

# HSBC Fund Update

## – HSBC GIF Brazil Equity

### Market review

With +0.7% (in USD terms) in August, Latin American equity markets underperformed Emerging Markets' +2.5% (USD) while slightly outperforming Developed Markets' +0.3% (USD). Colombia' +9.6% (USD) led the region, followed by Mexico's +1.4% (USD) and Brazil's modest +0.9% (USD). On the flip side, Peru was the largest underperformer in Latam with -4.4% (USD), followed by Chile's -4.1% (USD), and Argentina's -2.2% (USD).

Overall, the CRB commodity index stagnated with a minor -0.4% (USD) movement but this hides a stark contrast between, with the Brent's +7.5% (USD) uptick and nickel's -8.3% (USD) as well as copper's -6.8% (USD) in August.

Brazilian equities had a nearly neutral August and were supported by a stronger BRL. The official impeachment of Dilma Rousseff by the Brazilian Senate on August 31 provided a new milestone in a complex political bottleneck. As Michel Temer was officially instated as Brazil's new President by the same process, we may see new policy-making possibilities in the short and medium term but no positive impact on the economy should be expected anytime soon. As a result, we continue to expect uncertainty to potentially drive volatility for Brazilian equities.

According to the latest available data points from July, economic activity and industrial output continued their rebound while retail sales remained depressed on a year-to-date basis. This has driven unemployment up to the same level as 2009's high. Extended National Consumer Price Index (IPCA) inflation continues to creep up, essentially fuelled by producer prices rather than consumer prices in the past six months.

On a positive note, the trade balance still remains a positive, nearing USD40 billion at end of August. The current account continues to close. The fiscal deficit remains a fundamental point of worry as gross debt reached 70% of GDP in August.

### Portfolio strategy

Our Fund underperformed the comparative index in August. Most sector provided overall neutral contributions to fund performance. The key detracting factor was stock selection in Industrial stocks (-51 bps relative contribution in total for the sector). Stock selection in Consumer Discretionary also proved detrimental (-20 bps).

Top contributors:

- ▶ Raia Drogasil (zero holding): The stock fell 9% in August after investors took profits following a 130% surge between 31 December 2015 and the end of July this year
- ▶ Cia Siderurgica Nacional (zero holding): The stock dropped 22% in USD in August as the execution of asset sale plan failed to fulfil market expectations and steel prices decreased globally

Bottom contributors:

- ▶ CCR (overweight): The stock fell by 8% in August after investors took profits following an 85% surge between 31 December 2015 and the end of July this year
- ▶ Arezzo (overweight): The stock fell by 6.9% in August. The company posted single-digit growth (adjusted for currency rate effect) in top and bottom lines but suffered from the tough consumer environment

## Outlook

We see good momentum building up from H1 for Brazilian equities into H2 2016. We expect Brazil's economy to contract again this year, with consensus projecting a -3.5% GDP shrinkage in 2016, and growth to resume with 1.0% in 2017.

Household consumption should still feel the pain from a weak job market but net exports should be supportive.

As it stands, we still expect easing inflation and improved FX leading to lower near-term rates.

The Brazilian equity 12-month forward estimates as of end June for Price-to-Book (P/B) is 1.37x and 9.06% for Return on Equity (ROE). The Brazil market remains somewhat of a barbell portfolio with perceived quality remaining expensive and select perceived value remaining cheap with not much in-between. We would expect the value names to continue closing the gap.

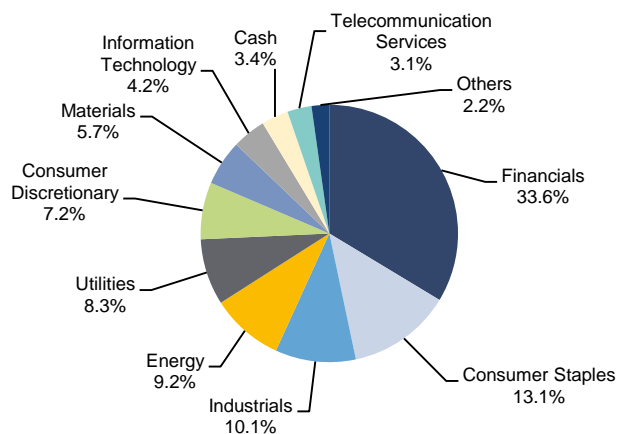
We expect 2016 to be a structural adjustment period for the country and for recovery to take time and we believe that this period could have the potential to enable economic transformation.

The rebound from the recession in Brazil will take time as the root causes of macroeconomic imbalances can only be addressed step after step with the appropriate combination of policy making and structural reforms. New political leadership was confirmed in August 2016 with Michel Temer officially instated as Brazil's new President until the end of 2018. His recent policy proposals are now expected to support private sector economy and to involve budget cuts in the public sector. Brazil's ability to reform the regional states' debt and social security will depend on the Temer administration's ability to implement its reform agenda in the medium term, and that means securing sufficient political support. Both areas need improvement in order to better Brazil's long-term fiscal position.

We will also monitor key external factors, including:

- ▶ More supportive US and European activity levels and consumption and a stabilized outlook for Chinese growth
- ▶ Chinese slowdown could continue to further drive commodity price volatility
- ▶ Looming inflation stemming from weak FX

## Sector allocation<sup>1</sup>



## Top 10 holdings<sup>1</sup>

Name	Weight (%)
Petrobras - Petroleo Bras	9.2
Itausa-Investimentos Itau-Pr	8.3
Banco Bradesco S.A.	8.1
Ambev Sa	7.5
Ccr Sa	4.7
Bb Seguridade Participacoes	4.5
Itau Unibanco Holding S-Pref	4.4
Kroton Educacional Sa	4.3
Cielo Sa	4.2
Bm & Fbovespa Sa	4.0

## Performance<sup>2</sup>

Class AD in USD terms					Annualised		
%	1 mth	3 mths	6 mths	1 yr	3 yrs	5 yrs	Inception (22 Dec 2004)
NAV	0.3	27.4	61.2	34.3	-9.9	-12.3	3.4
NAV*	-5.0	20.7	52.8	27.2	-11.5	-13.2	2.9
BM	0.5	32.5	66.1	40.6	-2.5	-7.3	8.6

Source: 1. HSBC Investment Funds (Hong Kong) Limited as at 31 August 2016. Data shown is for illustrative purposes only and does not constitute any investment recommendation.

2. HSBC Global Asset Management & Morningstar, Inc. as at 31 August 2016, 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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HSBC Global Asset Management (Singapore) Limited  
21 Collyer Quay #06-01 HSBC Building Singapore 049320  
Telephone: (65) 6658 2900 Facsimile: (65) 6225 4324  
Website: [www.assetmanagement.hsbc.com/sg](http://www.assetmanagement.hsbc.com/sg)  
Company Registration No. 198602036R