RESULTS AND DIVIDEND

For the six months ended June 30, 2020, revenue remained stable at HK$4,184 million despite the coronavirus (COVID-19) pandemic. Owing to property revaluation loss, net loss attributable to shareholders was HK$2,537 million. Loss per share was HK56 cents.

When excluding property revaluation and all related effects, underlying net profit attributable to shareholders decreased 11% to HK$1,989 million. The corresponding earnings per share declined to HK44 cents.

The Board has declared an interim dividend of HK17 cents per share payable on September 29, 2020 to shareholders of record on September 16, 2020. The amount is the same as the year before.

BUSINESS REVIEW

Since my last letter on January 21, the world has changed substantially. Within a day or two after I wrote, China – and the world – woke up to a novel coronavirus, now called COVID-19. It was first reported in Wuhan, one of the largest cities in Central China, where we are completing a huge mall and an office tower. Like many similar epidemics in human history, it spread quickly. Soon it became a global pandemic given globalization and international air travel. Although the virus is not particularly deadly – globally about 4% of the affected have died – it being asymptomatic in some people makes it particularly troublesome. An infected person without symptoms or has not yet developed symptoms can already be contagious. Since it usually takes as many as 14 days for symptoms to develop, such a person can still travel around the world, thus spreading the virus, albeit unknowingly.

Fortunate for our mainland China business, the country contained the spread well. Timely and drastic measures taken have been effective. Even at the epicenter in Wuhan, seven months on, the problem is for the time being behind us. But history tells us that there is often a second or even a third wave before a pandemic disappears. In fact, the later rounds could be more serious than the first. There are indications that a second wave is now surfacing in some parts of China, although it seems to be not that severe. We will have to see.

Hong Kong, our other market, also contained the pandemic relatively well. Until the third wave arrived a week or two ago, there were only about 1,200 cases, the majority of which were imported. The death rate was also very low. However, the third wave has proven to be more aggressive, and the city has again gone into emergency mode.

Ironically, COVID-19 may, in some ways, prove to be beneficial for our business in both markets. Locally, it ended the riots that began a year ago in June. Just as the street violence was about to rear its ugly head again in January after a lull, the pandemic stopped it. While the negative effect on our business due to the public health threat is more severe in the immediate term, there should be fewer lingering effects. The social disturbance, however, has lasting ones. I wrote about the latter six months ago and will expand on it later in this letter.

It is beyond question that the violent mobs seriously threatened and harmed their fellow citizens, and engaged in the wanton destruction of property, including some shopping centers. If not stopped, they may one day damage our malls and offices as well. Fortunately, so far, our facilities have not been seriously affected. Nevertheless, our business has been hurt.

The aftermath of the pandemic may also turn out to be advantageous to our business on the Mainland. Recall that last year I wrote about a 2018 research report by a reputable consulting firm, Bain & Company. It stated that at the time of writing, only about 27% of luxury goods purchases by Mainland Chinese were transacted within the country, not counting Hong Kong. By 2025, the number is expected to reach 50%, while global sales by the Chinese will double. This means that domestic purchases will quadruple in the coming four to five years on the strength of existing customers, even before new customers are considered. I also told my readers that a leader of a top luxury brand thought that this estimate was conservative. Whatever the case, this is good news for us.

The pandemic has greatly brought forward this repatriation of purchases. In fact, with the cessation of international travel, it may now be reaching 100%. Consider our experience during the first half of this year.

Six months ago, I predicted that our Mainland retail rental business would experience a boom. This was truly the case for the whole of January until the pandemic broke. Right around Chinese New Year, which fell on January 25 this year, people recognized the seriousness of the public health threat and our tenant sales suddenly plummeted. When the problem appeared to somewhat come under control in late March, and social distancing rules were partially relaxed, our business began to come back to life. Retail sales figures for April were already back to levels seen in the same month of 2019. By May, the luxury brands in our malls saw their sales soar. This upward surge has continued to this day. High-end shopping is alive and well, but regular purchases, while also recovering, remain stalled at levels well below the previous year.

The immediate explanation for the vibrant sales in luxury items is "shopping with a vengeance". The wealthy folks have been starved for many months of the pleasure of shopping. Here I should mention a rarely discussed but significant psychological difference: luxury shopping is for pleasure, while regular purchases are mainly for necessity.

However, there is a much more significant long-term reason. With almost all international flights cancelled, the only places to shop nowadays are in domestic malls like ours. After all, price equalization in the past year or two, through the lowering of import taxes by Beijing and through price adjustments by the brands themselves, means that shopping overseas does not make that much sense anymore.

Once international travel fully resumes, some purchases may leak out again, but it may not be significant. Here are a few reasons. First, Sinophobia is growing in the West. If one is no longer welcome in New York City, London, or Paris, why go there to shop? Even Hong Kong, which is part of China, had riots last year partly targeting the Mainland Chinese. This will strike this city out from the list of desirable shopping destinations.

Secondly, recognizing that China is already their number one market globally and growing the fastest, top international brands now stock their Chinese shops with the latest products and carry the most complete lines. They are as good as their counterparts in any metropolis in the world.

Thirdly, customer service and hence the shopping experience of wealthy shoppers in China is now as exquisite as anywhere outside China. While in Paris, these top spenders may have to line up from the end of a queue to enter a boutique on a busy day, but in China we know our important customers! Consider Hang Lung's CRM (Customer Relationship Management) program "HOUSE 66". It now covers all of our malls in the country and is thriving. Purchases by our members have accounted for an increasing percentage of total luxury sales. From our highly successful annual VVIP events for top customers, we have learned that many of them met each other at our events and have become friends. No doubt they exchange ideas on fashion. As such, it makes sense to them, economically, socially, and otherwise, to keep shopping at our facilities.

Fourthly, being creatures of habit like everyone else, once accustomed to the pleasures of buying domestically, inertia will build against shopping overseas.

Of late I have heard some mall owners complain that, in spite of the pandemic being contained and the government's encouragement to spend, they have not seen much improvement in their business. This is the case for those retailers positioned to cater to the masses. Both footfall and retail sales are still below the norm. The same is true of our sub-luxury malls. The question is why.

Let me offer a few plausible reasons. First, COVID-19 definitely hurt the average citizen more than the affluent. The former had more to worry about, including keeping their jobs. Again, with all of us married to our habits, buying daily necessities on the Internet has become even more prevalent during the lockdown period. Unlike shopping for luxury items, which is far less likely to be done online and there are few alternatives, the convenience of e-commerce for everyday items is unmatched in China. The country may well be the most advanced in any of the major economies in the world in this regard. Finally, footfall in all malls has not fully recovered, including the high-end ones. It is just that those who visit expensive stores are more likely to buy, and the value of their purchases are so much higher.

That said, I have little doubt that people will, in time, flock once again to shopping malls of all kinds. Being social creatures, human beings have a need to interact with one another. As I have written before, in some parts of the world, for centuries people have been gathering at souks, not just for the shopping but also for the social interactions. Now they go to malls. In the West, there are more choices of activities and Westerners tend to like outdoor pastimes, yet the opposite is true of Asians. So, my advice to those mall owners who are experiencing a slow recovery is as follows: just wait a little longer. Or, better yet, use this lull to improve your properties so that they will be more competitive once the market recovers – for recover it will. This is, of course, not just my advice to others but to my colleagues as well, especially those in charge of our four-star facilities.

Whatever the case, the impact of the pandemic has been severe for about two months. Beginning in February, many types of commercial activities were ordered to close by the local governments. In our malls, it included cinemas, gyms, and education-related operations. It was not uncommon, given the large size of our facilities, to have 30 to 40 such tenants temporarily out of business, accounting for perhaps 20% to 25% of lettable area. Some of these are only now beginning to reopen.

In extreme cases, all malls in some cities were ordered to close (except grocery stores) beginning in early February. Riverside 66 in Tianjin was shut for 36 days, and Center 66 in Wuxi for 13 days. This was why the former was the worst performer in our portfolio. Retail sales were down 40% compared to the first half of 2019. Center 66, however, demonstrated amazing resilience. Despite being closed for almost half a month, it still sold 13% more goods in the first six months than the year before. This shows how strong luxury spending is on the Mainland.

Since April, all of our top-end malls – Plaza 66 and Grand Gateway 66 in Shanghai, Center 66 in Wuxi, Spring City 66 in Kunming, and to a lesser extent, Forum 66 in Shenyang – have been going gangbusters. Those in Shanghai and Wuxi were executing 40% to 60% more sales during April to June than in the same months the year before. Even Grand Gateway 66, which is still undergoing its Asset Enhancement Initiative (AEI), did 41% more. All these took place while footfall was still far below that of the previous corresponding period. Spring City 66 in Kunming was opened last August so there is nothing to compare it with, but sales were robust. The strength has continued to this day.

COVID-19 will one day subside. Putting it aside for the moment, it seems that all the stars are aligned for our Mainland business. China is now by far the world's biggest and fastest growing luxury goods market. This has not escaped the notice of top international brands; in fact, they must have been the first to know. Terrible China-U.S. relations notwithstanding, they are rushing to open stores all over the Mainland. Given the quality of all our malls, we are one of their top choices for a landlord.

As those familiar with this Company know, many of our malls have successfully migrated to become a "Home to Luxury", as we call them, with more entering the ranks. In Shanghai, Grand Gateway 66 has joined Plaza 66 as a solid five-star facility. Our first outside Shanghai was Center 66 in Wuxi. Less successful so far, but definitely of the same genre, is Forum 66 in Shenyang. Then came Spring City 66 in Kunming last August which was born as a "Home to Luxury". Olympia 66 in Dalian is also well on its way to join this league, as many first-tier global brands have already signed up and are in the process of moving in. Once completed a little over a year from now, it will be the only truly luxury mall in that city, a position which we have targeted from the day we bought the land in 2009.

Heartland 66 in Wuhan already has many top names committed. Delayed for about six months by COVID-19, we now expect inauguration next March or April. Not much over a year from now, all luxury brands should have opened for business. Plans are in place to transform Parc 66 in Jinan to the same league, although the outcome is as yet less clear. Chances are also very good for our latest project, Westlake 66 in Hangzhou, to achieve the same eminence once it is ready in 2024. After all, it was planned as such.

All told, within 14 months from now, at least seven of our 10 completed malls will be luxury ones – by global standards. In the past, I have more than once explained why such facilities have much higher financial returns. Our goal is that by 2024, nine out of our then 11 properties will be five-star. They should be among the best in the world in terms of profitability as well as aesthetics.

The process entails the signing up with many top-tier fashion brands. Consider this pipeline: in the three years from 2019 to 2021, we are executing over 70 such leases. In 2019, we did 13, of which all brands have moved in. This year, the number now stands at 38 of which the majority has already opened for business. Next year, at least 19 more will join us. Those that moved in last year were mostly in Spring City 66 in Kunming and Grand Gateway 66 in Shanghai, with the rest in Plaza 66 in Shanghai and Center 66 in Wuxi. The majority of those who were signed this year went to Spring City 66, followed by Grand Gateway 66 and Center 66. The rest are spread over Forum 66 in Shenyang and Olympia 66 in Dalian, and one in Plaza 66. Those slated for 2021 are so far concentrated in Olympia 66 in Dalian and Heartland 66 in Wuhan.

Now let me turn to a troubling issue, that of the situation in Hong Kong. A month after mass rioting began in June 2019, I wrote to you about it. It died down in January 2020 partly due to the pandemic, and partly due to the movement running out of steam. The latter is not unlike the fate of mass social uprisings elsewhere. Nonetheless, discontent among the more radical definitely bubbles under the surface. On June 30, the Standing Committee of China's National People's Congress enacted the National Security Law (NSL) regarding Hong Kong, which will likely become a turning point.

With Hong Kong being our home base from which 46% of our rental revenue is derived, we are obviously concerned with such a major piece of legislation. It cannot but introduce uncertainties. Will it be for the better or the worse where our business is concerned? Upon study and reflection, I have come to the conclusion that it is for the better, not because I like it, but because Hong Kong can no longer survive without it.

In my letter of six months ago to shareholders of our majority shareholder Hang Lung Group Limited (HLG), I wrote quite extensively about the history of Hong Kong after her return to the Motherland. I will not repeat it here except to summarize it in one sentence: Beijing had been way too soft on implementing the Basic Law that guides Hong Kong. This has emboldened the opposition to damage the "One Country, Two Systems" construct. The radicals advocating independence from China – or two countries, two systems – had gained momentum, which if go unchecked would spell the death of "One Country, Two Systems". Violence has greatly escalated over the past decade. It has gotten to the point of spiraling out of control. The police force, which was ordered to exercise great restraint, did so, and was on the brink of collapse. Something needed to be done to rescue the "One Country, Two Systems" framework. Things had evolved to such an extent that without the NSL, it could not be done.

As a businessman, I also examine the situation from a practical perspective. For six to seven months last year, average citizens were deprived of social stability and personal safety. Walking on our streets had become unsafe. The city had almost succumbed to the law of the jungle. How can businesses exist under such conditions?! If uncorrected, the economy would sooner or later collapse, but that was one of the intentions of the opposition, in order to force the local government to resign. Their stated purpose in writing was to ensure the destruction of both Hong Kong and Beijing on the international front.

There are only two ways to restore social stability and personal safety: send in the PLA (People's Liberation Army), or enact the NSL. The opposition was trying to force Beijing's hand to do the former. The consequences would have been dire and far-reaching, and Beijing was not so foolish as to fall into that trap. So, the NSL had to be introduced. It is altogether legal; at this stage Beijing does not only have the right but also the obligation to do it.

Does Beijing want to legislate for Hong Kong? Of course not. If they had wanted to, they could have done it anytime in the past 23 years. According to Article 23 of the Basic Law, Hong Kong is obligated to pass a locally legislated national security law. In my opinion, that would have been the best. We tried it in 2003 but failed. Since that time, the local political environment has become so toxic that there is now no hope of passing it. Probably China was the only country on earth where part of her territory was not covered by some form of national security legislation.

So, for two primary reasons, Beijing was forced to enact it for Hong Kong: to safeguard "One Country, Two Systems" and to restore social stability. Initial indications are that the NSL has been effective, but like any new law, there are still many details, especially on how it is applied, that are yet unclear.

In my Letter to Shareholders in the 2019 Interim Report, I analyzed extensively the developments in China-U.S. relations, since it cannot but affect Hong Kong and mainland China, and so our business. In my letter of the same day to the HLG shareholders, I ventured further on the subject but from a different angle. Later in this letter, I will give an update. But for now, I will only say that the latest developments of this most important bilateral relationship in the world has something to do with Hong Kong's present NSL.

As we all know, the U.S. in the past few years has chosen to fall into Thucydides's Trap, a term coined by Professor Graham Allison of Harvard University. In more normal times, Beijing would have cared very much about the reactions of Washington, D.C. to whatever she does regarding Hong Kong. That was the case before and after 1997. But in the past year or so, the U.S. has taken the gloves off and put on brass knuckles. It has publicly called China her enemy number one. As a result, Beijing has no more reason to care what Washington, D.C. thinks regarding Hong Kong. It gives Beijing a free hand to do what is necessary to save Hong Kong, namely, to enact the NSL. From my perspective, this is one of the very few good outcomes of the deteriorating China-U.S. relations.

America's reaction has been expectedly fierce. It is directed at Beijing more than at Hong Kong. Today what the U.S. leaders say about this city is just political talk. It has almost nothing to do with facts, truths, or righteousness. In the arena of global politics, all these matter little. When two elephants fight, it is the grass that suffers. Hong Kong is but collateral damage. Since there is nothing that any of us can do to change the situation, we will just have to live with it. As a business enterprise operating here, we should understand the big picture and plan accordingly. This we try to do, and here I report.

Now let me turn to our business performance. Whereas the second half of 2019 was dominated by the effects of the Hong Kong riots, the first six months of this year was all about COVID-19. The impact of the public health threat on our retail rental is more severe than the social unrest of last year. The former's effect, however, will be short-lived. Social unrest, however, has fundamentally damaged many parts of Hong Kong's economy.

Consider our retail sales and the hospitality industry, both of which are big job creators. Before last year, it is estimated that some 30% of all private consumption was related to the Mainlanders visiting our city. 80% to 90% of our tourist arrivals were from north of the border. The riots last year amply demonstrated that a good number of our citizens do not welcome these visitors. As such, it is plausible that at least two-thirds of their spending has been chased away. This translates to a roughly 20% drop in Hong Kong's total retail sales and a far higher percentage of hotel vacancies. I wonder how many industries can see their top line fall by this magnitude and still survive.

As a result, many of our shops, restaurants, and hotels will be closed. The associated jobs will be cut, and unemployment will inevitably rise. Salary increases will slow greatly if not fall. The economy may even shrink for a few years. Who should bear this responsibility?

Since October last year, we had to grant rent relief to selected Hong Kong tenants. It has a prolonged effect because the amount foregone has to be amortized over the remaining lease term. If more relief were to be yielded, then there would be a cascading effect that might last another two years. Given the third wave of the pandemic which Hong Kong is now experiencing, this is a distinct possibility.

Six months ago, I wrote something prescient, but was wrong in the reason. I penned, "Let me paint a somewhat harsh scenario where Hong Kong rents would fall by 5% per annum for the next two years." The presumption then was that the street riots would continue. It turned out that the social unrest was forestalled by the pandemic, something which I mentioned but could not have foreseen its impact. So for a different reason, at least for the past six months, our Hong Kong rental revenue did fall by 5%. Operating profit therefrom was down 10%.

So far, we have been able to keep occupancy rates up, but this will be difficult moving forward. Rental margin, average unit rent, and rental reversion have all retreated somewhat. Retail tenant sales for the first five months of the year dropped almost 30% and, as a result, occupancy cost has gone up. Our Hong Kong offices have performed about the same as our retail portfolio.

Due to COVID-19, we had to grant a one-time across-the-board relief on base rent for retail tenants on the Mainland. They paid 50% base rent for three weeks. Nevertheless, for the half year under review, rental revenue in RMB terms still rose 9% compared to the same period a year ago. But since the currency depreciated against the Hong Kong dollar by 4.5%, it only grew 4% on our books. Excluding new properties, revenue went up 3% in RMB. Shanghai advanced by 8% and those outside fell 6%.

In the past six months, the external environment did not allow us to sell many properties. We did part with the last penthouse at the Hong Kong residential project, The Long Beach. Unit price was quite satisfactory. In accordance with the accounting rules, recognition of revenue and profit of this sale took place this month, i.e. in the second half of this year. Ahead of the sale of Mainland serviced apartments in the coming few years beginning 2021, we had to build up a sales team, whose costs were fully reflected in the interim results.

Given the horrific external environment, a valuation loss was to be expected. The total amount of HK$4,642 million represents about 2.5% of our investment property portfolio. The number in Hong Kong was approximately 3.6% of its book value, and on the Mainland, 1.9%.

Taking advantage of the low interest rate environment, we optimized our debt portfolio by issuing some new bonds to refinance the old ones and repay more expensive bank loans. Net debt to equity held at a healthy level of 20.8%.

In terms of rental revenue split, Hong Kong now accounts for less than 46%, and the Mainland over 54%. The gap will continue to widen, as our RMB denominated business should continue to outstrip our performance in Hong Kong. We are also adding many square meters on the Mainland.

To summarize, in Hong Kong dollar terms, revenue was almost exactly the same as last year. Locally it was down 5%, but on the Mainland it was up 4%. Underlying net profit attributable to shareholders retreated 11% to just shy of HK$2 billion. Due to the sizable revaluation loss compared to the gain in the previous year, we recorded a net loss attributable to shareholders of a little over HK$2.5 billion. This is the first time the Company has ever seen a loss. Since we had warned shareholders in a public statement dated June 5, this should not be a surprise to anyone. This is only an accounting loss and does not affect any of our operations, including our cashflow.

There are two cash items whose amounts would have been too small to be mentioned here, but I will do so now due to their symbolic significance. The first is that, like other responsible enterprises, we donated RMB10 million to help Hong Kong and the Mainland fight the pandemic. The other is that we have decided not to apply for the Hong Kong Government's Employment Support Scheme (ESS) designed to help employers during the pandemic. Under this scheme, cash is given to eligible enterprises to offset staff salaries with the condition that they promise not to lay off staff for a defined period of time. For us, the total amount could come to almost HK$70 million.

Upon deliberation, your Board decided unanimously not to apply for ESS, and announced our decision early to the community. The scheme is meant to help companies with genuine financial needs. Although our business, like everyone else's, is hurt, our finances are strong and can weather the storm. As such, we should free up limited public resources for the needy. We also made known that we have no plans to lay off staff or reduce salaries.

This is a good time to share with my English readers about the meaning of the Company's motto, "We Do It Right". It is a short form of the Chinese motto which is equally succinct but even more meaningful. In Chinese it means, "We Choose Only the Best, and We Do Only What is Right". When there are choices, we always pick the best. What "the best" is depends on the situation. For example, when hiring a staff, we pick the candidate who is the most competent and ethical. There is no room for nepotism, a problem that plagues many Asian corporations, even the publicly listed ones. Or, when we buy land on the Mainland for a mall, we will not settle for second best.

To "Do Only What is Right", or in our English motto, simply "We Do it Right", will often touch upon ethical and moral issues. Adhering strictly to this principle over the long years has built us a pristine reputation in the investment community. This is why we have won most of the reputable awards in corporate social responsibility for our industry in recent decades. We do not win these awards for the sake of winning. We win because integrity is ingrained in our corporate culture.

Not applying for the ESS is just one manifestation of "Do Only What is Right". We do not object to others' applying for it as it is not against the law to do so, but we hold ourselves to a higher moral standard. Since HK$70 million is not that small a sum, I wanted all our shareholders to know the reason behind the decision of your management and your Board.

PROSPECTS

The external environment in the past year could not be more disturbing – the COVID-19 pandemic, Hong Kong's social unrest, and the unfolding specter of China-U.S. relations. All have a direct impact on our two markets in Hong Kong and mainland China. Those who have read my letters of the past two years should not be surprised that I am very concerned about Hong Kong, but quite bullish about the Mainland.

The impact of COVID-19 on the retail sector is as severe as anything I have known, but it should be short-lived. Once gone, it is gone. We just do not know when it will go.

Last year's social unrest in Hong Kong almost dealt a death blow to Hong Kong as the Pearl of the Orient. As I will explain later, to restore her to her former glory is perhaps possible, but it will require Hong Kong people to work together with Beijing. If not, Hong Kong will gradually wane and lose her luster.

In the 2018 year-end letter dated January 2019 and the 2019 Interim Report of July 2019, I have written extensively on China-U.S. relations. However, to the surprise of many, myself included, the deterioration has greatly accelerated and so requires further comment. I fear that it may have reached a point of no return. It is said that the U.S. is always in need of an enemy. The saddest thing is that it is, in my opinion, unnecessary.

Thucydides's Trap is not new in history. Under the right set of circumstances, it will happen, as human nature will dictate so. If the incumbent power believes that it can defeat the rising power, it will try. The U.S. is now thinking that this is her last chance before China becomes inordinately powerful. At such a juncture, America has a highly unusual president in Donald Trump. Being surrounded by people with even more extreme views than himself, he has led the country straight into the trap. History will show this move to be one of the greatest follies of the 21st century.

In recent months, the U.S. has coerced other English-speaking countries and a few Continental European states to join her. Some of them reversed previous decisions and have toughened their stance on China. In the latest manifestation of this contrived animosity, they are now lumping China and Russia together, almost as a joint target. This, to me, is indeed unwise. Russia and China are not natural friends – they share a 4,200-kilometer border, with one side full of people but poor in natural resources, and the exact opposite on the other side – but they are now forced to work together.

Frankly, with Russia being rich in energy resources and Western Europe deficient in these, I doubt if most Continental European countries will in the longer term go along with the U.S. In fact, as America becomes even more of a bully than before, many key European capitals may consider Washington, D.C. to be more difficult to work with than Moscow. A transatlantic rift may not be too far away, although I foresee the U.K. will always side with the U.S. Just as during World War II (WWII), she has no choice, especially now given Brexit.

The Cold War has returned, and this time it is even more dangerous. China today is not the U.S.S.R. of yesteryear. With China and Russia working together, they can be a formidable opponent, and Continental Europe will become the key battleground. Having been on the wane politically and economically since WWII, perhaps this will shake up these countries and put them back on the global front stage. They will, at least, rearm, which will have the side benefit of stimulating their moribund economies.

As to the U.S., McCarthyism has returned domestically. A few brave souls are still voicing sensible words of reason. I fear that, very soon, these too will fall silent. There are already clear signs. What happened to freedom of speech? For reasons different from those of Russia and China, America is increasingly practicing the same tenets. The former pair did it to keep their respective countries strong; the U.S. now does it to keep her newfound and self-created enemies at bay.

So the world has arrived at another pivotal moment. What happens today will change the course of the world in the coming few decades. It is akin to the onset of the Cold War after WWII, China's opening up to the world, and the fall of the Berlin Wall. For China, these three globally significant events draw parallel with three defining moments: the Korean War, U.S. President Nixon's visit, and the June 4, 1989 incident that took place the same year as the fall of the Berlin Wall. Each of these events changed the world and took decades to change again.

Let us not blame President Trump for everything. Soon after 1989, there had been discussions already in U.S. policy circles of the perceived need to contain China. Many experts argued against it, and I was in that camp. But as China gained economic strength, her opponents became more worried and more vocal. Once the issue is raised to the level of national security, whether it is true or not somehow becomes irrelevant. Few people will dare to speak his or her mind. All of a sudden, everyone sees China as a threat. It became a chorus.

In this regard, the role of the media is critical: it magnified the negative sentiments. Given human nature, anything negative is reported more in the press, for only bad news is news. The tide thus created can and usually does drown out all contrary opinions, such that freedom of the press becomes hollow. Opposing views would be unreported or at least go unnoticed. It can be deliberate or inadvertent, but the result is the same. When that happens – and we are close to that point – it will take tremendous moral courage for anyone to speak up.

The last Cold War ended almost 30 years ago. Sadly, it coincided with the June 4, 1989 tragedy in China. Together, these two events brought on the beginning of a divergence between China and the U.S. The decline was gradual until Donald Trump arrived on the scene. A man prone to take unexpected positions and make not well-considered decisions, he has snuffed out possibilities for moderation, thus a new Cold War is born.

Recent polls in the West show that their citizens feel more negative towards China now than any time in the past few decades. Are these views informed and based on independent thinking? I doubt. People everywhere are the same. They react primarily to external stimuli, such as the words of their leaders or the press. Many people disagree with President Trump's domestic policies because they are knowledgeable on the issues. But when it comes to international affairs, frankly most people everywhere are ill-informed. I find it to be the case in the U.S. as in China.

A year ago, I wrote that the trade dispute was only a tertiary conflict between the U.S. and China. The primary and secondary ones are technology superiority leading to military supremacy, and currency domination. In fact, the center stage has of late been shifted from trade to the far more serious issue of technology.

In the past few years, the U.S. targeted China's Huawei, which is a hardware company. One reason would be that America's monopoly in spying is being threatened. Now even Chinese software application companies are targeted. The reason given is incredulous: data integrity. Frankly, any government with a network can already tap into the personal data of almost anyone they want. There is no such thing as a Clean Network.

Of late, there are indications that the U.S. may also weaponize financial flows. This can well be a "nuclear" option. In this regard, I worry for America more than China. As the victim, China will surely suffer, but she can handle it. What about the instigator?

America's economy to a good extent relies on the U.S. dollar being by far the world's most significant reserve currency. Her ability to print an inordinate amount of the greenback enables the country to live beyond her means. It is not too much to say that much of the global financial system is built on the confidence on the U.S. dollar. It does not take too much imagination to see how this confidence can be shaken. When this happens, everyone will suffer but especially the U.S. Who can bring the U.S. dollar down? Only one country – the U.S.

So, what will happen to trade between China and the U.S.? For now, it does not matter that much since COVID-19 is slowing it down anyway, but what will happen when international transportation returns to normal levels? In the first Cold War, which lasted about 40 years, commercial interactions between the two camps were minimal. Now the U.S. and China are the top two trading countries in the world and are intricately connected to each other. How will international trade evolve in a post-COVID-19 world? It is hard to foresee at this stage. I refer my readers to my letter to the HLG shareholders of even date on a discussion of this topic.

Fortunately for China, the three-pronged onslaught did not happen 20 years ago or even 10 years ago, when her ability to withstand was much weaker. Now, after 40 years of Reform and Opening-up, there should be sufficient capital, human talent, technologies, international networks, and a domestic market to get by acceptably.

I do not believe that the U.S. will be able to beat China to submission, which may well be the unspoken intention of Washington, D.C. (Interestingly, the present U.S. administration has never declared its endgame!) If so, the best alternative for the U.S. is to work with China. As I have previously written, the number two is not a challenger, except in the minds of the number one, nor does the former have the ability to be a global leader. In fact, China is very happy to play second fiddle to America. Sadly, the U.S. cannot accept that. America is never good at compromising or at diplomacy, since she can always resort to her military and economic might.

There is no denying that America is the most creative country in the world. One of her inventions that the Chinese can never come up with is the oxymoron “First among equals”. The Chinese, on the other hand, is supposed to be good at adaptation or copying with a twist. So please allow me to adopt something that few Westerners have concocted: China is happy to be “Second among equals”. Unfortunately, the U.S. does not understand this, nor is she willing to accept it.

Despite this hostile relationship with the West, China will not give up on her many foreign friends. In fact, she will try her best to build even closer and more comprehensive relations with, among others, developing economies such as those in Africa and Latin America. These countries are rich in natural resources that China needs, but their consumption power for Chinese manufactured products cannot compare to that in the U.S. and Western Europe. Ultimately, the biggest market for Chinese goods would still be the domestic one. As such, I expect an ever-rising local consumerism to lead her economy.

Look at China another way. For the first 30 years or so since her Reform and Opening-up began in 1978, the country relied on muscle and sweat to make money. Thanks to her population size and hardworking citizens, who were willing to sacrifice for a better future for their children, if not for themselves, she began to gather initial wealth. In the past 20 some years, aside from blue-collar workers, the educated – and there are many of them – began to primarily use their brains to create fortunes. Experimentation in technologies of all sorts took off, and some were eventually employed to build huge companies. For example, today China is probably the first, if not the only, truly cashless society among all major economies. Finally, considerable wealth has been accumulated in the society, to the extent that the huge middle class began to join the early wealthy to use capital to make more money. Witness all the investment houses, insurance companies, and pension funds that have popped up in the past decade or two. So now all three cylinders of wealth creation are proceeding. We will see a continuous expansion of the nouveau riche.

As long as the Chinese domestic society remains relatively peaceful, the country should still be one of the best places to do business and make money. We are fortunate to be well established there to participate in the many opportunities that the commercial real estate sector offers.

Back in Hong Kong, the city should remain Asia's leading international financial center and perform acceptably. Our clients these days are mainly from the Mainland, and we are still by far their best choice. In this regard, I expect closer financial ties between this city and those north of the border. Increased connectivity can only be good for both sides. Shanghai-Hong Kong Stock Connect, Shenzhen-Hong Kong Stock Connect, and now Bond Connect are just the beginning. Much more money can flow in both directions. Just as in the old days when this city was the main channel for international money to enter the Mainland, today we will also play a key role in channeling funds out. There is a lot of wealth in the country that is looking for global investment opportunities.

Now that the U.S. is making an issue of Hong Kong because she wants to hurt China, it is conceivable that Washington, D.C. may take even more drastic actions. Consider the recently passed Hong Kong Autonomy Act. However, many of the severe measures that the U.S. can muster will likely end up hurting herself more. As such, she has to tread carefully.

One of the long-lasting effects of COVID-19 is the exponential growth of money supply. This is prevalent around the world, including the U.S. and China. While the increased amount will keep interest rates low, which is critical for America, it may also make the U.S. Dollar more vulnerable to the confidence placed on it by the international capital markets.

Aside from financial services, I can hardly think of any other significant industries that Hong Kong can rely on to keep her economy strong. Since 1997, whenever Hong Kong needed help, our citizens would ask Beijing for favors. Personally, I was unhappy with that. We should first rely on ourselves. After all, that was the spirit that had prevailed in this city for decades, knowing that our then colonial master was only interested in extracting benefit from us and not bestowing it. Such a fighting spirit has served us well. But somehow after 1997, many of my fellow citizens no longer feel embarrassed to ask the Motherland for economic goodies. And for better or worse, Beijing always obliged.

This time round, with the self-created conundrum that we are in, I do not see how Hong Kong as an economy can continue to thrive without the help from the Motherland. Today, only Beijing can make Hong Kong prosper again. But will they? I believe they are willing, but with certain conditions. Equally significant is a question for my fellow Hong Kong citizens: are they aware of the seriousness of the economic perils that some of them have exacted on our city as a result of last year's riots? I fear the answer. If it is on the negative, then perhaps the city is not yet ready to recover.

Hong Kong must alleviate Beijing's worry about political trouble. This is a real test on the intelligence of Hong Kong people. Most of them do not have any clue about what really took place in the past 23 years. Some even actively participated in hurting Hong Kong. Now facing a systemically damaged economy and rising unemployment, many will lose their jobs. What will they do? I suppose their answer may again be: blame Beijing. If so, then Hong Kong does not deserve to shine again.

As we all know, as a small entrepôt, Hong Kong must serve our clients well, whomever they are. This is even more so today, since the service sector now accounts for some 94% of our economy. In the first 40 years or so after WWII, we made money mainly from serving the West. This was why we had to learn English and speak it as well as possible. In the past 20 some years, our clients from the rest of China are increasing. So now we had better speak Putonghua well.

I love Hong Kong; I grew up here and have built a business and my career here. As I have told my friends, I am pessimistic about my home city but I am not passively so. That was also my attitude as I worked in the past three decades to better China-U.S. relations. Whatever the case, having lived for many years overseas and now still traveling (before COVID-19) the world incessantly, I consider myself a global citizen. I am not wedded to any single place. This should somehow ease the pain of watching Hong Kong wane. Hopefully that day will never arrive.

Many Chinese believe that the U.S. is on the decline. I disagree. Similarly, a good number of my American friends think that China will implode, especially with pressure from the outside. I seriously doubt. I believe both nations will be fine. This is why I am at ease in both places, as I am also in many other parts of the world.

Personal endeavors aside, as Chairman of your Company, I have to be realistic. In business, many things are beyond our control and we have to be nimble to minimize risk and maximize profit potential. So, what should we do with our Hong Kong assets, which are not inconsequential?

As we all know, there are often good opportunities to make money in troubled times. Those who remember our history should be aware of how we took advantage of the Asian Financial Crisis of 1997 to 2002 and greatly benefitted our shareholders. Similarly, we grasped the opportunities proffered by the cash-strapped district governments of Mainland cities about a decade ago, and bought prime pieces of land on the cheap. Now we are considering what to do next.

For the remaining months of this year, my belief is that we will still likely be under the threat of the pandemic, although it may ebb and flow. It is possible that, in this regard, the situation on the Mainland will be better than in Hong Kong.

As far as Hong Kong's street riots are concerned, it seems that, so far, the NSL has ushered in some much-needed quiescence. It is still too early to say whether this situation will hold.

If my assessment is not too far from the truth, then Hong Kong rents will still come under pressure for the rest of the year. It is hard to imagine having good news on this front. As to selling more luxury homes on Blue Pool Road, where we still have nine for sale and two for lease, it is almost impossible to predict. If there is good news, it may come from this direction.

On the Mainland, we should do well – perhaps very well – as long as the virus does not return with a vengeance. Once the threat is over, I expect a very strong market for several years to come. After all, we are perhaps better positioned to benefit therefrom than most, if not all.

I would like to take this opportunity to thank our colleagues who remained in Wuhan, the epicenter of the pandemic, throughout the lockdown period. During that time, we had almost 200 staff there including almost 20 from Hong Kong. They have been most professional, prudent, and loyal. The same was true of the other cities where we have a presence. In addition, under Hong Kong leadership, especially our Human Resources team, morale was kept high everywhere. We were most relieved that not a single member of our staff in Wuhan was tested positive for the virus. Before the resumption of work, we paid for the testing of not only our own colleagues, but all the workers of our contractors who were employed on our site.

It is also appropriate that I should single out our frontline staff who could not work from home during these challenging times. They were the most exposed to the danger, and I salute them all.

Ronnie C. Chan
Chairman
Hong Kong, July 30, 2020