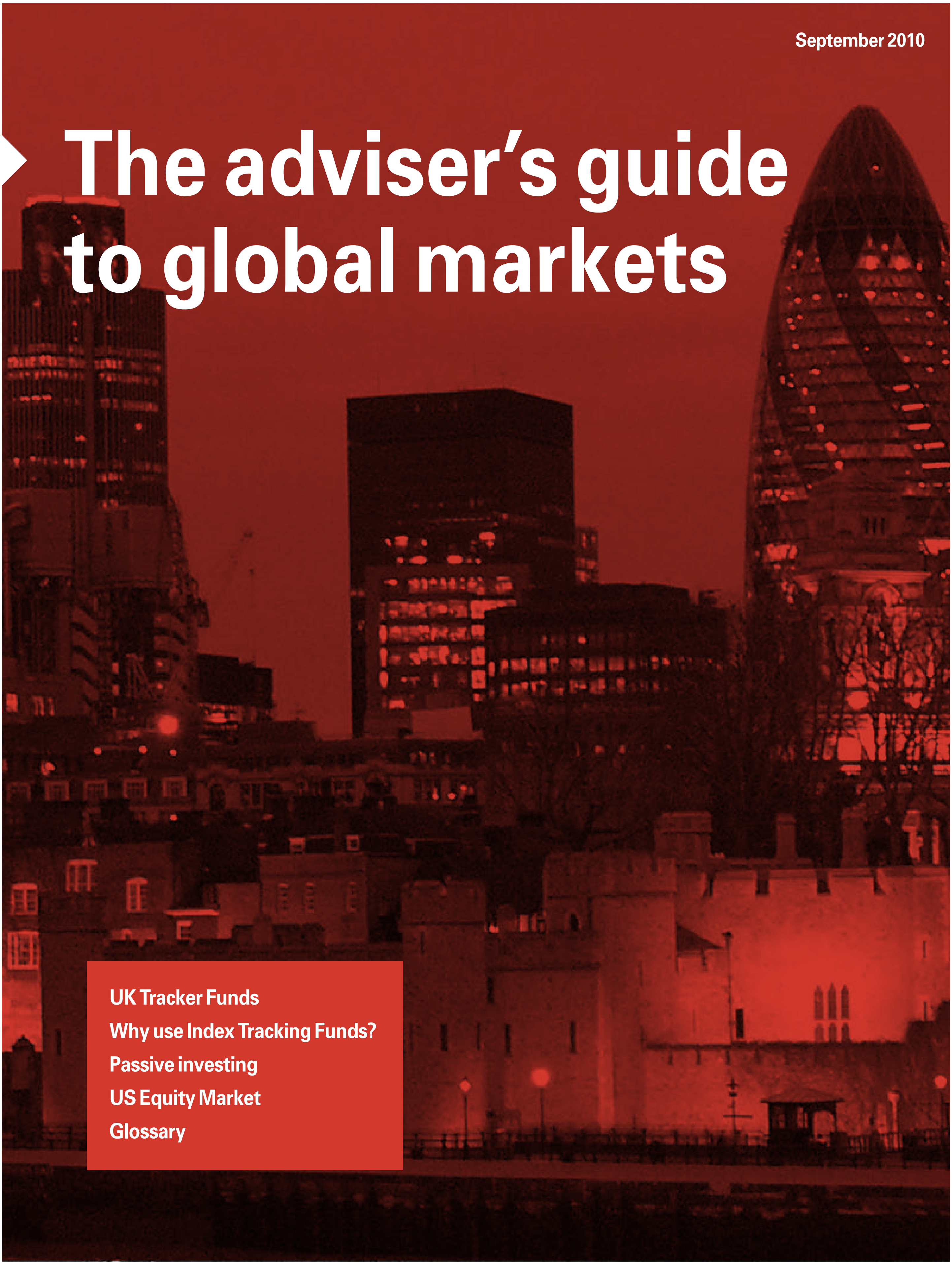
September 2010

The adviser's guide to global markets



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HSBC
Global Asset Management

For Professional Advisers only

UK tracker funds offer home comforts and global exposure

Structure of FTSE 100 and All Share indices reflect evolution of the world's economy

Investing in Index Tracking Funds is a simple and cost effective way for investors to diversify their portfolio, giving them the opportunity to invest in a wide range of stocks and business sectors that inhabit the particular index being tracked.

For UK investors in particular, investing in a UK Index Tracking Fund, such as the HSBC FTSE All-Share Index or HSBC FTSE 100 Index Fund, will often be a core strategy as investors will know and feel comfortable with the many household names that comprise the index, such as Tesco and GlaxoSmithKline.

Overseas exposure

Investing in a FTSE 100 or FTSE All Share Index Fund does not mean investors are necessarily left with no overseas exposure - far from it as many UK listed companies increasingly derive a large chunk of their profits from overseas.

In fact some 70% of UK plc earnings are derived from overseas markets, so even the most domestically focused of investors are likely to have a significant portion of their cash invested in companies which generate at least some of their profits abroad.

Take GlaxoSmithKline. It is the largest pharmaceutical company by value in the UK, is British-owned and headquartered here, but it is also the world's second largest research-based pharmaceutical firm and accounts for some 5.5% of the globe's pharmaceutical market, with profits of just under £2bn derived from emerging markets and Asia Pacific regions.*

> £2bn Profits made by UK- listed GlaxoSmithKline in the emerging markets and Asia Pacific

Indeed the FTSE 100 Index today boasts a host of multi-national corporations, with companies such as Rio Tinto, BHP Billiton and British American Tobacco (BAT) deriving the majority, if not all, of their profits overseas.

In 2000, for example, the majority of British American Tobacco (BAT) profits came from the Canadian market and more recently they have expanded into Turkey and Indonesia.

BHP Billiton ranks among the world's top producers of iron ore and coal and is a major producer of petroleum products such as crude oil and natural gas.

With operations worldwide, BHP Billiton also produces aluminium, base metals and diamonds.

Changes at home

The FTSE 100 Index not only reflects the increasing globalisation of companies and shifts in patterns of the world economy, it also mirrors the changing shape of the UK economy.

Launched in 1984, roughly one third of the original companies are still in the index, which reshuffles quarterly with companies being promoted or relegated according to the index rules.

Today one of the most important industrial sectors making up the index is the resources sector, but this has changed drastically over the years.

A decade ago, Telecoms Media and Technology (TMT) was the most important sector in the index in terms of performance. The banking sector subsequently rose in importance, at one point accounting for more than 20% of the FTSE 100's total worth, compared with just 5% in the 1980s.

Today, the dominance of companies in the index that are involved in oil and mining reflects not only the UK but the global economy's growing reliance on these types of resources.

Best of both worlds

There is little doubt that the globalisation of FTSE 100 companies is likely to continue as companies increasingly trade on an international basis. Index Funds tracking the FTSE 100 and FTSE All Share indices will therefore continue to offer investors a way of participating in the economic changes affecting the UK, while at the same time engaging in blue chip companies that derive a large part of their profits from overseas.

***Source: GlaxoSmithKline as at 31 May 2010**

Keeping it pure and simple

Ten reasons why investors should consider Index Tracking Funds

1 Lower Total Expense Ratios (TERs). Index Tracking Funds represent a lower-cost alternative to 'active' fund investing. No team of stock pickers or fundamental research analysts is required to back a quantitative approach, which mirrors the performance of a given index.The Annual Management Charge (AMC) on Index Tracking Funds are typically lower than their active counterparts and the additional costs of trading should be kept to a minimum via the use of sophisticated quantitative, or 'tracking' techniques.

2 Minimise tracking error. If your view is that the overall market will drive returns, Index Tracking Funds can be a great way to capture long term investment opportunities. For example, our index replication methodology is well tested. Investment implementation is done by a global team of quantitative experts and the range of funds on offer from HSBC Global Asset Management are designed to give investors closely matched exposure to a broad range of well–known local and international stock markets with associated tracking costs minimised as far as possible.

3 Create and offer simple solutions. Index matching strategies, are a very consumer friendly method of investing. The indices being tracked such as the FTSE 100 Index or the FTSE All-Share Index which represents the wider market are typically well known. As Index Tracking Funds simply echo the performance of an index, they can offer investors a cost-effective and transparent way into some of the world's biggest and most diverse markets.

4 A potentially attractive instrument for advisers. The simple and clean nature of Index Tracking Funds make them potentially well-suited for the post Retail Distribution Review (RDR) world of more transparent charging for investors as well as a simpler remuneration structure for advisers. In addition they offer comparable pricing with Exchange Traded Funds (ETFs), but clients do not need to have share dealing facilities in place when choosing an Index Tracking Fund. For execution only and advisory business an Index Tracking Fund is a potential product choice, whilst indexation can be potentially ideal for clients who are not comfortable with active fundamental approaches.

5 Reflect your investment views. Professionals can reflect tactical investment views in their discretionary portfolios or gain access to a market as part of a strategic asset allocation in a cost efficient way. The fear that under-performance by an active manager could have a negative impact on the return of a portfolio is largely eliminated by coupling a passive with an active strategy.

6 Achieve diversification among securities. A feature of active fund management can be the degree of out or under-performance at certain points in the economic cycle. This is due to the manager reflecting their style in the stocks that they choose to own and in part due to the fact that relative performance is driven by what they don't choose to own. For their part Index Tracking Funds achieve diversified exposure to the market and seek to deliver a consistently close match to its performance.

7 Manage and control relative risk exposures. Indexation is one way to gain exposure to markets ahead of an active fundamental strategy. Typically indexation portfolios use a wide range of financial instruments to try and ensure that maximum liquidity is maintained and the costs of trading are as low as possible.

8 Invest effectively in efficient markets. History tells us that indexation can out-perform active management. Warren Buffett, the world's most famous stock picker has admitted as much, particularly in developed markets. Active management can detract value and therefore performance, after fees, significantly so in some circumstances. When it comes to investing, consumers can pay to employ the resources to choose active managers very wisely, or opt for indexation for all or at least part of their portfolio instead.

9 Investing smaller components of an asset allocation strategy. If you don't have millions to invest in a particular set of circumstances and/or you need to unbundle a series of transactions as part of a range of investments in financial markets, Index Tracking Funds can provide access to national, regional or global indices or a particular asset class in a potentially convenient way, gaining exposure to a wide range of securities, in some cases across many geographical markets. With HSBC Global Asset Management's suite of Index Tracking Funds, this can be done for as little as £50 a month, with an AMC of just 0.25%.

10 Reflect specialist objectives. If clients have restrictions (such as the avoidance of derivatives or an unwillingness to incur unnecessary expenses) that they wish to be reflected in their choice of investments, the transparency of holdings that Index Tracking Funds can offer makes them potentially great building blocks for these types of bespoke portfolio.

A Passion

Your queries answered about

How do you keep track of changes in an index?

HSBC has access to all major index providers' data which we continuously monitor to keep track of all change notifications and the dates they are due to happen. The impact of these alterations is then analysed and we then decide on whether to trade and implement an index change.

All significant changes are traded with emphasis on minimising tracking error, trading costs and maximising transaction quality. We also carefully analyse the impact of participation of index changes by active investors, such as hedge funds, to determine the extent to which the price impact of a change is already reflected in a security's price. Therefore increasing the possibility of trading our requirements at a favourable price.

How do you assess risk in a passive fund?

Risk management is core to our process and we have a dedicated team of risk management specialists to ensure that portfolios are managed appropriately. Strong emphasis is placed on minimising investment and operational risks; our investment management process incorporates constant monitoring of portfolio positions, as well as strict observation of operational and counterparty risk factors. The investment teams analyse sources of tracking risk by analysing the portfolios exposure on a bottom-up and top-down basis while the compliance department monitors portfolios on a daily basis to ensure that the portfolios are consistent with both client and regulatory guidelines.

What are the potential advantages of passive indexation investment?

The most obvious advantage is the simplicity of the strategy. In an era where complex investment structures have been perceived to be central to the current problems in the global financial system, the straightforward approach of an Index Tracking Fund is an important appeal to investors seeking to better understand how their investment portfolios are being managed. Given the relative simplicity of the strategy, Index Tracking Funds can operate on a more cost effective basis as there is no need to hire a large team of analysts and fund managers. The strategy is also less prone to the risk of losing 'star' fund managers.

As part of the risk-averse approach taken by HSBC in the management of its Index Tracking Funds, we avoid taking positions in complex over-the-counter derivatives used by some index fund providers. The strategy also offers a high level of diversification, giving investors the opportunity to invest in a wide range of stocks and business sectors in the relevant market.

for Passive

the world of passive investing

by Harvey Sidhu

How do the costs compare with active funds? What about trading costs?

We aim to consistently deliver returns as close as possible to those of the relevant market index. Minimising trading costs and other charges is central to achieving this objective for investors. Given the passive risks implied with the strategy, Index Tracking Funds tend to only transact on the basis of changes to the composition of a fund's benchmark and fund flows. In comparison, an actively managed fund will trade on the basis of changes in a fund manager's perception of the relative attractiveness of the stocks within its universe. Given that markets and corporate events are highly dynamic, these perceptions of attractive opportunities can alter very regularly, with its associated impact of trading within an actively managed fund.

What place can passive funds play in building a portfolio?

Index Tracking Funds can help investors to diversify their portfolios and offer the possibility of long-term positive returns on a cost-effective basis. Index Tracking Funds can be particularly useful in developed and sophisticated stock markets, where a very large proportion of the financial information that investors require is available to all.

Index Tracking Funds also offer the possibility of high diversification as well as the ability to follow an index of a certain capitalisation, such as small capitalisation stocks, or a sector, such as oil companies.

How can advisers use passive investments and recommend them to clients?

Advisers can use these investments to form the core of their clients' portfolios, to offer a high level of diversification and to reduce the monitoring time that you would have with active funds. The adviser can then concentrate his research activities on the areas of the client's portfolio requiring a higher level of tailoring.

Harvey Sidhu joined HSBC in December 2000 as a quantitative equity analyst within the Global Research Group. He is presently Senior Fund Manager & Head of Passive Equity Funds, HSBC Global Asset Management, where he has been managing equity Index Funds since March 2005. Prior to his time with HSBC, Harvey worked at Rothschild Asset Management for three years where he joined as a graduate and was responsible for quantitative research covering global equity strategy and later junior fund manager covering European equities.

Harvey holds an MSc in Investment Management from City University Business School in London.

Accessing the world's largest equity market - USA

US active managers have a poor track record when it comes to beating the market over the long term.

In 1998 Warren Buffet, often dubbed the Sage of Omaha, the world's most famous stock-picker, told a group of MBA students that 99% of people who invest should extensively diversify and not trade, leading them to an index fund with very low costs.

He reiterated this view in 2007 when he said that most actively managed funds would struggle to beat a cheap index tracker over the longer term.

The latest five-year data by Standard and Poor's, comparing active versus passive funds underlines this view.

Over the last five years, about 60% of actively managed large cap US equity funds have failed to beat the S&P 500 and the figures get worse when it comes to the mid-cap sector where 77% of funds have failed to beat the S&P 400.*

Across many different indices the stats are equally downbeat. For example, over the past five years, about 65% of all US equity managers failed to outperform their respective Russell Indexes.*

As the principal stock market in the world, the US has a large number of indices which are calculated in several ways for analysing the stock market. The most common ones are the Dow Jones Industrial Average, the Nasdaq Composite and Standard & Poor's 500.

Dow Jones Industrial Average

The Dow Jones Industrial Average or DJIA is a price-weighted, the oldest and certainly the most popular stock-market indicator series. It is a price-weighted average of the 30 large, well-known industrial stocks that are generally substantial companies (blue chips) and are listed on the NYSE. The constituent stocks are widely held by investors and well known for the quality and wide acceptance of their products and services, with strong histories of sustained growth.

HSBC North American Index Fund Top 10 Holdings

1	Exxon Mobil Corp.	2.42%
2	Apple	1.90%
3	Microsoft Corp.	1.67%
4	Procter & Gamble Co.	1.51%
5	General Electric Co.	1.48%
6	Intl Business Machines Corp.	1.38%
7	Johnson & Johnson	1.36%
8	Bank of America Corp.	1.34%
9	JP Morgan Chase & Co.	1.33%
10	Wells Fargo & Co.	1.26%
	TOTAL	15.73%

Source: HSBC as at 30 June 2010

The NASDAQ Composite

The NASDAQ Index is a market weighted index of over 3700 stocks that are traded over-the-counter. Smaller capitalisation companies dominate this index and it has a market value that is only around 13% of the NYSE listed companies, as at 31 May 2010.

Russell 1000

The Russell 1000 Index consists of the largest 1000 companies in the Russell 3000 Index. This index represents the universe of large capitalisation stocks from which most active money managers typically select.

Standard & Poor's 500

The S&P 500 has been widely regarded as the best single gauge of the large cap US equities market since the index was first published in 1957.

The index is market cap weighted and has over US$ 3.5tn benchmarked, with index assets comprising approximately US$ 915bn of this total (as at 31 May 2010). The index includes 500 of the foremost companies in leading industries of the US economy, capturing 75% coverage of US equities.

The HSBC American Index Fund aims to closely replicate the S&P 500 index. At 493 holdings, the index is almost fully replicated. The team will actively exclude a stock at the bottom end of the index if they believe it will leave the index or faces bankruptcy.

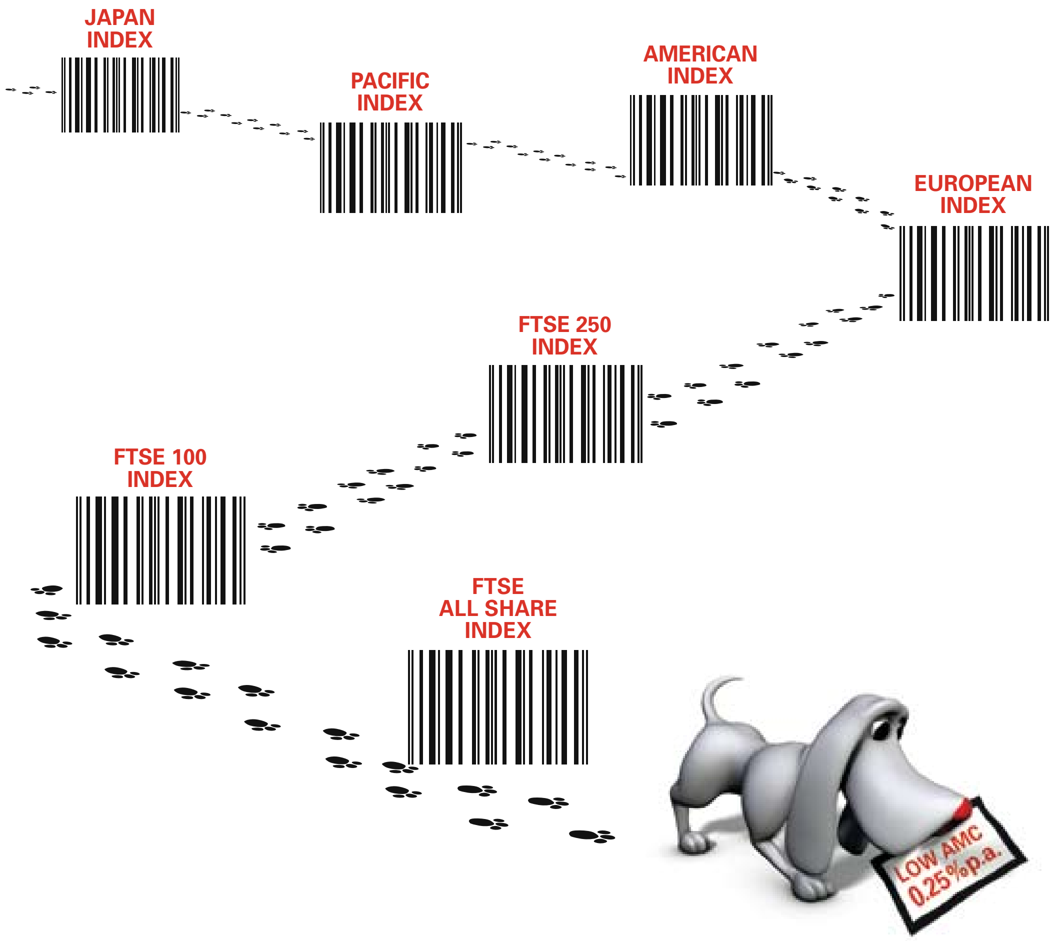
The internal tracking error on the fund is low, with the three-year to end-August 2009 annualised figure just 10bps.

The annual management fee was reduced from 100bps to 25bps in September 2009 resulting in an anticipated TER of 27bps.

The tight tracking error combined with one of the lowest TERs win the industry, enabled the fund to achieve an S&P AAA rating.

***Source: Standard & Poor's, as at 30 May 2010, Total Return USD**

On the trail of the seven AAA* rated HSBC Index Tracking Funds



Our funds are available through all major third party platforms. For further information call **0845 602 6908**† or visit **www.assetmanagement.hsbc.com/indextrackers**

STANDARD & POOR'S AAA FUND MANAGEMENT RATING

HSBC

Global Asset Management

For professional advisers only and not for distribution to retail clients. *AAA rated by Standard & Poor's as at 31 July 2010. †To help us continually improve our services and in the interests of security we may record and/or monitor your communications with us. Past performance refers to the past and is not a reliable indicator for future returns. "FTSE®", "FT-SE®", "Footsie®", "FTSE4Good®" and "techMARK" are trade marks jointly owned by the London Stock Exchange Plc and The Financial Times Limited and are used by FTSE International Limited ("FTSE") under licence. "All-World®", "All-Share®" and "All-Small®" are trade marks of FTSE. The FTSE 100 Index, FTSE 250 Index and FTSE All-Share Index are calculated by FTSE. FTSE does not sponsor, endorse or promote this product and is not in any way connected to it and does not accept any liability in relation to its issue, operation and trading. It is important to remember that the value of investments, and the income from them, can go down as well as up and is not guaranteed and that the investors may not get back the amount originally invested. The Funds referred to are sub-funds of the HSBC Index Tracker Investment Funds OEIC. The Authorised Corporate Director and Investment Manager is HSBC Global Asset Management (UK) Limited, who provides information to professional advisers and their clients on the investment products and services of members of the HSBC Group. All applications are made on the basis of the current HSBC Index Tracker Investment Funds prospectus, simplified prospectus and most recent annual and semi annual report, which can be obtained upon request free of charge from HSBC Global Asset Management (UK) Limited, 8, Canada Square, Canary Wharf, London, E14 5HQ, UK, or the local distributors. Investors and potential investors should read and note the risk warnings in the prospectus. Where overseas investments are held the rate of currency exchange may affect the value of investments. Approved for issue in the United Kingdom by HSBC Global Asset Management (UK) Limited. Authorised and regulated by the Financial Services Authority.

HSBC Index Tracking Funds

Fund Name	Charges	Min. Investment
HSBC FTSE 100 Index Fund (S&P AAA)	0.25% annual, Nil initial	£1,000 initial, £500 additional £50 per month savings scheme
HSBC FTSE 250 Index Fund (S&P AAA)	0.25% annual, Nil initial	£1,000 initial, £500 additional £50 per month savings scheme
HSBC FTSE All-Share Index Fund (S&P AAA)	0.25% annual, Nil initial	£1,000 initial, £500 additional £50 per month savings scheme
HSBC European Index Fund (S&P AAA)	0.25% annual, Nil initial	£1,000 initial, £500 additional £50 per month savings scheme
HSBC American Index Fund (S&P AAA)	0.25% annual, Nil initial	£1,000 initial, £500 additional £50 per month savings scheme
HSBC Pacific Index Fund (S&P AAA)	0.25% annual, Nil initial	£1,000 initial, £500 additional £50 per month savings scheme
HSBC Japan Index Fund (S&P AAA)	0.25% annual, Nil initial	£1,000 initial, £500 additional £50 per month savings scheme
HSBC UK Gilt Index Fund	0.25% annual, Nil initial	£1,000 initial, £500 additional £50 per month savings scheme

Glossary

- **Direct Replication** An index fund that fully replicates an index as closely as possible by containing stocks which are in the same proportions to that of the index.
- **Indirect Replication** Indirectly replicate an index by using financial instruments to track the performance of a cross-section of shares that mirror the index as closely as possible.
- **Total Expense Ratio (TER)** A calculation of total annual costs of investing in a fund expressed as a percentage. Annual costs include the fund manager's annual charge plus custody, auditor, trustee and registrar service charges. The lower the annual TER, the lower the annual costs to the investor.
- **Index Volatility** This measures the variability of investment returns relative to an index. It is calculated as the standard deviation of the monthly or quarterly relative returns.
- **Index-Tracking Fund** A fund which aims to match the returns of a particular market index. The fund may hold all the stocks in the particular index or use a mathematical model to select a sample of stocks that should perform as closely as possible to the index.
- **Index** A measure updated regularly that gives a representation of the movement in value of a specified group of securities that make up the index.
- **Passive Management** Investment approach which aims to track the returns of a particular market index.
- **Tracking Error** This is the measure of the variability of investment returns relative to an index. It is calculated as the standard deviation of the monthly or quarterly relative returns.