HSBC Fund Update

– HSBC GIF Asia ex Japan Equity Smaller Companies

September 2014

Summary

- MSCI Asia ex Japan Small Cap index continued its uptrend in August and posted a positive return of 1.7% in US dollar terms
- The Fund made good gains in August and outperformed the index, mainly due to positive stock selection on both the country and sector level
- We have conviction in opportunities among regional alternative energy and Chinese textile names and we also like several stocks related to offshore oil and gas exploration in South East Asia

Market overview

MSCI Asia ex Japan Small Cap index continued its uptrend in August and posted a positive return of 1.7% in US dollar terms.

In China, both official and HSBC Purchasing Manager's Index (PMI) eased in August, registering at 51.1% and 50.2% respectively. The easing in both figures reflected softer demand conditions and business operation activity. On the other hand, July activity data came in on the weaker side of market expectations. Industrial production increased 9.0% year-on-year, slightly lower than market consensus of 9.2%, mainly driven by the decline in mining and electricity output growth. Fixed asset investment also missed forecast and fell to 17%, weighed down by weaker property investment. The decline in both banks' new loan creation and total social financing also drew market concern. In light of the softer activity data released during the month, it is expected that the policy makers in China will likely maintain their accommodative policies and continue to deliver targeted easing measures in the second half of the year.

Korea gained ground and was the best performing market during the month. Thailand also outperformed, with improving macro data and positive developments on the political fronts being key drivers of the market. On the other hand, Taiwan small cap market lost ground and was the worst performer in August. On a sector level, information technology outperformed, while energy and materials retreated and lagged the market.

Portfolio strategy

The Fund made good gains in August and outperformed the index, mainly due to positive stock selection on both the country and sector level. Our selection in consumer discretionaries was beneficial, with our investment in China's Nexteer Automotive being a notable contributor, as the company's stock rallied on the back of positive 1H14 earnings report. Our selection in financials was also positive, mainly driven by our holding in Beijing Urban Construction.

Sector allocation was roughly flat. On the other hand, country allocation was negative, mainly driven by an underweight in Korea and overweight in Hong Kong.

Outlook

After a disappointing first quarter, Asian equities showed clear signs of rebound in the second quarter and the rally seems to be gaining momentum. Exports have picked up in countries such as China, India and Malaysia. For countries where the trend remains subdued, leading indicators generally point to a better outlook in the second half of the year. Improving external demand driven by global economic recovery especially in the developed markets should be positive for Asia's growth outlook.

HSBC Global Asset Management

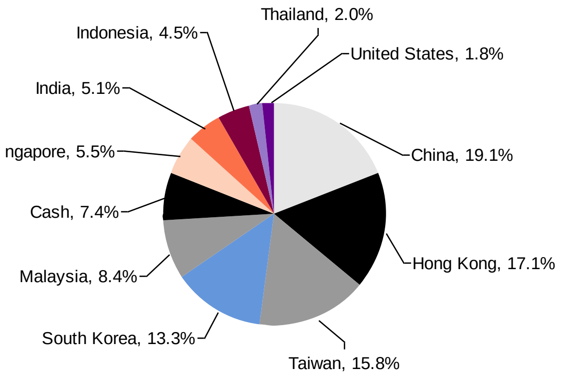
Another catalyst of the Asian equity market is the efforts made among Asian policymakers to push forward structural reforms to boost productivity. Suppose interest rate is low and debt is easily available, these might initially be used to fund worthwhile investment with higher economic returns. However, as time goes on, profitable projects should become harder to find and thus cost of capital would likely to increase to reflect the higher uncertainty of sustainable returns. However, if central banks strive to maintain the abundance of liquidity within the markets, this will not be the case. Projects with marginal return or low visibility of earnings will still manage to get funded. Cheaper credit may also reduce the pressure on organisations to enhance efficiency and control costs, which may eventually lead to margin compression and a less sustainable profitability. In fact, this is a problem that Asia has been facing.

The good news is that policy makers in Asia have realised the criticality of this issue and have started to take actions. For example, the reform blueprint announced in China following the Third Plenum and the strong agenda put forth by India's Prime Minister Modi, all pointed to the region's dedication in promoting a recovery in productivity. We believe these structural reforms should inevitably be a significant positive driver of equities within the region.

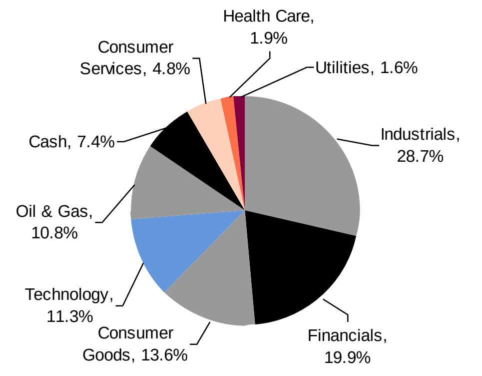
We continue to find pockets of attractive stocks within the small cap markets. In particular, we have conviction in opportunities among regional alternative energy and Chinese textile names. We also favor several stocks related to offshore oil and gas exploration in South East Asia.

Source: HSBC Global Asset Management (Hong Kong) Limited as of September 2014. Data shown is for illustrative purposes only and does not constitute investment recommendation to buy or sell in the above-mentioned sectors, securities or countries. Past performance is not indicative of future returns.

Country allocation[1]



Sector allocation[1]



Top 10 holdings[1]

Name	Weight (%)
KWG Property Holding	2.2
Man Wah Holdings	2.1
Pacific Radiance	2.1
GS Home Shopping Inc	2.1
WT Microelectronics	1.9
King Yuan Electronics	1.9
Ezion	1.8
Panin Financial TBK PT	1.8
Dongbu Insurance	1.8
Nexteer Automotive	1.8

Performance[2]

Class AD in USD terms					Annualised		
%	1 mth	3 mths	6 mths	1 yr	3 yrs	5 yrs	Inception (21 November 1997)
NAV	4.1	8.9	15.3	36.4	16.7	18.3	11.1
NAV*	-1.3	3.2	9.3	29.2	14.6	17.0	10.8
BM	1.7	5.2	9.9	21.3	7.0	10.3	9.2

Source: 1. HSBC Investment Funds (Hong Kong) Limited as at 31 August 2014. Data shown is for illustrative purposes only and does not constitute investment recommendation to buy or sell in the above-mentioned sectors, countries or securities.

2. HSBC Global Asset Management & Morningstar, Inc. as at 31 August 2014, dividend reinvested in USD terms.

*Net of sales charges. BM (Benchmark) = MSCI Asia ex-Japan Small Cap Index. With effect from 1 November 2008, the benchmark has been changed to the MSCI Asia ex-Japan Small Cap Index. The new benchmark will ensure that the Fund's performance is measured against a benchmark more suited to its strategy. Past performance is not indicative of future returns.

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