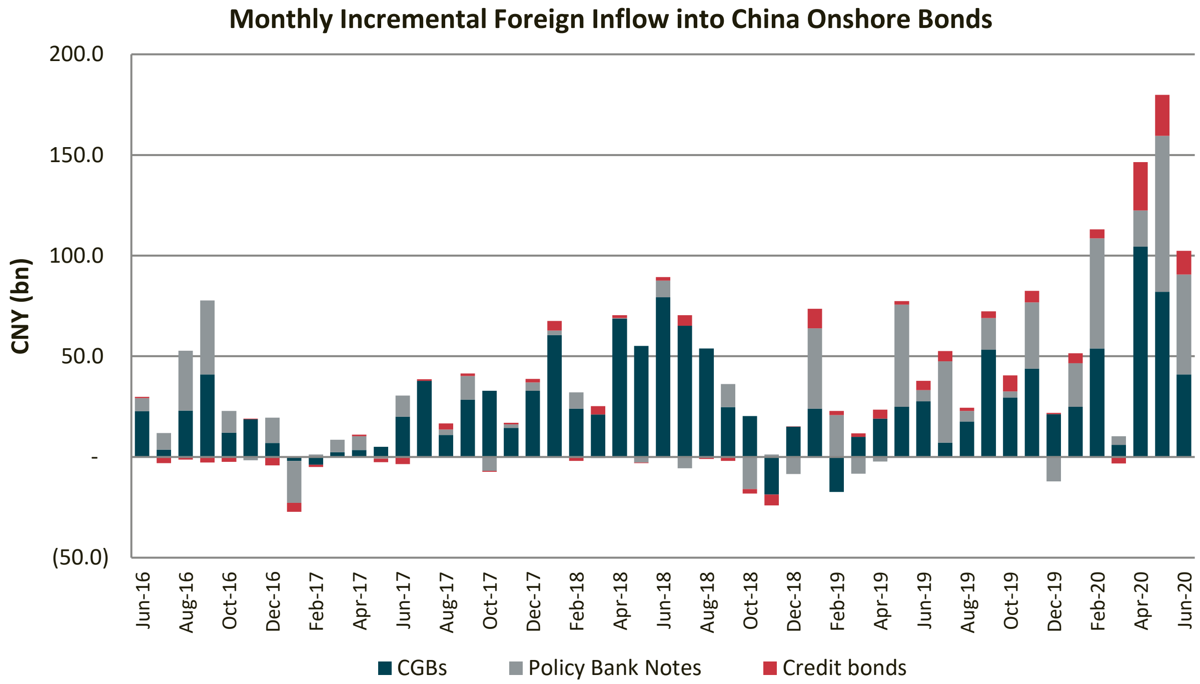
JULY 2020

CHINA BOND MARKET: A STAND-ALONE HAVEN ASSET CLASS

Since our March 2020 writeup titled "The birth of a new haven asset and currency: Chinese RMB bond", the Chinese onshore bond market has seen accelerated foreign capital inflow. As of June 30, 2020, cumulative foreign holdings of Chinese onshore bond has reached CNY 2.6 trillion, according to State Administration of Foreign Exchange (SAFE). At Income Partners, we have also received substantial inflows into one of the RMB bond funds we manage during July. We believe the recent inflow reflects investors' recognition that China onshore bond market should be viewed as a stand-alone haven asset class rather than part of emerging market universe- a conviction we have long held.



Source: Wind, June 2020

On the other hand, Chinese bonds, due to its relatively stronger fundamentals, low correlations and higher yields than G7 economies, offer DM and EM investors alike an alternative haven asset class. It is our belief that, over time, it will be challenging for US Treasury bonds to maintain its dominance in safe haven status. The Covid-19 pandemic and subsequent market performance has accelerated investors' recognition of this view. Consequently, we believe this is the beginning of an emerging trend from global investors increasing their allocations to this new haven asset.

Suites 3311-3313, Two IFC, 8 Finance Street, Central, Hong Kong 香港中環金融街8號國際金融中心2期3311-3313室
T 電話 (852) 2169 2100 F 傳真 (852) 2869 6991 www.incomepartners.com

RMB BONDS SHOULD NOT BE VIEWED WITHIN EMERGING MARKET CONTEXT

The recent pandemic has been a stress test for global economy. China has well contained the COVID-19 at early stage, and proved its economic and financial system resilience. Both Chinese onshore bond market and currency have outperformed those in global emerging market with much lower volatility (see charts below). It is our long held conviction that China's onshore bond market should be viewed as a stand-alone haven asset class, rather than part of emerging market universe.

Chart 1. China outperformed EM aggregate bond indices

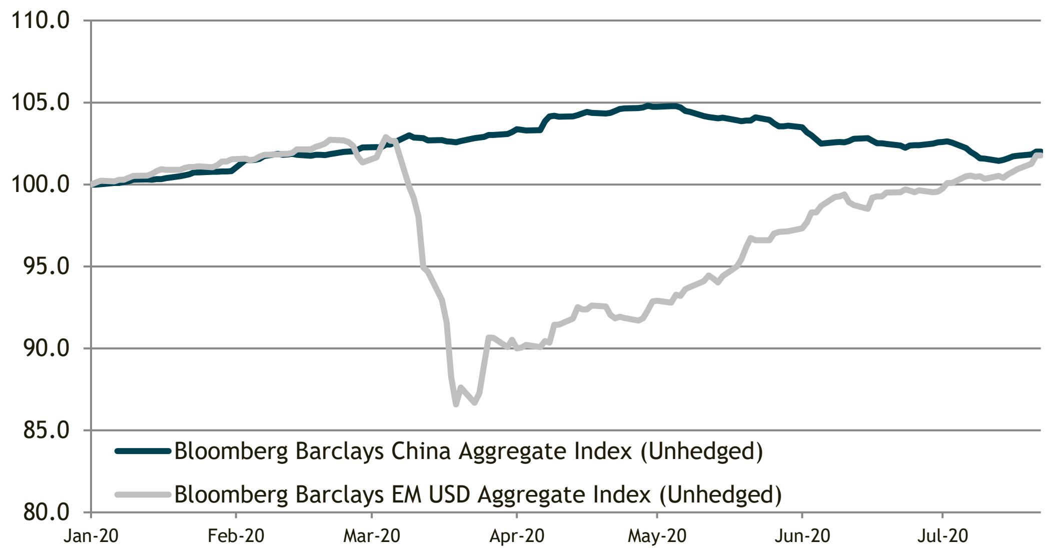
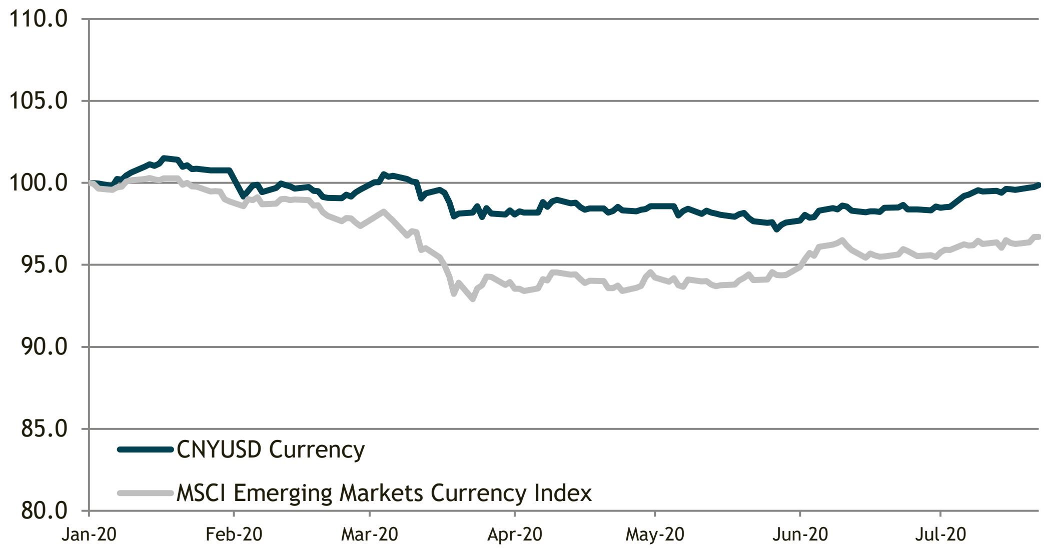


Chart 2. China Outperformed US and Global Aggregate Bond Indexes



Source: Bloomberg, 22 July 2020

CHINA HAS STRONGER ECONOMIC FUNDAMENTAL, DISCIPLINED MONETARY AND FISCIAL POLICY IN THE POST-PANDEMIC WORLD

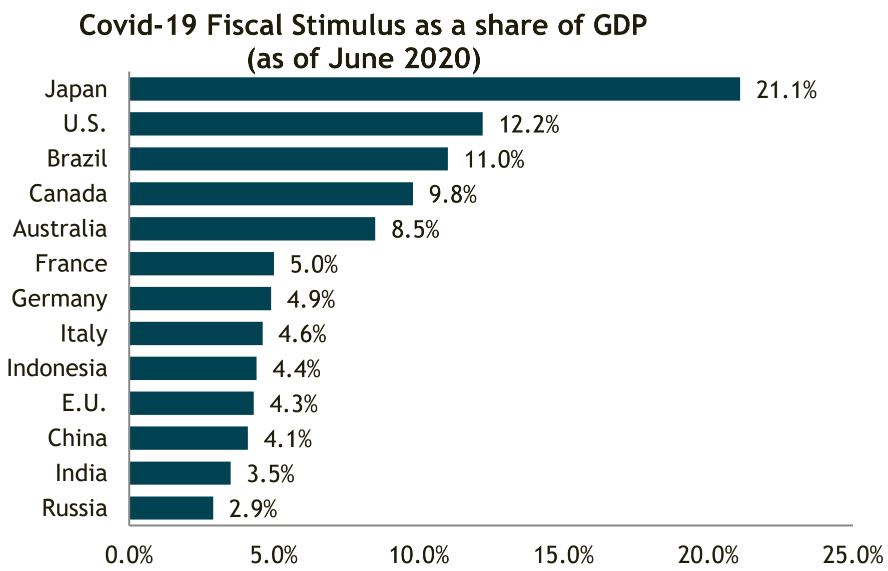
Compared to other major economies, China's economy has been resilient thanks to effective virus containment and robust domestic demand post lockdown. According to IMF's projection, China is the only country that may print positive real GDP growth for 2020 and shall lead the rebound in 2021.

Real GDP (%)	2019	2020e	2021e
Advanced Economies	1.7	-8.0	4.8
United States	2.3	-8.0	4.5
Euro Area	1.3	-10.2	6.0
Japan	0.7	-5.8	2.4
United Kingdom	1.4	-10.2	6.3
Canada	1.7	-8.4	4.9
Emerging Markets and Developing Economies	3.7	-4.8	4.2
China	6.1	1.0	8.2
India	4.2	-4.5	6.0
Brazil	1.1	-9.1	3.6
South Africa	0.2	-8.0	3.5
Mexico	-0.3	-10.5	3.3

Source: IMF, World Economic Outlook Update, June 2020.

As shown in the following chart, China has been relatively conservative this year in putting on large fiscal or monetary stimulus, providing its government ample room to deal with post-pandemic uncertainties.

Chart 3. Fiscal stimulus as % of GDP



Source: Statista, Income Partners, June 2020.

As a result, we expect China's sovereign debt / GDP ratio to only experience mild increase while other economies will see sharp rise in that ratio due to massive stimulus and muted inflation.

		China*	US
2019	Fiscal Deficit / GDP	-5.5%	-4.6%
	Gov't Debt / GDP	55.6%	106.9%
2020E	Fiscal Deficit / GDP	-7.5%	-16.4%
	Gov't Debt / GDP	**61.0%**	**121.7%**
2021E	Fiscal Deficit / GDP	-6.5%	-9.6%
	Gov't Debt / GDP	**64.8%**	**128.9%**
2022E	Fiscal Deficit / GDP	-5.5%	-5.0%
	Gov't Debt / GDP	**67.2%**	**131.4%**

Source: US Treasury Department, JP Morgan and Income Partners. (*) Including local government bonds and special government bonds issued in dealing with COVID-19.

To sum up, we think China's better fundamentals and outlook post the COVID-19 pandemic shall bolster investor confidence in China-related assets.

EXCELLENT TIMING TO ALLOCATE AFTER THE RECENT SELLOFF IN ONSHORE RATES

Since May, China's onshore 10-year government bond yield has been moving higher gradually, from 2.54% as of 30 April to 3.05% as of 10 July. Several major factors are behind the selloff:

1. China's economy has steadily recovered from the low in March as the country has largely contained Covid-19 since early March.
2. China's overall credit expansion (Aggregate Financing) has accelerated for 4 consecutive months from February's 10.7% YoY to June's 12.8% YoY, thanks to the accommodative monetary policy by PBOC after the Pandemic.
3. The sharp rally of Chinese equities into July increased investors' risk appetite which in turn led to higher rates.

After the recent selloff, we began to see value in onshore rates bonds for the following reasons:

1. The current 3.05% yield in 10-year Chinese government bond has already priced in a lot of optimism on China's economy, and is even a bit overshoot vis-à-vis the pre-pandemic level of 3%, in our view. The reality is, China is still recovering from the lagging impact of Covid-19 and consensus forecast for second half GDP growth is 4-5%, much lower than last year's 6.1%.
2. Looking forward, major risk factors facing China include much weaker external demand, a slower economic recovery in the second half and high unemployment rate, etc. These risks will add volatility to the market and potentially create rates rally opportunity.

3. In a zero interest rate and recessionary environment among developed markets, it is difficult for Chinese rates to overshoot on the upside too far for too long.

   Since mid-February, with the strong rally of US Treasury yield, the yield differential between 10y Chinese government bond and US Treasury has widened to 240bps as of 10 July, almost at the widest level over the past 5 years. It makes China's onshore rates bonds even more attractive than before.

Chart 4. US Treasury and Chinese Government Bond 10 year Yields

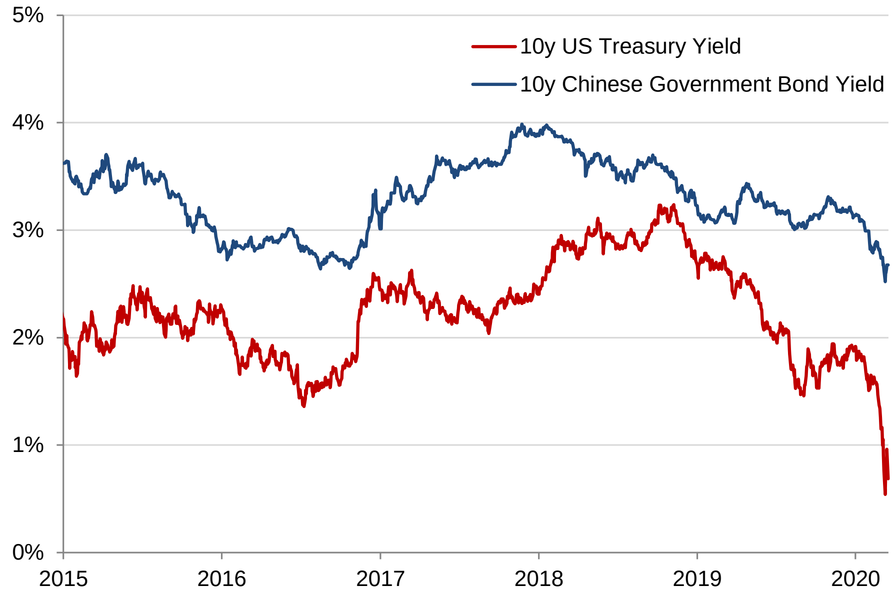
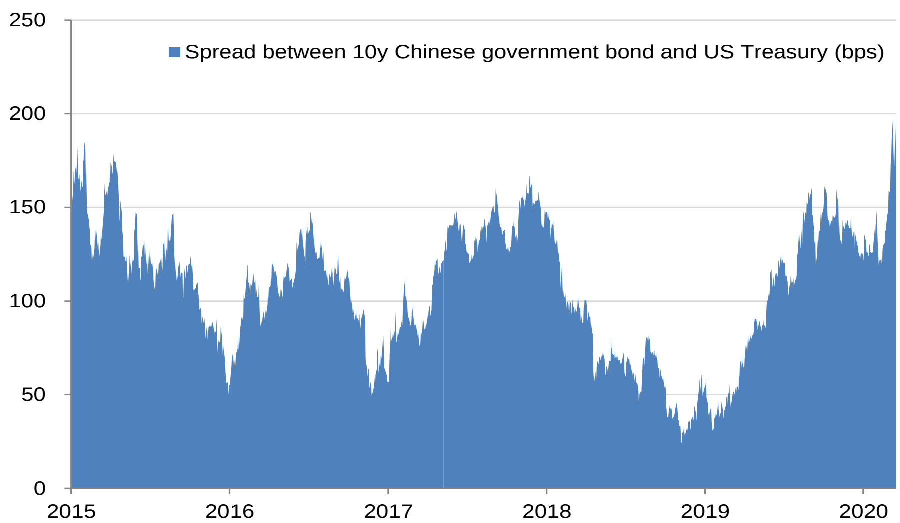


Chart 5. Spread between 10 year Chinese Government Bond and US Treasury



Source: Bloomberg, Wind, June 2020

We have turned more constructive on Chinese rates under these considerations, and believe now is a good time for investors to start to allocate into China's onshore rates bonds.

CONSTRUCTIVE ON CHINESE YUAN OUTLOOK

China began to internationalize Chinese Yuan (CNY, also known as RMB) in 2010 when Hong Kong started as the first offshore RMB clearing center. Since then,

1. There are more than 10 RMB clearing centers out of China, including Hong Kong, Macau, Singapore, Tokyo, London, Paris, etc.
2. Cross-border trade settlement in RMB has grown from zero in 2010 to over USD600 billion equivalent in 2019.
3. Offshore RMB bond market has grown into a USD 70 billion equivalent market at the end of 2019.
4. With the opening of China's onshore bond market, inflows into China onshore bonds have been accelerating in recent years. According to State Administration of Foreign Exchange (SAFE), total foreign holdings of China onshore bonds reached CNY 2.6 trillion as of June 30, 2020.

Over the past 12 months, USDCNH spot tested 7.20 in 3Q2019 before US and China came to Phase I deal amid US-China trade tensions and in 2Q2020 when China introduced the Hong Kong Security Law. We think these headwinds are fading and turn more constructive for RMB.

With the US FED adopting zero interest rate policy and introducing unlimited QE, the trajectory of USD is turning flat or even downward. RMB has been moving in line with the USD index since 2015 and, given our view that USD has peaked and trending downtrend, the downside of RMB is limited. In addition, as discussed above, China looks set to lead the economic rebound among major economies post pandemic. Stronger fundamentals as well as more open domestic markets will continue to attract foreign inflow and hence bolster the currency. Last but not least, the large yield differential between China and US provides good support for RMB. As an example, 3m Libor is below 0.3% while China interbank SHIBOR is around 2.5%. The 10y CGB and US treasury yield spread stands at 230bps, close to historical high.

Considering these factors, we believe the environment has turned more favorable for a stable or even stronger RMB in the near future.

CONCLUSION: NOW IS THE TIME TO ALLOCATE INTO CHINA ONSHORE BOND MARKET

- The Covid-19 pandemic and subsequent market performance has accelerated investors' acceptance of our long-held view that Chinese onshore bond is a stand-alone, "safe haven" asset.
- Now is the time to gain exposure to the RMB bond market, especially for long term investors seeking return enhancement and diversification, given attractive domestic bond yields and supportive currency outlook
- Income Partners has long-running, unparalleled investment expertise in RMB fixed income markets with stable investment teams in both Hong Kong and Shanghai. Since 2010, we have provided our investment partners customised managed account solutions as well as comingled vehicles to gain exposures to the RMB bond markets.

DISCLAIMERS & IMPORTANT INFORMATION

This report is issued by Income Partners Asset Management (HK) Ltd. ("Income Partners") and has not been reviewed by any regulatory authority. It is not intended as an offer, solicitation, advice or recommendation to buy or sell any securities or any products. This report may not be received by and is not intended for any U.S. Person other than a U.S. Person who is an "accredited investor" as defined in Regulation D under the U.S. Securities Act of 1933, a "qualified purchaser" as defined in the Investment Company Act and the regulations thereunder, and "qualified eligible persons" as defined by the U.S. Commodity Futures Trading Commission ("CFTC") Rules and Regulations or the rules and regulations thereunder. This report is for distribution only under such circumstances as may be permitted by applicable law. Nothing in this report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient's individual circumstances or otherwise constitutes a recommendation. It is provided to you solely for information purposes only. No representation or warranty, either express or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein, nor is it intended to be a complete statement or summary of the securities, markets or developments referred to in the report. We have prepared this report without consideration of the investment objectives, financial situation or particular needs of any investor. You should consider your own investment objectives, financial situation and particular needs before taking any action with respect to a financial product referred to in this presentation. In particular, we are not acting as your adviser or assuming any duty of care in this respect. To the extent permitted by applicable law, none of Income Partners, its affiliates, or any officer or employee of Income Partners, accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents, including for negligence. Investments involve risk. Under some market conditions it may be impossible to liquidate a position. Losses incurred in trading can be substantial.

- Investment in the China market is subject to emerging market risk including political, economic, legal, regulatory and liquidity risks.
- Investment involves risk. Past performance is not a guarantee or a reliable indicator of future results and no guarantee is being made that similar returns will be achieved in the future.
- In making investment decisions, investors should not rely solely on the information in this document and should read relevant offering document for further details including the risk factors. This document does not constitute an offering document.
- Index or benchmark data are for reference purposes only and no comparability or relevance is warranted or implied. Care should be taken as the composition, volatility, duration, yield and other features may from time to time be materially different from the indices and the underliers of the indices. Indices may rebalance or change its composition and weighting of its underliers from time to time and no regard has been given to such changes in this document. The recipient should conduct its own research and be familiar with the characteristics and underliers of any indices.