

**Remarks by Mr Norman T.L. Chan,**  
**Chief Executive of the Hong Kong Monetary Authority**  
**on 25 January 2017**  
**at the announcement of**  
**Exchange Fund's investment results for 2016**

*(Translation)*

Investment Performance of the Exchange Fund in 2016

I am announcing the investment performance of the Exchange Fund in 2016. The Exchange Fund posted an investment income of HK\$61 billion in 2016. Of this, equity holdings registered a gain of HK\$33.6 billion, with HK\$28.3 billion from overseas equities and HK\$5.3 billion from Hong Kong equities. Bond holdings brought an income of HK\$33 billion. Other investments recorded a gain of HK\$10.2 billion up to the end of the third quarter. A negative currency translation effect of HK\$15.8 billion on non-Hong Kong dollar assets was recorded. The overall rate of return of the Exchange Fund in 2016 was 1.8%. Specifically, the Investment Portfolio, not including the Long-Term Growth Portfolio (LTGP), achieved a rate of return of 2.8%, while the rate of return on the Backing Portfolio was 0.7%.

2. The total market value of investments under the LTGP, which primarily invests in private equity and real estate, stood at HK\$174.9 billion as at the end of 2016, with private equity amounting to HK\$112 billion and real estate at HK\$62.9 billion. The outstanding investment commitments amounted to HK\$133.8 billion. Regarding investment performance, the LTGP recorded an annualised internal rate of return of about 10.9% since its inception in 2009. The overall performance is satisfactory.

3. In 2016, the fee payable to the Fiscal Reserves was HK\$23 billion, while the fees for placements by Government funds and other statutory bodies totalled HK\$9.6 billion. Amounts payable to the Future Fund in 2016 are not included in the above figures, pending the finalisation of the annual performance of the LTGP for

2016. The relevant figures will be disclosed in the HKMA's Annual Report 2016 to be released later this year.

### Review of 2016

4. 2016 was full of surprises and black swan events. The global financial markets were highly volatile and turbulent. Market concerns over a hard landing of Mainland China's economy and a slowdown in the global economic growth in January last year prompted Hong Kong and other major equity markets to fall sharply. It was not until mid-February that the equity markets were stabilised. However, the result of the Brexit referendum in June and the outcome of the US presidential election in November took the market completely by surprise. That said, the equity markets only experienced short-lived setbacks and quickly recovered lost ground. For 2016 as a whole, the global equity markets performed well in general and the Exchange Fund's equity holdings recorded an investment income of HK\$33.6 billion.

5. Bond markets became the safe haven in the first three quarters of 2016 and performed quite well. However, in the fourth quarter, with the heightened expectations of US interest rate hikes, in particular after the US presidential election, the yields of US Treasuries rose and bond prices fell. At the same time, the US dollar appreciated sharply. Higher interest rates and a strong US dollar affected the performance of the Exchange Fund in the fourth quarter. This is partly due to the fact that bonds account for a relatively high proportion of the Fund's assets, and partly because the Exchange Fund inevitably needs to hold some non-US dollar denominated assets as part of our strategy of investment diversification. As a result, the income from the Fund's bond holdings in 2016 only amounted to HK\$33 billion, and there was a negative currency translation effect of HK\$15.8 billion.

6. In the past two to three years, in view of the worsening external investment environment, we have already deployed a series of defensive measures. First, we have reduced the Fund's holdings in long-term bonds and increased short-term bonds and cash to lessen the negative impact of possible increase in US interest rates on bond valuations. Secondly, we have reduced the Fund's holdings of non-US dollar and non-Hong Kong dollar assets to mitigate the negative currency translation

effect caused by a strong US dollar. The share of these assets was lowered to around 8% at the end of 2016 from 17.5% at the end of 2014. Thirdly, we have expanded investments under the LTGP. These defensive measures enabled the Exchange Fund to achieve an investment income of over HK\$60 billion in 2016 despite a very difficult investment environment.

### Investment Outlook for 2017

7. Stepping into 2017, the global political and economic environment is still highly complex and unpredictable. Although the new US administration has begun, there are still great uncertainties over the direction of its trade, economic and fiscal policies, as well as the approach, extent and timing of implementation of the policies. It also remains to be seen how long the current optimistic market sentiment will last. In Europe, the coming national elections in the Netherlands, France and Germany, as well as the impending formal trigger of the Brexit process in the UK in March, will bring about further uncertainties and may result in market turbulences. In addition, the pace of US interest rate normalisation is still highly uncertain, and will affect global fund flows, exchange rates and asset markets.

8. In the face of the continued complex and difficult investment environment, we will adopt a combination of both prudent and proactive strategies. While continuing to implement defensive measures, we will expand investments under the LTGP with a view to minimising the shocks brought by short-term market fluctuations and achieving better returns for the Exchange Fund in the medium to long term.