HSBC Fund Update – HSBC GIF Indian Equity

April 2015

Summary

- The Fund underperformed the reference benchmark in March mainly driven by stock selection but sector allocation effects were also negative
- Valuations of cyclical sectors continue to remain compelling, even as near term earnings and Return On Equities (ROEs) remain challenged due to issues of operating and financial leverage
- We expect India's Gross Domestic Product (GDP) to recover from three years of below trend growth and accelerate further

Market overview

The domestic market indices BSE Sensex and Nifty were down 4.8% & 4.6% respectively during March. Amongst the sectors, healthcare & telecom were the best performers while materials and utilities turned out to be the worst performing sectors (all in local currency). The fund's benchmark, Standard & Poor's (S&P)/Industrial Finance Corporation of India (IFCI) India Gross was down 3.6% in USD term.

Key events driving the market were:

- The government was able to pass three key reform bills during the ongoing session of the parliament viz Foreign Direct Investment (FDI) in insurance, coal mines bill and mines & minerals regulation. However, there was disappointment on the crucial Land acquisition bill as the government failed to convince opposition parties on the changes proposed in the bill and hence has been deferred. In a clear positive deviation from past, the first half of the Budget session saw both houses of the parliament clocking very high productivity levels.
- In a surprise move, the Reserve Bank of India (RBI) cut the repo rate by 25 bps in an inter policy action. This is the second rate cut in the current cycle and came just after the Union budget and the agreement on the monetary policy framework between the government and the RBI.
- Externally, the unfolding geo-political issues in Yemen and its likely impact on crude oil price had a bearing on the equity market performance during the month.
- Despite the weakness seen in the equity markets, the institutional segment led by Foreign Institutional Investors (FIIs) and domestic Mutual Funds (MFs) continued to be net buyers during the month. Domestic insurers on the other hand continued to see selling and they have so far net sold equities worth USD 2.4 bn this year [Calendar Year (CY)15].
- Reports from coal ministry indicated that the government rejected bids for three coal blocks in the first two rounds of auctions. The same has been challenged by the impacted companies in Delhi High Court.
- The second round of auctions for 13 non-operational coal blocks saw relatively lesser bidding intensity compared to the earlier round.
- The telecom spectrum auction process was completed during the month which saw very high bidding intensity. Government garnered ~Rs. 1.09 trillion through the process (~USD 17.5 bn), however major part of it will be paid by the companies in a staggered manner.
- The Current Account deficit for 3Q Fiscal Year (FY)15 came in at ~USD 8.4 bn or 1.6% of the Gross Domestic Product (GDP), reporting a decline of ~USD 1.7 bn quarter-on-quarter (qoq). The narrowing of deficit was on account of improved service exports and lower investment income outflows.

Portfolio strategy

HGIF Indian Equity underperformed the reference benchmark in March mainly driven by stock selection but sector allocation effects were also negative. The overweight position in IndiaBulls and LIC Housing Finance detracted as they fared worse than market heavyweight HDFC Bank, in which the portfolio is underweight. This is a reversal of recent positive price trends on our financials holdings. Also detracting was Jindal Steel & Power which was negatively impacted by news as its winning bid in a recent re-auction of its coal mining block was rejected by the Government. In the Energy sector our holding of Cairn India detracted in part due to continuing weak oil prices but also due to a tax demand, which it intends to challenge.

HSBC Global Asset Management

The Fund's underweight position to healthcare and telecoms also weighed on performance as defensives fared better than cyclicals in March.

We expect a continuation of our portfolio positioning and sector allocations through 2015 as well, rather than any big shifts. Valuations of cyclical sectors continue to remain compelling, even as near term earnings and ROEs remain challenged due to issues of operating and financial leverage.

We continue to prefer cyclicals over defensives due to:

- Higher growth expectations
- Potential beneficiaries of rate cuts
- Compression of risk premiums
- Wide valuation gap between cyclicals and defensives

Outlook

We believe the market movement will be influenced by the following factors:

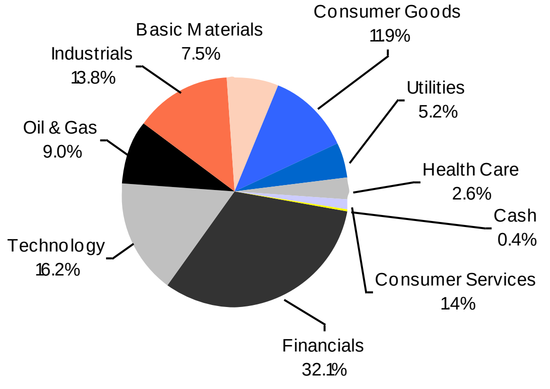
- The second leg of the Budget session of the parliament and any newsflows on key legislation / reforms to be taken up during the session
- The status of the Land Acquisition bill, a key reform agenda for the government
- RBI's bi-monthly policy meeting is slated for 07 Apr and any inter policy rate action move from the central bank
- The 4QFY15 earnings season to kick start from the second week of April

The market valuations are nudging above historical averages, but catalysts led by affirmative government action, could drive earnings growth and a re-rating.

Looking forward, we expect India's GDP to recover from three years of below trend growth and accelerate further on the back of some structural reforms as & when initiated. The FY16 budget document is a clear indication of the government's focus on investment led growth and also to move India's growth trajectory into a higher & at the same time a sustainable level. We also expect to see both reduced operating and financial leverage benefiting earnings of the companies in which we are invested much more than the defensive part of the market. With a rebound in GDP, corporate earnings are bound to recover and revert to mean profitability. This would be a tailwind for valuations which are currently marginally above long term averages.

Earnings for corporate India for FY15 and FY16 are expected to grow at about 7.3% and 14.9% respectively.

Sector allocation[1]



Top 10 holdings[1]

Name	Sector	Weight (%)
Axis Bank	Banks	6.1
ICICI Bank	Banks	5.8
Tata Motors	Industrial engineering	5.6
HCL Technologies	Software & computer services	5.4
Maruti Suzuki India	Automobiles & parts	4.8
Wipro	Software & computer services	4.5
Oil & Natural Gas Corporation	Oil & gas producers	4.3
Indiabulls Housing Finance Ltd	Financial Services	4.2
Infosys	IT-Hardware & Equipment	3.6
Housing Development Finance	Real estate	3.3

Performance[2]

HSBC GIF Indian Equity Class AD					Annualised		
%	1 mth	3 mths	6 mths	1 yr	3 yrs	5 yrs	Inception (1 Mar 1996)
NAV	-7.5	1.5	3.5	23.0	7.5	-1.1	16.1
NAV*	-12.4	-3.8	-1.9	16.5	5.6	-2.1	15.8
BM	-3.6	5.7	8.4	28.5	11.5	3.7	9.7

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. Past performance is not indicative of future returns. BM = Benchmark = S&P/IFCI India Index.

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