HSBC Fund Update
– HSBC GIF Chinese Equity

September 2014

Summary

- Chinese equities were up slightly in August, with the MSCI China 10/40 posting a gain of 0.3% even as China's recovery momentum showed signs of weakening
- The Fund recorded a negative return and underperformed the index driven by sector allocation
- We continue to like sectors and stocks with low macro correlation and strong earnings growth prospects, and those that stand to gain from reforms

Market overview

Chinese equities were up slightly in August, with the MSCI China 10/40 posting a gain of 0.3%. China's recovery momentum has shown signs of weakening as recent macro indicators were generally below expectations.

Both China's 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.

Telecommunication services continued to gain ground and outperform the market, driven by China Mobile's plan to cut operating expenses. Healthcare and energy also had a good run during the month. Meanwhile, consumer staples retreated and was the worst performing sector in August.

Portfolio strategy

The Fund recorded a negative return, and underperformed the index driven by sector allocation.

Sector allocation was negative. Our underweight in consumer staples was beneficial to relative performance, but the positive was outweighed by our underweight position in telecommunication services.

Stock selection was positive, mainly due to our selections in industrials, with our investment in China Singyes Solar Technologies being a notable contributor. We are positive about the outlook for the company as we expect strong distributed photovoltaic installation in China in the coming years with strong policy support. In addition, selection in utilities was beneficial as well, with Huadian Fuxin Energy being the top contributor to relative performance in August.

Outlook

We expect the government to step up its selective and targeted policy measures, such as expanding targeted People's Bank of China (PBoC) lending to improve the monetary transmission mechanism and lower the cost of funding for selective sectors/the real economy; further relaxing housing policies to lower mortgage rates and ease mortgage lending standards for homebuyers; accelerating ongoing infrastructure and social housing construction and probably starting new projects; and taking measures to attract private investment, among others. On the other hand, the government will likely remain vigilant against financial instability risks and maintain a tight bias on shadow banking activities. Meanwhile, we also expect the government to continue pushing forward reforms, which will continue to be one of the most important drivers of Chinese equities as a whole going forward.

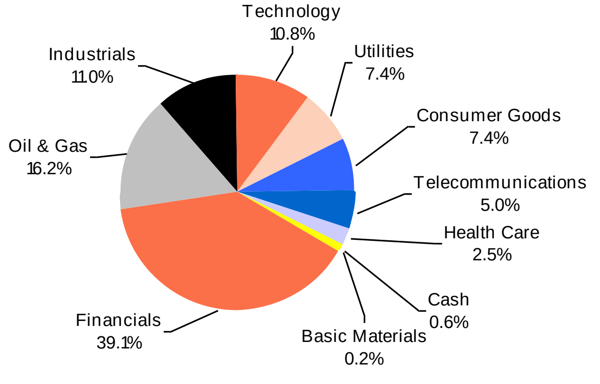
HSBC Global Asset Management

Valuations now sit at an attractive level of 1.5x 2014 price-to-book, with an expected return on equity of 14.7% for the MSCI China index.

We continue to like sectors and stocks with low macro correlation and strong earnings growth prospects, and those that stand to gain from reforms. We are currently finding opportunities within the environmental protection-themed names, the new energy, and automobile sectors. We like logistics companies that can benefit from the acceleration in e-commerce business. We also see investment opportunities within Independent Power Producers (IPPs) benefiting from asset restructuring.

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 or securities. Past performance is not indicative of future returns.

Sector allocation[1]



Top 10 holdings[1]

Name	Sector	Weight (%)
Tencent Holdings	Software & computer services	9.2
China Construction Bank	Banks	7.7
Industrial and Commercial Bank of China	Banks	7.2
CNOOC	Oil & gas producers	6.1
China Life Insurance	Insurance	4.3
China Petroleum and Chemical	Oil & gas producers	4.3
Chongqing Changan Automobile	Automobiles & parts	3.9
China Mobile	Telecommunications	3.8
Agricultural Bank of China	Banks	3.5
Ping An Insurance	Insurance	2.8

Performance[2]

HSBC GIF Chinese Equity Class AD					Annualised		
%	1 mth	3 mths	6 mths	1 yr	3 yrs	5 yrs	Inception (25 Jun 1992)
NAV	-1.4	12.3	9.4	13.7	4.5	3.9	10.3
NAV*	-6.6	6.4	3.7	7.7	2.7	2.8	10.0
BM	0.3	11.9	13.1	18.2	7.6	6.5	4.9

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 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 China 10/40 Capped Net Index. Past performance is not indicative of future returns.

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