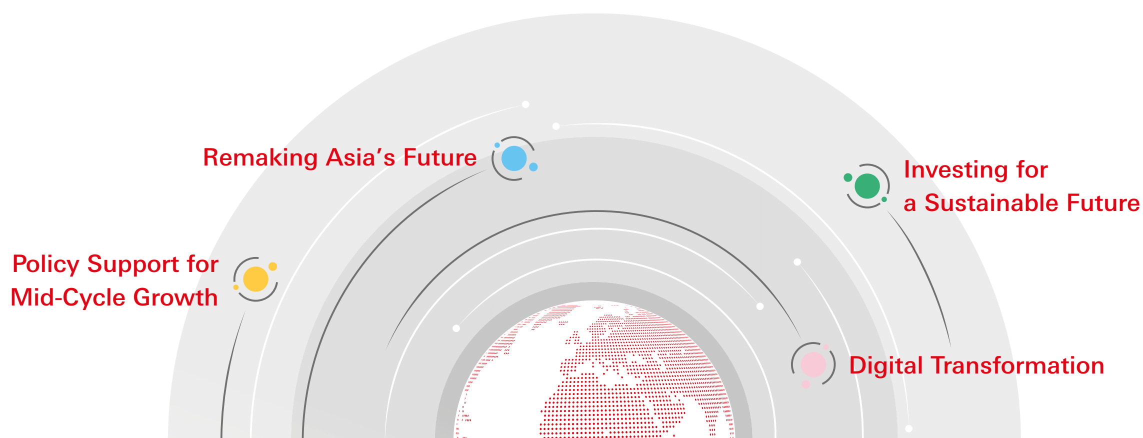
And that brings us to our third trend related to sustainability. The triggers of the past two years – the health crisis, energy crisis and environmental disasters – have only further increased what we already knew about the importance of addressing climate change and social issues. But the recent events may still serve as an accelerator, making 2021 and COP26 as a pivotal point. Technological progress is likely to be an accelerator in the fight against climate change, as Bill Gates clearly explains in How to Avoid a Climate Disaster. The Global Coal to Clean Power Transition Statement – an agreement between nations to work together on technology, including common standards – will be key to watch because technologies which see most cooperation may see more breakthroughs, higher volumes, economies of scale and rapidly falling costs. This will extend the structural trend of declining green premiums.

In the digital world, the increased demand of the past two years meets with the structural trend of rapid innovation. The exponential growth in artificial intelligence (AI) and use of deep learning, increased computer power and specialised semiconductors expand the capabilities of machines and processes. This has applications in all sectors, including fintech, automation and healthcare. Digitalisation had sometimes been slow in the healthcare sector because of a desire to keep a human factor, but the benefits of rapid data analysis and the breakthrough in gene sequencing for the development of new treatments are clear. So here again, the recent boost in demand for healthcare services and innovation coincides with the longer term trends of technological innovation, global ageing, rising demand for healthcare services from the EM middle class and increased global demand for products and services linked to a healthy lifestyle.

Overview of our themes

We summarise the four Top Trends in our familiar core-satellite graphic below. In the following pages, we detail the narrative as well as the specific thematic investment opportunities we have identified.

Our Top Trends and High Conviction Themes



Remaking Asia's Future

- Asia's Consumer Revival
- Asian Credit Opportunities
- China's Green Revolution
- Next Generation Asia Tech Leaders

Policy Support for Mid-Cycle Growth

- American Renewal
- DM Financials – Focus on Subordination
- European Growth Leaders
- Infrastructure 2.0
- Resilient Carry in High Yield and EM

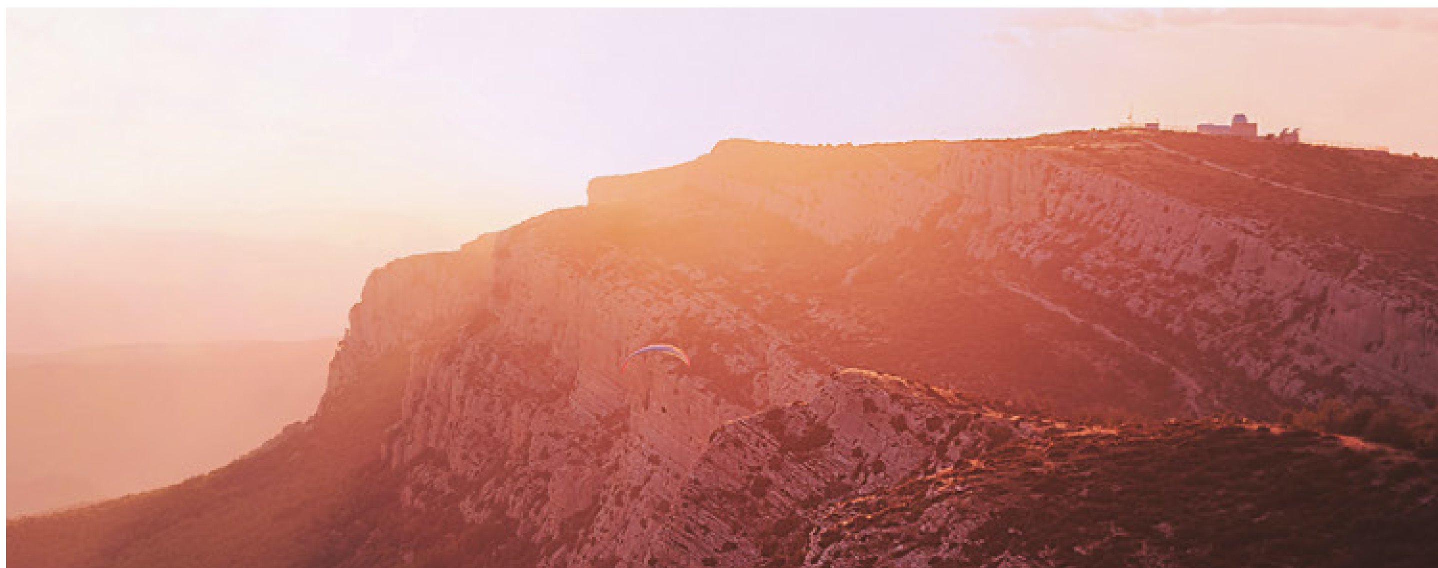
Digital Transformation

- Automation and AI
- Biotech, Genomics and Devices
- Smart Mobility
- The Metaverse
- Total Security

Investing for a Sustainable Future

- Energy Transition
- Financing Biodiversity Action
- Sourcing Income in a Sustainable Way
- The Rise of "S" in ESG

Source: HSBC Global Private Banking, December 2021.



Remaking Asia's Future

Asia's growth model is turning to technological innovation, the net-zero transition and continued growth in consumption.

Our four high conviction themes

1. Asia's Consumer Revival
2. Asian Credit Opportunities
3. China's Green Revolution
4. Next Generation Asia Tech Leaders

Asia's fundamental strength has been on full display as the region has gained market share in global trade throughout the pandemic crisis and stayed resilient to supply chain disruptions. In response to exogenous shocks from the pandemic crisis, supply chain bottlenecks and energy crunch, major Asian economies have stepped up technology upgrade, energy transition, vaccination progress and structural reforms to remake their economies into a more sustainable, quality-focused and resilient growth model. Beijing's pursuit of "Common Prosperity" and economic growth model shift from property construction towards high-end manufacturing and green investments reflected a significant paradigm shift from the decades-long development focus on quantity of growth to high-quality, low-carbon and inclusive growth.

Being home of 80% of global semiconductor manufacturing capacity, Asia is well placed to lead the world's electronics supply chain upgrade and technological innovation to meet unabated demand growth for chips and electronic products propelled by the global wave of digital transformation and automation. Asia's dominant position in the global electronics supply chain is attributable to the enormous size of its domestic market and strong competitive edges of its technology manufacturers. Asia accounts for 60% of global semiconductor sales with China alone contributing over 30% of global semiconductor revenues, providing a distinctive scale advantage for technology investment and innovation.

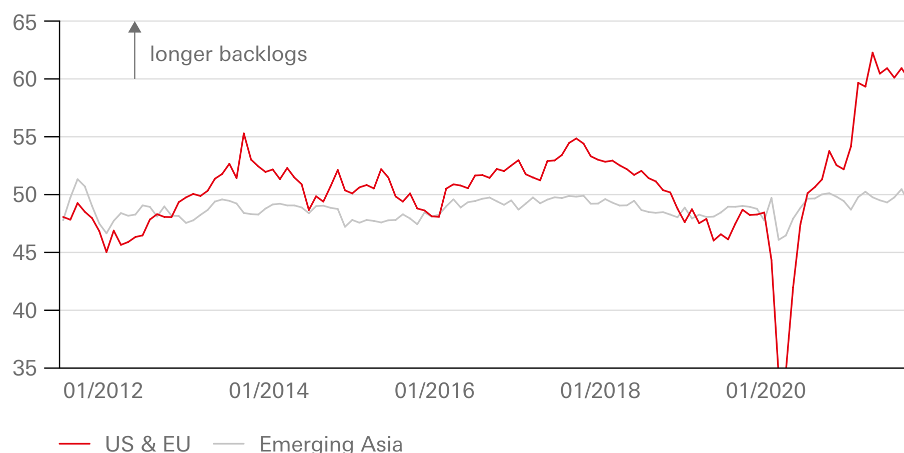
Continued supply chain disruptions in the western countries have shifted demand towards consumer goods and industrial products manufactured in Asia. Export volumes in Asia ex-Japan are currently 15% above the pre-pandemic level, thanks to steady rise in the region's market share in global trade as supported by the highly competitive manufacturing supply chains. Despite the market noise about supply chains relocation from China, FDI inflows rose to record highs in China and India in 2021, boosting strong capex spending in manufacturing investment which remained the key growth driver of Asia's post-pandemic recovery. We expect China's export volume to grow 23.6% in 2021, well above 4.8% in the US and 9.4% in the Eurozone.

Notably, around 60% of goods traded by the Asian economies and 60% of FDI are intra-regional. ASEAN has become China's largest trading partner for the first time, overtaking the EU, with the share of China's exports to ASEAN economies surging to 15% in the first half of 2021 from 12% in 2015. We believe Asia's powerful intra-regional trade networks and positive structural growth will underpin further concentration of the global manufacturing supply chains in the region due to its above-global average economic growth and increasing share of world trade. This will provide a strong driver to support robust capex investment in Asia's manufacturing upgrade, automation and technological innovation.

Asia stands out as a global leader in energy transition and clean energy investments. Given Asia accounted for 52% of global carbon emissions in 2020 while China and India are the world's number one and third-largest carbon emitting countries, revamping the region's power mix and industrial processes away from coal power towards clean energy and electrification will be critical factor for the successful implementation of the Glasgow Climate Pact signed at COP26. Asia currently has 45% share of global installed renewable capacity, well above 25% in Europe and 16% in North America. The International Energy Agency (IEA) projects that Asia alone will account for 64% of new renewable capacity additions globally between 2019 and 2040.

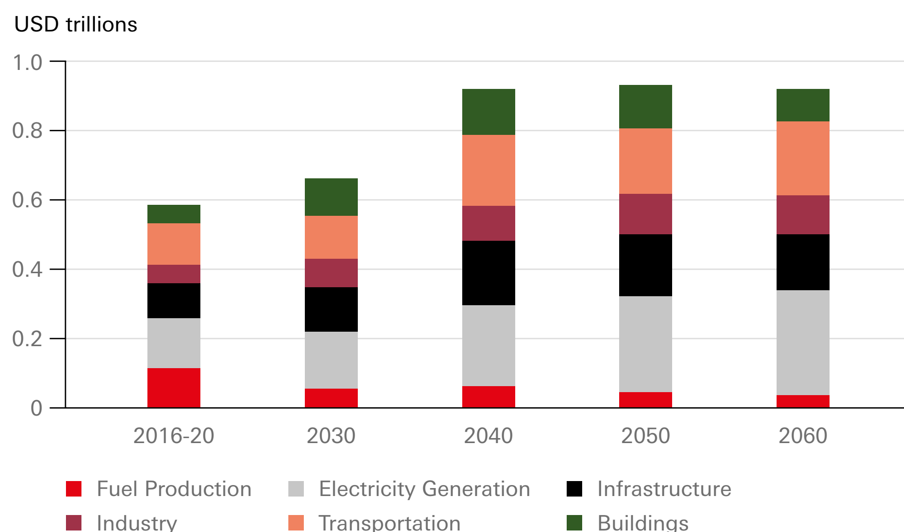
The surprise China-US joint declaration on enhancing climate actions announced during COP26, together with new net-zero targets announced by India (2070), Thailand (2050, CO2 only) and Vietnam (2050), should offer new catalysts to accelerate Asia's green investments to achieve carbon neutrality. China and Indonesia are among the 110 countries which signed a pledge to end and reverse deforestation by 2030, making green financing for biodiversity another key priority on the climate agenda. The net-zero pledges made by China, India and other Asian economies will drive a massive energy transition and industrial upgrade to meet Asia's decarbonsiation goals. India also committed to accelerating renewable energy buildout and a 45% reduction in carbon intensity by 2030.

PMI order backlogs in the US and EU much more severe than in Asia



Source: Markit, HSBC Global Private Banking, December 2021. Past performance is not a reliable indicator of the future performance.

China's annual green investments are estimated to surpass RMB5 trillions on average between 2020-2060



Source: IEA estimates, HSBC Global Private Banking, December 2021. Past performance is not a reliable indicator of the future performance.

The IEA estimates China would need to invest more than RMB200 trillions (equivalent to 200% of GDP in 2020) in the next 40 years to achieve carbon neutrality. We see a potential RMB2 trillions (around 2% of GDP) technology and green stimulus package to be rolled out by Beijing in 2022 to accelerate corporate investment in industrial upgrading and net-zero transition. We estimate the PBoC could release over RMB1 trillions in low-interest green re-lending to support issuance of over RMB1.7 trillions green loans to finance sustainable projects. The central government will likely increase public spending to drive innovation of core technologies and buildout of digital infrastructure by issuing another RMB1 trillions green sovereign bonds to finance green investments, including upgrades of the power grids to adapt to the rapid development of solar and wind power.

As Asia enters the mid-cycle phase in the post-COVID-19 recovery, we expect more substantial rebound in consumer spending will become an important growth driver for the regional economies in 2022. After a slow start, many Asian economies have caught up with the advanced economies in vaccination progress, with most countries expected to achieve at least 75% of their populations fully vaccinated by end-2021. We expect the positive vaccination deployment and the shift of more Asian countries towards the "Living with COVID-19" strategy will facilitate economic reopening and resumption of international travel in 2022. China's vision to promote "Common Prosperity" should bode well for the expansion of middle class consumers and the medium-term shift of the economy towards a consumption-led growth model under the "Dual Circulation Strategy".

Asia's Consumer Revival

Overview

- With rising vaccination rates and new development in COVID-19 treatment, more Asian countries are moving towards "living with COVID-19" strategy. This should be positive to the reopening beneficiaries.
- Asia should contribute half of global consumption growth in the next decade given China's pursuit of common prosperity and more higher-paid jobs in Southeast Asia.

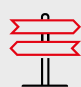
The Opportunity

- As the Southeast Asia countries decides to adopt "living with COVID-19" policies and gradually open their borders, the service industry should see rebounds in profitability.
- China's pursuit of common prosperity should lead to further urbanisation, rising income levels and expansion of middle class. All these should support demand for mass consumption, consumption upgrade, digital and green consumption and healthcare services.
- Asian consumer preference for local brands should provide tailwinds for strong domestic consumer brands. According to NielsenIQ's report, 62% of FMCG sales in the region comes from local brands.
- Digital consumption is unlikely to ebb. Companies that can provide convenient services to customers and insights to retailers should fare better but investors should be selective on country and company fundamentals.

Why now?

- In December, the State Council issued the new fiscal plans for Zhejiang, which is the pilot zone for "common prosperity". These plans will help raise Zhejiang's middle income group to 80% of total population by 2025.
- As at mid-December, Mainland China, Singapore, South Korea, Japan, Malaysia vaccinated near or over 80% of their population with at least one dose of vaccine.
- As at mid-December, Singapore had the Vaccinated Travel Lane with 24 countries to allow for quarantine free travel. Thailand has allowed vaccinated tourists from 63 low-risk countries to visit the country without quarantine requirement.
- China will host the Winter Olympics in February 2022, an event that should boost aspiration consumption.

New opportunities in the coming decades



There is an annual disposable income target of RMB75,000 in Zhejiang pilot zone for "common prosperity" by 2025 vs RMB52,397 currently.

McKinsey expects 50% of global consumption growth to come from Asia between 2020-2030.

China's 2020 urbanisation rate was 64% vs ~80% for high income economies in 2019.

Source: McKinsey, World Bank, NBS, Central Committee of the Communist Party of China, State Council, Government of Zhejiang province, HSBC Global Private Banking, December 2021.

Asian Credit Opportunities

Overview

- The recent surprise default by a few Chinese property developers intensified market concerns about contagion risks across the sector. While the sell-off in the real estate bond market in China has intensified, it remains mostly concentrated in fragile lower-rated developers.

- To manage contagion risks from the Chinese property sector, we have a strong preference for Asian IG bonds for their quality and yield pick-up versus DM and other EM IG.

The Opportunity

- We believe that contagion risks from Chinese developers' debt crisis may continue to weigh on risk sentiment and keep volatility in Chinese credit markets elevated.

- As the refinancing channels remain limited for lower-rated developers that have fragile credit fundamentals, we prefer focusing on quality, such as Asian IG bonds, which account for 80% of the overall Asian credit market. They have seen their credit spreads remaining elevated compared to pre-pandemic levels and are attractive versus their DM and EM peers. Within Chinese property bonds, we favour green-tier developers with improving balance sheets, decent credit profiles, clear deleveraging plans and strong track records on sales momentum and cash flow generation.

- We also seek carry opportunities in Indonesian hard currency bonds, selected Indian hard currency corporate credit and Chinese SOEs.

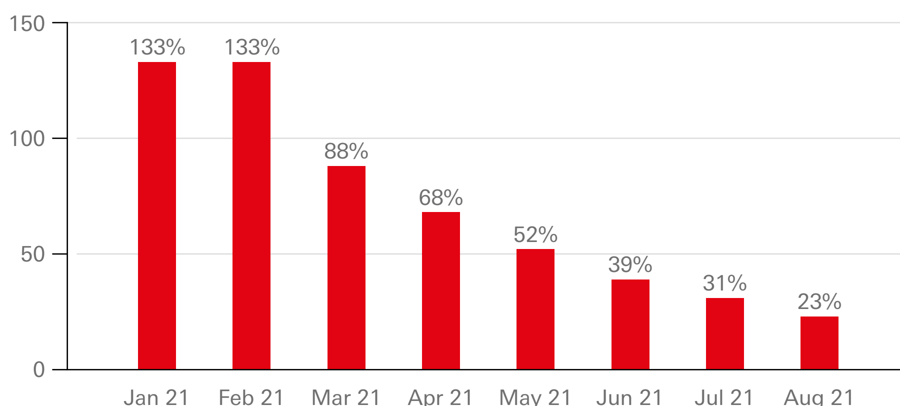
Why now?

- Chinese Property HY bond yields are now at a decade high as aftershocks from defaults, missed payments and ratings downgrades ripple through the bond market. While we avoid this segment for the moment, due to rising concerns over refinancing and limited visibility on the timing of any potential policy support, valuation on Asian IG and some of green-tier developers has improved and is attractive relative to other EM ex Asia peers.

- We also focus on Indonesia, whose credit fundamentals remain strong in the face of the easing pandemic headwinds and most SOEs with USD bonds will continue to receive support from the government. The HY sector is also reinforced by the positive demand-supply dynamics.

- Indian corporate credit fundamentals have become more stable and have even gradually improved in some cases.

China's property tightening has resulted in a sharp slowdown in contracted sales in Q3 2021



Source: China National Bureau of Statistics, HSBC Global Private Banking, December 2021. Past performance is not a reliable indicator of future performance.

China's Green Revolution

Overview

- With the goals of reaching carbon emissions peak by 2030 and carbon neutrality by 2060, China will need to step up its efforts to promote the usage of cleaner energy and find new ways to reduce its carbon footprint.

- The IEA estimates that China will need to invest more than RMB200 trillions till 2060 to achieve carbon neutrality, with electrification likely the largest driver of investment.

The Opportunity

- Solar and wind energy installations are expected to continue to increase during the 14th Five-Year Plan. We expect the cumulative solar and wind installations to continue to rise to 602GW and 557GW in 2025, respectively, from 252GW and 282GW in 2020.

- The adoption of NEV (New Energy Vehicles) will pick up in China given policy support and change in consumer preference. We project 2021-23e NEV annual growth to reach 117%, 37% and 28%, respectively. EV penetration could hit 31% in 2025e and 59% in 2030e. This should benefit the EV and EV supply chain sector.

- With increasing renewable energy mix and its intermittent nature, China needs to invest in energy storage capacity and smart grids. We expect energy storage demand to jump to 890GW in 2030e, up from 35GW in 2020.

- Clean hydrogen will become more common given its advantage in storage, resilience and transport of energy.

Why now?

- The State Council announced that China would work towards having 80% of its total energy mix from non-fossil fuel sources by 2060 . It targets to reach over 1,200 GW of installed capacity by 2030.

- The recent power crunch highlights the need to secure stable renewable energy supply via better energy storage.

- The December Central Economic Work Conference that set the economic agenda for 2022 called for an acceleration in green evolution with a smooth transition from coal to clean energy sources.

- China's carbon trading market, which currently only includes power companies, will expand to cover financial institutions and other eight of China's major emission-intensive industries by 2025, according to the comment by the chairman of Shanghai Environmental and Energy Exchange made in December 2021.

- The PBoC officially announced a new lending tool to encourage bank lending to green projects with preferential rates.

New opportunities in the coming decades

The IEA estimates China will need >RMB200trn to meet its climate goals.

Government aims to reduce carbon intensity by 18% from the 2020 level by 2025, and by >65% from the 2005 level by 2030.

Coal accounts for >50% of the final energy consumption by industry, but the share is forecasted to drop to <5% by 2060.

Source: HSBC Global Private Banking, December 2021, The International Energy Agency and The State Council of the People's Republic of China.

Next Generation Asia Tech Leaders

Overview

- North Asia aspires to take the lead in global advanced manufacturing. China is focused on technology upgrade and self-sufficiency. Japan, South Korea and Taiwan are already home to many cutting-edge manufacturing plants. Southeast Asian countries are picking up the opportunities from the recent supply chain disruption to attract new investments in advanced and traditional manufacturing.

The Opportunity

- Beijing will likely push for more investment in advanced tech such as digital infrastructure and smart city clusters. Tax incentive for R&D, increase in spending on basic research, and measures to widen and deepen funding channels for startups should support its pursuit of technology upgrade and localisation. Local leaders in the innovative industries, the high-tech hardware industries, and the provision of critical technologies should benefit.

- We also see investment opportunities in electronics, machinery, electric vehicles, high tech materials and semiconductor in Japan, South Korea and Taiwan.

- In Southeast Asia, the digital economy should continue to expand. The manufacturing sector in the region should also benefit from automation adoption. BCG expects ASEAN countries to see an increase in the annual manufacturing FDI of up to USD22 billions.

Why now?

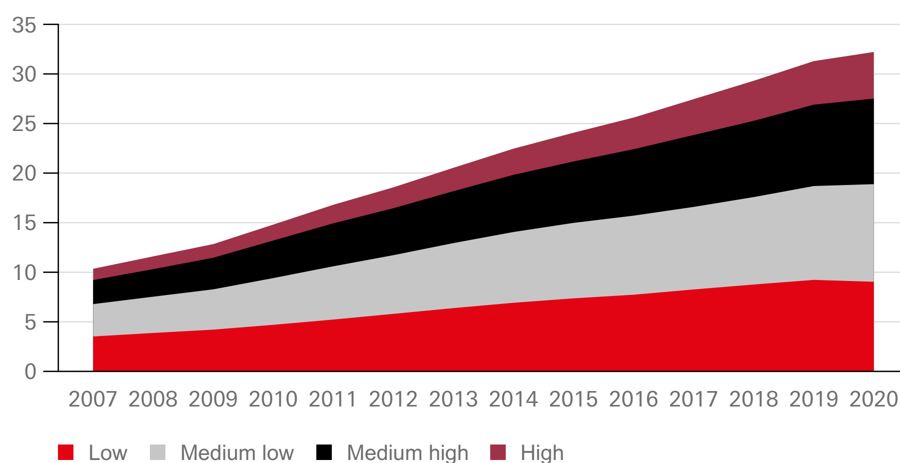
- China's Ministry of Industry and Information Technology said that China would speed up its new industrialisation and digitisation

process for the transition from "made in China" to "designed in China".

- Artificial intelligence, semiconductor, quantum computing, neuroscience, biotechnology, medicine, earth and space exploration, network communications (including 5G), and modern energy resources are highlighted as key support areas in China's 14th Five-Year Plan.
- The supply chain disruptions and the chip shortage mean further diversification in manufacturing capacities and production base are needed.
- The common trade rules in the RCEP agreement would facilitate the regional optimisation of the supply chains.

China is transitioning to more high-end manufacturing

Annual Industrial Production, in RMB trillions



Source: CEIC, HSBC Global Private Banking, December 2021.

Policy Support for Mid-Cycle Growth

As policy changes in the mid-cycle stage, we focus on those areas with the strongest support.

Our five high conviction themes

1. American Renewal
2. DM Financials – Focus on Subordination
3. European Growth Leaders
4. Infrastructure 2.0
5. Resilient Carry in High Yield and EM

Economic growth and inflation have been well above normal in 2021, and both should come down in 2022. In the case of economic growth, the fear is that it slows too quickly, while for inflation, the fear is that it does not come down quickly enough. In other words, our hope and belief is that the inflation cycle is shorter than the economic cycle; while those who worry about stagflation believe the opposite, i.e. that the inflation will remain stubbornly high and contribute to the economic slowdown. Policy makers have a big role to play on both fronts and markets will therefore pay very close attention to the policy measures they will take, on both the fiscal and monetary policy front.

We believe the policy mix still remains favourable, and supports a range of thematics across equity and fixed income markets.

Fiscal policy: spending and taxes

Through fiscal policy, governments can have a direct impact on the economic growth side. Big investments in infrastructure are likely to boost activity for several years and extend the economic cycle, given the long duration of most infrastructure projects. This is taking place around the world, in the US, Europe and Asia. Investment in infrastructure such as roads, bridges, schools, healthcare and

digital infrastructure is much overdue in many countries across developed and emerging markets.

Infrastructure can help fulfil another increasingly common objective as well, of increased fairness and the fight against inequality. The pandemic has further increased inequalities, and inflation has put pressure on lower income households' finances. We think that governments will try to fine-tune their fiscal and social policies to try to halt or reverse the growing inequality. So while governments cannot continue to spend at the same pace as they did during the pandemic, and need to address the rapid growth of the debt pile over the past few years, it is unlikely that they will resort to the austerity measures that were common after the great financial crisis, because they increased inequality and produced a political backlash. This time around, any tax reform will probably be highly progressive, with tax increases oriented towards high incomes and strong corporates on the one hand, but improved social security and rising minimum wages on the other.

If tax policies are implemented in this way, labour markets continue to improve, and governments continue to roll out effective vaccination programmes, consumer spending and the outlook for consumer stocks should remain resilient. A resilient consumer and infrastructure investment should both contribute to a soft landing for the economy. However, rising taxation and rising wages will probably lead earnings growth to slow from the record pace of recent months.

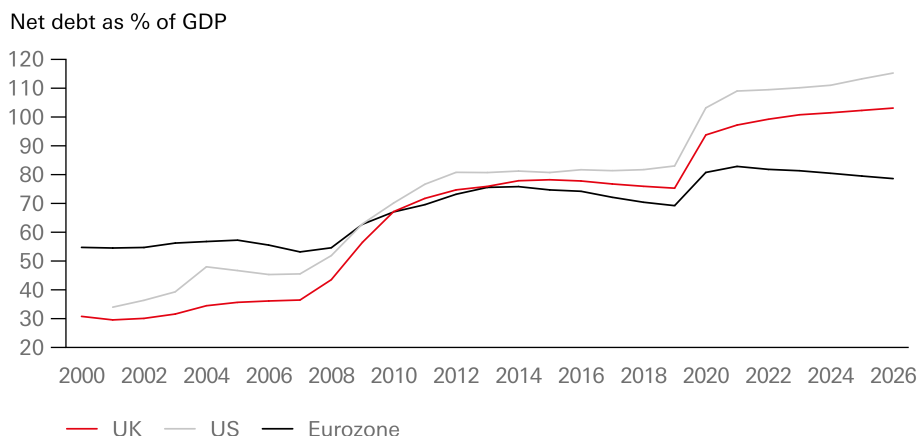
Monetary policy

Engineering a soft landing of inflation is the task of central banks. They generally believe that some of the drivers of inflation (such as used car prices and commodity price base effects) are temporary, and that inflation should therefore come down in coming quarters. That should allow them to take a gradual approach to policy tightening, and in turn keep real yields relatively low. But on the other hand, it is impossible to know when the supply chain issues and shortages in the labour market will start to ease, and markets will therefore continue to react to the volatile economic news flow. Central banks have somewhat different views on the inflation issue and the appropriate policy action to take, which complicates the picture for investors. The Bank of England already hiked in November, while the Fed should start hiking in March and the ECB is on hold. So there are two aspects to the rate outlook: still low, but more volatile. And as a result, we continue to forecast a 'low but volatile' Treasury outlook. Relative to 2021, where the 10-year

US Treasury mostly traded in a 1-1.5% range, we think we will see a broader 1-2% range in 2022, as there is more uncertainty and inflation may stay high for most of the first half of 2022.

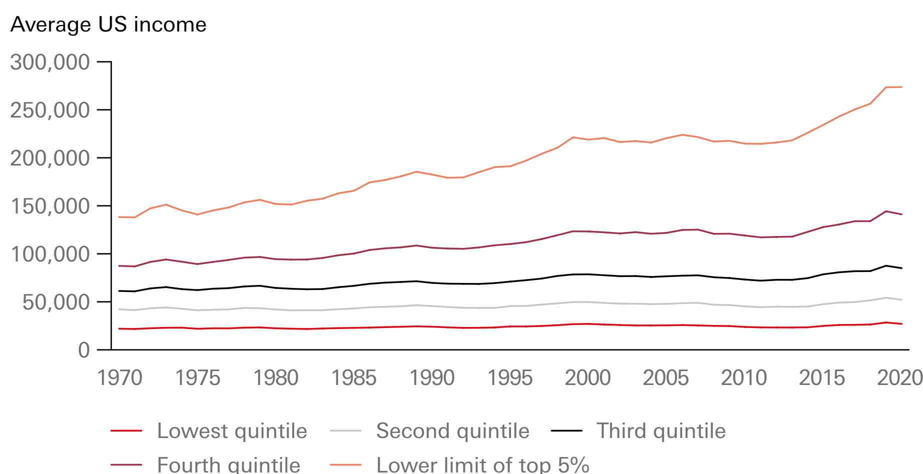
In summary, our 'policy-driven support for mid-cycle growth' Top Trend refers to the stabilising forces coming from fiscal and monetary policy, which will help extend the cycle and dampen stagflation risks by trying to engineer a soft landing of growth and inflation. There are of course execution risks and potential market surprises, which we will continue to monitor. But overall, the fiscal policy measures we've seen so far support our high conviction themes related to infrastructure, the American renewal and European growth leaders. Monetary policy is supportive of the search for yield and our HiCos of Resilient carry in high yield and EM, and DM financials – focus on subordination.

Growing debt piles will force governments to raise taxes, but they will do so only slowly to avoid hurting the economy



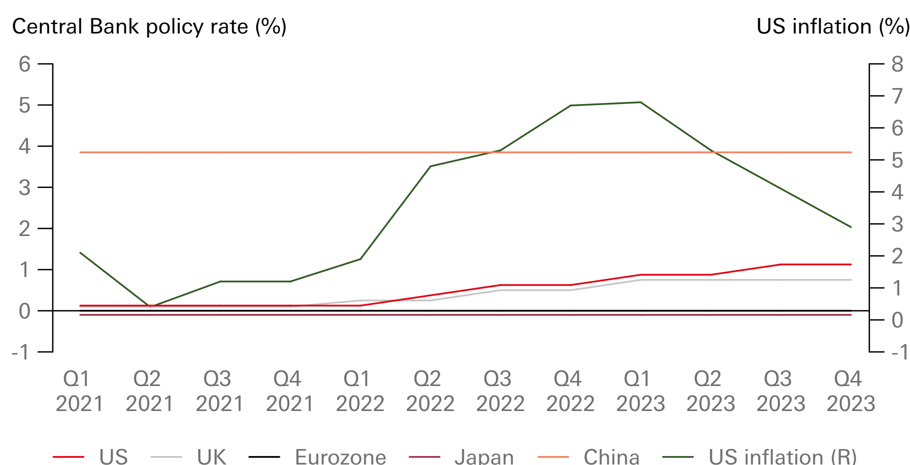
Source: IMF, HSBC Global Private Banking, December 2021.

The gap between high and low incomes has risen further. Tax and spending policies will be designed to help ease this inequality issue



Source: US Census bureau, HSBC Global Private Banking, December 2021.

Central bank tightening should remain very gradual as the big spike in inflation is generally assumed to be transitory



Source: Bloomberg, HSBC Global Research, HSBC Global Private Banking, December 2021. Forecasts are subject to change.

American Renewal

Overview

- US economic growth remains well above historic averages. Vaccines and therapeutics should enable the services sector to reopen.
- The unemployment rate is declining steadily while wage growth has improved consumer balance sheets.
- Goods consumption soared during the pandemic while services consumption is starting to accelerate.
- Monetary & fiscal policies remain accommodative. Interest rates should stay contained, supporting consumption.
- The technology revolution and building a sustainable infrastructure should lift the economy and jobs growth.

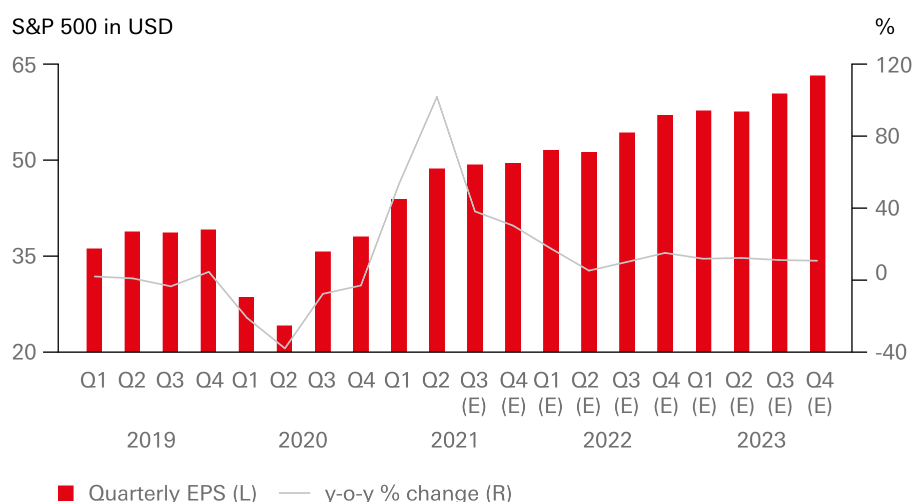
The Opportunity

- We remain constructive on the US consumer, with a focus on the interest rate sensitive sectors of financials and housing. US markets have outperformed global markets. For consumer stocks, despite the outperformance, fundamentals remain attractive.
- Labour markets remain tight but should continue to expand as COVID-19 concerns wane. Unemployment rate is steadily declining and wage growth is strong.
- The low interest rate environment is supportive of consumer spending by providing access to capital. Inflation should slow in 2022 as supply rises to meet demand.
- The cyclical upswing, combined with several secular trends, remain supportive for strong labor markets and good consumption.
- Services spending should rebound as the economy continues to reopen which historically has accounted for the majority of consumer spending.

Why now?

- After COVID-19 related weakness, the US economy is rebounding rapidly. Vaccination rate is at two-thirds of population and introduction of approved therapeutic drugs should remove barriers to re-enter the labour force and reopen the services sector.
- A new budget in place with infrastructure spending and social programs should lift the economy this year. 5G rollout is underway and the technology revolution, infrastructure spending, and inventory rebuilding will create high value added jobs.
- Extended federal aid programs ended, forcing workers back into labour force. As other forms of excess savings dissipate, consumers will have to return to work.
- Introduction of President Biden's infrastructure and Sustainability programs provide signal to investors that rebuilding and creating a more sustainable America is underway.

Corporate earnings forecast to rise 18% in 2022 which is supportive of the US equities



Note: (E) = Estimates
Source: Bloomberg, HSBC Global Private Banking, December 2021.

DM Financials – Focus on Subordination

Overview

- The DM Financials sector has been through a period of transformation since the Global Financial Crisis, with a strong focus on capital adequacy. It's an industry wide endeavour which remains in place over ten years later.

- Banks have strengthened their balance sheets significantly in response to stringent regulatory requirements under the Basel III accord, evidenced by stronger capital and liquidity ratios. Meanwhile, asset quality remains benign in spite of the COVID-19 pandemic, owing to a host of targeted fiscal measures and the subsequent rebound in economic growth. Insurance companies have also built large equity cushions in recent years.

The Opportunity

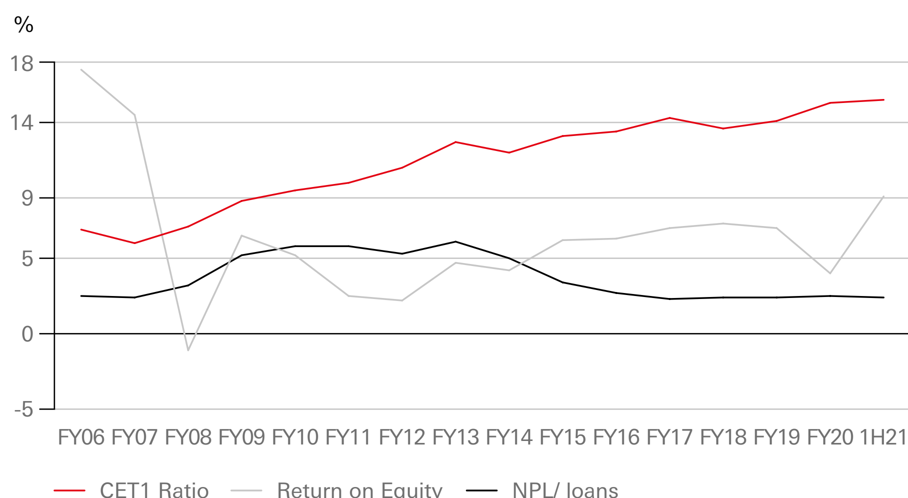
- Given the strength of fundamentals and in particular capital positions, we currently view subordinated debt instruments as a valuable source of carry in the structurally low yield environment.

- For Banks, we have a preference further down the capital structure for USD and EUR currency Basel III Additional Tier 1 (AT1) bonds. AT1 securities issued by European banks as Contingent Convertibles (CoCos) and US banks in Preferred Stock format provide attractive yields, on a selective basis for banks with high quality fundamentals. We look for large buffers above minimum regulatory capital requirements in order to absorb the impact of rising shareholder returns. At an index level, USD AT1 CoCos yield over 4% (spread 288bps), while in EUR index yields are around 3.4% (spread 390bps), as at 12 November 2021*.

- We also view the risk-reward for Restricted Tier 1 (RT1) CoCos from selected European Insurers as attractive. USD RT1 CoCo index yields stand at 4% (spread 260bps), with EUR index yields of 3.1% (spread 350bps) as at 12 November 2021*.

* Source: Index data from IHS Markit iBoxx.

European Banks – Fundamental Snapshot



NPL = Non-Performing Loans, >90 days passed without the scheduled payments being made.
Source: HSBC Global Private Banking, Company Reports, December 2021.

Why now?

- DM banks continue to post strong quarterly earnings, benefiting from a combination of loan reserve releases, robust capital markets results and stabilising net interest income trends. Non-Performing Loan ratios should remain low despite the gradual unwinding of government support, as economic growth is expected to remain above trend in 2022.

- Bank Common Equity Tier 1 (CET1) capitalisation ratios are close to all-time highs across both Europe and the US, averaging 15.5% and 12.1% respectively at the second quarter of 2021.

- The more stringent Solvency II regulation in Europe has been a positive for bondholders, as insurers have since built significant equity buffers and exhibited capital prudence. We estimate that the average Solvency II Capital Ratio (SCR) among insurers stood at 206% at FY20, over double the 100% regulatory minimum.

European Growth Leaders

Overview

- A successful vaccine roll-out across Europe has positioned the region well for a continued recovery in the coming year.

- This should push growth to 4% across the Eurozone in 2022, driven by strong domestic demand and robust labour markets.

- For once, the opportunities for growth are domestic as well as global as consumer demand recovers.

- Fiscal policy is aligned to growth too, with the €750 NextGenerationEU fund ramping up spending this year to average 0.8% of GDP over 2022 and 2023.

- Unlike the fall-out from the financial crisis, stress in capital markets is low, further supporting the rebound.

The Opportunity

- Strong growth underpinned by a lack of systemic stress across the Eurozone is supportive of financials, which have chronically under-performed the broader equity index and trade at a 33% discount to book value.

- The NextGenerationEU fund enables the periphery markets to invest cheaply, with a focus on Green investments. Alongside ambitious carbon emissions reduction targets there is opportunity for structural growth.

- We forecast consumer spending to grow by 6.1% in 2022, boosting the Consumer Discretionary sector. Many of these companies are world leaders that can also gain from the strong consumer demand globally that is fueled by strong wage gains and large savings.

Why now?

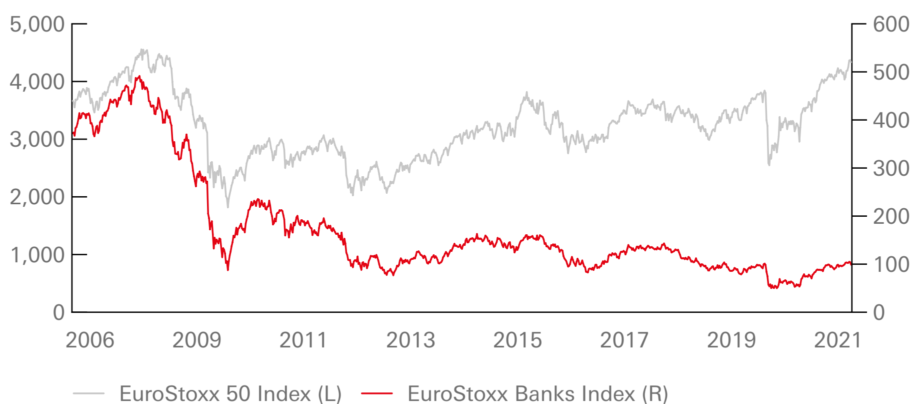
- This is an unusually strong growth backdrop for the Eurozone, creating a cyclical opportunity in a market that has lagged the US.

- Now is a great time to invest ahead of a surge in investment spending with a focus on clean energy. There

are ambitious projects in wind, solar, hydrogen and the transition to electric vehicles.

- European companies are market leaders in the Consumer Discretionary sector and can for once leverage both domestic and global demand.
- Valuations of the Stoxx 600 ex UK are almost 20% below the MSCI World index based on price-to-forward earnings multiples.

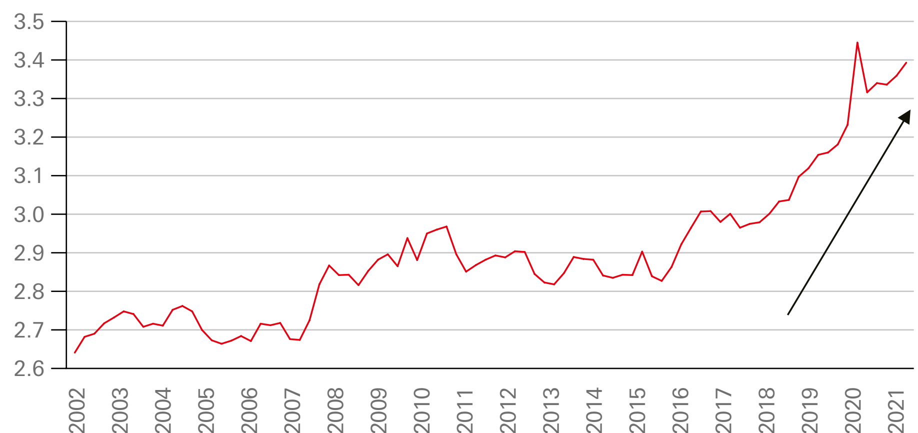
Banks have chronically underperformed broader equity markets



Source: HSBC Global Private Banking, December 2021.

Infrastructure 2.0

R&D spending increasing in terms of Real GDP



Source: Federal Reserve Bank of St. Louis, HSBC Global Private Banking, December 2021.

Overview

- To lift economic growth and create jobs, governments are increasing spending on infrastructure.
- The logistical backbone needs to be modernised for the emerging digital economy. Digital & physical security needs to be incorporated.
- Physical infrastructure includes rebuilding roads, bridges and utilities. Digital infrastructure includes 5G and other associated technologies. Human infrastructure includes closing the digital divide and providing support and education.
- Historically, infrastructure creates jobs, wealth, and improves productivity and profitability.

The Opportunity

- In an effort to stimulate economic growth, governments are spending on rebuilding and modernising infrastructure. We are at the beginning of a multi-year rollout of next generation technologies that are expected to lift productivity and profitability across the globe.
- Physical infrastructure should benefit from renewal, upgrades or replacements to adapt to new ways of working, consumption patterns and distribution. Rising sustainability concerns are triggering a replacement of aging infrastructure with environmentally cleaner alternatives.
- The digital infrastructure, especially next generation mobile networks like 5G, is a key enabling component of the infrastructure upgrade. In addition, cyber security must be incorporated to provide secure transactions. Sustainable digital infrastructure must be able to secure to create smart cities and grids.

Why now?

- Historically large fiscal stimulus packages have been introduced in numerous countries to repair and modernise infrastructure. These programs should serve as facilitators for further larger investments in markets.
- Major central banks remain accommodative and interest rates should remain lower than expected, encouraging further investment.
- This multi-year digital revolution is just beginning with the global 5G rollout. The incorporation of digital and interactive infrastructure should further lift productivity and return on investment, encouraging further investments.
- Rising climate issues and the creation of a more sustainable global economy will necessitate continued development of smart infrastructure.

Resilient Carry in High Yield and EM

Overview

- In this mid-economic cycle, we are overweight on Global High Yield and EM bonds in Hard Currencies (HC). The former benefits from positive ratings' migration on the back of falling leverage and improving economic prospects. The latter enjoys low levels of interest rates in DM countries and to some extent, higher commodity prices.
- However, we focus mainly on resilient carry opportunities given the expected slowdown of global economic growth.

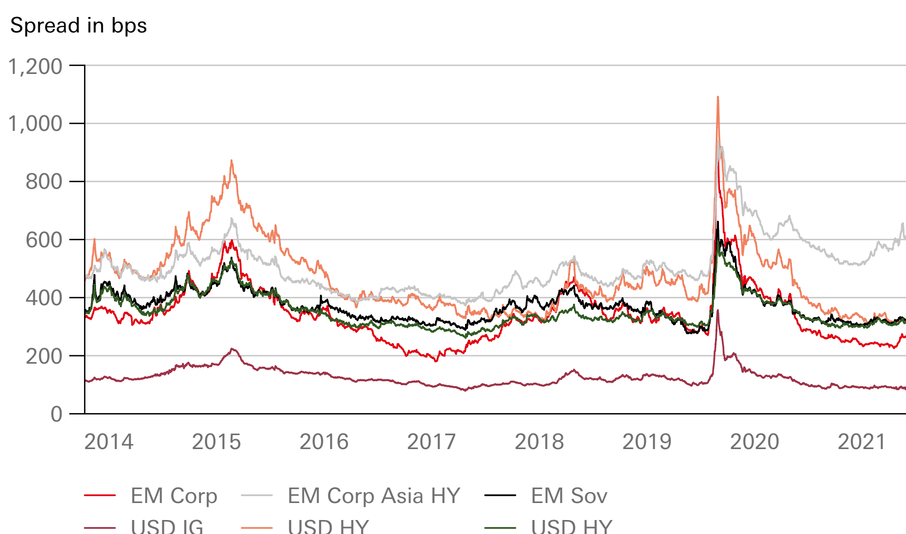
The Opportunity

- In terms of corporate credit, we continue to favour US, European and UK High Yield (HY) as we expect them to continue to benefit from the economic expansion. We continue to adopt a cyclical stance and favour the Energy, Leisure and to some extent the Travel sectors, but in a very selective manner.
- We believe that EM HC bonds will continue to provide an attractive risk/return combination. We maintain our mild overweight on Asian credit with a strong quality bias for Asian IG, Chinese SOE issuers and better quality Chinese green-tier developers. We believe the longer-term outlook remains positive as stronger developers will prevail, improving industry credit metrics and standards. We also seek carry opportunities in Indonesian and selected Indian HC corporate credit. Outside of Asia, we have upgraded the Gulf Cooperation Council HC credit to a mild overweight, acknowledging reduced fiscal imbalances and the region's commitment to support weaker neighbours.

Why now?

- Even though the Fed will probably hike interest rates three times this year, the overall level and pace of monetary tightening should remain slow. The economic environment has not normalised yet and inflation fueled by supply-side disruptions and surging energy prices should ease gradually, keeping a lid on yields.
- In this environment, we believe the best strategy is to focus on carry opportunities expressed through DM HY and EM credit markets. However, it is important to focus on companies with stronger balance sheets and improving credit fundamentals, such as declining leverage and increasing cash flow generation.
- With benchmarks yields remaining low for longer while inflation is biting, Global HY and EM bonds in HC provide a yield pick up of over 300bps.

Global High Yield and EM bonds offer more than 300bps yield pick up



Source: HSBC Global Private Banking, Bloomberg, JPM, ICE BOFAML indices, December 2021. Past performance is not a reliable indicator of the future performance.

Digital Transformation

Digitisation is the enabler of rapid innovation – not just in the IT space but across sectors.

Our five high conviction themes

1. Automation and AI
2. Biotech, Genomics and Devices
3. Smart Mobility
4. The Metaverse
5. Total Secuirty

The 2020s will undoubtedly the be the decade of digitalisation, when many individual technology components start to work harmoniously together just as barriers to communications are lifted and they effectively work for a virtual network of devices. Digitalisation of devices and networks allows data to flow seamlessly from one place to another facilitating integration and expansion of capabilities. Advancing electrification is providing greater access to the single power source that drives the new technologies including ever more powerful computers, sensors, screens, automated systems, communications and increasingly transportation.

Let's explore this fascinating area of technology with a five practical examples that illustrate how digitalisation is transforming businesses and lives today.

The basic human skills of communicating and interacting was little changed for millennia, but since Marconi introduced the telephone to the world in 1876, things have never been quite the same. The internet and subsequent network digitalisation have been key enablers of the development and growth of online social platforms and networks. The potential of a polite wine and cheese party seems a limited option compared to the potential of today's global networks providing opportunity to connect globally with any of the other millions of users. This in turn has led to the emergence of the metaverse, a virtual world where 3D headsets make the experience evermore immersive with avatars replacing humans and commerce being transacted using crypto-assets including non-fungible tokens (NFTs). This virtual Shangri La is attracting evermore people who look to spend time in paradise and avoid the day-to-day

routine or the confines of working from home. Our metaverse investment theme captures the major trends and developments in this exciting and fast moving new technology frontier.

Digitalisation and its impact are in clear view but often go unnoticed or unattributed. The introduction of digital cellular networks (1983 in the US) enabled telephone calls to be made from any location a significant step in itself. Fast forward four decades and digitalisation of the telephone network enabled existing and new product and services to be offered through a completely new channel and formats as they were accessed in new ways by a far wider group of consumers. The name 'mobile telephone' seems no longer valid, as the device replaces many other former household objects besides the fixed line telephone, camera; music stereo; television; maps; address book; diary; stationary; compass; tape measure; calculator; dictaphone etc.. To put things in perspective, today's smartphone user has more available computing power than NASA had for its Apollo missions to the moon.

It could be argued that digitalisation has transformed not only the technology but also society.

Connectivity is also a factor in our next topic, but not between people, rather things, moving things. Mobility and transportation are central to commerce and people, but most forms of mobility operate independently, hence a car, train, ship or airline need driver, captain or pilot and maybe even a crew. That is starting to change with the roll-out of the latest generation of mobile networks as things can increasingly start 'talking' to each other digitally. Smart mobility is still in its infancy but is growing fast. Various forms of transport are increasingly connected either via services such as satellite navigation or streaming music to autonomous trains and buses. Electrification of our transport systems should help accelerate the interconnectedness and enable the introduction of evermore services including continuous vehicle diagnostics; precise location of a delivery; vehicle tolls; active control transportation availability to better meet demand.

Interconnectivity is important for the next phase in the development of automation, our third topic. In 2020, it is estimated there are 3 million robots worldwide (The World Robotics 2021 Industrial Robots), the majority of the market is in five countries: China, Japan, the US, South Korea and Germany and this is forecast to rise by 31% between 2020 and 2023 according to International Federation of Robotics (IFR). In order for automation to achieve its full potential, robots and other automated equipments need to develop greater spatial awareness, should be able to connect to other equipments and work independently. Recent advances in AI software involving deep learning and hardware promises to deliver some of these necessary developments. Digitalisation of that data will progressively enable devices to exchange data and information.

AI also has exciting applications in healthcare. For our fourth example, let's start by considering the fundamental building blocks for life, namely DNA and the sequence of chemical bases that provide the unique biological code for each living organism. The human genome contains 3 billion chemical bases that are unique to that individual. That is a large amount of data in itself. Imagine scientists wanting to compare the genomes of several thousand humans to detect genetics anomalies or mutations that may be responsible for a particular medical condition. A combination of automated sequencing

and screening using AI software can both enhance and accelerate a process that would be almost impossible by manual methods.

As with many positive developments in life, the free movement of data brings with it certain inherent risks particularly relating to security, our fifth and final example. Data comes in many forms and potential uses, the majority of which are harmless, but covert access of data and information and its illegal use has become a major criminal enterprise. In 2021, cybercrime is expected to cost the global economy in excess of USD1 trillion (Businesswire, December 2020). News of hackers, malware and ransomware attacks litter news headlines with grim regularity, impacting governments, corporates and private individuals. Unsurprisingly this activity has driven the rapid growth of the cybersecurity industry revenues in 2021. The industry is expected to continue its expansion to meet future security needs. The pandemic has accelerated many technology trends from contactless payments to the shift to on-line services. These critical services increasingly need robust protection.

Automation and AI

Overview

- Automation has been growing for many years but development has been relatively slow and remained confined only to certain industries.
- A combination of rapidly improving technologies, growing societal comfort in using technology and the necessity imposed by the pandemic are expanding the demand for robots and automation around the globe, particularly in services.

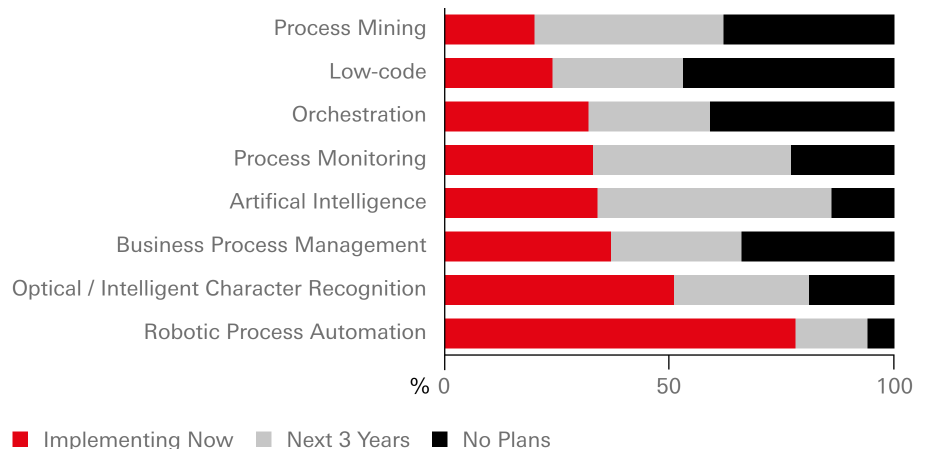
The Opportunity

- Robot sales continue to boom with the International Federation of Robotics (IFR) forecasting unit sales of autonomous mobile robots rising 31% between 2020 and 2023, with 13% of that expected just in 2021.
- The OECD expects robust global growth of 5.5% in 2021 and 4% in 2022 with the World Robotics 2021 Industrial Robots report showing a record 3 millions robots in factories around the world.
- The majority of the market is in five countries: China, Japan, the US, South Korea and Germany with Asia being the largest consumer with 71% of new installations in 2020 coming from the region.
- The industrial economy is reliant on automation to improve profits and productivity. Sales of robots in the US in 2021 are expected to be +17% on 2020 figures as a result of post crisis recovery.

Why now?

- With the pandemic easing and global economies on a recovery and renewal trajectory, sales of robots are expected to see additional growth.
- The development of 5G and the associated hardware, in particular robotics, is making huge advances, creating new opportunities for industry and services.
- A focus on more local supply chains should see an increase in capex spending and with that, it should bring a focus on automated technologies.
- Advancement of data management and the techniques involved in artificial intelligence are raising the value of automated processes to companies.

Automation plans of organisations



Source: HSBC Global Private Banking, Deloitte Intelligent Automation Survey, December 2021.

Biotech, Genomics and Devices

Overview

- Healthcare budgets are growing faster than inflation in most countries as populations age and/or grow.
- Innovative new technologies are enabling healthcare services to be delivered in novel ways, often at lower overall cost and with better patient outcomes.
- The pandemic has been a catalyst for the rapid adoption of many cutting-edge and digital technologies.

The Opportunity

- Biotechnology is delivering novel complex, ground-breaking treatment for previously difficult to treat diseases including monoclonal antibodies and gene therapies.
- Genomics is leading to a greater understanding of gene based diseases and their causes.
- Gene sequencing, screening, and editing (CRISPR) technologies are offering breakthrough therapy opportunities.
- AI applications are accelerating and enhancing the diagnosis of diseases.
- Stem cell based therapies are starting to show promise.
- Connected devices and sensors offer continuous patient monitoring and a rich source of data.
- RNA and DNA vaccine technologies offer great potential for preventative medicine in large populations.

Why now?

- Rapid evolution of several ground breaking technologies such as gene therapies, lasers and automation are now being used in practical applications and treatment regimens.
- The pandemic has drained national resources, so the need for efficiencies is much needed.
- There is a backlog of elective healthcare procedures (e.g. hip and knee replacements, corrective surgeries etc.) due to the pandemic.
- Shortages in healthcare resources call for fast paced and effective technological solutions.

Global average national health expenditure

Source: The World Bank, HSBC Global Private Banking, December 2021.

Smart Mobility

Overview

- Smart mobility includes the integration of intelligent technologies in transportation, but it is also about governments, companies and individuals making smart decisions about their choices of mobility given the environmental and demographic challenges.

- The Paris Agreement, the COP26 and the recent IPCC climate study give an even greater sense of urgency to the adoption of zero-emission technologies, including in transportation. Electricity, hydrogen, biofuels and ammonia are potential zero-emission or green fuels that should help reduce emissions.

The Opportunity

- Electric vehicle (EV) purchases have accelerated significantly in several major economies as consumer adoption gains momentum as new models are introduced.

- EV infrastructure is being added at a rapid pace in several companies to meet growing demand.

- Battery technology continues to advance benefiting from increased R&D budgets and soaring applications.

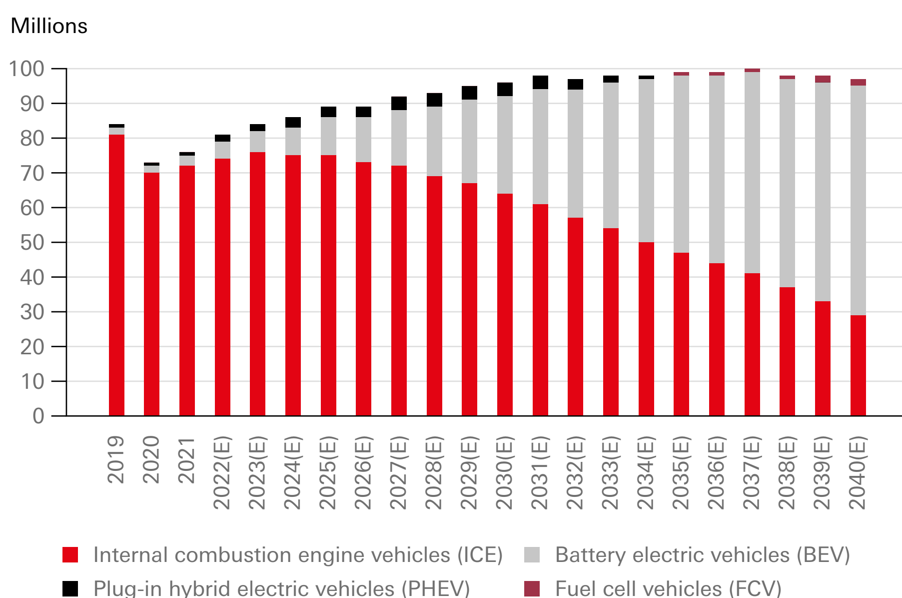
- The roll-out of 5G networks, in-vehicle and sensor technologies are connecting transportation to the surrounding environment and other forms of transport.

- Commercial vehicles and trains could benefit from the advancements in hydrogen fuel cell technology.

Why now?

- Transportation companies and systems are being forced to phase out the use of fossil fuels over the next decade as countries strive to achieve net-zero-emissions.
- Technologies have advanced sufficiently to make alternative energy formats (lithium batteries, fuel cells, bio-fuels) to provide a viable economic zero-emission alternative source of power to fossil fuels for transportation.
- Fiscal stimulus packages in several major economies have environmental and infrastructure provisions that should also provide some additional financial impetus.

Global passenger vehicle sales by power train



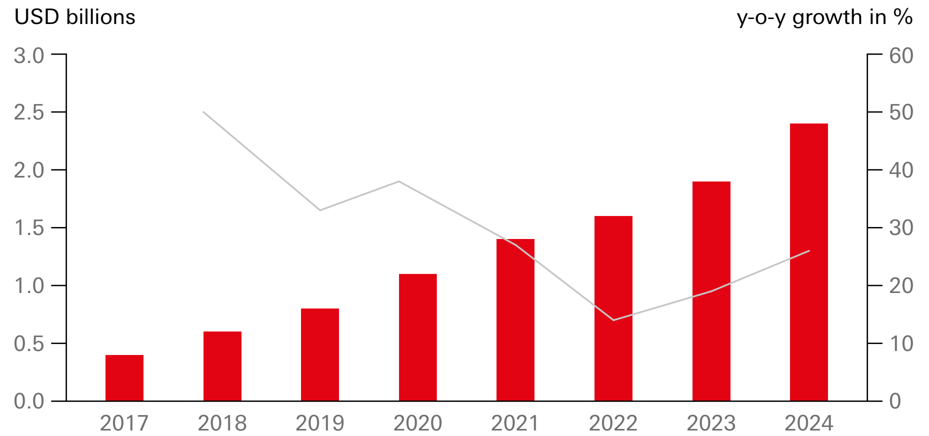
Note: (E) = Estimates
Source: Bloomberg, HSBC Global Private Banking, December 2021.

The Metaverse

Overview

- The metaverse – a digital universe where people can interact, that is connected to the real world economically is gaining traction and momentum with associated technologies advancing rapidly.
- Wearables, 5G, chips, 3D software engines, optical tech, online interaction comfort, blockchain, non-fungible tokens (NFT's), VR, AR and smart contracts are combining to bring the metaverse to the forefront of investor opportunities.

Global Virtual Reality (VR) gaming revenue



Source: HSBC Global Private Banking, Statista, 2020 – 2024 estimated, December 2021.

The Opportunity

- In a world where corporates are operating a hybrid work from home model and people are growing up conditioned to socialise digitally, there is a vast opportunity for investors as the metaverse expands.
- The technological advances in VR headsets are getting interest from corporates considering conducting meetings in a VR space, a step on from video calls.
- Entertainment will be altered completely. Entertainers can deliver their art to vast audiences at once. This has begun already when Fortnite hosted a Travis Scott Concert in 2020 to an audience of 12 millions and pocketing the artist USD20 millions.
- Retail could also be vastly different with NFT technology able to authenticate the originality of a digital outfit, vital for luxury goods in particular and some luxury brands have begun to experiment with digital offerings.
- Travel, socialising, healthcare and finance are all facing disruption from the metaverse opportunity.

Why now?

- The pandemic has moved the world and corporates to allow more flexible, hybrid working approaches and VR, including VR spaces, look likely to play a key role.
- Recent developments of faster and better data networks via 5G, cloud networks, 3D engines and the supporting data management techniques provide the infrastructure for the metaverse to be built out.
- Recent announcements by many high profile digital companies to focus their strategy on the metaverse demonstrates a tech race for this new economic ground and a commitment of capital and expertise to the opportunity.

Total Security

Overview

- The need for physical and digital security has increased with more globalisation and connected devices, companies, governments, and people.
- The global pandemic and recession exacerbated trends like work from home and e-commerce. Increased use of digital education, financial products, healthcare, and e-commerce are expanding the need for security.
- For goods like energy, food creation and distribution, spending on physical and digital security has risen throughout the pandemic.

The Opportunity

- The infrastructure spending programs underway must incorporate the need to provide both physical and digital security. The internet of things, device to device communication, and smart devices all require updated infrastructure and security to operate safely.
- Digital security incorporates hardware, software, and services to prevent and deter physical and digital attacks.
- A more interconnected global economy with cutting edge digital smart tools increases the need for digital security analysis.
- Governments, corporations, and individuals will drive demand for all forms of security in an effort to protect privacy, transactions, and data.

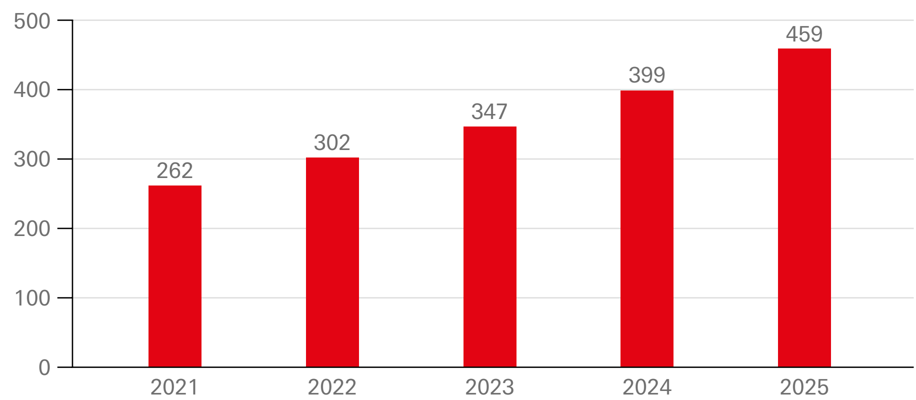
Why now?

- The drive to modernise infrastructure and to create a more sustainable global economy is creating greater demand for security in both physical and digital form.
- The global economy and the services sector is reopening. This increased demand is creating bottlenecks in

supply chain networks, and investment in rebuilding inventories and those networks must be done securely.

- Recent cyber crime and terrorist attacks on utilities and government networks have created insecurity and exposed vulnerabilities that must be addressed.
- Government and corporate budgets have focused on physical and digital security and the need to train employees in secure practices will be incorporated into those budgets.

Global cybersecurity spending



Source: Cybersecurity Ventures, HSBC Global Private Banking, December 2021.

Investing for a Sustainable Future

Sustainability is now key for all stakeholders, and investors can benefit from rapid innovation in this area.

Our four high conviction themes

1. Energy Transition
2. Financing Biodiversity Action
3. Sourcing Income in a Sustainable Way
4. The Rise of "S" in ESG

Mother nature is yearning for help. If the recent natural calamities around the globe epitomise anything, it is the urgency to tackle climate change. It is really here and we all need to do our bit to halt what some scientists call the potential beginning of the 'Sixth Mass Extinction'. It's time to turn words into action as humanity stands at the "*edge of an abyss*", using the phrase of UN Secretary-General Antonio Guterres.

The COP26 conference held in Glasgow in November 2021 marked one such time to take action. Thousands of delegates from the private sector, climate activists and hundreds of heads of states gathered together with the ambition to keep global warming limited to 1.5C, mostly by targeting net-zero carbon emissions by 2050 and halving global emissions by 2030. To get there, it is clear that action is needed at every level.

HSBC and other financial institutions have taken several initiatives to stem climate change and reverse its adverse impact. At COP26, for example, HSBC joined the "Powering Past Coal Alliance" to tackle the hard issues head-on, which includes phasing out the financing of coal-fired power and thermal coal mining by 2030 in the EU and the OECD and 2040 in all other markets. We are working on structuring a relatively speedy decarbonisation strategy; aligned with science-based targets for limiting

global warming to 1.5C above pre-industrial levels in 2100.

Beyond the action by governments and institutions, individuals will play a key role as well, and the way we invest will need to become more sustainable. We believe sustainability should feature both in the core portfolio strategy, but also in the thematic satellites, under our trend of 'Investing for a Sustainable Future'. By doing so, investors would not only help save the planet, they'd also be able to take advantage of structural investment opportunities which offer the potential to generate handsome returns.

To tackle climate change, phasing out unabated coal use and transitioning from coal to clean energy is vital. Hence, we think that going forward, energy transition will be a key area of focus in the world of sustainable investing. Global initiatives to phase out existing coal-fired power have started in earnest. These include electrification, development of green infrastructure which will reshape the energy model for the society, technology upgrade which will help renewable energy generation, carbon capture, sequestration and energy management. Unlocking finance for clean energy, infrastructure and skills, and decarbonising heavy industry are critical in achieving the net-zero ambition. Heavy infrastructure spending in these areas offer attractive investment opportunities for investors, particularly in Asia, where reliance on coal power plants is particularly acute, but there's now a clear will to work towards this much needed energy transition.

In EU, the cost of carbon allowances (the cost of emitting one tonne of carbon emissions by heavy polluters) jumped from 50 Euros in July 2021 to about 90 Euros in December 2021 and is expected to go up to circa 105 Euros looking at the forward curves of gas and coal in 2023 (partly fuelled by EU's recent gas supply crunch)*. The price of carbon allowances is also expected to keep rising given the increased net-zero greenhouse pledges of governments and institutions. As expected, higher carbon prices discourage the use of fossil fuels and enhance the appeal of green energy technology. They also improve the investment case for emerging technologies like Carbon Capture and Storage (CCS). Moreover, pricier carbon credits are also transforming the economics of clean fuels like green hydrogen, which is made using renewable energy like solar and wind. We think these new markets and technologies offer attractive investment opportunities to investors.

In addition to exploring structural opportunities offered by energy transition, we also believe that sourcing income in a sustainable way is a key investor consideration in a changing investment environment which becomes more ESG aligned. Finding income in a 'low growth, low yield' world remains a challenge for all investors in today's investment landscape. But by investing in sustainable companies, investors will tend to increase their exposure to high quality growth companies, while also weaving in ESG and sustainability factors. That can make the portfolio more resilient, without denting its returns or income. It is also noteworthy that since the sustainable investments universe is multi-asset in nature, investing in an array of sustainable investments diversifies the risk exposure.

Furthermore, while environmental issues are often in the spotlight, social issues are just as important and form an important part of almost all UN SDGs (Sustainable Development Goals). Research shows that socially responsible companies greatly benefit from a diverse workforce. Companies with more diversity and inclusion are more innovative and less prone to making big mistakes, due to diversity of thought. A diverse work force can improve employee motivation and

retention, broaden the talent pool and better serve their diverse clientele. All these are key components of corporate success. Beyond Diversity & Inclusion (D&I), social issues such as nutrition, quality education, access to clean water and sanitation are all growing in importance. Well-being is another UN SDG which has gained relevance in the wake of the pandemic. Plus, longer expectancy of life in general and higher government deficits have raised the demand for sustainable healthcare, a key component of fiscal spending in the developed world. Sustainable healthcare needs to be affordable, made possible by technological and pharmaceutical research and advancements. These areas offer attractive sustainable investment opportunities, in our view.

Finally, financing biodiversity action should continue to gain relevance and priority in the world of investments. Biodiversity is vital for maintaining natural cycles of weather, the food chain and life on earth. But climate change and rising pollution levels are increasingly contributing to loss of natural habitats and as a result, the earth's biodiversity is in a sharp decline. The population sizes of mammals, birds, fish, amphibians and reptiles have seen an alarming average drop of 68% since 1970. It's alarming that 50% of world's habitable land area is being used for agriculture and is leading to a sharp reduction in biodiversity. With more and more of such stark statistics coming to the fore, public opinion is turning against companies which harm biodiversity, putting pressure on corporates to preserve resources by facilitating recycling and focusing on development of a circular economy. Shareholders are calling on companies to adopt targets to cut carbon emissions. But focusing on this isn't just a charitable effort. Adoption of such sustainability focused measures comes with big potential economic benefits too. Innovative new technologies which lead to better farming practices, use of new ingredients like alternative protein open up new sustainable possibilities to meet the demand of a rising population. Sustainable fishing practices and water sanitisation, development of new biodegradable materials as alternatives for plastic – all offer attractive structural investment opportunities for investors.

We also think that an adequate allocation to sustainable investments via Hedge Funds (HF) and Private Equity (PE) also offers new and attractive investment opportunities. HF and PE can play a pivotal role in decarbonising the economy through their active ownership approach. As new technologies often originate in private markets and need time to develop, the longer-term investment horizon of PE may be well adapted. HF and PE are often able to spot early stage investment opportunities, which, if successful, can proliferate and be exited later at lucrative multiples.

* Source: Bloomberg, December 2021

More needs to be done

10/130

The number of female world leaders at COP26 against the number of male leaders depicts how we are still far from gender parity.

0.82c

What women get paid for every USD1 men get paid in the US.

33-year low

US women's labour force participation is at a 33-year low, as more take on a caretaker role at home due to remote schooling.

5.0x and 4.1x

The COVID-19 mortality rate of Bangladeshi and Pakistani people living in the UK, compared to White British.

Energy Transition

Overview

- The creation of a sustainable global economy has taken center stage for social objectives.
- Global initiatives at all levels of society are targeting a transition away from carbon heavy energy to lighter alternatives.
- Investment in sustainability focused infrastructure is increasing rapidly.
- Geopolitical bargaining around energy is pushing many regions to think of internal solutions.
- Technology and data are advancing the ability of energy providers to deliver lower carbon energy at equivalent costs.

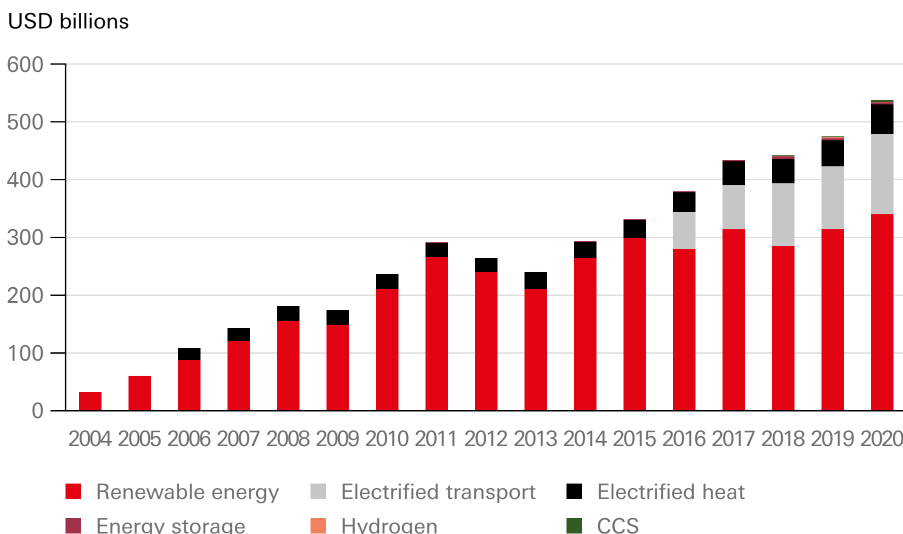
The Opportunity

- Global climate change initiatives and net-zero carbon targets are leading public and private entities to invest heavily and reshape the energy model for society.
- The massive infrastructure spending programs announced in major economies are focused on investing in sustainable models for global energy markets.
- Recent energy price volatility has raised demand for more local, consistent alternatives that are also greener in nature.
- Technologies for renewable energy generation, carbon capture and sequestration, and energy management are making lower carbon energy sourcing more economically competitive.

Why now?

- Governments, corporates and individuals – all agree that significant steps are needed to slow the pace of climate change and adjusting the energy mix to result in fewer carbon emissions.
- The US, Europe and China have all recently committed heavily to greener energy objectives and these new budgets are just getting funded.
- Many governments are currently facing political pressure on local energy needs due to high energy prices from other nations.
- Energy transition provides multiple avenues for the energy industry to modernise and become more sustainable.

Energy transition investment



Source: Bloomberg NEF, HSBC Global Private Banking, December 2021.

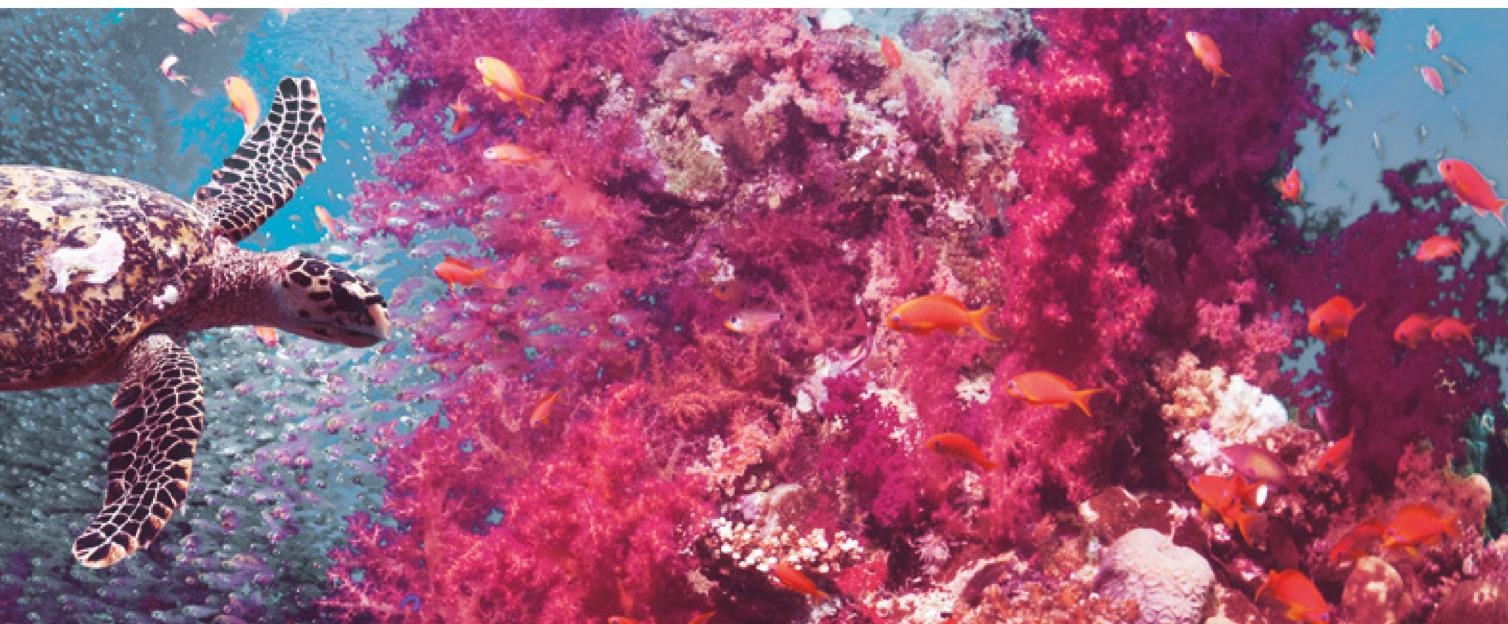
Financing Biodiversity Action

Overview

- Habitat loss, rising pollution, climate change, exploitation and other human activities are reducing biodiversity.
- Earth's biodiversity is in sharp decline. The population sizes of mammals, birds, fish, amphibians and reptiles have seen an alarming average drop of 68% since 1970.
- 50% of the world's habitable land area being used for agriculture is leading to a sharp reduction in biodiversity.
- Only 4% of the world's mammals and 30% of the world's birds are wild.

The Opportunity

- Public opinion is putting more pressure on companies, businesses which preserve resources by facilitating recycling and further development of a circular economy.
- The economic benefits of biodiversity are substantial in numerous sectors. Innovative technologies and new ingredients like alternative proteins open up new sustainable possibilities to meet the demand of the rising population.



- Development of sustainable fishing business models and limiting pollution through water sanitation present opportunities. So do alternatives to plastic in everyday life including the development of sustainable materials such as bio based, biodegradable or long-lasting.

- Similarly, application of new farming practices and the introduction of innovative technologies and equipment can reduce the negative impact on the environment and also present attractive investment opportunities.

Why now?

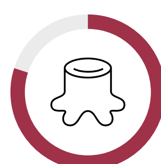
- With the world's population forecast to reach 10bn by 2050 and food security a key concern, traditional agriculture and fishing methods are threatening many species with extinction.

- Consumers, businesses and public authorities are now becoming increasingly aware of the importance of biodiversity and promoting actions for its restoration or preservation.

- Companies which mitigate environmental damage therefore have a substantial growth opportunity.

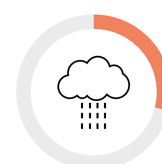
The environmental impacts of food production

Agriculture is responsible for 80% of global deforestation



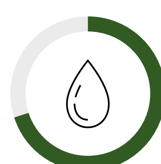
80%
Real
Deforestation

Food systems release 29% of global GHGs



29%
Global GHGs

Agriculture accounts for 70% of freshwater use

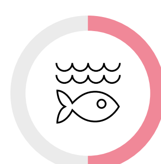


70%
Freshwater Use

Drivers linked to food production cause 70% of terrestrial biodiversity loss

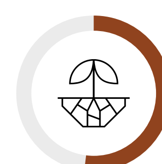
70%
Terrestrial
Biodiversity Loss

Drivers linked to food production cause 50% of freshwater biodiversity loss



50%
Freshwater
Biodiversity Loss

52% of agricultural production land is degraded



52%
Degraded
agricultural land

Source: WWF Living Planet Report 2020, CBD, GSDR, ELD initiative, HSBC Global Private Banking, December 2021.

Sourcing Income in a Sustainable Way

Overview

- The search for yield remains a key challenge in the post-pandemic world of low rates, low inflation and low growth.
- Investing sustainably leads investors towards quality companies, which consider ESG and sustainability factors in their long-term strategy to increase corporate resilience.
- Focusing on sustainable companies across asset classes helps to enhance portfolio resilience while generating attractive income and making a societal and/or environmental impact.

The Opportunity

- Corporate leaders around the world have intensified their sustainability focus to respond to customer demands, regulatory changes, net-zero ambitions and rising resource scarcity.
- Incorporating ESG considerations into the broader financial analysis can help to mitigate risk exposure, unlock opportunities and deliver long-term capital growth.
- Investors can contribute to and participate in the sustainability revolution thanks to different investment approaches, such as ESG enhanced, impact or thematic. This enables investors to contribute to the solution while generating income in a multi-asset approach.

Why now?

- Investors still face a considerable income challenge in this structurally low yield environment, forcing them to take on additional risk to increase return. It is thus important to increase portfolio's resilience and quality in this post-COVID-19 world.
- Companies are increasingly incorporating sustainability considerations into their core strategy to better weather ESG tail risks, such as pandemics, climate change and social issues. These companies build corporate resilience aiming to deliver long-term growth and unlock new business opportunities.
- The global economy navigates through the mid-cycle stage where quality and low risk stocks tend to outperform. Putting on an ESG lens and focusing on sustainability can increase the quality of portfolios.

Adding an ESG lens helps to deliver long-term capital growth sustainably

Source: HSBC Global Private Banking, Bloomberg data, December 2021.

The Rise of "S" in ESG

Overview

- The social aspects of ESG may often receive less attention than environmental issues, but they are just as important. Almost all UN SDGs include a social angle.
- A company's business model is only sustainable if it acts in a socially responsible way towards its employees, customers and society.
- The pandemic, COP26 and BLM movement are all shining the spotlight on social issues.

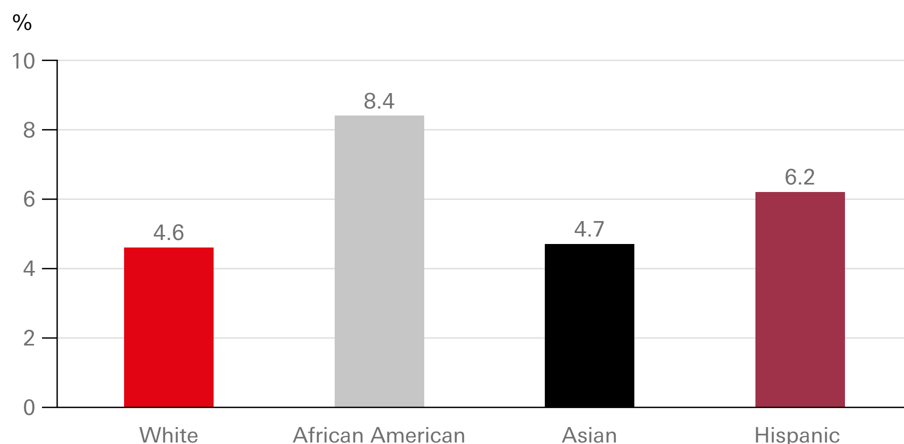
The Opportunity

- Being a socially responsible company does not come at a cost. In fact, research suggests that companies with more diversity are more innovative and less prone to making big mistakes, due to diversity of thought.
- A diverse work force can improve employee motivation and retention, and broaden the talent pool. It should also better reflect the composition of a company's clients, and hence create a better understanding of the goods and services they require, ultimately boosting sales and profits.
- Beyond D&I, social issues such as nutrition, quality education, access to clean water and sanitation are all growing in importance.
- The pandemic, and increased life expectancy are highlighting the need for healthcare. To be sustainable, this needs to come at an affordable cost, which is possible thanks to innovations in technology and pharma.

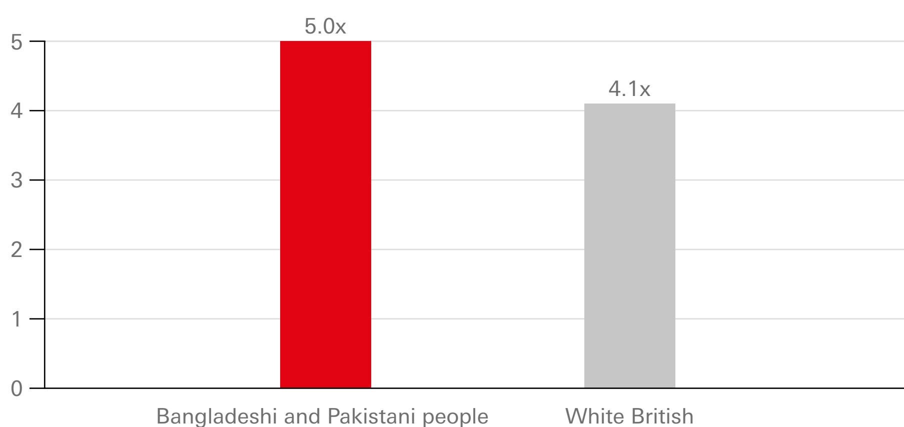
Why now?

- The COVID-19 pandemic and climate change have been hitting women, ethnic minorities, lower income households and poorer countries harder than others. COP26 raised the profile of women, indigenous populations and minorities as key allies in the fight against climate change.
- Governments, shareholders, employees, consumers and activists are increasingly demanding that companies integrate all social aspects in their business strategy.
- Flows into ESG funds and ETFs are growing rapidly. Although the 'E' still dominates, many vehicles use a broad approach integrating social aspects too, supporting flows into companies that score well on social aspects.

The respective unemployment rates living in the US



The COVID-19 mortality rates in the UK



Sources: Payscale, UK Office of National Statistics, US Bureau of Labor Statistics, December 2021.

Disclaimers

Risks to our View

The key risk factors include adverse regulatory changes, health concerns, spectrum cost and allocation issues excess capital expenditure by telecom operators, trade tensions, evolvement of 5G standards, uncertainties in pricing and demand for new products and services in 5G and related offerings.

Risk Disclosures

Risks of investment in fixed income

There are several key issues that one should consider before making an investment into fixed income. The risk specific to this type of investment may include, but are not limited to:

Credit risk

Investor is subject to the credit risk of the issuer. Investor is also subject to the credit risk of the government and/or the appointed trustee for debts that are guaranteed by the government.

Risks associated with high yield fixed income instruments

High yield fixed income instruments are typically rated below investment grade or are unrated and as such are often subject to a higher risk of issuer default. The net asset value of a high-yield bond fund may decline or be negatively affected if there is a default of any of the high yield bonds that it invests in or if interest rates change. The special features and risks of high-yield bond funds may also include the following:

• Capital growth risk - some high-yield bond funds may have fees and/ or dividends paid out of capital. As a result, the capital that the fund has available for investment in the future and capital growth may be reduced; and

• Dividend distributions - some high-yield bond funds may not distribute dividends, but instead reinvest the dividends into the fund or alternatively, the investment manager may have discretion on whether or not to make any distribution out of income and/ or capital of the fund. Also, a high distribution yield does not imply a positive or high return on the total investment.

• Vulnerability to economic cycles - during economic downturns such instruments may typically fall more in value than investment grade bonds as (i) investors become more risk averse and (ii) default risk rises.

Risks associated with subordinated debentures, perpetual debentures, and contingent convertible or bail-in debentures

• Subordinated debentures - subordinated debentures will bear higher risks than holders of senior debentures of the issuer due to a lower priority of claim in the event of the issuer's liquidation.

• Perpetual debentures - perpetual debentures often are callable, do not have maturity dates and are subordinated. Investors may incur reinvestment and subordination risks. Investors may lose all their invested principal in certain circumstances. Interest payments may be variable, deferred or canceled. Investors may face uncertainties over when and how much they can receive such payments.

• Contingent convertible or bail-in debentures - Contingent convertible and bail-in debentures are hybrid debt-equity instruments that may be written off or converted to common stock on the occurrence of a trigger event. Contingent convertible debentures refer to debentures that contain a clause requiring them to be written off or converted to common stock on the occurrence of a trigger event. These debentures generally absorb losses while the issuer remains a going concern (i.e. in advance of the point of non-viability). "Bail-in" generally refers to (a) contractual mechanisms (i.e. contractual bail-in) under which debentures contain a clause requiring them to be written off or converted to common stock on the occurrence of a trigger event, or (b) statutory mechanisms (i.e. statutory bail-in) whereby a national resolution authority writes down or converts debentures under specified conditions to common stock. Bail-in debentures generally absorb losses at the point of non-viability. These features can introduce notable risks to investors who may lose all their invested principal.

Changes in legislation and/or regulation

Changes in legislation and/or regulation could affect the performance, prices and mark-to-market valuation on the investment.

Nationalisation risk

The uncertainty as to the coupons and principal will be paid on schedule and/or that the risk

on the ranking of the bond seniority would be compromised following nationalisation.

Reinvestment risk

A decline in interest rate would affect investors as coupons received and any return of principal may be reinvested at a lower rate.

Changes in interest rate, volatility, credit spread, rating agencies actions, liquidity and market conditions may significantly affect the prices and mark-to-market valuation.

Risk disclosure on Dim Sum Bonds

Although sovereign bonds may be guaranteed by the China Central Government, investors should note that unless otherwise specified, other renminbi bonds will not be guaranteed by the China Central Government.

Renminbi bonds are settled in renminbi, changes in exchange rates may have an adverse effect on the value of that investment. You may not get back the same amount of Hong Kong Dollars upon maturity of the bond.

There may not be active secondary market available even if a renminbi bond is listed. Therefore, you need to face a certain degree of liquidity risk.

Renminbi is subject to foreign exchange control. Renminbi is not freely convertible in Hong Kong. Should the China Central Government tighten the control, the liquidity of renminbi or even renminbi bonds in Hong Kong will be affected and you may be exposed to higher liquidity risks. Investors should be prepared that you may need to hold a renminbi bond until maturity.

Risk disclosure on Emerging Markets

Investment in emerging markets may involve certain, additional risks which may not be typically associated with investing in more established economies and/or securities markets. Such risks include (a) the risk of nationalisation or expropriation of assets; (b) economic and political uncertainty;

(c) less liquidity in so far of securities markets; (d) fluctuations in currency exchange rate; (c) higher rates of inflation; (f) less oversight by a regulator of local securities market; (g) longer settlement periods in so far as securities transactions and (h) less stringent laws in so far the duties of company officers and protection of Investors.

Risk disclosure on FX Margin

The price fluctuation of FX could be substantial under certain market conditions and/or occurrence of certain events, news or developments and this could pose significant risk to the Customer. Leveraged FX trading carry a high degree of risk and the Customer may suffer losses exceeding their initial margin funds. Market conditions may make it impossible to square/close-out FX contracts/ options. Customers could face substantial margin calls and therefore liquidity problems if the relevant price of the currency goes against them.

Currency risk – where product relates to other currencies

When an investment is denominated in a currency other than your local or reporting currency, changes in exchange rates may have a negative effect on your investment.

Chinese Yuan ("CNY") risks

There is a liquidity risk associated with CNY products, especially if such investments do not have an active secondary market and their prices have large bid/offer spreads.

CNY is currently not freely convertible and conversion of CNY through banks in Hong Kong and Singapore is subject to certain restrictions. CNY products are denominated and settled in CNY deliverable in Hong Kong and Singapore, which represents a market which is different from that of CNY deliverable in Mainland China.

There is a possibility of not receiving the full amount in CNY upon settlement, if the Bank is not able to obtain sufficient amount of CNY in a timely manner due to the exchange controls and restrictions applicable to the currency.

Illiquid markets/products

In the case of investments for which there is no recognised market, it may be difficult for investors to sell their investments or to obtain reliable information about their value or the extent of the risk to which they are exposed.

Alternative Investments

Investors in Hedge Funds and Private Equity should bear in mind that these products can be highly speculative and may not be suitable for all clients. Investors should ensure they understand the features of the products and fund strategies and the risks involved before deciding whether or not to invest in such products. Such investments are generally intended for experienced and financially sophisticated investors who are willing to bear the risks associated with such investments, which can include: loss of all or a substantial portion of the investment, increased risk of loss due to leveraging, short-selling, or other speculative investment practices; lack of liquidity in that there may be no secondary market for the fund and none expected to develop; volatility of returns; prohibitions and/or material restrictions on transferring interests in the fund; absence of information regarding valuations and pricing; delays in tax reporting; - key man and adviser risk; limited or no transparency to underlying investments; limited or no regulatory oversight and less regulation and higher fees than mutual funds.

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