

Asia Strategy

May 27, 2021

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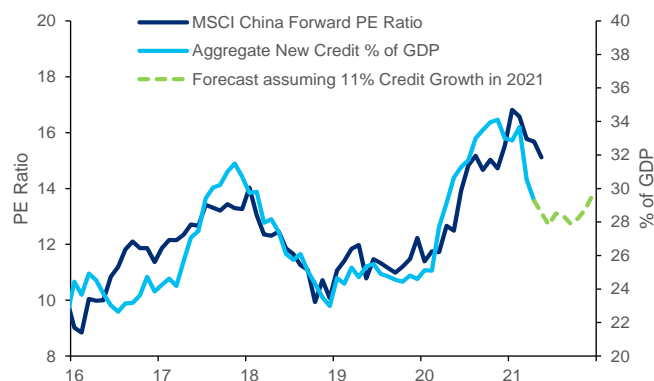
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Darkness Before Dawn

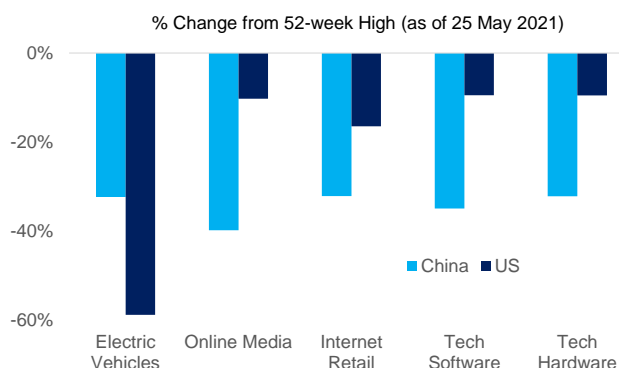
- We believe that China's policy tightening is nearly complete, and Chinese equity performance could improve in the second half.
- On credit, while Huarong continues to gather attention, we believe it is systemically important and relatively inexpensive to save. Broader default trends are actually improving. The pace of credit expansion is also likely to stabilize in 2H (**Figure 1**)
- The tightening in tech regulations continues, but is already advanced in the fields of anti-trust, fintech and data handling. We believe the underperformance of Chinese tech on policy tightening is likely to reverse some in 2H (**Figure 2**).
- COVID resurgence in Asia is concerning, but also receding, due to greater vigilance in prevention, which proved could contain past waves. Greater vaccine availability in 2H could help Asia to partially re-open, though clearly lagging the US and Europe.
- We look at how regional currencies might behave in this backdrop, especially as the USD resumes weakening after the recent bout of inflation fears.

Figure 1: The pace of credit expansion may still slow in June, but the majority of the tightening appears complete



Source: Bloomberg, as of May 24, 2021

Figure 2: Chinese tech performance was far below that of the US, already pricing in significant regulatory risk



Source: Bloomberg, as of May 25, 2021

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Darkness Before Dawn

Among a litany of market worries, we believe Chinese policy is about to become less of a concern

Infection, inflation, market correction, policy normalization, there is no shortage of things to worry about as the second quarter passes the halfway mark. Indeed, these factors had made us bring our asset allocation to be more resilient to these risks, such as reducing exposure to Chinese and US equities this year, while adding to Healthcare. The immediate direction for equities may still be uncertain, as it is unclear how much US yields and inflation might rise in the coming months and how the markets might react.

However, the prospects for economic recovery have not diminished. More importantly, the risks of tighter policy in China have been mostly released, while policy may pivot towards a less hawkish stance in 2H. The policy driven correction in China appears much more advanced than in the US and have priced in a lot more bad news.

The COVID resurgence in Asia is also likely to come back under control and enable more recovery in 2H

The risks associated with another wave of COVID are also better understood and new measures have been taken to deal with it. Though still too early to declare victory, these measures have helped to bring down the new case counts in recent weeks (**Figure 3**). Taiwan and Malaysia new cases remain worrisome, while India's infection rates remain elevated, though declining. The lagging pace of vaccinations (**Figure 4**) needs to be addressed with more policies to encourage inoculations, but we remain of the view that more re-opening could be done in 2H.

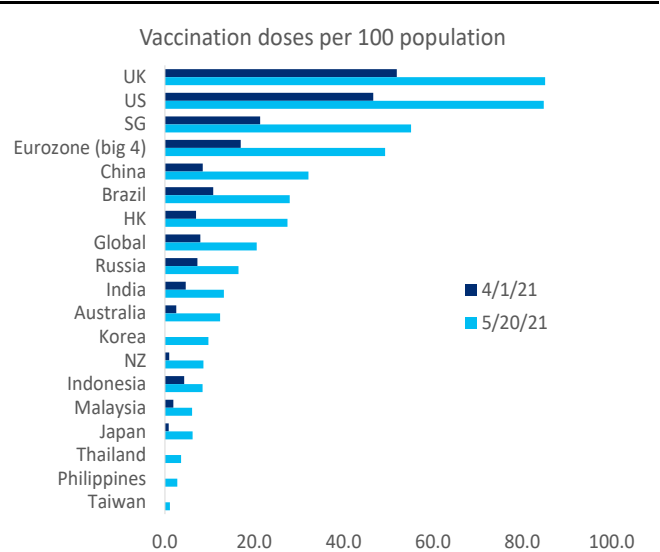
In this issue, we look at how China's credit and regulatory policy make be near an inflection point to give a potentially more supportive environment for equity performance in 2H. We also look at how the USD and some of the key Asian currencies might behave with this outlook.

Figure 3: After daily new cases surged in April-May, most markets in Asia are seeing a drop, likely due to renewed vigilance on masks and social distancing

| | Feb-Mar Avg | Peak in Apr-May | % Chg to Peak | Latest Day | % Chg Since Peak |
|-------------|----------------|--------------------|------------------|------------|---------------------|
| Taiwan | 2 | 723 | 38096% | 595 | -18% |
| Thailand | 82 | 9,635 | 11676% | 2,713 | -72% |
| India | 16,741 | 414,188 | 2374% | 222,315 | -46% |
| APAC | 34,748 | 465,193 | 1239% | 263,816 | -43% |
| Japan | 1,103 | 7,914 | 618% | 2,740 | -65% |
| Philippines | 2,715 | 15,298 | 463% | 4,894 | -68% |
| SG | 11 | 52 | 373% | 36 | -31% |
| Australia | 8 | 37 | 350% | 10 | -73% |
| Malaysia | 2,090 | 6,976 | 234% | 6,509 | -7% |
| EU | 109,164 | 237,597 | 118% | 20,933 | -91% |
| Korea | 431 | 797 | 85% | 516 | -35% |
| HK | 19 | 30 | 61% | 1 | -97% |
| China | 28 | 45 | 58% | 17 | -62% |
| Brazil | 59,032 | 93,317 | 58% | 37,498 | -60% |
| US | 61,456 | 80,987 | 32% | 26,410 | -67% |
| Indonesia | 7,183 | 6,731 | -6% | 5,280 | -22% |

Source: Bloomberg, as of 23 May 2021

Figure 4: While progress is being made and Singapore leads in vaccination rates, most of Asia remain global laggards



Source: Bloomberg, as of 20 May 2021

China: Headwinds Beginning to Ebb

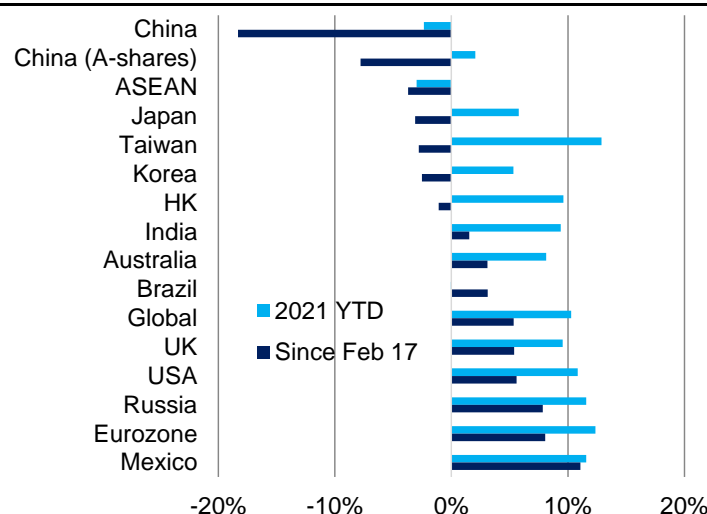
One of the key features of global equity markets so far in 2021 is the underperformance of Chinese equities, particularly the popular names in tech and consumer sectors. This was driven by a broad tightening in credit and regulatory policies that we flagged in January when we took our China allocation down from overweight to neutral.

We believe that China's policy tightening campaign is nearly complete and its equities may perform better in second half

Now, we believe that the risks of additional policy tightening in China have diminished. Indeed, policy may pivot towards a less hawkish stance in 2H. The correction in Chinese equities appears much more advanced than in the US and have priced in a lot more potential bad policy news. Meanwhile, the prospects for economic recovery have not diminished, particularly as the Chinese Communist Party gears up to celebrate its 100th birthday on July 1st.

Since Feb 17, when the initial global market wobble began, MSCI China has fallen 18%, while A-shares were down by 10%. Meanwhile, US and most other markets have had gains or smaller drawdowns. China is also among the few market to record a year-to-date decline (**Figure 5**). This underperformance brought MSCI China's forward PE ratio to 15x, versus the US at 21x. This 29% valuation gap is about half standard deviation below the 15-year average reading (**Figure 6**).

Figure 5: Chinese equities underperformed the world since mid-February



Source: Bloomberg, as of May 25, 2021

Figure 6: MSCI China forward PE is now 30% below that of the US



Source: Bloomberg, as of May 24, 2021

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Credit tightening may be poised to soften

The main culprit for the underperformance is active policy tightening in credit and in regulation. But we see light at the end of the tunnel on both fronts.

On the credit front, there are lingering issues, such as Huarong, but overall credit conditions may become less restrictive in the second half. Aggregate new credit in the past 12 months through April amounted to 29% of GDP, which is down from 34% last November. This drop is consistent with the drop in valuations of Chinese equities so far from 17x forward PE in February to 15x now. The new credit to GDP ratio may drop further, which could further weigh on equities. But even then, the implied drag on valuations

(Figure 7), when combined with expected earnings growth, represents less than 10% downside from current index levels.

In recent days, the market became worried again about Huarong, the troubled and systemically important state-owned manager of distressed assets. The New York Times¹ published a story that the government is contemplating a restructuring plan that may involve significant losses to bond holders, which brought another bout of selling in Huarong paper.

While the issue requires monitoring, we remain of the view that Huarong is systemically significant and any resolution would have to ensure that the confidence in the system is not jeopardized. (see [Asia Strategy | China's Credit Tightening Coming to Roost](#)).

Huarong has \$42.8bn in marketable debt outstanding, half of which are offshore (Bloomberg). This is a relatively small amount compared to the value of confidence in China's CNY330tn (\$50tn) banking system. We believe authorities are likely to find money to meet near term debt obligations, while seeking to dispose assets and reduce counterparty risk over a prolonged period of time, rather than a quick decision that could bring back memories of the Lehman debacle.

Looking at China's broader corporate default trends, however, things might be improving. As we noted previously, China's credit tightening had brought defaults to a record US\$16.4bn in 1Q. This was the most concentrated in February, when \$9.3bn defaulted, among which, \$1.5bn was offshore USD bonds. But since then, there had been no offshore defaults in March-April, and onshore default numbers have also fallen to \$1.9bn in April, or slightly below average since 2018 (Figure 8).

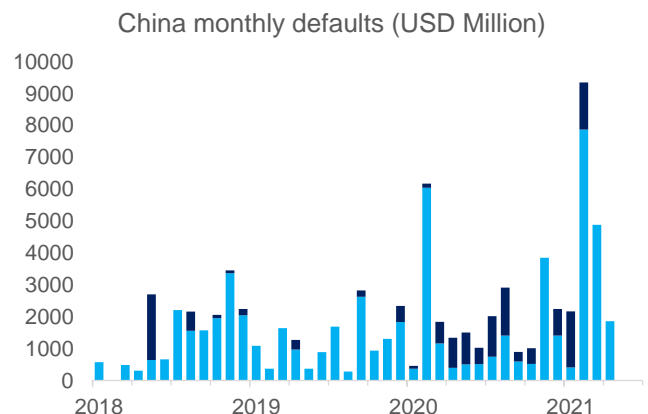
Defaults have been shrinking since February, as the economy expanded and perhaps less emphasis placed on immediate deleveraging

Figure 7: The pace of credit expansion as % of GDP may still slow in June, but the majority of the tightening appears complete



Source: Bloomberg, as of May 24, 2021

Figure 8: China's defaults have eased since February, with zero offshore USD bond defaults in past two months



Source: Bloomberg as of April 30, 2021

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It is difficult to tell whether the drop in defaults is a result of policy or of economic growth. While the economic recovery is continuing, it is losing some momentum in April, when the growth of industrial production (IP) and retail sales both slowed. For IP, this may be the result of a normalization of industrial utilization across the globe, which is eroding China's advantage as the first manufacturing hub to recover from the pandemic. The fading

¹ "China's Biggest 'Bad Bank' Tests Beijing's Resolve on Financial Reform", New York Times, 18 May 2021

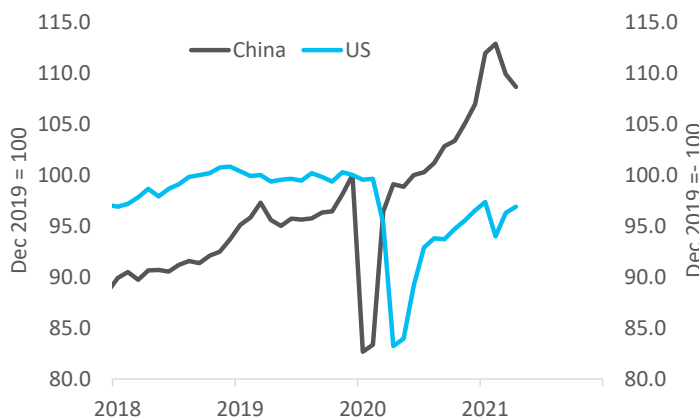
demand for autos, after last year's surge, is also responsible. In all IP is 6.6% annualized above April 2019 levels, which is consistent with China's pre-pandemic pace (**Figure 9**).

Weakening growth momentum also signals for "taking their foot off the brake pedal"

Retail sales also missed expectations, as consumers bought less home electronics and autos. Real retail sales growth is losing some momentum in the spring, but remain well above pre-pandemic levels. The cases for IP and retail both show that US and China are among the leaders of recovery, while others still have a longer path to recovery and may benefit more from re-opening (**Figure 10**).

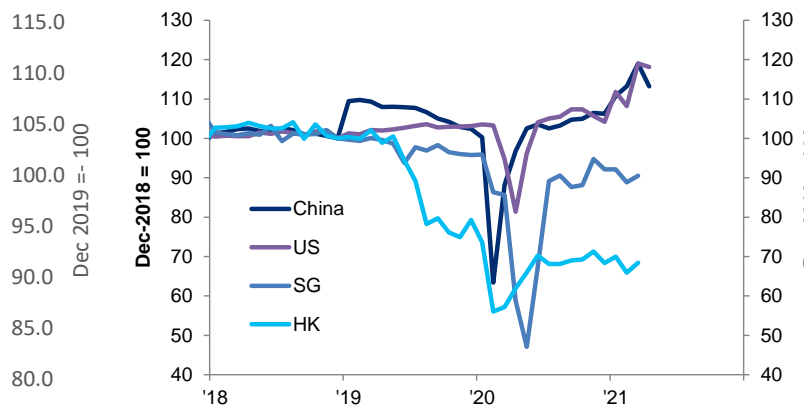
In sum, the credit tightening has had some impact on economic activity, which many would argue is premature at this still early stage of recovery. This ebbing momentum could help to convince policymakers to "take their foot off the brake pedal" at least marginally in 2H.

Figure 9: China's IP has outgrown the US during the pandemic, but is losing some momentum as global manufacturing capacity opens up



Source: Bloomberg, as of May 18, 2021

Figure 10: Real retail sales in China and US have both rebounded to over pre-pandemic levels, while others like Hong Kong and Singapore lag



Source: Bloomberg as of April 30, 2021

Tech regulations mostly clarified, entering implementation phase

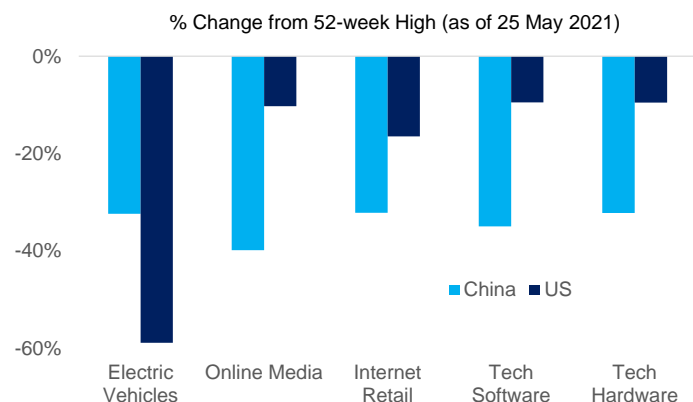
On the tech regulation front, the major rules over anti-trust, fintech and data handling have already emerged (see [Asia Strategy | Looking Through 2Q Risks](#)). Some recent actions included penalizing unnecessary data gathering at navigation apps and false advertising at online education providers, as well as investigations into Meituan. These came after the famous Alibaba fine, the rules against predatory competitive behavior and fintech capital requirements (see **Figure 21** for a list of major regulatory changes this year).

The tech and related sectors have been hit twice by credit and regulatory tightening that may reverse some in 2H

There remain some uncertainties about data handling rules. But mostly, the next stage is for the companies involved to carry out reorganizations and adjust their business models in accordance with regulations. We believe this is better than the open ended risks seen just a few months ago.

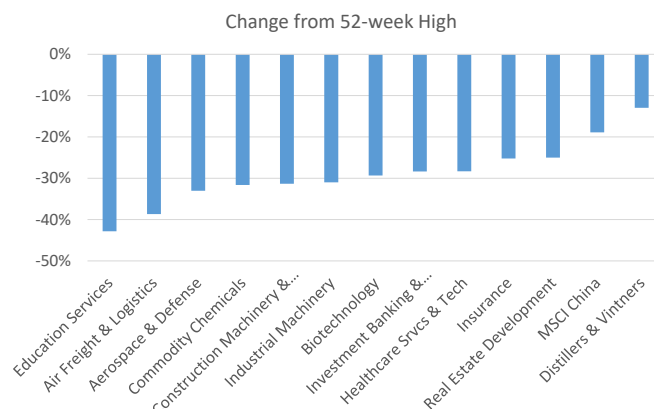
As a result of these comprehensive regulatory changes, Chinese tech stocks have fallen by over 30% on average from their 52-week highs, compared to 13% on average for their US counterparts (**Figure 11**). Moreover, less tech heavy industries have also seen intense drawdowns. Tech-reliant industries, such as logistics, education, biotech and health tech, were impacted by both tech regulations and credit tightening in some instances. We have also seen significant selloffs in certain non-tech industries like real estate, distilling, insurance and brokerage (**Figure 12**). If the regulatory overhang and credit tightening lessens, Chinese share price performance is likely to improve in 2H 2021.

Figure 11: Chinese tech performance was far below that of the US, already pricing in significant regulatory risk



Source: Bloomberg, as of May 25, 2021

Figure 12: MSCI non-tech industries that have gone through significant corrections from 52-week highs



Source: Bloomberg, as of May 25, 2021

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The 100th Anniversary

July 1st is the 100th Anniversary of the founding of the Chinese Communist Party. The policy priority surrounding the celebratory months would be stability, which likely means taking the foot off the brakes in terms of economic policy in the second half.

However, in order to set the nation's development on the right path, several key policy principles are likely to remain long after the celebrations this year, including greater efficiency and competitiveness, less dependence on leverage, and controllable systemic risk. These objectives are likely to improve sustainability in many of China's growth industries.

Asian currencies amid milder and more volatile USD weakness

The USD had gone through an intense 13% decline since the Fed responded to the pandemic with unprecedented easing last March. In 1Q this year, we saw a countertrend rebound in the DXY index from under 90 in early January to above 93 by late March. This rebound was mostly driven by excessive short USD positioning (**Figure 13**), that was squeezed by inflation and Fed worries, as well as US fiscal stimulus.

Since April, that positioning squeeze had passed and fundamental factors are again exerting influence and the dollar index retreated to below 90, erasing all year-to-date gains. We see 3 key fundamental drivers for USD weakness at least for the coming couple of years.

- Global recovery is driving capital flows to higher return assets outside of US.
- Significant debt accumulation by the US would require additional borrowing and higher taxes, both are likely to impair long term growth prospects.
- The Fed has great tolerance for above trend inflation and is likely to retain relatively dovish stance.

While the near-term direction is less clear, the resumption of weakness in USD aligns with our view, although the next stage of USD weakness would likely take a much more moderate trajectory compared to 2020.

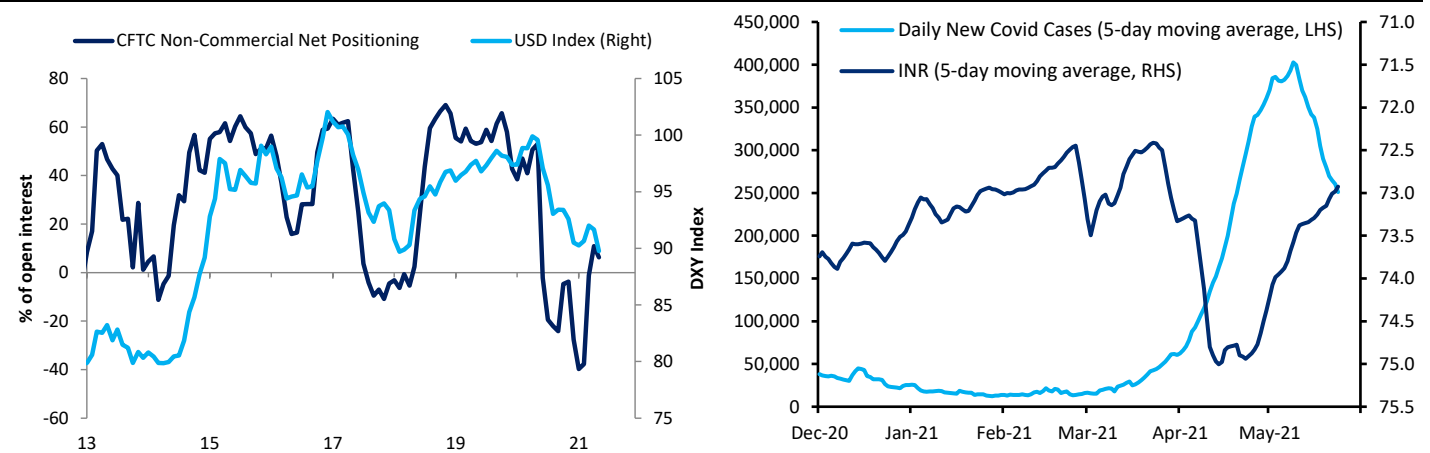
In the near term, the USD direction is driven by the uneven Covid situation across regions. As the US and UK lead the world in vaccinations, many EMs are lagging (**Figure 3 and Figure 4**). The divergent results in containing the virus have been a main driver to global asset valuations, including EM currencies. India, for example, experienced turbulence in the INR along with its fight against the massive surge in infections in April-May (**Figure 14**). This highlights lingering pandemic risks to markets. But even then, INR and other EM

USD weakness has resumed after short squeeze in 1Q, further moves are likely to be more moderate

currencies strengthened in recent weeks, as EM central banks hold of easing while the Fed actively convinces markets of its dovish commitment.

Figure 13: USD has resumed its downward trend after a rebound in 1Q21

Figure 14: INR strengthens amid improving Covid situation in India



Source: Bloomberg, as of 24 May, 2021

Source: Bloomberg, as of 24 May, 2021

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CNY is near fair value at around 6.40, further moves are likely to be more moderate

CNY near fair value, with investor flows and carry providing support

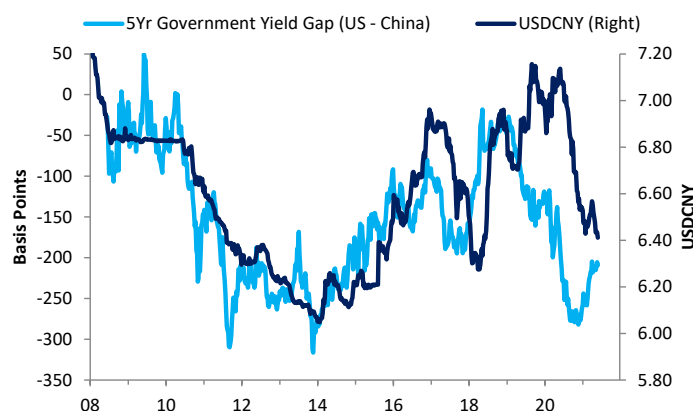
The Chinese Yuan (CNY) has appreciated against the USD by 10% in the past year. This was mostly due to the pandemic response by the Fed, but also aided by the People's Bank of China (PBOC)'s relatively tight monetary policy, which caused Chinese yields to rebound earlier, along with China's earlier start of recovery. We believe that at this point, the CNY is at or near fair value, and further moves are likely to be more moderate.

Positive carry and potential equity rebound could aid the currency in 2H

- **Yield gap with the US** – The positive carry for Chinese government bonds vs the US has narrowed since last November, as US yields rose, while Chinese ones fell. The aforementioned rise in corporate defaults and the correction in equities pushed more funds into Chinese sovereigns. The carry for 5yr government paper narrowed from nearly 300bps last Nov to just above 200bps now. At this point, 6.40 exchange rate for USDCNY appears to be fair value, as opposed to the massive mispricing during the height of the trade war (**Figure 15**).
- **Trade surplus and FX reserves** – China's trade surplus reached a record \$639bn in the 12 months ended March 2021. Together with USD depreciation, this lifted China's FX reserves by \$150bn. These gains benefited from the suspension of industrial activity globally due to the pandemic. But activity is now resuming and would likely take away some of the gains in trade and FX reserves, which would take away a source of strength for the currency.
- **Fund inflows** – The period of max carry in 2020 brought in massive amounts of investor inflows. On the bond side, foreign ownership of Chinese bonds nearly doubled from the end of 2019 to \$494bn in April 2021. While the positive carry remains attractive at over 200bps, the narrowing has slowed down bond inflows in recent months (**Figure 16**). The equity flows were also strong in 2020, slowed to a trickle in March-April this year, and is just beginning to rebound in recent weeks. Additional equity inflows could help support the CNY in the 2H. But we suspect this would be a more moderate flow than in 2020.

In sum, we expect CNY to be stronger in 2H, as a result of recovery and potential investor inflows, but at a more moderate pace and could see more back and forth.

Figure 15: China's yield gap over US has narrowed and the current exchange rate appears near fair value



Source: Bloomberg, as of 24 May, 2021

Past performance is no guarantee of future results. Real results may vary.

Figure 16: Positive carry remains large at over 200bps, but the narrowing has slowed down bond inflows



Source: Bloomberg, as of 24 May, 2021

JPY is poised to weaken, as recovery continues, but lagging the US

The movement of USDJPY has been dominated by the path of US Treasury yields since the start of 2021 (Figure 17). We suspect this relationship would continue amid global economic recovery and likely to pressure USDJPY higher for the following reasons.

- **Yield gap with the US**—We see the 10-yr US Treasury yield going up to 2% by the end of 2021 and be range bound at 2-2.5% in the coming couple of years. The yield differential between the USD and JPY is likely to widen moderately, as Japan's recovery is likely to be much later than that of the US.
- **Economy continues to recover amid COVID**—The Bank of Japan (BoJ) left its Yield Curve Control target on 10-year JGBs steady at about 0%, and held the policy-balance rate at -0.1%. It also raised its GDP forecast to 4% and 2.4% in 2021-22, versus 3.9% and 1.8% previously. This suggest that the economy is recovering despite the rising concerns over Covid, which means earnings recovery and equity markets are reasonably well supported.
- **COVID risks to keep BOJ dovish**—COVID relapse remains the key risk, particularly whether the Olympics gets to take place. Still, at this stage, the impact of the Olympics on the economy is already minimized and markets do not price in much expectations. As of 24 May, only 4.4% of the Japanese population has received at least one dose of coronavirus vaccine, significantly less than that in the UK (56.8%), US (49.2%) and EU (34.9%). This would support the BOJ's dovish stance, even while the economic recovery continues. Together, this spells a **potential risk-on scenario in the financial markets, which is likely to support USDJPY. (Figure 18)**

JPY may weaken vs the USD in 2H amid continue recovery and a dovish BOJ, while US yields may climb

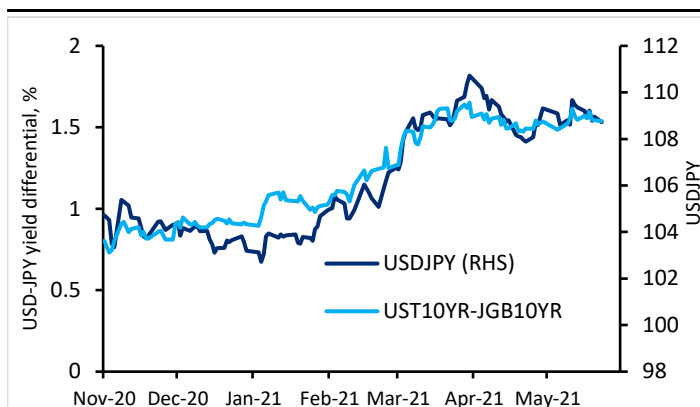
AUD strength from recovery, commodities and a potentially active RBA

The AUD gained 9.5% against the USD in 2020, but has remained in a range between 0.75 and 0.80 so far in 2021. Looking forward, the economic recovery is gaining pace, commodity rally has far outpaced the currency, and the Reserve Bank of Australia (RBA) may be at the precipice of potential tapering at a similar time as or even ahead of the Fed. As a result, we may see moderately stronger AUD this year.

- **Economic recovery** – The unemployment rate continued to decline from the peak of 7.5% seen in July 2020 to 5.5% in April 2021, as the number of employed workers has actually exceeded the pre-pandemic level. NAB business confidence rose to a new high in April (Figure 19), suggesting further strength in business investment and employment ahead. Retail sales picked up sharply by 1.3%/m in March and 1.1%/m in April, showing a shift in spending from goods to services as the economy reopens.

AUD may show further strength as recovery boosts commodities and the RBA considers tapering

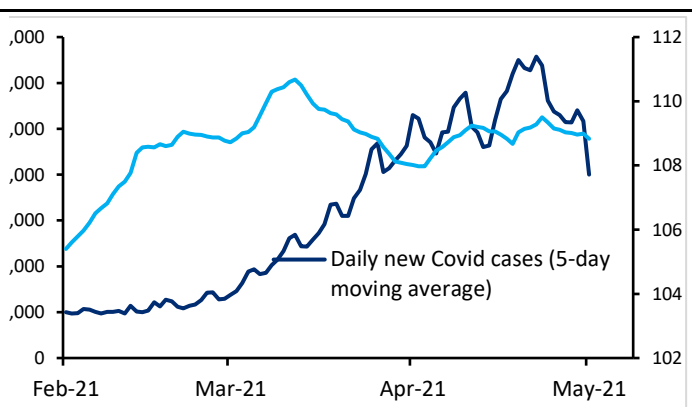
Figure 17: JPY weakens as USD-JPY yield differential widens



Source: Bloomberg, as of 24 May, 2021

Past performance is no guarantee of future results. Real results may vary.

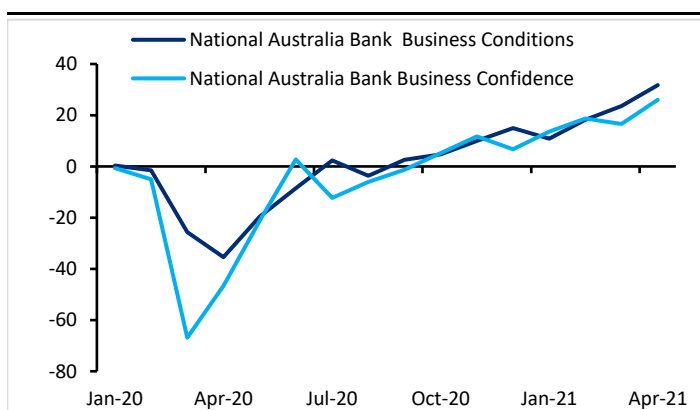
Figure 18: A resurgence in Covid cases since February has pushed USDJPY higher



Source: Bloomberg, as of 24 May, 2021

- **Commodity prices & China** – Rising commodity prices have supported the AUD. Amid bilateral tensions and China's efforts to curb commodity speculation, the AUD had underperformed what commodity prices might be implying (**Figure 20**). But as the demand for commodities is coming from around the world, and China still needs to increase imports to contain domestic inflation, the strength in commodities might not be over just yet. These factors would also make bilateral tensions less influential on the AUD, while demand is strengthening.
- **RBA on the fence** – In May, the RBA left policy unchanged and noted that the economic recovery has been stronger than expected and is predicted to continue. It revised up growth forecasts, while expecting inflation to remain subdued. The RBA also noted that rising house prices would not lead to tightening in monetary policy as it would cost jobs.
- Yet, at its July meeting, the RBA would decide whether or how to continue bond purchases, after the current AUD100bn program ends in September. The RBA would also consider whether to extend its yield curve control (YCC) operation to the next maturity. As such, **the July meeting may add to the current positive sentiment in the AUD if the RBA decides not to extend its YCC and/or if it decides not to fully extend its bond purchases program**. If so, this could come before the Fed's decision on asset purchases.

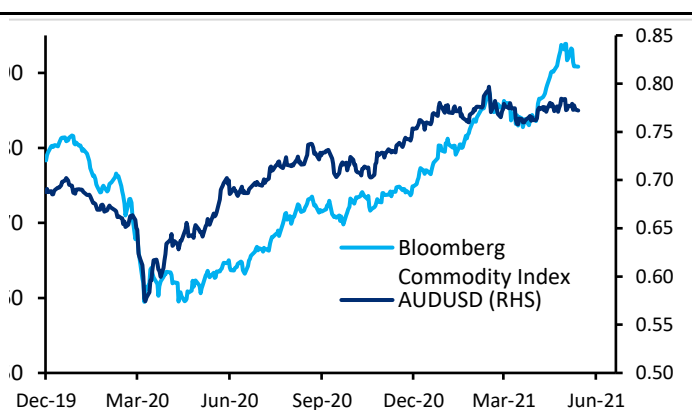
Figure 19: Business indicators have rebounded from the troughs and suggested further growth ahead



Source: Bloomberg, as of 24 May, 2021

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Figure 20: AUD has been trading higher along with surging commodity prices



Source: Bloomberg, as of 24 May, 2021

Figure 21: Major steps taken by Chinese regulators over technology firms

| Type of regulation | Actions Taken | Significance |
|--------------------|--|--|
| Antitrust | 3 internet companies fined CNY500K each in Dec 2020 | This was the first fine on internet businesses on antitrust grounds. The companies did not apply for antitrust pre-clearance for M&A activities where the resulting market concentration exceeds regulatory requirement |
| | Fines on Alibaba (\$2.8 or 4% of 2019 revenue) and launch investigation into Meituan | The key issue is platform exclusivity requirements where vendors are required to not use other platforms. Though the Meituan investigation has yet to conclude, market expectation is for 4% of 2020 revenue or about \$700mn. The size of fines were generally below expectations. |
| | 34 internet companies asked to conduct internal audit to rectify anti-competitive behavior | Baidu, JD, Pinduoduo, ByteDance, and others were included. Firms were asked to stop abusing their market dominance in a month from the . Many of them already made public commitment to halt platform exclusivity requirements. |
| | OCIS Comment: Ending exclusivity could present short term revenue challenges, but is likely to put the industry on a more sustainable trajectory and would force the industry to innovate rather than prevent innovation by destroying competition. This move favors smaller players, but also limits the tactics that startups can deploy to gain users. | |
| Fintech | China's central bank, banking and securities regulators announced plans for Alibaba to reorganize Ant Group as a financial holding company | The reorganized firm would be overseen by the PBOC and regulated as a bank. Ant is also required to rectify monopolistic behavior in its payments business, reduce the size of its Yuebao money market fund, end "information monopoly" on consumer data, and enhance corporate governance in insurance and credit activities to control leverage and minimize systemic risks. |
| | Regulators gathered 13 fintech firms to communicate objectives of necessary restructuring | Those firms included fintech arms of Tencent, ByteDance, Baidu, JD, Meituan and Didi. Some key requirements include setting up financial holding companies and keeping payment services separate from other financial services like lending and wealth management. Payment services are meant for individuals, while institutions should still use the banking system. Any overseas IPOs would have to be approved by regulators after reorganization. |
| | Extend payment licenses | On May 13, the PBOC extended payment licenses for 24 non-banking institutions to 2026. These included the traditional operators like UnionPay, as well as fintech firms like Ant and Tenpay. |
| | OCIS Comment: Valuations of fintech assets would clearly be lower after being reorganized and regulated as financial holding companies. But at least Ant would be able to list again when the reorganization is complete. The ability for second tier players to surpass dominant top tier players would become even harder as the cost of compliance has risen. This is meant for systemic stability, not for encouraging competition. Investors should still favor large top tier names in the space. | |
| Data Handling | Sharing of consumer credit data | Ending "information monopoly" over consumer data was a part of the Ant reorganization plan. To this end, Ant is planning to set up a personal credit reference company according to established rules announced by the PBOC in January, as part of its effort to enhance personal information protection and prevent the abuse of data usage as requested by the regulators. How this company would operate remains uncertain. |
| | Collection of unnecessary personal information | On May 2, the Cyberspace Administration of China named 33 utility apps (maps and language inputs) to rectify their practice of requiring users to provide or grant access to personal data before using the apps. The administration banned, in March, mobile app operators from declining to offer basic services to customers who refuse to provide "unnecessary" personal information. |

False advertising (Education apps)

On May 10, the State Administration for Market Regulation imposed fines of 2.5mn yuan (\$389,000) each on Yuanfudao, backed by Tencent, and Zuoyebang, which has received funding from Alibaba, for misleading claims varying from falsifying teacher qualifications to faking user reviews. This followed the penalties issued by the regulators last month on four private education providers, including GSX Techedu and TAL Education, for pricing violations.

OCIS Comment: The aim of regulating data management is to protect consumer information and to minimize monopolistic practices. But it remains uncertain as to how the consumer data would be used. What kind of business models are allowable for firms that have accumulated large amounts of consumer data. The personal credit reference company that Ant is trying to set up would be keenly watched as a pioneer that could provide some answers.

Source: Bloomberg, as of 24 May 2021.

Glossary

| Terms | Definition |
|-------|-----------------------------------|
| AxJ | Asia ex-Japan |
| AFC | Asian Financial Crisis (1998-99) |
| GFC | Global Financial Crisis (2008-09) |

Asset allocation definitions

| Asset classes | Benchmarked against |
|-----------------|--|
| Global equities | MSCI All Country World Index, which represents 48 developed and emerging equity markets. Index components are weighted by market capitalization. |
| Global bonds | Barclays Capital Multiverse (Hedged) Index, which contains the government -related portion of the Multiverse Index, and accounts for approximately 14% of the larger index. |
| Hedge funds | HFRX Global Hedge Fund Index, which is designed to be representative of the overall composition of the hedge fund universe. It comprises all eligible hedge fund strategies; including but not limited to convertible arbitrage, distressed securities, equity hedge, equity market neutral, event driven, macro, merger arbitrage and relative value arbitrage. The strategies are asset-weighted based on the distribution of assets in the hedge fund industry. |
| Commodities | Dow Jones-UBS Commodity Index, which is composed of futures contracts on physical commodities traded on US exchanges, with the exception of aluminum, nickel and zinc, which trade on the London Metal Exchange (LME). The major commodity sectors are represented including energy, petroleum, precious metals, industrial metals, grains, livestock, softs, agriculture and ex-energy. |
| Cash | Three-month LIBOR, which is the interest rates that banks charge each other in the international inter -bank market for three-month loans (usually denominated in Eurodollars). |

| Equities | |
|----------------------------|--|
| Developed market large cap | MSCI World Large Cap Index, which is free-float adjusted and weighted by market capitalization. The index is designed to measure the equity market performance of the large cap stocks in 23 developed markets. Large cap is defined as stocks representing roughly 70% of each market's capitalization. |
| US | Standard & Poor's 500 Index, which is a capitalization -weighted index that includes a representative sample of 500 leading companies in leading industries of the US economy. Although the S&P 500 focuses on the large cap segment of the market, with over 80% coverage of US equities, it is also an ideal proxy for the total market. |
| Europe ex UK | MSCI Europe ex UK Large Cap Index, which is free-float adjusted and weighted by market capitalization. The index is designed to measure large cap stock performance in each of Europe's developed markets, except for the UK. |
| STOXX 600 | The STOXX Europe 600 Index has a fixed number of 600 components, representing large, mid and small capitalization companies across 18 countries of the European region. |
| Japan | MSCI Japan Large Cap Index, which is free-float adjusted and weighted by market capitalization. The index is designed to measure large cap stock performance in Japan. |
| Asia Pacific ex Japan | MSCI Asia Pacific ex Japan Large Cap Index, which is free-float adjusted and weighted by market capitalization. The index is designed to measure the performance of large cap stocks in Australia, Hong Kong, New Zealand and Singapore. |
| China & HK | The MSCI China Index is a free-float weighted equity index, representing Chinese companies listed in Hong Kong, as well as American Depositary Receipts listed in the US. MSCI HK Index is a free-float weighted equity index, representing HK companies listed in HK. |
| Emerging market | MSCI Emerging Markets Index, which is free-float adjusted and weighted by market capitalization. The index is designed to measure equity market performance of 22 emerging markets. |

Asset allocation definitions

Bonds

| | |
|----------------------------|--|
| Developed sovereign | Citi World Government Bond Index (WGBI), which consists of the major global investment grade government bond markets and is composed of sovereign debt, denominated in the domestic currency. To join the WGBI, the market must satisfy size, credit and barriers-to-entry requirements. In order to ensure that the WGBI remains an investment grade benchmark, a minimum credit quality of BBB–/Baa3 by either S&P or Moody's is imposed. The index is rebalanced monthly. |
| Emerging sovereign | Citi Emerging Market Sovereign Bond Index (ESBI), which includes Brady bonds and US dollar -denominated emerging market sovereign debt issued in the global, Yankee and Eurodollar markets, excluding loans. It is composed of debt in Africa, Asia, Europe and Latin America. We classify an emerging market as a sovereign with a maximum foreign debt rating of BBB+/Baa1 by S&P or Moody's. Defaulted issues are excluded. |
| Supranationals | Citi World Broad Investment Grade Index (WBIG)—Government Related, which is a subsector of the WBIG. The index includes fixed rate investment grade agency, supranational and regional government debt, denominated in the domestic currency. The index is rebalanced monthly. |
| Corporate investment grade | Citi World Broad Investment Grade Index (WBIG)—Corporate, which is a subsector of the WBIG. The index includes fixed rate global investment grade corporate debt within the finance, industrial and utility sectors, denominated in the domestic currency. The index is rebalanced monthly. |
| Corporate high yield | Bloomberg Barclays Global High Yield Corporate Index. Provides a broad-based measure of the global high yield fixed income markets. It is also a component of the Multiverse Index and the Global Aggregate Index. |
| Securitized | Citi World Broad Investment Grade Index (WBIG)—Securitized, which is a subsector of the WBIG. The index includes global investment grade collateralized debt denominated in the domestic currency, including mortgage -backed securities, covered bonds (Pfandbriefe) and asset -backed securities. The index is rebalanced monthly. |

Indices

| | |
|---|---|
| CFETS RMB Basket Index | The China Foreign Exchange Trade System (CFETS) RMB currency basket measures the RMB versus foreign exchange currency pairs listed on CFETS. This index refers to the currency basket accepted by CFETS and the 13 currencies which make up the basket were selected based upon international trade-weights with adjustment of re-export trade factors. |
| DXY Dollar Index | The U.S. Dollar Index (USDX) indicates the general international value of the USD. The USDX does this by averaging the exchange rates between the USD and major world currencies. The ICE US computes this by using the rates supplied by some 500 banks. |
| ADXY Index / Asian Currency Index | This Bloomberg JPMorgan Asia Dollar Index is a trade and liquidity weighted index of 10 EM Asian currencies' exchange rate versus the US dollar. |
| Bloomberg Barclays Multiverse Total Return Index | The Multiverse Index provides a broad-based measure of the global fixed-income bond market. The index represents the union of the Global Aggregate Index and the Global High-Yield Index and captures investment grade and high yield securities in all eligible currencies. |
| Bloomberg Barclays Asian-Pacific ex-Japan local currency bond index | The Bloomberg Barclays Asian-Pacific Non-Japan Total Return Index Value Unhedged USD is a market capitalisation weighted index and measures the performance of local currency denominated government-related and corporate bonds of the Asia ex-Japan region. |
| iBoxx Asian US dollar Bond Index | Markit is a global index provider which is involved in designing, administering and calculating this index that covers USD segments of Asian fixed income markets. |
| CRB Industrial Commodities Price Index | A Thomson Reuters/Core Commodity Excess Return Index which uses an arithmetic average of commodity futures prices with monthly rebalancing. |
| CRB Industrial Metals Index | This data represents Commodity Research Bureau BLS Spot Indices (1967=100). The metals sub-index includes aluminum, copper, gold, iron ore, nickel, silver and steel rebar. |
| MSCI Asia ex-Japan Index | The MSCI Asia ex-Japan Index captures large- and mid-cap representation across 2 of 3 Developed Market countries (excluding Japan) and 9 Emerging Market countries in Asia. With 955 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. DM countries in the index include: Hong Kong and Singapore. EM countries include: China, India, Indonesia, Korea, Malaysia, Pakistan, the Philippines, Taiwan and Thailand. |

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| Bond credit quality ratings | Rating agencies | | |
|---|----------------------|----------------------------------|----------------------------|
| | Moody's ¹ | Standard and Poor's ² | Fitch Ratings ² |
| Investment Grade | | | |
| Highest quality | Aaa | AAA | AAA |
| High quality (very strong) | Aa | AA | AA |
| Upper medium grade (Strong) | A | A | A |
| Medium grade | Baa | BBB | BBB |
| Not Investment Grade | | | |
| Lower medium grade (somewhat speculative) | Ba | BB | BB |
| Low grade (speculative) | B | B | B |
| Poor quality (may default) | Caa | CCC | CCC |
| Most speculative | Ca | CC | CC |
| No interest being paid or bankruptcy petition filed | C | D | C |
| In default | C | D | D |

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