HSBC Fund Update

– HSBC GIF BRIC Equity

September 2014

Summary

- BRIC markets continued to deliver a positive return with the MSCI BRIC Index up 3.1%, as Brazil (+10.8%) took the top spot, rising on hope of a change in government
- The Fund delivered a positive return of 3.0%, against the customised equally weighted BRIC Index which rose 3.1%
- At the end of August, the Fund was overweight to China and India and was modestly underweight to Brazil while maintaining an underweight position in Russia

Market overview

The MSCI Emerging Markets index rose 2.1%, performing in line with Developed Markets (MSCI World index returned 2.0%) in August. The reform process in China, India and Indonesia; expectation of a political change in Brazil; European Central Bank's (ECB) pro-easing stance and better economic data in the US boosted Emerging Market (EM) equities.

BRIC markets continued to deliver a positive return with the MSCI BRIC Index up 3.1%. At a country level, Brazil (+10.8%) took the top spot, rising on hope of a change in government with election polls suggesting an increasingly competitive presidential race.

India (+2.4%) was the next best performer. Correction in the global crude prices acted as a positive catalyst.

China (+0.2%) took a breather in August after gaining about 14% in the previous three months. The market continued to go up in the first half of the month and reached year high level as liquidity remained to be supportive. However, the market gave up most of the gains later on after the July economic data showed signs of slow-down in economic activities.

Russia (-1.5%) remained volatile and fell on concerns of further sanctions after fighting escalated in east Ukraine, erasing earlier gains.

Ukraine Situation:

Over the month of August, the military conflict between rebel insurgents and Ukrainian forces intensified and relations between Russia on one side and Ukraine/European Union (EU)/US on the other, deteriorated. Russia launched an aid convoy, viewed by many observers as a way to increase military support for the insurgents, although this was denied by the Kremlin. Up to this point, Ukrainian forces had managed to gain back much ground from rebel-held territory, but following Russia's delivery of "aid", the insurgents' efforts were suddenly successful around their strongholds of Donetsk and Luhansk, and in addition they also opened a new front in the South of the country.

In early September, Ukrainian President Poroshenko announced an agreement on a cease-fire following a phone conversation with the Russian President Putin. Putin subsequently issued a seven-point plan calling for the end to the insurgent offensive in Eastern Ukraine which included international control over the proposed truce. The details of the plan were to be worked out between relevant parties at a planned 5th September meeting.

There is no doubt that both sides have felt increasing incentives to cease hostilities. The announcement came following the rebel's surge as described above and after the Ukrainian economic backdrop spiralled further downwards and the government admitting the need to ask for additional bailout cash from the west. The cease-fire plan announcement came also after the EU solidified possible plans for further sanctions against Russia including whether to boycott the 2018 football World Cup that Russia is to host, and on the eve of a North Atlantic Treaty Organisation (NATO) summit that will address increasing NATO support for newer members against the increased risks from Russia.

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At this point, the detail of the proposed cease-fire is not known. In any event, it seems unlikely that negotiations can fully progress until after scheduled Ukrainian elections on 26th October. It remains unclear whether existing US/EU sanctions will remain in place and if so for how long. Additional EU/US sanctions may still be forthcoming, despite the cease-fire announcement.

Portfolio strategy

The Fund delivered a positive return of 3.0%, against the customised equally weighted BRIC Index which rose 3.1%. The Fund remains ahead of the benchmark on a year-to-date basis.

Our holdings in Brazil made the largest contribution to relative performance whilst our holdings in India detracted the most.

Six of the top ten contributors to relative performance were Brazilian names. Notably, exposure to financials, such as Banrisul, Itau and Banco do Brasil, and real estate company Market Reference Value (MRV) added value as these stocks reported better than expected second quarter results and the increasingly competitive presidential elections boosted the Brazilian equity market in general.

The Fund also benefitted from its exposure to Tata Motors which rallied on announcement of a superb set of financial results which showed continued strong volume growth and margin expansion in its key market, China. Unfortunately, some of the gains were offset by our Indian positions. Overweight to materials names, Jindal Steel & Power and Sesa Sterlite underperformed on account of Supreme Court order mentioning that coal block allocation process from 1993 has legal flaws. Our exposure to Indiabulls Housing finance also weighed on relative performance as the stock underperformed the market due to consolidation post the very strong outperformance over the last one year. Another detractor was Jaiprakash Associates which underperformed the market due to concerns on execution of its de-leveraging plan.

During the month, we initiated a position in Megafon to increase our exposure to the domestic telcommunications sector on the back of attractive valuations. We sold our position in China Minsheng Banking as the company reported worse than expected results and on concerns about its balance sheet.

Outlook

Those markets which did very well last year, such as Developed Market (DM) equities, have not done as well this year. Year-to-date, Emerging Market (EM) has outperformed DM, with the MSCI Emerging Markets Net Index up 10.6% against 6.8% for the MSCI World Net Index. Investors who fled EM stocks in 2013 are now returning to the region, helping the market to regain momentum with EM funds seeing net inflows since April.

Year to date, the BRIC markets have also delivered a strong performance with the customised equally weighted BRIC Index up 10.5%. We continue to believe BRIC markets offer value given their potential for earnings growth. Valuation metrics are still supportive: current price-to-book for MSCI BRIC is 1.4x compared to 2.1x for MSCI World and a return-on-equity of 13.3% versus 12.3% respectively. Furthermore, concerns related to external imbalances, political risks or the growth outlook in China have receded lately, due to mostly smooth election processes and appropriate fiscal and monetary policy measures.

The catalyst for the region to show stronger performance could be an acceleration of global trade. Furthermore, elections in Brazil have the potential to increase asset market volatility, but also hold out the possibility that newly elected governments will be able to re-engage with the reform process (e.g. India), which is important to boost potential growth and reassure international investors.

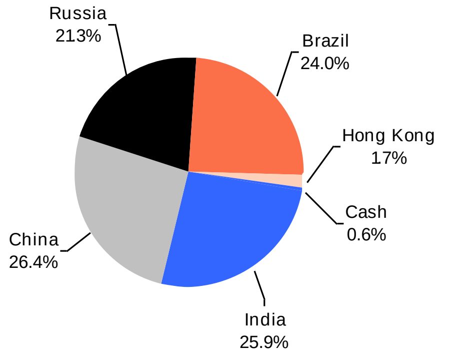
Risks to our outlook include volatility from external shocks, such as the US Federal Reserve normalising monetary policy and the potential for an increase in geopolitical risk, particularly in Iraq, Syria and Ukraine. In addition, if the recent Ebola outbreak was to further spread to key global economies, then history shows that there is a real risk to markets.

At the end of August, the Fund was overweight to China and India and was modestly underweight to Brazil while maintaining an underweight position in Russia. Sector weightings are largely an outcome of our stock level views. The current sector tilts relative to the benchmark see overweights in financials, materials and consumer discretionary and underweights in consumer staples, information technology and telecommunications.

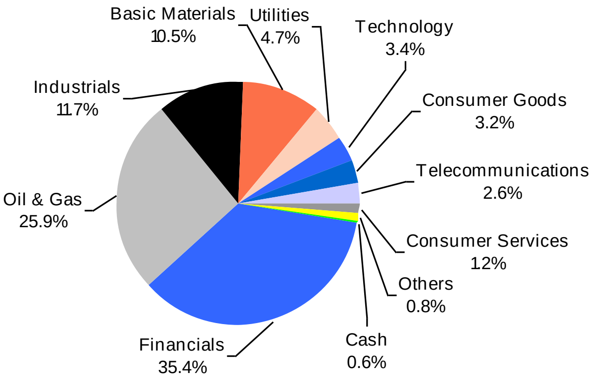
We continue to believe that an investment approach based on valuation and profitability will be rewarded in the medium term.

Source: HSBC Global Asset Management (Hong Kong) Limited as at 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

Geographic allocation[1]



Sector allocation[1]



Top 10 holdings[1]

Name	Sector	Country	Weight (%)
Lukoil	Oil & gas producers	Russia	4.6
Itau Unibanco Holdings SA ADR	Banks	Brazil	4.5
Gazprom	Oil & gas producers	Russia	4.4
Tencent Holdings Inc	Telecommunication Services	Cayman Islands	3.0
Banco Bradesco SA-ADR	Banks	Brazil	3.0
Tata Motors	Industrial engineering	India	2.8
Petroleo Brasileiro	Oil & gas producers	Brazil	2.7
Oil & Natural Gas Corporation	Oil & gas producers	India	2.6
Petroleo Brasileiro	Oil & gas producers	Brazil	2.5
Industrial and Commercial Bank of China	Banks	China	2.5

Performance[2]

Class AD in USD terms					Annualised		
%	1 mth	3 mths	6 mths	1 yr	3 yrs	5 yrs	Inception (1 Dec 2009)
NAV	3.0	7.8	25.0	30.6	0.2	3.2	9.2
NAV*	-2.4	2.1	18.4	23.8	-1.6	2.1	8.6

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 countries, sectors or securities.

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

*Net of sales charge. The Fund is actively managed without reference to any benchmark. Past performance is not indicative of future returns. Performance quoted prior to 1 December 2009 refers to the Class M1C of HGIF BRIC Equity. The Class M1C and AC have the same investment objective but different fee structures. However, M1C class had been closed for subscriptions.

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