HSBC Fund Update
– HSBC GIF Brazil Equity

April 2015

Summary

- The MSCI Brazil posted loss of 11.5% in March, underperforming the MSCI Latin America (LatAm) (-7.6%), Developed Market (DM) (-1.8%) and Emerging Market (EM) (-1.6%) benchmarks
- Brazil fundamentals have deteriorated by most measures since the beginning of the current decade. Years of overspending amid a deterioration of the growth-inflation trade-off led to a primary fiscal deficit – the first in more than a decade – high inflation, and an uncomfortable current account deficit
- We believe the government understands the importance of taking difficult steps and that President Rousseff might be prepared to support a politically costly adjustment.

Market overview

The MSCI Brazil posted loss of 11.5% in March, underperforming the MSCI LatAm (-7.6%), DM (-1.8%) and EM (-1.6%) benchmarks. During this time, the BRL lost 11.1% against the US dollar, closing the end of the month at BRL/USD 3.20.

The Brazilian Economy in March 2015:

a) March continued to be marked by the disputes between the Executive and the Legislative, as the latter tried to create new spending, undermining the fiscal effort of Finance Minister Levy.

b) On the activity front, Gross Domestic Product (GDP) expanded by 0.3% quarter-on-quarter (qoq) in 4Q14. For the full year, growth stood at 0.1%, with a 0.9% expansion in private consumption and a 4.4% drop in investment.

c) The numbers already incorporate the new National Accounts methodology. The data for 2012 and 2013 were revised upward after the adoption of the new methodology. The major revisions focused, from the demand side, on investment, and from the supply side, on the industry.

d) On the macro front, inflation data continued to climb while growth and confidence indicators continued to weaken.

e) The Monetary Policy Committee published the first-quarter Inflation Report. The report discussed the current realignment of relative prices (regulated prices, exchange rate) and concluded that the effects on inflation "tend to be limited to the short term and be strongly mitigated by 2016." The inflation forecasts included in the report support this conclusion. The report suggests that the interest-rate hiking cycle is nearing an end.

f) The central bank increased interest rates by 50 basis point (bp) to 12.75% and left the door open for additional hikes. Our Selic forecast is at 13.75% with one additional 50bps hike and two of 25bps.

g) S&P kept the Brazil rating and outlook unchanged at investment grade, while an estimated 2.2 million people took the streets to protest against the government.

h) According to a Datafolha survey, the government's approval rating dropped to 13% in March, from 23% in February. President Dilma Rousseff's rejection rate rose from 44% to 62%.

i) The exchange rate reached 3.20 real per dollar at the end of March – an increase of 11.5% over the previous month. The Brazilian Central Bank announced that, starting in April, it will no longer offer Foreign Exchange (FX) swap contracts, but will continue to renew the existing contracts. The Ibovespa fell 0.6% in real and 10.9% in dollars. The country risk measured by the 5-year Credit Default Swap (CDS) increased 41 bps, to 284 bps, reaching 306 during the month.

HSBC Global Asset Management

Outlook

Brazil fundamentals have deteriorated by most measures since the beginning of the current decade. Years of overspending amid a deterioration of the growth-inflation trade-off led to a primary fiscal deficit – the first in more than a decade – high inflation, and an uncomfortable current account deficit. Turning off the fiscal stimulus tap is the only way to prevent current strains from turning into breaking points.

The economic team, led by Finance Minister Levy, has been moving towards the right direction to correct the imbalances created by the previous years' policies.

These largely self-inflicted economic challenges look even tougher when exogenous factors are brought into the picture. These include:

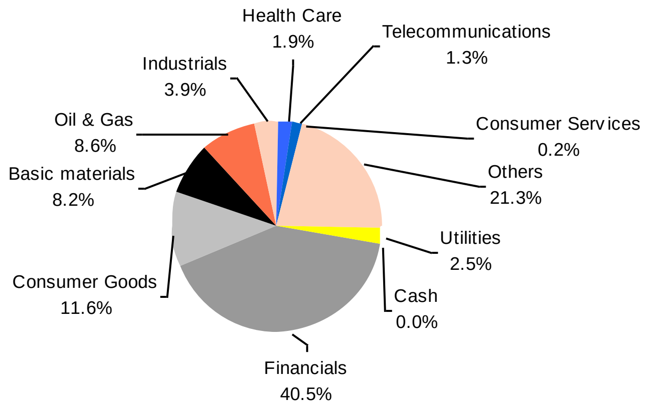
- A combination of global weaker commodity prices and stronger USD;
- The most severe drought in Brazil in many decades, possibly leading to energy rationing due to a heavy reliance on hydro-electricity;
- A corruption scandal involving Petrobras, the country's largest company, which has paralyzed the infrastructure sector and strained the relationship between the government and Congress
- Growing popular discontent

Despite the list of challenges, we believe it is possible for Brazil to turn the corner and improve within a short period of time. The main development investors should track over the next months is the degree of success of the ambitious fiscal measures proposed by Mr Levy's team, which add up to around 2% of GDP in 2016. The vast majority of proposed measures – around three-quarters – do not require Congressional approval suggesting that achieving a material correction of fiscal accounts depends mainly on the government's perseverance.

The government is trying to frontload the implementation of the fiscal measures, meaning that by the middle of this year we should be able to assess their effectiveness.

It is our view that the government may be able to deliver a material improvement in fiscal accounts in 2015. If this materializes – or even a significant fraction of it – the adverse economic conditions described above will ease, the imbalances will gradually correct, and the unavoidable recession of this year will lead to better prospects for the years ahead. We also believe the government understands the importance of taking difficult steps and that President Rousseff might be prepared to support a politically costly adjustment.

Sector allocation[1]



Top 10 holdings[1]

Name	Sector	Weight (%)
Itausa Investimentos	General financial	10.0
CCR SA	Others	8.5
Ambev	Beverages	6.2
CIELO	General financial	5.0
Totvs	Others	4.4
BRF - Brazil Foods SA	Food producers	4.3
Sao Martinho SA	Oil & gas producers	3.8
Itau Unibanco Holding SA ADR	General Financial	3.5
Sao Carlos Empreendimento	Real estate	3.3
Bradespar SA	General financial	3.2

Performance[2]

Class AD in USD terms					Annualised		
%	1 mth	3 mths	6 mths	1 yr	3 yrs	5 yrs	Inception (22 Dec 2004)
NAV	-11.8	-15.6	-28.4	-32.2	-20.4	-12.8	3.7
NAV*	-16.4	-20.0	-32.1	-35.8	-21.8	-13.7	3.2
BM	-10.4	-14.0	-25.8	-26.5	-16.6	-9.8	8.4

Source: 1. HSBC Investment Funds (Hong Kong) Limited as at 31 March 2015. 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 March 2015, dividend reinvested in USD terms.

* Net of Sales Charge. BM (Benchmark) = MSCI Brazil 10/40 Index. Past performance is not indicative of future returns.

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