Compelling Opportunities in Emerging Markets

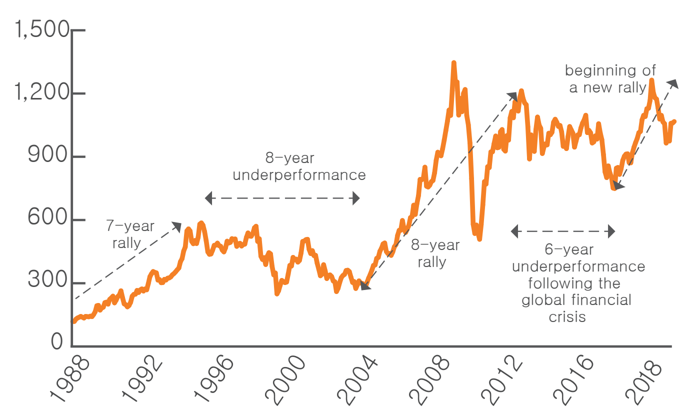
Emerging market (EM) equities pulled back in 2018, decoupling from US equities due to trade disputes, rising interest rates, a stronger US dollar, and rising political risks. With these factors behind us, a potential US and China trade resolution on the table, and an end to the US Federal Reserve's rate hiking cycle, we believe EM equities are attractive on an absolute and a risk-reward basis.

We remain positive on the asset class and believe that the rare combination of compelling valuations, higher growth potential, and attractive positioning will create opportunities for a re-rating of the asset class. Looking ahead, we believe that emerging markets are positioned for a significant rally in 2019.

Emerging Market Rallies Tend to Last for Years

After six years of underperformance relative to developed markets, EM pivoted into a multi-year positive cycle in 2016. Idiosyncratic events interrupted the turnaround in 2018, but also created an attractive opportunity for active investors as prices dislocated from fundamentals. The asset class regained its strength towards the end of 2018, as the market digested a potential US-China trade resolution along with a dovish stance from the US Fed. We believe that current conditions remain supportive for a multi-year rally in EM, and note that emerging market cycles have historically lasted six to eight years.

MSCI EM Index: Periods of Rallies and Underperformance

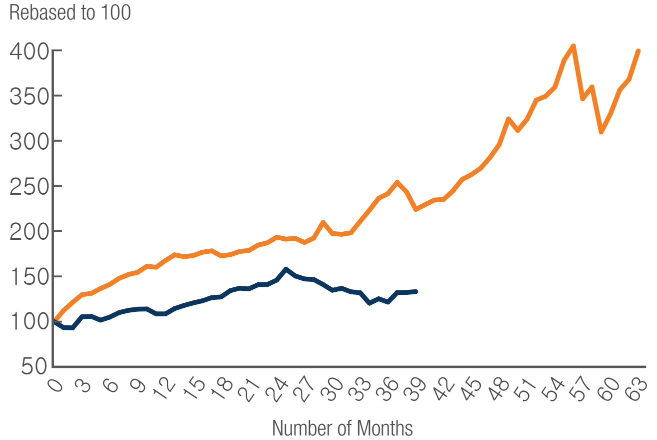


Source: Bloomberg, as of 3/31/19.

Growth prospects for emerging markets outpace those of developed markets.

There have been six emerging market rallies since the mid-1970s. On average, those rallies have delivered 232% returns.[1] We are seeing the current emerging markets run follow the path of the average six prior rallies and believe that it has the potential to double from today's prices.

Current EM Rally is Tracking the Average Prior EM Bull Market

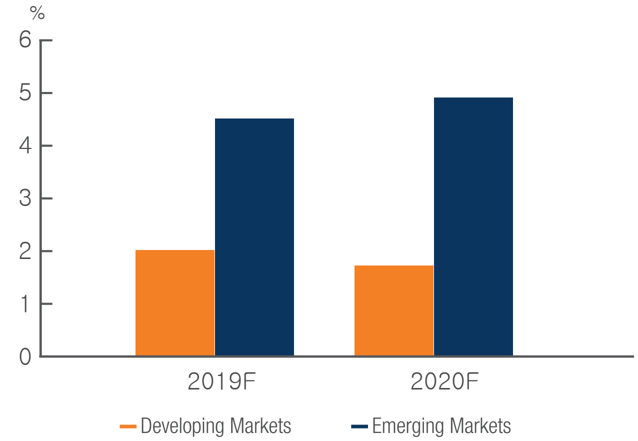


Average prior EM bull market: BofA Merrill Lynch Global Research, Bloomberg, Factset, GFD. Current EM bull market: Bloomberg, MSCI EM Price Return Index. As of 3/31/19.

GDP Growth in Emerging Markets to Strengthen

Growth prospects for emerging markets outpace those of developed markets. According to the International Monetary Fund, the expansion in major developed economies appear to have peaked while econo mies in emerging markets are expected to continue strengthening.

GDP Growth in EM Continue to Expand



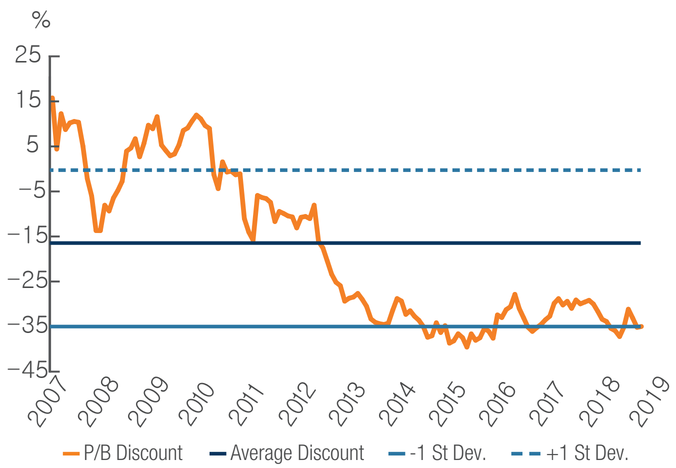
Source: IMF, World Economic Outlook Update, Jan 2019. F=Forecast.

Attractive Valuations and Stronger Earnings

Current valuations remain compelling with emerging market equities trading at a discount of roughly 35% relative to developed market equities. On a forward price-to-book basis, the average discount between emerging and developed market equities has historically stood at 18% over a 10-year period.

An earnings rebound also appears to be underway for emerging market companies. Emerging market corporate earnings are still coming from a low base, and improved operating and financial health of these companies should drive considerable margin expansion and earnings growth in the near to medium term.

Emerging Markets are Trading at a Discount



Source: Bloomberg. 2-year forward EM vs DM P/B Ratio. As of 3/31/19.

Investors Remain Underweight Emerging Markets

Emerging markets currently account for 12% of the global equity mar ket but global equity investors only have about a 5% allocation to emerging market equities, implying that investors are around 7% underweight emerging markets. We believe that the positive momen tum behind emerging market equities will close this gap over the next few years, which will support a re-rating of the asset class.

Investors are Under-Allocated to Emerging Markets

Source: EPFR Global, Thomson Reuters Datastream, HSBC calculations. As of 2/28/19.

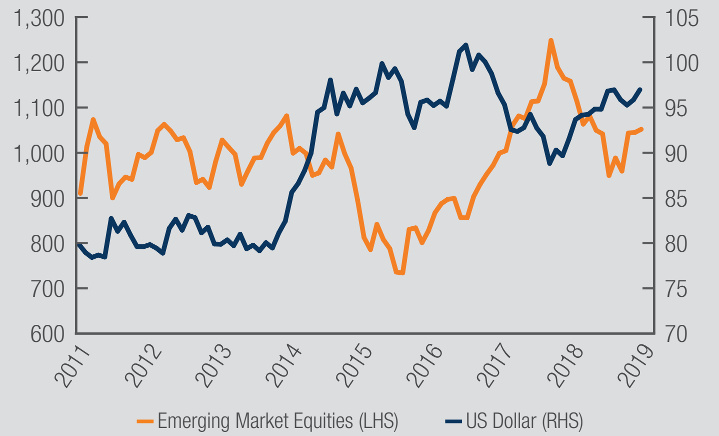
[1]Source: BofA Merrill Lynch Global Research, Mirae Asset.

Easing Concerns

US DOLLAR

We expect the US dollar to stay flat or weaken based on (1) an end to the US interest rate hiking cycle, (2) continued pressure from the US trade and fiscal deficits, (3) weaker year-over-year US growth, and (4) a re-allocation from previous overweight US assets to more diversified global portfolios. A more tepid US dollar has historically translated into stronger performance for emerging market countries and companies.

A Reversal of the US Dollar Should Support Emerging Market Equities



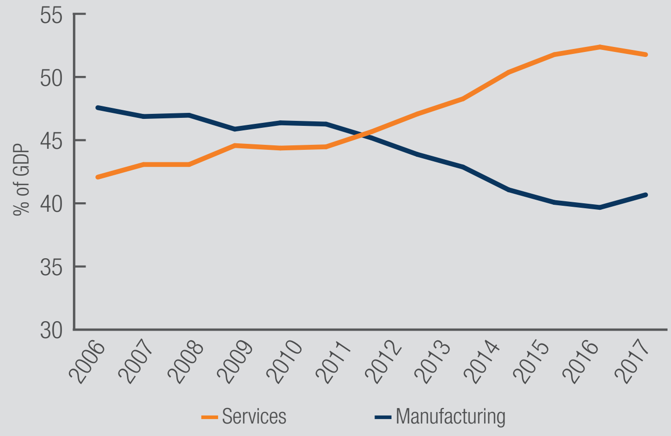
Source: Bloomberg. Emerging market equities are represented by the MSCI EM Index and the US dollar by the DXY Index. As of 3/31/19.

CHINA'S ECONOMY

The Chinese government is stabilizing its economy by implementing policies aimed at supporting growth. China's economy is expected to continue to slow as it shifts to a more sustainable growth model driven by consumption and services. The services industry now accounts for about 52% of China's GDP.

In addition, the inclusion of Chinese A-shares into the MSCI Emerging Markets Index should draw additional flows to Chinese equities and further support the currency.

China Transitions to a Consumer Services-Led Growth Model



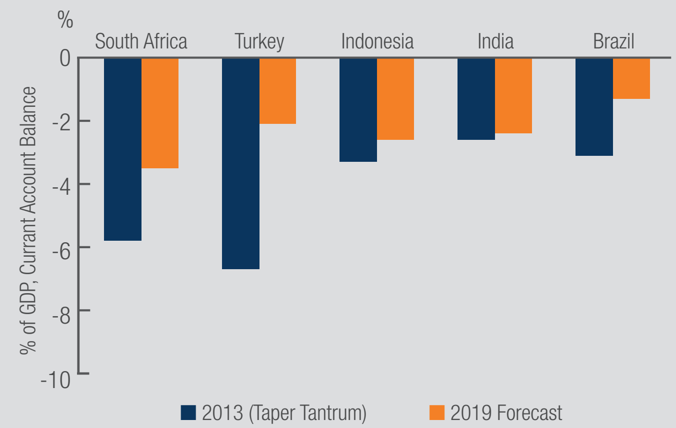
Source: National Bureau of Statistics of China.

BALANCE SHEET FRAGILITY

Emerging markets are less vulnerable to external currency and interest rate shocks than they were in the past, as their foreign reserves and current account balances have largely improved. Current accounts in many emerging market countries, including those of the Fragile 5, have generally improved since the 2013 Taper Tantrum.

Both governments and corporates have broadly learned their lessons from previous periods of volatility leading to more conservative and foreign exchange matched balance sheets.

Current Account Deficits Have Improved in the Fragile 5



Source: Bloomberg.

Forecasts are only projections and not guarantees.

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