Outlook

Macro and Asset Strategy

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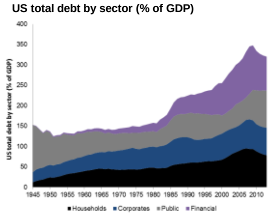
The global economy has been deleveraging in the aftermath of the global financial crisis (GFC)

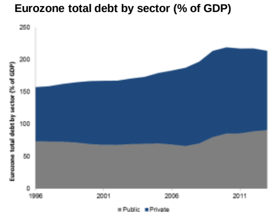
- Before the GFC household, government and financial balance sheets were levered up massively in Developed Markets
- Some progress has been made in paying down debt, but a lot more still to do

US total debt by sector (% of GDP)



Source: US Federal Reserve Financial Accounts (Flow of Funds), Bloomberg, HSBC Global Asset Management, as of October 2014

Eurozone total debt by sector (% of GDP)

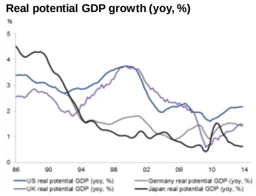


Source: World Bank, Eurostat, Bloomberg, HSBC Global Asset Management, as of October 2014

Falling potential GDP growth has led to a downgrading of consensus GDP forecasts over time

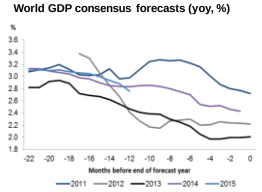
- The decline in potential growth rates is likely to have been one of the factors behind the secular decline in bond yields
- More recently the financial crisis damaged UK and to a lesser extent US potential growth rates
- Repeat pattern of the consensus overestimating the pace of the global recovery

Real potential GDP growth (yoy, %)



Source: OECD, as of October 2014

World GDP consensus forecasts (yoy, %)

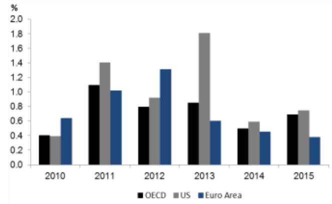


Source: Bloomberg, as of January 2015

The fiscal drag in 2015 for both the US and Europe is expected to be similar to that in 2014 but less than in 2013

- Fiscal drag will remain a small headwind to growth in 2015, but less than earlier this decade

OECD, US and Euro Area fiscal drag (% of GDP)



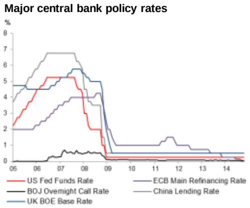
Source: OECD, as of November 2014

4

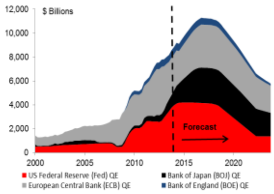
Monetary policy is diverging, but Fed tightening will be gradual and aggregate liquidity is not expected to peak until the end of 2016

- Interest rates expected to remain very low for the time being, although monetary policy measures are diverging causing volatility in the FX market in particular

Major central bank policy rates



Aggregate liquidity stock of major central banks



Source: Bloomberg, HSBC Global Asset Management as of January 2015

5

Commodity prices have fallen sharply, adding to global deflationary pressures but also likely to boost growth

- Spot oil prices have fallen over 50%, or $55 per barrel, since the end of June
- A recent IMF simulation suggests that a 20% fall in the oil price will boost world GDP by about 0.5%
- Each $10 fall in the oil price takes 0.4% off US CPI, 0.2% off Eurozone CPI and 0.1% off UK CPI
- That equates to 2.2%, 1.1% and 0.55% respectively

Commodity prices have fallen over the past few

Source: Bloomberg, IMF as of January 2015

6

Key global risks

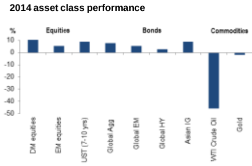
1. **Eurozone deflation risk**
   – With headline inflation in the Eurozone just above zero, there is a risk that the region could slip into sustained deflation if the ECB does not act aggressively enough
2. **China 'hard landing' risk**
   – There is a danger that what currently is a policy engineered slowdown in the Chinese housing market becomes much worse and negatively impacts the banking system. This represents a risk to our macroeconomic outlook and will need to be monitored closely
3. **US monetary policy risk**
   – There is uncertainty over both the pace and scale of US monetary policy tightening that will take place in 2015 and its likely impact on asset prices. The process of asset prices adjusting to tighter policy after six years of near zero interest rates is likely to result in market volatility and concerns over whether the economy can sustain higher interest rates

7

Volatility started to increase in Q4 2014

- Fixed income total return close to that of equities with US Treasuries returning 8.8% and Developed Market equities 10.4%
- Developed market equities outperformed emerging market equities in 2014 by over 4% in total return terms
- Commodities have fallen sharply, with WTI Crude Oil falling over 40%
- Volatility has generally been low throughout the year, though it spiked sharply in October and December of last year and early January of this year

2014 asset class performance



VIX Index and S&P 500 Index

Note: Performance quoted in total return terms. DM and EM equities expressed in local currency, bonds and commodities expressed in USD

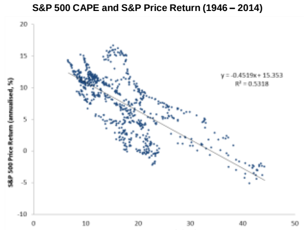
Source: Bloomberg, as of January 2015

8

Equity market valuation is a significant driver of long-term returns

- The relationship between Shiller's cyclically-adjusted PE ratio and the price return on the S&P 500 index becomes stronger as the holding period lengthens
- Over one year, just 4% of the variation in prices can be explained by the Shiller PE ratio at the start of the period. However, over ten years, over half of the price return is attributable to valuation at the start of the holding period

S&P 500 CAPE and S&P Price Return (1946 – 2014)



1946-2014

Holding Period	R-squared between Shiller PE and Price Return
1 Year	4%
3 Years	16%
5 Years	28%
10 Years	53%

Source: Robert Shiller Data, Bloomberg, HSBC Global Asset Management, as of November 2014

9

US equity valuations appear attractive relative to developed market government bonds

- The S&P 500 forward earnings yield relative to the yield on US 10-year TIPS is above its historical average and close to the upper one standard deviation band
- On this metric, although this valuation gap has narrowed over the last two years as the S&P 500 index has re-rated, US equities still appear attractive relative to perceived 'safe-haven' government bonds in real terms

S&P 500 earnings yield relative to US 10-year TIPS yield

Dotted lines indicate +/- 1 standard deviation from the historical average

Source: Bloomberg, DataStream as of January 2015

10

In addition, the cyclical outlook is also attractive for equities

- US equities tend to outperform US Treasuries as long as the unemployment rate is continuing to fall
- This suggests that equities could continue to outperform unless the Fed kills the recovery by tightening interest rates aggressively, or some other external shock damages the economy

MSCI US relative to 10Y UST versus the US unemployment rate

Source: Bloomberg, as of January 2015

11

Investment Implications

- Equity valuations do not yet look stretched and are at levels that have historically been consistent with moderate but positive long-term returns
- Developed market government bond yields likely to rise modestly as investors accept that the global recovery is sustainable and that the Fed is in the process of shifting its monetary policy stance
- We believe that the global economy is gradually healing but that the monetary policy backdrop remains biased towards being supportive
- Consequently, we continue to favour corporate assets in our multi-asset portfolios over perceived "safe-haven" developed market government bonds
- However, key risks to this outlook remain, including a sharper than expected slowdown in China and deflation in the Eurozone
- These risks and the volatility experienced in recent months serve as a reminder of the need to have a long time horizon when investing in risk assets and the benefits of holding a diversified multi-asset portfolio, including government bonds, and not one concentrated in just one or two assets or markets

12

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HSBC Economic Scale Indexation

January 2015

For professional clients only

HSBC Global Asset Management

Introduction
Capturing Equity Beta

The objective of investing in equities is to capture "equity beta"

- Investors continue to believe that an equity risk premium exists and has value
- In a world of "market efficiency," cap-weighting is the optimal approach, either as a low cost passive strategy or as a risk-measurement template for active management
- Given a belief that markets are "inefficient," alternative weighting schemes and active management are attractive
- Rebalancing, whether "passive" or "active," harvests market noise and adds value

We believe Alpha and Beta equity investment objectives are best achieved through capabilities that have conceptual clarity and use an investment process that is differentiated by design and implemented with discipline

Capturing Equity Beta

How 'efficient markets' changed investment management

Efficient Market Hypothesis

All information on all investments is known

Returns are proportional to systematic risk, not knowledge

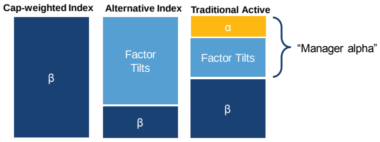
Cap – weighted index optimal

16

Capturing Equity Beta – adding excess returns?

Does market inefficiency = traditional active management

- Active products seek to manage idiosyncratic risk with judgment and fundamental analysis
- However they bundle together the style exposure and stock selection, often resulting in disappointing returns relative to a passive benchmark
  - The median manager struggles to outperform the cap weighted benchmark (Malkiel (1995), Gruber (2000,2003))
  - Those that do often only sustain this alpha over short periods
- Factors are important in explaining manager returns*



Source: Callan
* Fama and French 2010 found that mutual funds in aggregate experienced net returns that underperformed the Fama-French factor benchmarks by about the costs in expense rations between 1984-2006. Mok, Bender & Hammond 2013 showed traditional Fama-French Factors accounted for roughly 50% of average alpha using US institutional fund returns

17

Capturing Equity Beta

Alternative weighting strategies

If cap-weighted indices are not efficient …

- Excess volatility driven by macro events, market noise
- Risk can be mispriced
- Efficient market hypothesis does not hold
- Has less attractive characteristics and risks

… it is better to calculate index weights without linking to security prices …

- Creating stable weights
- Different approaches:
  - Equal weighting
  - Risk weighting
  - Fundamental weighting

… and to add a rebalancing mechanism to capture pricing errors

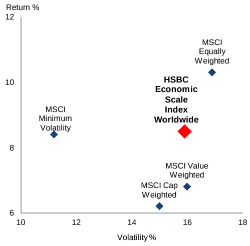
- Proportional to pricing errors
- Contra-trade to pricing errors and momentum
- Frequency matters
- May underperform when pricing errors persist

Source: HSBC Global Asset Management, as of June 2014.
For illustrative purposes only.

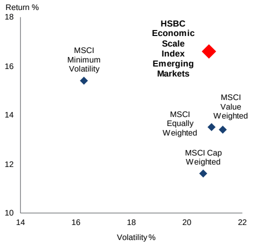
Alternative Indexation – differing factors, differing returns and risks

Performance - Supplemental Information

Returns for Worldwide



Returns for Emerging Markets



Source: HSBC Global Asset Management., Bloomberg, Datastream, MSCI Barra, All returns are monthly total returns in GBP(with gross dividends re-invested) from 31st December 2001 to 30 September 2014. HSBC Economic Scale Index data prior to 15 June 2012 is back tested (simulated) data calculated by the independent calculation agent, the Euromoney Indices team. Data subsequent to the Index launch date has been calculated daily by Euromoney. **Past performance and back tested (simulated) data are not a reliable indication of future returns.** Back tested performance results have many inherent limitations and were achieved with the benefit of hindsight by means of a retrospective application of the HSBC Economic Scale index rules based methodology to determine the appropriate weightings. The results do not represent the results of actual trading using client assets and as such do not include any dealing costs that may be incurred by funds tracking an Index. No representation is being made that the Index will or is likely to achieve results similar to those shown. In fact, there are frequently sharp differences between back tested performance results and actual results subsequently achieved. The data is supplemental to the GIPS® compliant presentation at the end of this material.

Alternative weighting strategies

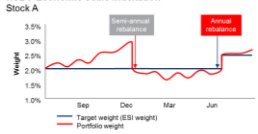
Rebalancing can be your friend

Investment objective:	**Capture the equity risk premium and use rebalancing to harvest short-term pricing errors in cap-weighted indices**

- **Pure play on rebalancing**
- **Tempered factor exposures**
- **Cost-efficient proprietary index avoids index licensing fees**

Market cap-weighted index
Stock A

HSBC Economic Scale Indexation
Stock A



Source: HSBC Global Asset Management, as of June 2014.
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Fundamental indexation

Tempered style exposures

- Fundamental indexing is not simply an alternative way of obtaining exposures to systematic factors that have historically contributed to outperformance
- In the case of fundamental indexation, especially as it relates to HSBC Economic Scale Indexation, there is a tempered exposure to value and small cap factors, but these are small in comparison to the strategy's alpha

	Index	Out-performance	Market beta	Small-cap beta	Value beta	Tracking error
1	**HSBC ESI Worldwide**	2.22%	0.995	0.235	0.260	2.67%
2	**HSBC ESI Emerging Markets**	4.24%	0.975	0.055	0.286	3.72%
3	**HSBC ESI World**	1.68%	0.997	0.211	0.262	2.77%

HSBC ESI Indices can generate 'Alpha' through avoiding the biases inherent in cap weighting

Index data prior to 15 June 2012 is back-tested (simulated) data calculated by the independent calculation agent, Euromoney Indices. Data subsequent to the Index launch date has been calculated daily by Euromoney Indices. Past performance and back-tested (simulated) data are not a reliable indication of future returns. Back-tested performance results have many inherent limitations and were achieved with the benefit of hindsight by means of a retrospective application of the HSBC Economic Scale Index rules-based methodology to determine the appropriate weightings. The results do not represent the results of actual trading using client assets and as such do not include any dealing costs that may be incurred by funds tracking an index. No representation is being made that the Index will or is likely to achieve results similar to those shown. In fact, there are frequently sharp differences between back tested performance results and actual results subsequently achieved. Data is supplemental to the GIPS® report at the end of this presentation.
Source: Datastream, data (using weekly total returns in GBP with gross dividends re-invested) from 4th July 2001 to 01 October 2014.

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Any performance information shown refers to the past should not be seen as an indication of future returns. It is important to remember that these alternative indices don't outperform all the time. In particular in a momentum driven bubble (such as with technology stocks in the late 90s) share prices can diverge from fair value for an extended period. In such cases HSBC ESI strategy will underperform capitalisation weighted indices as rebalancing does not improve returns. However when the bubble bursts and share prices drop back towards fair value then the HSBC ESI should outperform.

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23

Appendix

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HSBC Economic Scale Indexation

Index methodology comparison

	HSBC ESI Worldwide	FTSE RAFI AW 3000	MSCI Value Weighted
Weighting basis	Value-Added	Average of weights • Sales • Dividend • Cash Flow • Book Value	Average of weights • Sales • Cash Earnings • Earnings • Book Value
Stock universe	Listed company universe across Developed and Emerging Markets ~50,000 names	FTSE Global All Cap Index ~7,400 stocks	MSCI AC World cap-weighted index ~2,400 stocks
Index constituents	Screen stocks for information availability, liquidity, availability and size to enable full replication ~2,300 names	Select companies with the largest fundamental weights ~3,000 names	~2,400 stocks
Rebalance frequency	Twice yearly.	Annually	Twice yearly.
Rebalancing timing	June December	March	Last business day of May Last business day of November

Source: HSBC Global Asset Management. For illustrative purposes only. Diversification does not protect against a loss in a particular market. There is no guarantee that any investment strategy will work under all market conditions. Investing involves risk including the possible loss of principal.