

HSBC Fund Update

HSBC Global Investment Funds – Russia Equity (“the Fund”)

November 2011



Douglas Helfer, Manager of HSBC GIF Russia Equity Fund

Douglas Helfer joined HSBC Global Asset Management (UK) Ltd. in January 2006 as Senior Fund Manager – Europe, Middle East & Africa (EMEA). He was previously at F&C Emerging Markets where he was responsible for EMEA and ran their Russia Fund. Prior to this he worked at Brunswick and Clifford Chance. Douglas started his career working for the US Embassy in Moscow in 1988. He speaks fluent Russian. Douglas has a BA in Soviet and Eastern European Studies from the University of Colorado, an MA in Russian Studies from the University of London and an MBA in Finance from City University Business School.

How did Russian equities perform during October and what were the key drivers?

Russian equities rebounded strongly in October, paring back approximately half the losses incurred in the August to September period, whilst outperforming both wider GEM and BRIC. As was the case for much of the year, the key drivers were external; encouraging growth data from the United States and hopes that policy makers in Western Europe would assemble enough ammunition in their battle against spiraling sovereign debt to reassure markets. The Russian market remains high beta and susceptible to risk appetite changes in the wider global arena; as such, it has followed sentiment back down again in November.

What effect is the global financial market turmoil having on growth and other macro-economic indicators within Russia?

There is still scant evidence to suggest that global financial market dislocation has had a direct impact on macro-economic dynamics within Russia. Growth indicators continue to support recent trend-level growth of 4.5% to 5% - September's Purchasing Managers' Index moved up to the key 50.0 level, retail sales increased 9.2% and unemployment was steady at 6.6%. However, industrial production fell slightly on a month-on-month basis, but this is thought to be a seasonal trend. System-wide loan growth also saw significant month-on-month increases, with the corporate sector rising by 5.0% and retail up 3.6%, with total 2011 growth comfortably positioned to end the year at about 20%. The oil price has held up remarkably well versus other global commodity prices since the onslaught of this year's market turmoil, and this continues to support gross domestic product (GDP) and corporate earnings growth. Inflation continues to dissipate, with a 0% month-on-month figure for September bringing the year-on-year level down to 7.2%, a significant improvement on the 9.2% run-rate we saw back in January.

Beyond economics, what other domestic factors will the market be focusing on in the coming weeks?

There have been developments recently that appear to be clearing the way for Russia finally to be joining the World Trade Organisation after years of stalled talks. Many market observers are now suggesting that a formal agreement will be concluded by mid-December. The key long-term implication of this would be the attraction of investment, with some analysts forecasting that this could add between 0.3% and 1% to annual sustainable GDP growth rates. In the short term, the effect would improve market sentiment.

At a corporate level, the key development over the month was a report that Gazprom's management is considering a significant increase in its dividend payout in 2011 - perhaps even doubling last year's record \$3bn. A \$6bn payout would equate to a 4.5% yield at current prices. If this happens, it would go some way to addressing one of the key corporate governance complaints on the company and the wider Russian market. The Russian market is trading on a price-earnings ratio of 5x forward earnings (versus an emerging market average of 9x) and a price-to-book value of 0.85x (versus an emerging market average of 1.5x), near the bottom end of its 10-year average in both absolute and relative terms. Earnings are still forecasted to grow by over 30% this year, making the Russian market the cheapest and one of the fastest-growing in the world. Should companies begin to pay out bigger dividends, the discount compared to other emerging market peers may begin to fall.

Have you made any changes recently and how is the portfolio positioned currently?

Our investment style has a strong bias for value and we continue to focus the portfolio in companies that appear inexpensive given the returns they are generating. Our current positioning is similar to that of recent months with an overweight in energy and financial names. Following a sharp sell-off in mining and steel stocks in Russia, we have been adding slowly to this sector. At the sector level, we remain underweight in telecoms and utilities.

Source of macroeconomic data: Bloomberg & HSBC Global Asset Management (Hong Kong) Ltd, as of 31 Oct 2011. For illustrative purposes only and does not constitute investment recommendation to buy or sell in the above-mentioned securities and sectors.

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