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China has grown over the years to become the world’s second largest economy and is today contributing to 19% of the world’s GDP growth. China is a key component to the global economy and the same can be said of its role in the capital markets: Chinese onshore bonds outstanding total USD 11 trillion while Chinese onshore equities’ market capitalisation amounts to USD 8.5 trillion. This enormous onshore market has been gradually allowing foreign investor access through various channels as the Chinese government takes steady steps to liberalise its economy and improve its financial system. Global index providers for both bonds and equities are now beginning to add Chinese onshore securities into their indices, thus prompting global investors to rethink asset allocation strategies.

Chinese bonds represent 10% of the global bond market

Chinese equities represent about 15% of the global equity market

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Chinese equity market structure

Market structure of onshore and offshore equity markets

Shenzhen A-shares (onshore)
- ~2,100 stocks (including SME & ChiNext)
- USD3.5trn market cap (41% free float)
- ~900 stocks available via Shenzhen-HK Connect
- 1-year ADV: USD39bn
- 17.7x forward P/E
- TTM dividend yield: 1.12%

Shanghai A-shares (onshore)
- ~1,400 stocks
- USD5.0trn market cap (31% free float)
- ~570 stocks available via Shanghai-HK Connect
- 1-year ADV: USD32bn
- 11.4x forward P/E
- TTM dividend yield: 2.38%

Hong Kong Stock Exchange (offshore)
- ~1,800 stocks (including H-shares)
- USD4.4trn market cap (88% free float)
- 1-year ADV: USD11bn
- 11.4x forward P/E
- TTM dividend yield: 3.76%

Source: HKEx, SSE, SZE, Bloomberg, HSBC Global Asset Management
Data as of June 2018. *ADV = average daily trading volume

Investor profile
- The onshore A-share market is largely owned by retail investors, who often lack the necessary market knowledge and are easily swayed by sentiment. Therefore, A-shares tend to display greater volatility than offshore H-shares

Company size
- A greater proportion of large-cap companies gives the Hong Kong market a more mature profile. In comparison, there are a larger number of small and mid-cap stocks in the A-share market, which tend to be under-researched and often mispriced

Sector breakdown
- The Hong Kong market is dominated by financials, real estate and traditional industries, whereas the A-share market, esp. Shenzhen, offers more opportunities in new economy sectors such as technology, healthcare and e-commerce

Valuation dispersion
- The A-share market has greater valuation dispersion due to less mature investor profiles. Hence, stocks can sometimes trade significantly higher or lower than their fair value

1. removed top and bottom 1% outliers to calculate average
Source: HKEx, SSE, SZE, Bloomberg, HSBC Global Asset Management, data as of June 2018

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Chinese bond market structure

Market structure of onshore and offshore bond markets

China USD bonds (offshore)
- ~3,200 issues
- USD800bn outstanding
- Yield: 5.12%
- Duration: 3.8 years

China CNH bonds (offshore)
- ~1,200 issues
- USD77bn outstanding
- Yield: 4.44%
- Duration: 3.0 years
- Average bid-ask spread: CGB 5-10bps; Corps 15-25bps

China CNY bonds (onshore)
- ~32,500 issues
- USD11trn outstanding
- Yield: 4.37%
- Duration: 3.6 years
- Average bid-ask spread: 2-7bps

Years to maturity profile
- Chinese bond markets have relatively short duration compared to US, Euro and EM. The offshore CNH market has shorter duration as 20% of the market is composed of non-rated certificate of deposits (CDs). The offshore Chinese USD market is more liquid for long dated bonds

Credit profile
- Credit rating of Chinese onshore bonds show little differentiation as they are rated only by local rating agencies using a different rating scale. As deleveraging continues and insolvent companies start to fail, local rating agencies and investors will reassess their perception of the bond market, improving credit pricing in future

Sector breakdown
- Government, local government and policy bank bonds account for almost 70% of the onshore bond market, while the rest are made up of issues from local government financing vehicles and corporates

Gross issuance
- New CNH bond issuance dwindles as onshore bond market becomes more accessible and as liquidity is better in the USD market, but more favourable tax treatment over onshore bonds and attractive yield carry makes CNH bonds appealing

Note:
1. Reference indices: CNY – ChinaBond New Composite Index; USD – JACI China Index; CNH – Markit iBoxx ALBI China Offshore Index
Source: ChinaBond, Markit, JPMorgan, Bloomberg, HSBC Global Research, HSBC Global Asset Management, data as of June 2018

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Equity market liberalisation

The Shanghai-Hong Kong Stock Connect, which was launched in 2014, and the Shenzhen-Hong Kong Stock Connect, which was launched in 2016, are effective, simple and straightforward channels for foreign investors to access onshore Chinese equities and have also served as the key trigger to the decision by MSCI to add Chinese A-shares into their indices. Access under the Stock Connect channels has also improved over time, as evidenced by the significant expansion of the daily quota allowed. The introduction of Chinese Depository Receipts (CDRs) is another step towards market liberalisation and one intended to encourage tech giants to seek onshore listing. As market liberalisation continues to speed up, so would the representation of Chinese markets within global indices and benchmark-tracking portfolios.

Impact of A-share inclusion into MSCI Emerging Markets Index

- A-shares are now included in key MSCI indices that are tracked by USD5.3 trillion of assets. China may see about USD20 billion flow into the onshore equity market upon 5% initial inclusion in September 2018, and potentially hundreds of billions of inflows upon full inclusion.

Northbound flows have begun to catch up with southbound flows

- Although China A-shares have come under pressure in 1H18 amidst concerns over moderating growth and heightened trade tensions, northbound flows continued to be strong and hit historical highs in May 2018.

Investors are trimming underweights in Chinese equities

- Benchmark tracking investors have been adding to Chinese equities aggressively since 2016. In the longer term, increased flows and foreign ownership could encourage other listed companies in China to improve their corporate governance standards and business models.

Foreign ownership still significantly lags those of other major markets

- Foreign ownership of onshore equities has grown by 70% y-o-y to USD190 billion, but is merely 2.7% of the total tradable market. While it took around 7-10 years for Korean and Taiwanese stocks to be fully included into MSCI indices, the pace of inclusion for A-shares will be driven by the pace of liberalisation.

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Bond market liberalisation

Onshore bonds will be included in the BGA index for the first time thanks to the launch of Bond Connect in 2017, which further opened up onshore bond markets to foreign investors. Unlike other channels available to access onshore bonds, Bond Connect does not require a domestic account and custody, and its offshore infrastructure enables foreign investors to trade onshore bonds following international practices. This, along with newly available onshore FX hedging and a more liberalised currency, allows foreign investors to manage position and risk at lower cost and higher efficiency. As onshore bonds gain increasing weight in key indices, it is very difficult for foreign investors to do nothing (i.e. natural underweight) as China is one of the largest bond markets that offer attractive yields and growth.

Impact of onshore bond inclusion into BBG Barclays Global Aggregate index

- Starting in April 2019, the inclusion will take place over 20 months with 5% scaling factor and will fully include onshore government and policy banks issues by November 2020, bringing in USD140bn to the market

![Graph showing percentage change before and after inclusion]

(Number of foreign institutions with access to onshore bond market

- Significant ease of access and anticipation for further index inclusion, which may bring in a total of USD250bn-USD350bn flows to the onshore bond market, have led to unprecedented rise in number of registered institutional investors since 2017

![Graph showing number of foreign institutions with access to onshore bond market]

CNH deposits on the rise

- Loosening of access routes to the onshore market will increase demand for CNH and lead to more CNH deposits, which in turn also benefits liquidity of the CNH bond market. However, strength in USD is a factor to watch out for

![Graph showing CNH deposits billion]

There is large potential for foreign participation in China’s bond market

- To many foreign investors, onshore Chinese bonds offer good yield carry with relatively short duration. With low foreign ownership and less correlated monetary policy compared to other major markets, these bonds provide good diversification to foreign portfolios

![Graph showing foreign holdings of onshore bonds as % of onshore bond market]

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Accessing China through our investment capabilities

We offer clients fulfillment options via our fund range or, if preferred, a segregated mandate, encompassing Chinese equities, fixed income, multi-asset and passive investing.

<table>
<thead>
<tr>
<th>Key strategies</th>
<th>Chinese equity</th>
<th>RMB fixed income</th>
<th>China multi-asset</th>
<th>Passive China-A*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Key propositions</td>
<td>High-conviction and diversified portfolio focusing on stocks with below average valuation for a given level of profitability</td>
<td>Focusing actively on term structure, duration, sector allocation, product selection and credit rating</td>
<td>Mixed asset with income tilt. Flexible allocation across onshore/offshore equities and bonds within a risk budget</td>
<td>Passive ETF tracking the progressive inclusion of China-A shares into the MSCI EM index</td>
</tr>
</tbody>
</table>

| Investment universe | H-shares | Red chips | A- and B-shares | Onshore RMB and offshore RMB/non-RMB denominated fixed income/debt securities | A/B/H-shares, red chips and ADRs Onshore/offshore fixed income in RMB and other currencies | Stocks included in the MSCI A-share Inclusion Index** |

Segregated mandate considerations
The market access options, and their pros and cons are detailed below:

**QFII/RQFII (equity and bond)**
+ Broader range of products available
+ Primary market participation (e.g. IPO)
- Licensing from CSRC; quota approval from SAFE; account opening with onshore custodian
- Pre-funding required
- Cannot be borrowed or transferred. Clients must apply themselves

**CIBM Direct (bond)**
+ Easy access to interbank bond market without quota
+ Hedging tools available
- Onshore account opening and regulatory filing
- Pre-funding required

**Stock Connect (equity)**
+ Not subject to individual quota
+ Easier registration process
+ Delivery versus payment available
- Less coverage than QFII/RQFII
- No primary market activity

**Bond Connect (bond)**
+ Simplest access without onshore custodian and account opening without quota
+ Use of international practices and offshore infrastructure
+ No pre-funding requirement
- Lack of trading platform option
- Limited hedging tools

Source: HSBC Global Asset Management as at 30 June 2018. For illustrative purpose only. Please refer to appendix for more information on each access channel.
*The launch date of the exchange traded fund is 27 July 2018
**The index tracks the progressive partial inclusion of A shares in the MSCI Emerging Markets Index overtime
Why HSBC Global Asset Management?

Investing in China’s onshore capital markets requires not only high quality research, but also knowledge of the different accounting practices and other uncommon rules. Investors also need to understand the different access channels available and the suitability of these channels to their investment objectives. HSBC Global Asset Management is a pioneer in Chinese investments, with deep experience in investing in both offshore and onshore Chinese securities.

Strong track record managing Chinese assets since 1992

Significant local resources and presence in China

A well resourced, stable and award winning team

A robust investment process built on solid proprietary research

A network of opportunities

Presence in 26 countries and territories

$481.7bn under management

141bn Asia-Pacific

Around 600 investment professionals

79 Americas

348 EMEA

160 Asia-Pacific

1. Asia-Pacific includes employees and assets of Hang Seng Bank, in which HSBC has a majority holding. Source: HSBC Global Asset Management as at 31 March 2018. Any differences are due to rounding.
Appendix I: Accessing onshore equity and bond markets
Qualified Foreign Institutional Investors (QFII) and Renminbi Qualified Foreign Institutional Investors (RQFII) schemes

QFII and RQFII schemes are the earliest routes created for foreign investors to access the onshore markets. However, foreign ownership of the onshore markets has not seen explosive growth in part due to complex application process, capital control and lack of currency hedging tools. As part of its effort to open up Chinese capital markets in the recent years, the government has not only further increased the approved quota, but also starting in June 2018, removed the 3-month lock-up period and 20% monthly repatriation limit and allowed onshore FX hedging.

<table>
<thead>
<tr>
<th></th>
<th>QFII Scheme</th>
<th>RQFII Scheme</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Launch</strong></td>
<td>◆ 2002</td>
<td>◆ 2011</td>
</tr>
<tr>
<td><strong>Approved/available quota</strong></td>
<td>USD99bn/ USD51bn</td>
<td>RMB616bn/ RMB1,324bn</td>
</tr>
<tr>
<td><strong>Available instruments</strong></td>
<td>Exchange traded securities (including IPOs), equity index futures and funds</td>
<td>Fixed income products traded in inter-bank bond market (CIBM)</td>
</tr>
<tr>
<td></td>
<td>◆ Fixed income products traded in inter-bank bond market (CIBM)</td>
<td>◆ Other instruments approved by CSRC and FX derivatives (for hedging purpose)</td>
</tr>
<tr>
<td><strong>Eligibility</strong></td>
<td>◆ Approved institutional investors</td>
<td>◆ Approved institutional investors</td>
</tr>
<tr>
<td><strong>No. of approved investors</strong></td>
<td>308</td>
<td>221</td>
</tr>
<tr>
<td><strong>Currency</strong></td>
<td>◆ Onshore RMB</td>
<td>◆ Offshore RMB</td>
</tr>
<tr>
<td><strong>Price limits</strong></td>
<td>◆ +/- 10% (and 5% for stocks under special treatment)</td>
<td></td>
</tr>
<tr>
<td><strong>Foreign ownership limits</strong></td>
<td>Individual investor: 10% of a company’s total issued shares</td>
<td>Aggregate: 30% of a company’s total issued shares</td>
</tr>
<tr>
<td><strong>Settlement cycle</strong></td>
<td>◆ Stocks on T; cash on T+1 (fail trade not allowed)</td>
<td></td>
</tr>
<tr>
<td><strong>Lock-up period</strong></td>
<td>◆ No</td>
<td></td>
</tr>
<tr>
<td><strong>Repatriation limit</strong></td>
<td>◆ No. Daily limit for open-end funds</td>
<td></td>
</tr>
<tr>
<td><strong>Tax treatment</strong></td>
<td>◆ 10% withholding tax on coupon and dividend. Exempt for government bonds</td>
<td></td>
</tr>
<tr>
<td></td>
<td>◆ Capital gains tax only temporarily waived for QFII and RQFII from 17 Nov 2014</td>
<td></td>
</tr>
<tr>
<td></td>
<td>◆ No value added tax (VAT) for deposit interest, dividend and trading income</td>
<td></td>
</tr>
<tr>
<td></td>
<td>◆ Capital gain is temporarily exempt from VAT</td>
<td></td>
</tr>
<tr>
<td></td>
<td>◆ Coupon income from non-government bonds is subject to 6% VAT</td>
<td></td>
</tr>
<tr>
<td><strong>Market entry timeframe (indicative only) and process</strong></td>
<td>◆ 5-7 months time for full China access</td>
<td></td>
</tr>
<tr>
<td></td>
<td>◆ CSRC: application for QFII/RQFII license</td>
<td></td>
</tr>
<tr>
<td></td>
<td>◆ SAFE: quota filing (within basic quota), or approval (exceeding basic quota)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>◆ PBOC Shanghai: filing within SAFE quota for CIBM investment</td>
<td></td>
</tr>
<tr>
<td><strong>Advantages over other channels</strong></td>
<td>◆ Participation in primary market, including IPO, rights and warrants issuance</td>
<td></td>
</tr>
<tr>
<td></td>
<td>◆ Broader access to instruments such as investment funds</td>
<td></td>
</tr>
<tr>
<td></td>
<td>◆ Invest in stocks that are not included in Stock Connect</td>
<td></td>
</tr>
</tbody>
</table>

**Note:**
1. Available quota = Total quota (QFII = USD150bn; RQFII = RMB1,940bn) – Approved quota

Source: HSBC Securities Services, HSBC Global Asset Management, data as of June 2018

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Appendix I: Accessing onshore equity market
Shanghai-Hong Kong and Shenzhen-Hong Kong Stock Connect programmes

<table>
<thead>
<tr>
<th>Shanghai-Hong Kong (Northbound)</th>
<th>Shenzhen-Hong Kong (Northbound)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Launch</strong></td>
<td>◆ 2014</td>
</tr>
<tr>
<td>Daily quota¹ (no aggregate quota)</td>
<td>◆ RMB52 billion</td>
</tr>
<tr>
<td></td>
<td>◆ RMB42 billion</td>
</tr>
<tr>
<td>Available instruments</td>
<td>◆ All constituent stocks on SSE 180 Index and SSE 380 Index</td>
</tr>
<tr>
<td></td>
<td>◆ All constituent stocks on SZSE Component Index, SZSE Small/Mid Cap Innovation Index with market cap &gt; RMB6bn</td>
</tr>
<tr>
<td></td>
<td>◆ Stocks with A/H dual-listing</td>
</tr>
<tr>
<td>Eligibility for northbound</td>
<td>◆ All investors, except ChiNext is open to institutional investors only</td>
</tr>
<tr>
<td>No. of stocks available</td>
<td>◆ ~570</td>
</tr>
<tr>
<td></td>
<td>◆ ~900</td>
</tr>
<tr>
<td>Currency</td>
<td>◆ Offshore RMB</td>
</tr>
<tr>
<td>Settlement cycle</td>
<td>◆ Stock on T and cash on T+1 (fail trade allowed)</td>
</tr>
<tr>
<td>Lock-up period</td>
<td>◆ No. Unless 1) the securities cease to be constituent stock of relevant indices; 2) placed under risk alert, or delisted from SEHK</td>
</tr>
<tr>
<td>Repatriation limit</td>
<td>◆ No</td>
</tr>
<tr>
<td>Trading</td>
<td>◆ No block trade, day trading and naked short selling</td>
</tr>
<tr>
<td></td>
<td>◆ Subject to conditions, margin trading and covered short selling are allowed</td>
</tr>
<tr>
<td>Latest developments</td>
<td>◆ Quadruple expansion of daily quota</td>
</tr>
<tr>
<td>Potential changes in future</td>
<td>◆ Shanghai-London Stock Connect in 2H18</td>
</tr>
<tr>
<td></td>
<td>◆ ETF Connect for southbound investors in 2H18</td>
</tr>
<tr>
<td></td>
<td>◆ Primary/IPO Connect, TBC</td>
</tr>
</tbody>
</table>

Stock Connect trade flow illustration

Note:
1. Daily Quota Balance = Daily Quota - Buy + Sell + Adjustment
Source: HKEx, HSBC Securities Services, HSBC Global Asset Management, data as of June 2018
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## Appendix I: Accessing onshore bond market

China Interbank Bond Market (CIBM) Direct and Bond Connect

<table>
<thead>
<tr>
<th></th>
<th>CIBM Direct</th>
<th>Bond Connect (Northbound)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Launch</td>
<td>2016</td>
<td>2017</td>
</tr>
<tr>
<td>Quota</td>
<td>No. Pre-file amount to invest</td>
<td>No. Also no pre-filing with PBoC</td>
</tr>
<tr>
<td>Available instruments</td>
<td>Interbank market cash bonds, repo and FX, interest rate and bond derivatives</td>
<td>Interbank market cash bonds and FX derivatives</td>
</tr>
<tr>
<td>Eligibility</td>
<td>Sovereign entities, financial institutions and their products, and other eligible mid/long term investors</td>
<td>All institutional and retail investors</td>
</tr>
<tr>
<td>No. of approved investors</td>
<td>1,010 foreign investors and products</td>
<td>356</td>
</tr>
<tr>
<td>Currency</td>
<td>Offshore RMB or other currencies</td>
<td></td>
</tr>
<tr>
<td>Settlement cycle</td>
<td>T+0, T+1 or T+2 (fail trade allowed)</td>
<td></td>
</tr>
<tr>
<td>Lock-up period</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Repatriation limit</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Market entry timeframe (indicative only) and process</td>
<td>6-11 weeks for non-sovereign entities</td>
<td>Abide to international laws and trading practices</td>
</tr>
<tr>
<td></td>
<td>7-15 weeks for sovereign entities</td>
<td>Use of offshore infrastructure from Hong Kong to access onshore bonds</td>
</tr>
<tr>
<td></td>
<td>Assessment by settlement agent</td>
<td>No onshore filing and account opening with onshore custodian</td>
</tr>
<tr>
<td></td>
<td>Registration with PBoC</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Account opening with intermediaries</td>
<td></td>
</tr>
<tr>
<td>Potential changes in future</td>
<td>ISIN codes to be assigned to all bonds</td>
<td>Launch of trade allocation from mid-July</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Full realisation of the delivery versus payment settlement system</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Access to repo and derivatives markets</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Discounts of up to 50 per cent in Bond Connect transaction fee</td>
</tr>
</tbody>
</table>

### Bond Connect trade flow illustration

![Diagram showing the trade flow between global market, Hong Kong, and Mainland China]

Source: HKEx, BCCL, HSBC Securities Services, HSBC Global Asset Management, data as of June 2018

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The value of investments and any income from them can go down as well as up and investors may not get back the amount originally invested.

- Exchange rate risk: Investing in assets denominated in a currency other than that of the investor’s own currency perspective exposes the value of the investment to exchange rate fluctuations.

- Liquidity risk: Liquidity is a measure of how easily an investment can be converted to cash without a loss of capital and/or income in the process. The value of assets may be significantly impacted by liquidity risk during adverse market conditions.

- Emerging market risk: Emerging economies typically exhibit higher levels of investment risk. Markets are not always well regulated or efficient and investments can be affected by reduced liquidity.

- Derivative risk: The use of derivatives instruments can involve risks different from, and in certain cases greater than, the risks associated with more traditional assets. The value of derivative contracts is dependent upon the performance of underlying assets. A small movement in the value of the underlying assets can cause a large movement in the exposure and value of derivatives. Unlike exchange traded derivatives, over-the-counter (OTC) derivatives have credit and legal risk associated with the counterparty or the institution that facilitates the trade.

- Operational risk: The main risks are related to systems and process failures. Investment processes are overseen by independent risk functions which are subject to independent audit and supervised by regulators.

- Concentration risk: Funds with a narrow or concentrated investment strategy may experience higher risk and return fluctuations and lower liquidity than funds with a broader portfolio.

- Interest rate risk: As interest rates rise debt securities will fall in value. The value of debt securities is inversely proportional to interest rate movements.

- Derivative risk (leverage): The value of derivative contracts depends on the performance of an underlying asset. A small movement in the value of the underlying can cause a large movement in the value of the derivative. Over-the-counter (OTC) derivatives have credit risk associated with the counterparty or institution facilitating the trade. Investing in derivatives involves leverage (sometimes known as gearing). High degrees of leverage can present risks to sub-funds by magnifying the impact of asset price or rate movements.

- Emerging market fixed income risk: Emerging economies typically exhibit higher levels of investment risk. Markets are not always well regulated or efficient and investments can be affected by reduced liquidity, a measure of how easily an investment can be converted to cash without a loss of capital, and a higher risk of debt securities failing to meet their repayment obligations, known as default.

- High yield risk: Higher yielding debt securities characteristically bear greater credit risk than investment grade and/or government securities.

- Contingent Convertible Security (CoCo) risk: Hybrid capital securities that absorb losses when the capital of the issuer falls below a certain level. Under certain circumstances CoCos can be converted into shares of the issuing company, potentially at a discounted price, or the principal amount invested may be lost.
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Expiry date: 31 October 2018