

Compelling Opportunities in Emerging Markets

3Q 2017



Emerging market equities are delivering strong returns this year, extending their 2016 recovery. On a year-to-date basis, emerging market (EM) equities have continued to outperform developed market (DM) equities, with the MSCI Emerging Markets Index gaining 25.8% compared to a return of 13.7% for the MSCI World Index.¹

We believe that we are in the early innings of a sustainable emerging markets rally due to the rare combination of compelling valuations, higher growth potential, and attractive positioning. Previously perceived headwinds, such as Chinese tightening and the direction of the US dollar, are no longer major concerns, in our view. We believe there are many reasons for investors to be optimistic on emerging market equities for the rest of 2017 and beyond.

Sources and Important Information

¹Source: MSCI. As of 7/31/17

²Source: EPFR Global, outflow period 2013-2016

³Source: EPFR Global, UBS

Emerging Market Rallies Tend to Last for Years

Emerging markets have underperformed developed markets over the last half decade, resulting in capital outflows of over \$150 billion.² This began to reverse in mid-2016, but recent inflows only represent roughly 30% of assets lost in the last down cycle,³ leading us to believe we are in the very early stages of an emerging markets rally. History has shown that emerging market rebounds generally last six to eight years.

MSCI EM Index: Periods of Rallies and Underperformance



Source: Bloomberg, as of 6/30/17.

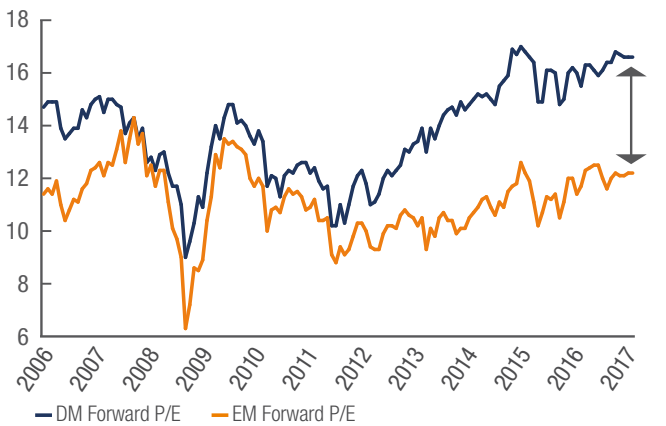
The change in expected growth rates has turned positive again for emerging markets for the first time since 2010.

Attractive Valuations and Stronger Earnings

Current valuations remain compelling with emerging market equities trading at a discount of roughly 27% relative to developed market equities. On a forward price-earnings basis, the spread between emerging and developed market equities is at one of its widest points in 10 years.

An earnings rebound also appears to be underway for emerging market companies. After reaching an inflection point last year, the net income margin for emerging market corporations has steadily risen. Emerging market corporate earnings are still coming from a low base. Improved operating and financial health of these companies should drive considerable margin expansion and growth in the near to medium term.

Emerging Markets are Trading at a Discount



Source: DataStream, IBES, MSCI, UBS. Based on 12-month forward P/E. As of 6/30/17.

A Rebound in Net Income Margins for EM Companies

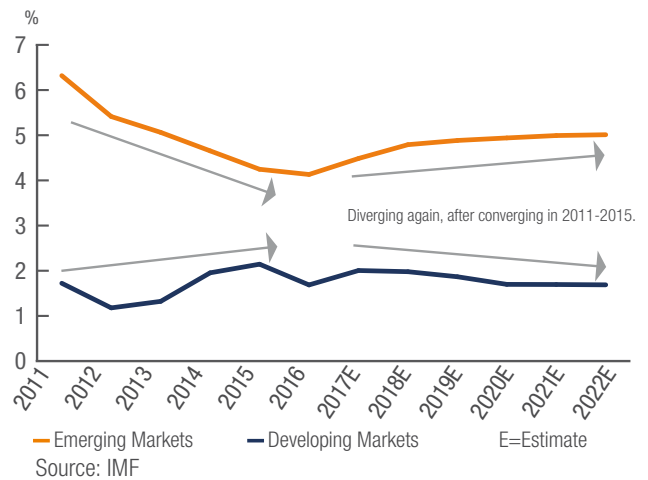


Source: MSCI, IBES, DataStream, HSBC. As of 6/20/17.

GDP Growth in Emerging Markets to Accelerate

Economic growth rates in emerging markets are expected to, once again, expand and diverge from developed markets. The change in expected growth rates has turned positive again for emerging markets for the first time since 2010. According to the International Monetary Fund, GDP growth rates in emerging markets will accelerate while GDP growth rates in developed markets decelerate. This growth gap is likely to continue through 2022.

Diverging GDP Growth Between EM and DM

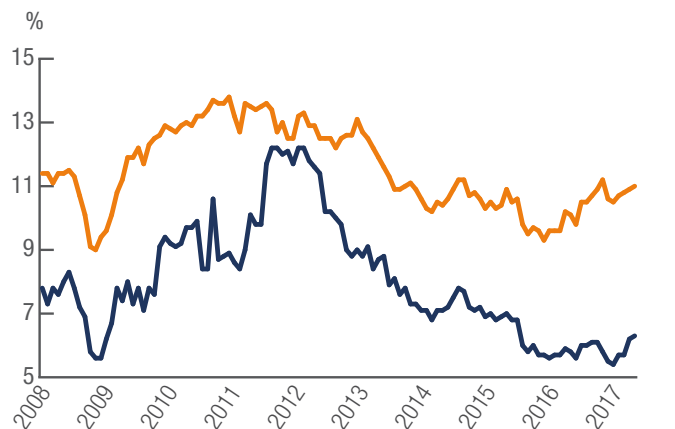


Source: IMF

Investors Remain Underweight Emerging Markets

Emerging markets currently account for 11% of the global equity market but global equity investors only have about a 6% allocation to emerging market equities, implying that investors are around 5% underweight emerging markets. We believe that the positive momentum 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.

Easing Previous Concerns

US DOLLAR STRENGTH

Historically, a strong US environment was seen as a negative for emerging markets but today's environment is different. Emerging markets are less vulnerable to external currency and interest rate shocks as their foreign reserves and current account balances have broadly improved.

EM Reserves and Current Account Balances Have Improved

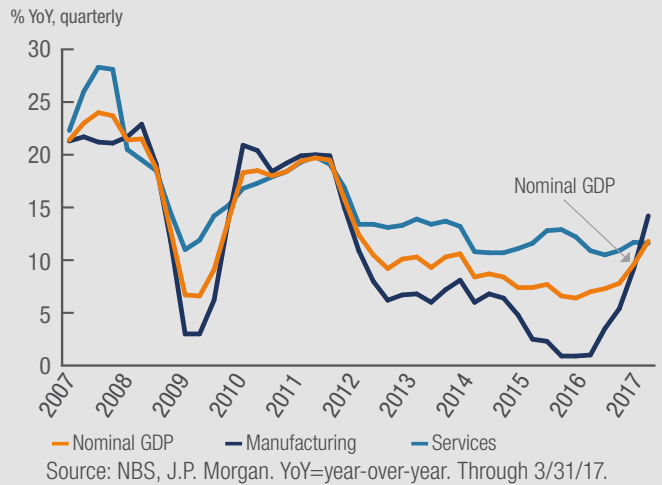


CHINA'S ECONOMY

The strength of China's economy has a significant impact on overall emerging markets performance. Growth stabilization, economic rebalancing and supply-side structural reforms, while maintaining financial stability, remain top priorities for China. The recent better-than-expected economic figures have allowed the government to move forward with tightening measures to rein in credit growth, lower financial risk and shift to a more sustainable growth model.

In addition, the inclusion of Chinese A-shares into the MSCI Emerging Markets Index should lead to a re-rating of Chinese equities and further support the currency.

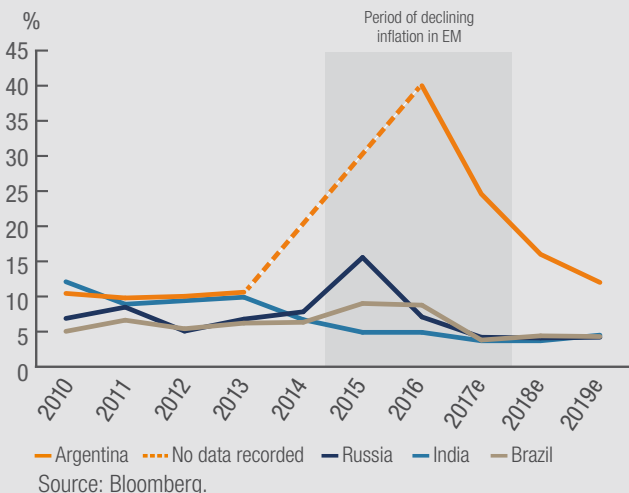
An Uptick in Growth for China's Economy



CURRENCY STABILITY

Local currency volatility has historically been a concern for US dollar investors into emerging markets. We believe that the combination of a global search for yield along with a declining inflation period across emerging markets will lead to local currency strength and stabilization within the regions. As a side note, lower inflation levels are also allowing central banks to reduce interest rates, which should act as an extra tailwind for emerging markets growth.

Declining Inflation in Select Emerging Markets



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