



Investment Outlook Seminar  
Dublin  
January 27<sup>th</sup>/28<sup>th</sup> 2010

Risk trade is on, but it's contingent

# HSBC Group

- ▶ **HSBC Group is a global bank, formed in 1865 in Hong Kong, HQ in London and reports in USD\$.**
- ▶ **Market cap circa \$200 Billion, with 10,000 offices in 86 countries.**
- ▶ **US\$ 2.5 trillion in assets, with \$1.2 trillion in deposits and \$1 trillion in loans. HSBC's loan to deposit ratio is circa 79%.**
- ▶ **HSBC's hallmark capital strength- HSBC has not availed of any Government support, capital or guarantees anywhere in the world.**

## Global Private Bank

- ▶ **PB Ireland is part of HSBC Global Private Bank, 3<sup>rd</sup> largest private bank in the world.**
- ▶ **A core business of HSBC, operates in 90 locations in 37 countries.**
- ▶ **2008 – PBT \$1.4 Billion with approx \$433 billion client AUM, 7000 employees.**
- ▶ **Consistent investment advice from across our global business given to our clients.**

# Our Key Takeaways

What	Investment Implication
1. The global recovery remains intact (for now).	The risk trade (equities, credit, commodities, carry trade) is still on.
2. Market complacent about future risks.	Upside for riskier assets has moderated. <u>Pare down relative risks.</u>
3. The risk of central bank policy errors remains significant.	We are buyers of risk at the moment, but it is <u>contingent.</u>
4. 2010 likely to be a year of sovereign risk rather than just financial sector risks.	Not ALL government bonds are safe havens.
5. Need to be tactical.	Hedge funds are well placed for a volatile year.

# Dichotomy between the structural and cyclical

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## Structural impediments

- ▶ Demographics
- ▶ Government debt
- ▶ Consumer debt
- ▶ Western unemployment rates

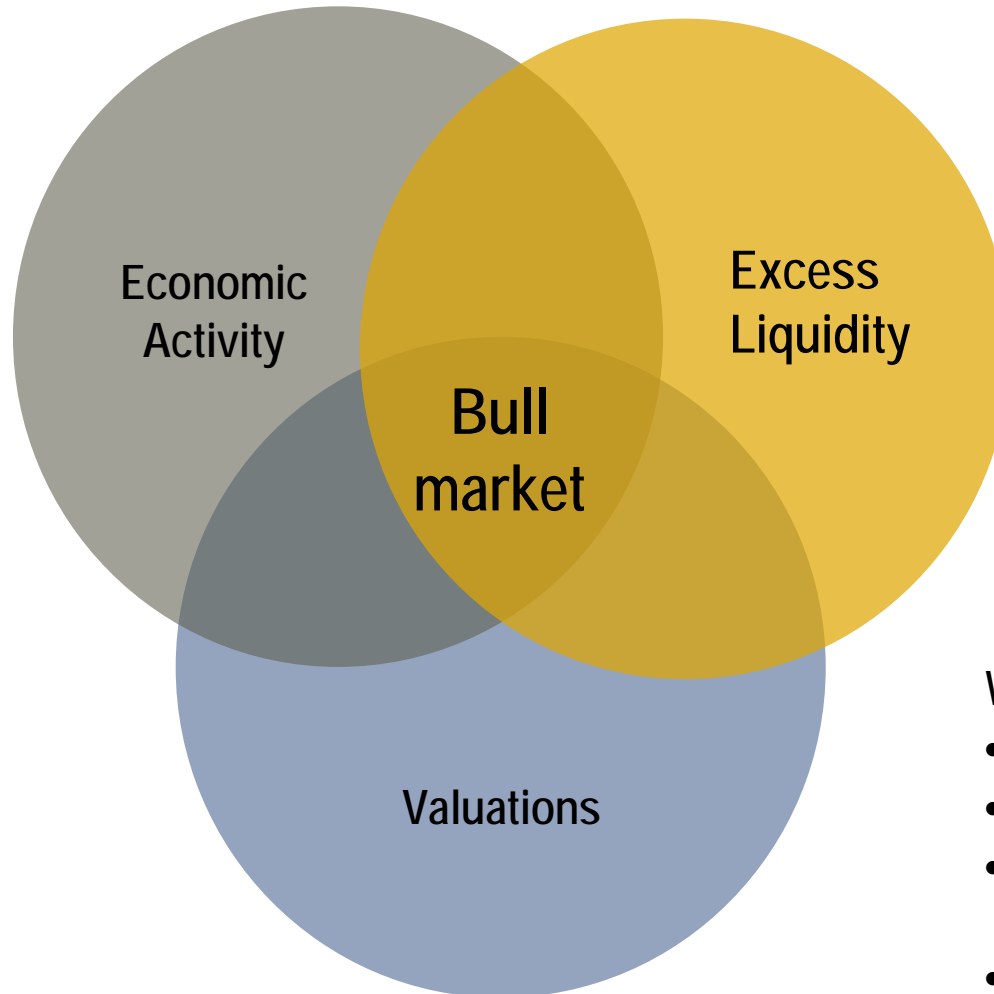
## Cyclical recovery

- ▶ Improving trade
- ▶ Inventory adjustments
- ▶ Financial conditions improving
- ▶ Productivity
- ▶ Emerging market demand

# The three spheres are aligned for risk taking

## What to watch:

- ISM and PMI surveys
- Labour data
- Inventory data
- Trade data (Baltic dry)



## What to watch:

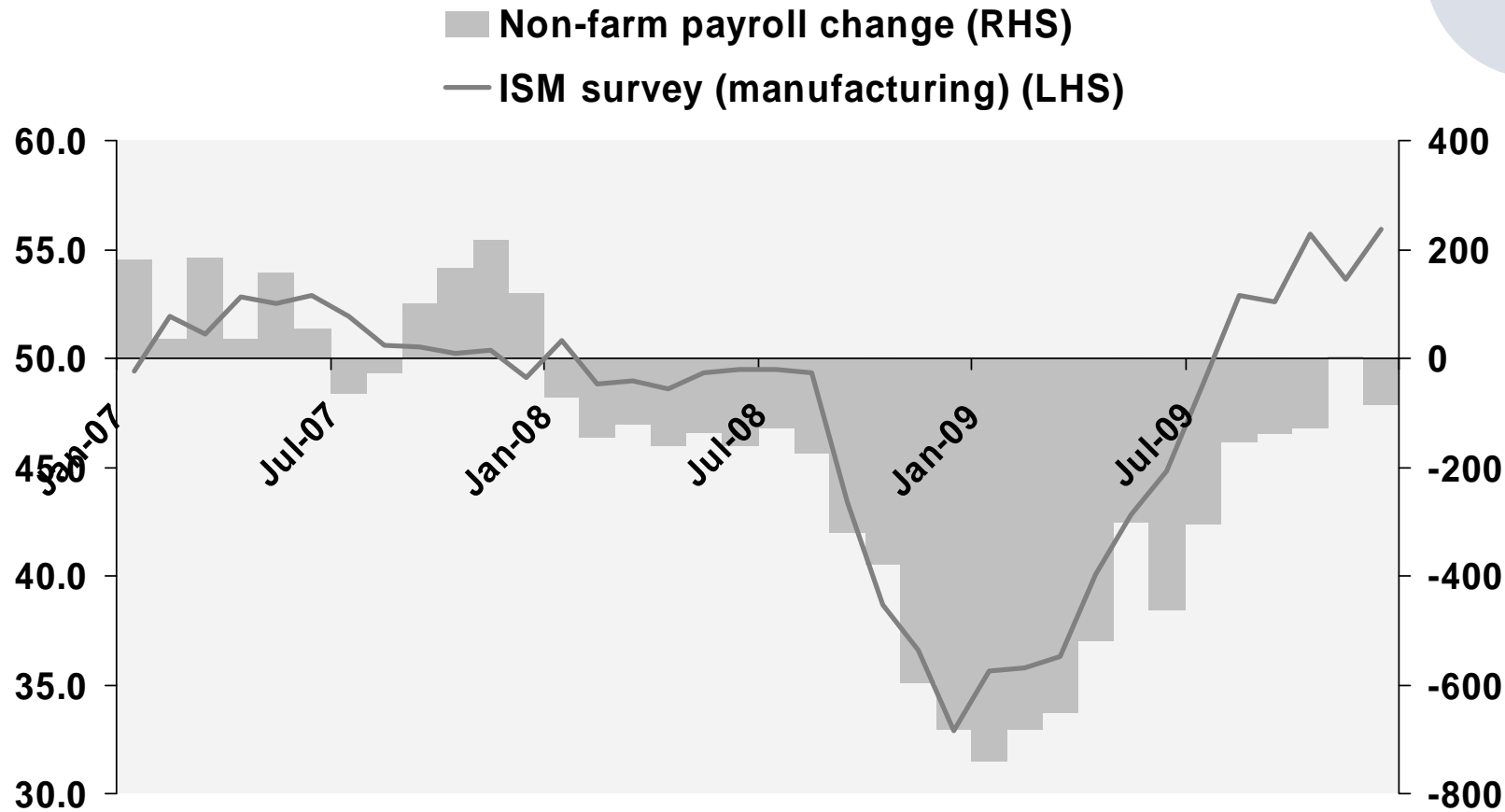
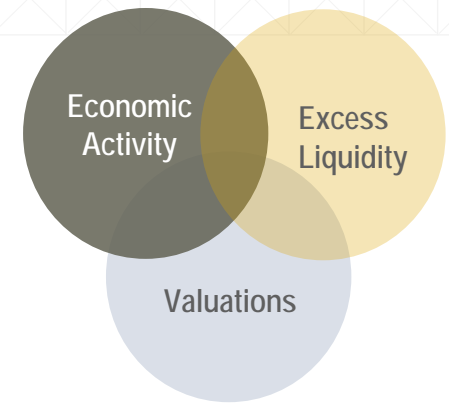
- Central bank's exit strategies
- Credit spreads
- Carry trade
- Yield curve steepness
- Relative money market AUM

## What to watch:

- Earnings!
- M&A activity
- Relative earnings momentum
- Relative yields

# Survey data still in expansionary territory

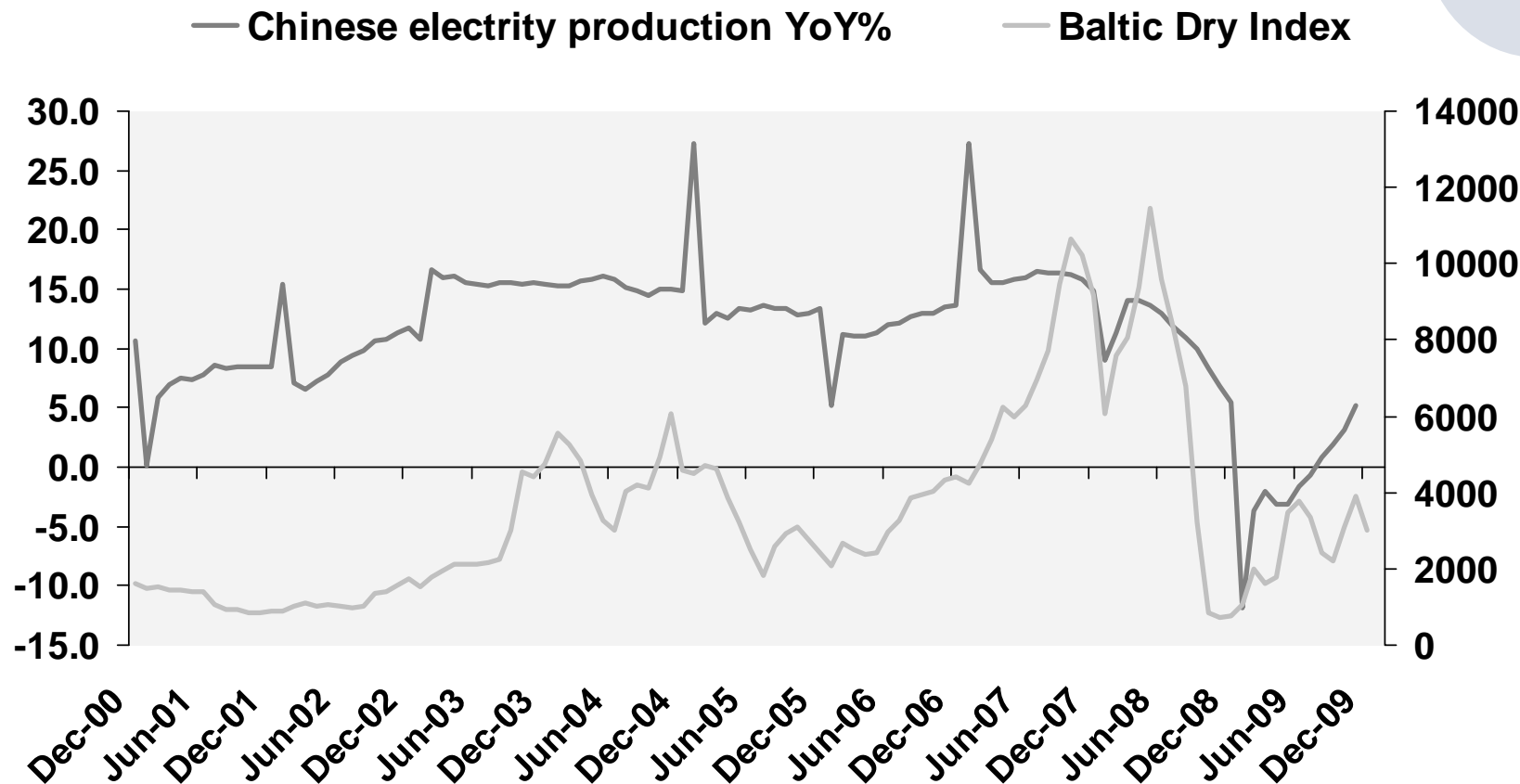
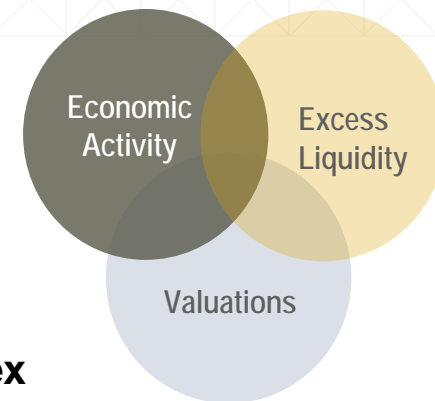
Economic recovery has so far been 'V' shaped.



Source: Institute for Supply Management, Bureau of Labor Statistics, Thomson Datastream, HSBC Private Bank as at 20 January 2010

# Chinese growth is driving global trade

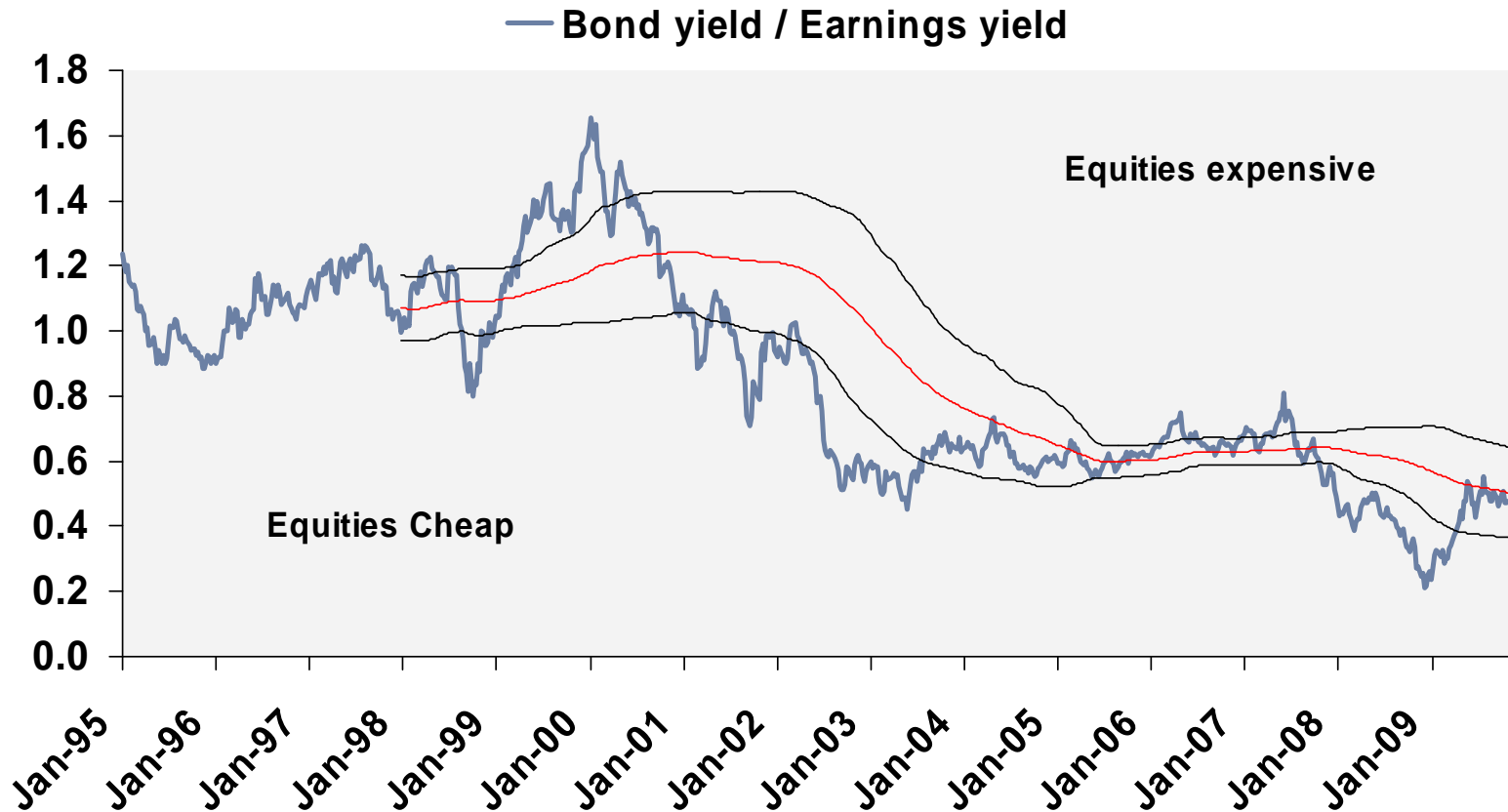
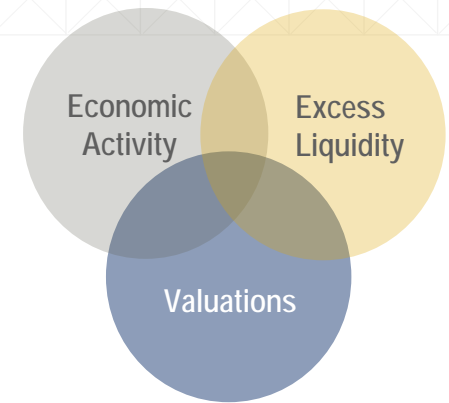
Global trade is rebounding strongly



Source: China Bureau of Statistics, Thomson Datastream, HSBC Private Bank as at 20 January 2010

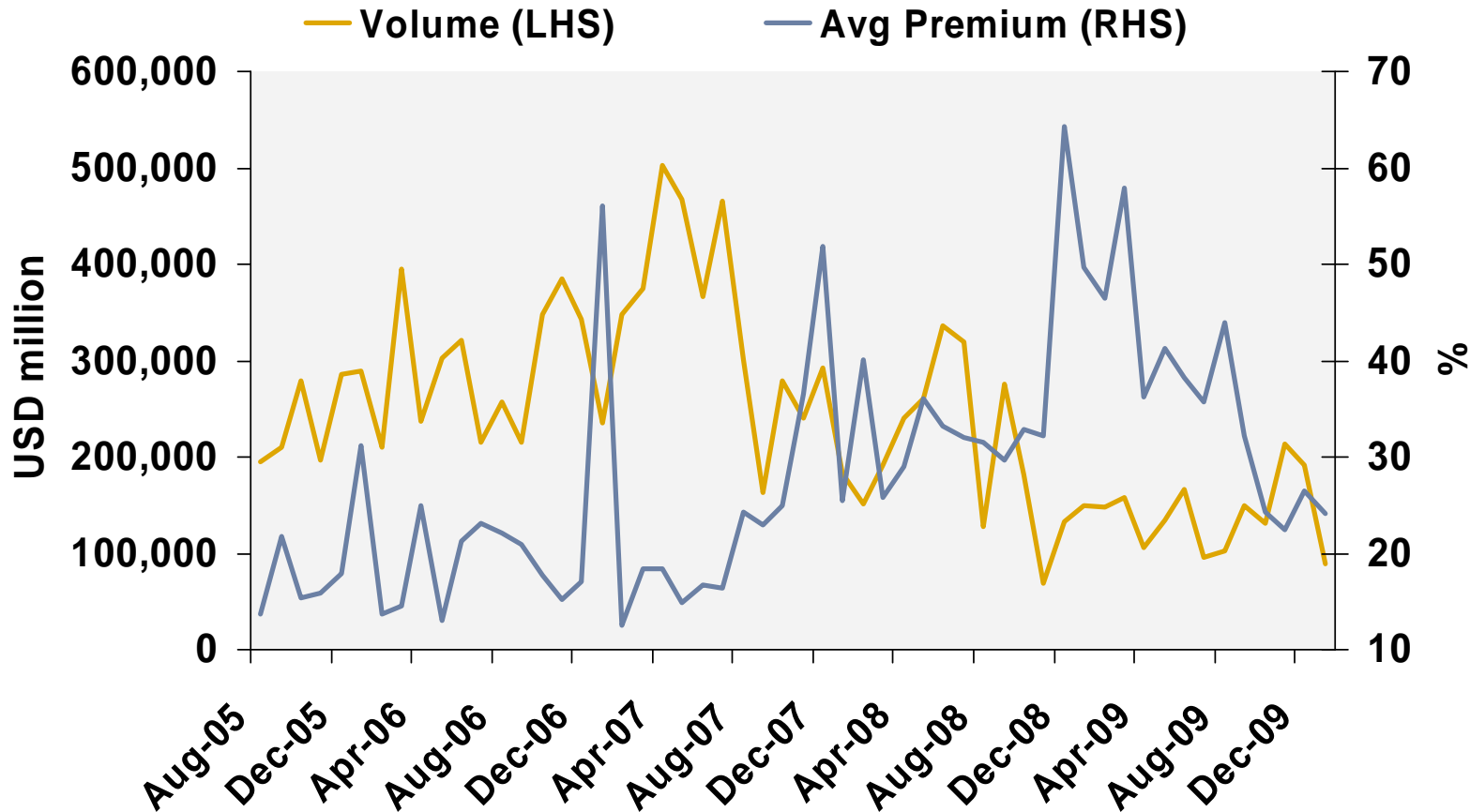
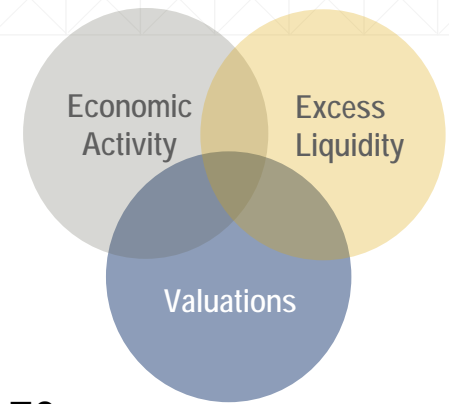
# Equity valuations are still in 'fair' territory

Aging population accumulating bonds rather than equities. As a result, bonds will look more and more expensive relative to equities.



Source: I/B/E/S Aggregates, MSCI, Thomson Datastream, HSBC Private Bank as at 20 January 2010

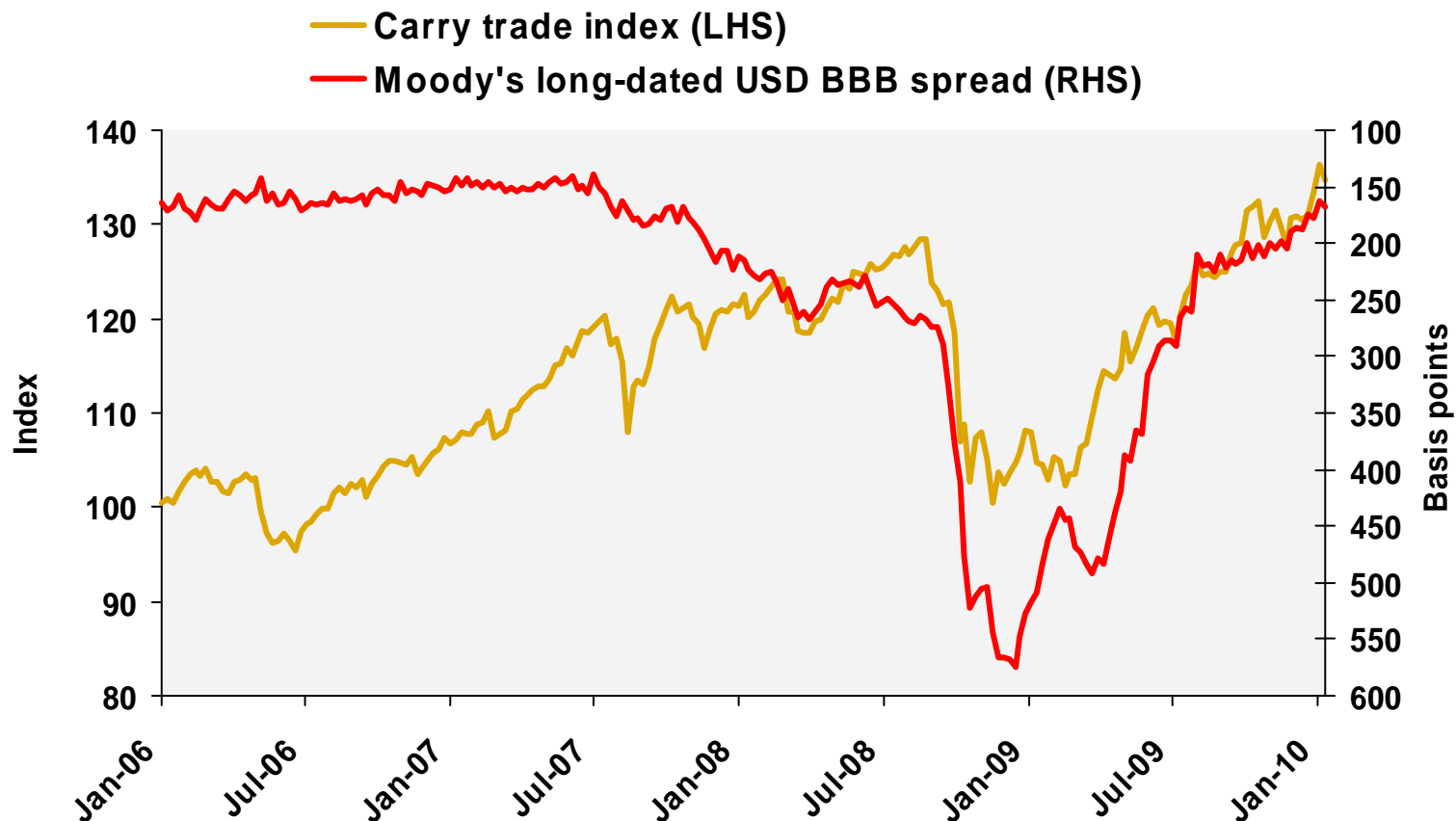
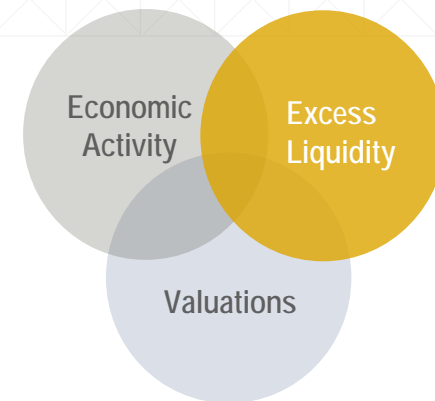
# M&A activity is still low and premiums are not excessive



Source: Bloomberg, HSBC Private Bank as at 20 January 2010

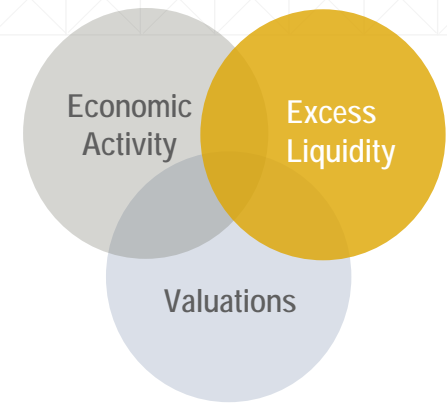
# Carry trade & credit spread

The search for yield is on and excess liquidity is driving markets higher.

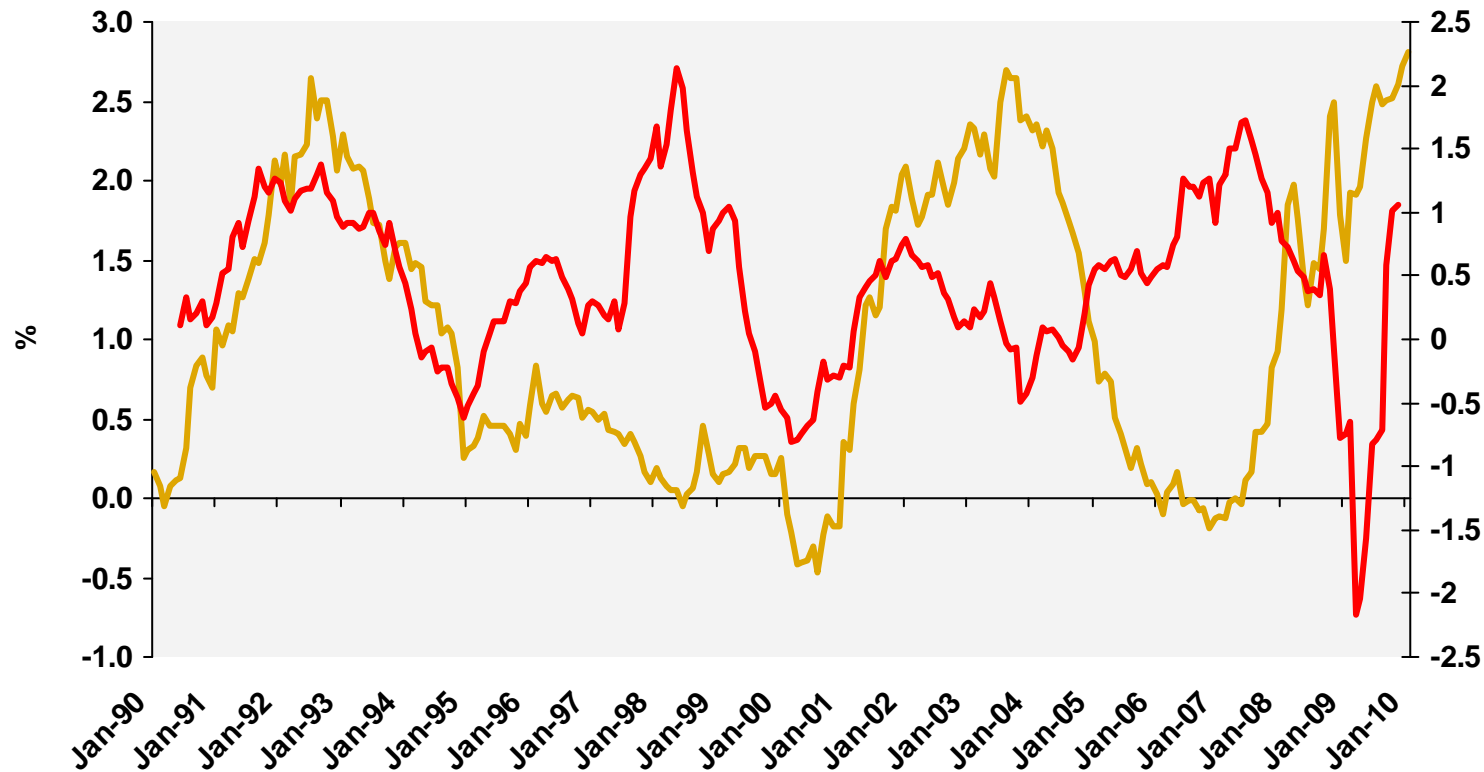


Source: Moody's, Bloomberg, HSBC Private Bank as at 20 January 2010

# Fixed income flows positive as cash yields low and yield differential large

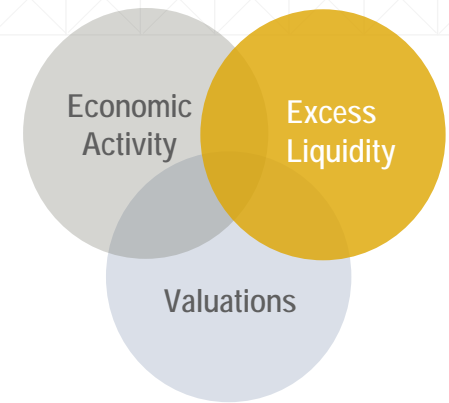


— UST steepness (10 - 2 years) (LHS)  
— US Corporate Bond fund flows (% of AuM) (RHS)

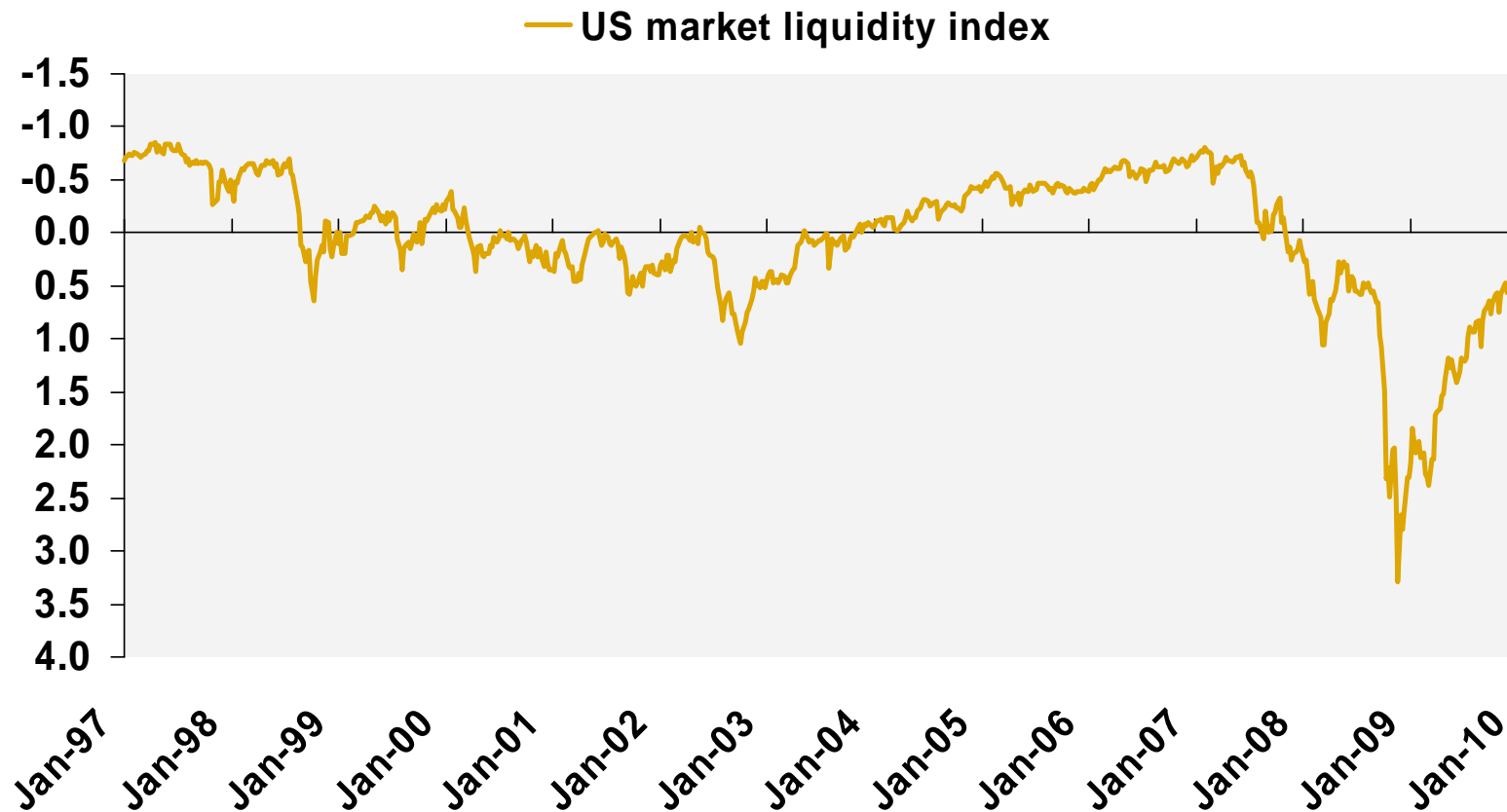


Source: Investment Company Institute, Thomson Datastream, HSBC Private Bank as at 20 January 2010

# Liquidity level is almost back at pre-crisis levels



Bid-offer spreads, credit spreads down and equity volumes up



Source: Citigroup as at 20 January 2010

# The five pillars of support are still intact

We maintain our bullish stance on risk. However, this outlook is contingent on five pillars of support:

Pillar of support	Status	Our comments
<b>A continuation of improving macroeconomic trends</b>	✓	Growth outlook still intact.
<b>Strong corporate earnings growth</b>	✓	Q4 earnings season pointing to an acceleration of earnings.
<b>Astute central bank policy</b>	✓	Inflation still muted in most part of the world. Base effects and commodity prices a worry for central banks with fixed inflation targets (ECB & BoE).
<b>Low and stable government bond yields</b>	✓	Sovereign default risks still an issue but unlikely to unhinge government yields in 2010.
<b>Gradual rise in commodity prices</b>	✓	No spike so far but oil prices have started to become a drag on the global economy.

# Another structural equity bull market unlikely

	1982	2009
Fed funds rate	18% and falling	0% and rising
10-year bond yield	15% and falling	3.8% and rising
Monetary base	\$170 bn and rising	\$2.2 tn and falling
Budget deficit-to-GDP ratio	-3% and improving	-10% and steady
Household debt-to-income	62% and rising	123% and falling
Inflation rate	10% and falling	4% and rising
Unemployment rate	10.8% and falling	10% and rising
Tax rates (highest marginal)	69% and falling	35% and rising
Union share of the job market	20% and falling	12% and rising
Global trade barriers	High and falling	Low and rising
Profit margins	6%	10%
S&P 500 P/E ratio (1-year trailing)	8 x	20 x
P/E ratio (10-year normalised real)	7 x	23 x
S&P 500 price-to-book ratio	1 x	2.2 x
S&P 500 dividend yield	6%	2%
Investor sentiment	10% bullish	88% bullish
Demographics - median age	25	52

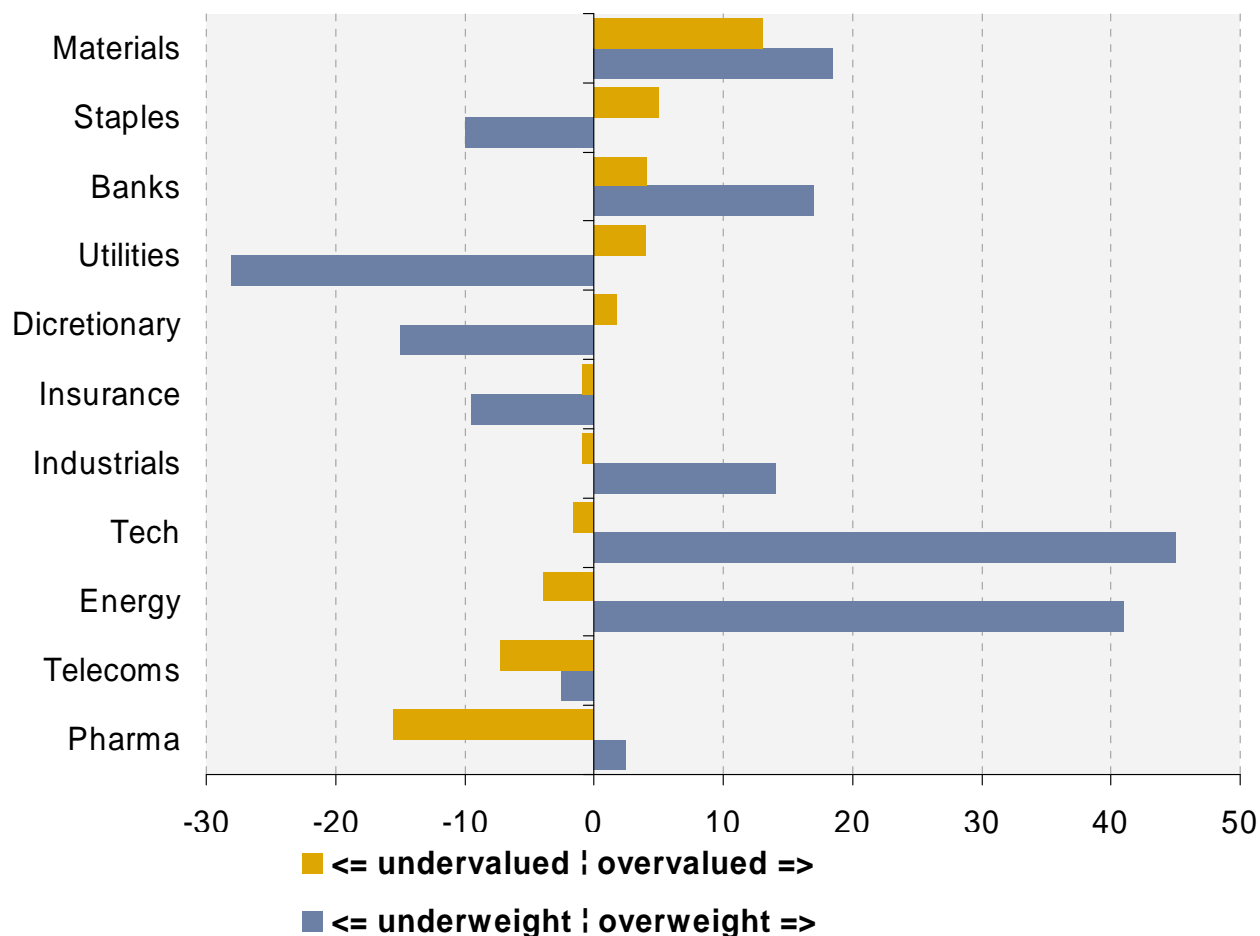
Source: HSBC Private Bank as at 20 January 2010

Note: US data

# Key Equity themes – overweight US

- ▶ Positive corporate earnings surprises continue
- ▶ Strong earnings growth expectations
- ▶ A high 10% with dividend yield > corp. bond yields
- ▶ Undervalued & under owned relative to emerging markets
  - Delivered P/E: 18.9
  - 12m fwd P/E: 14.2
  - EPS growth: 33.4%

## Global Fund Manager positions & valuation assessment

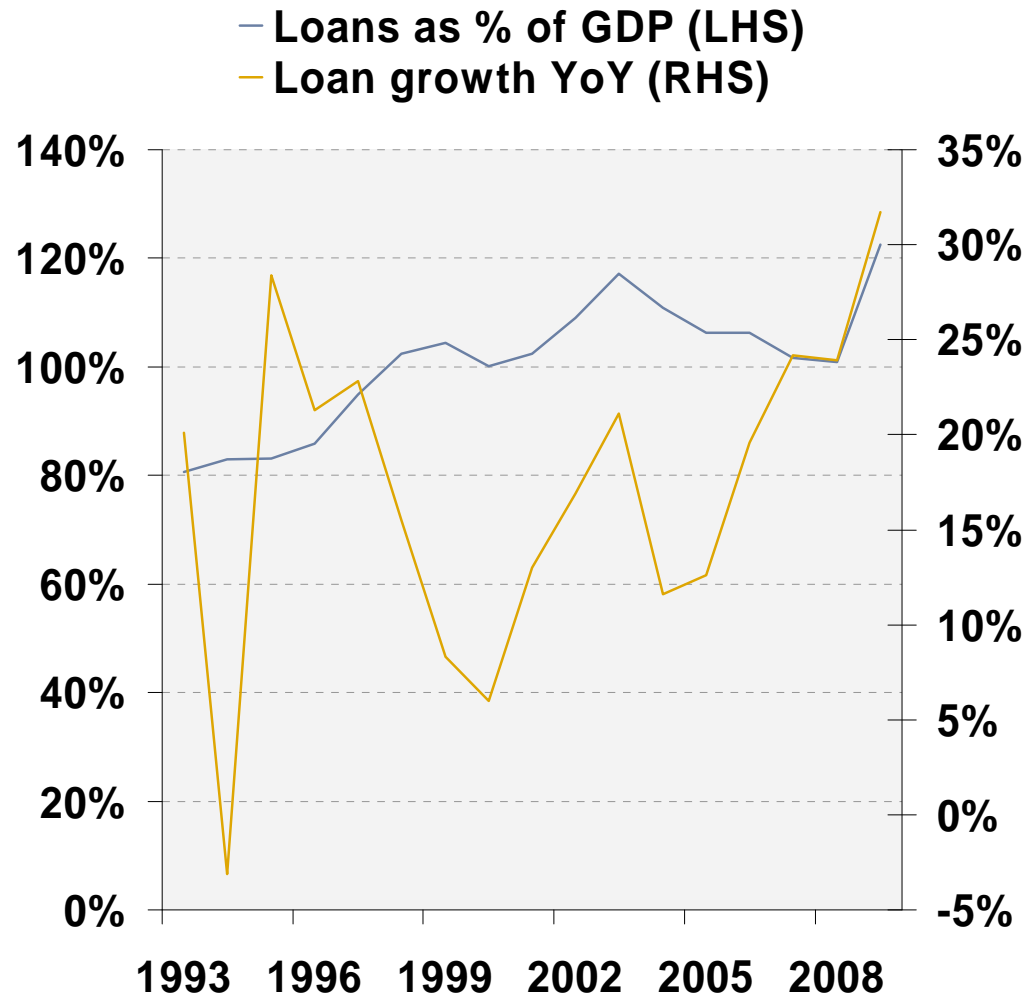


Source: Merrill Lynch Bank of America, HSBC Private Bank as at 20 January 2010

# Key Equity themes – cautious on China

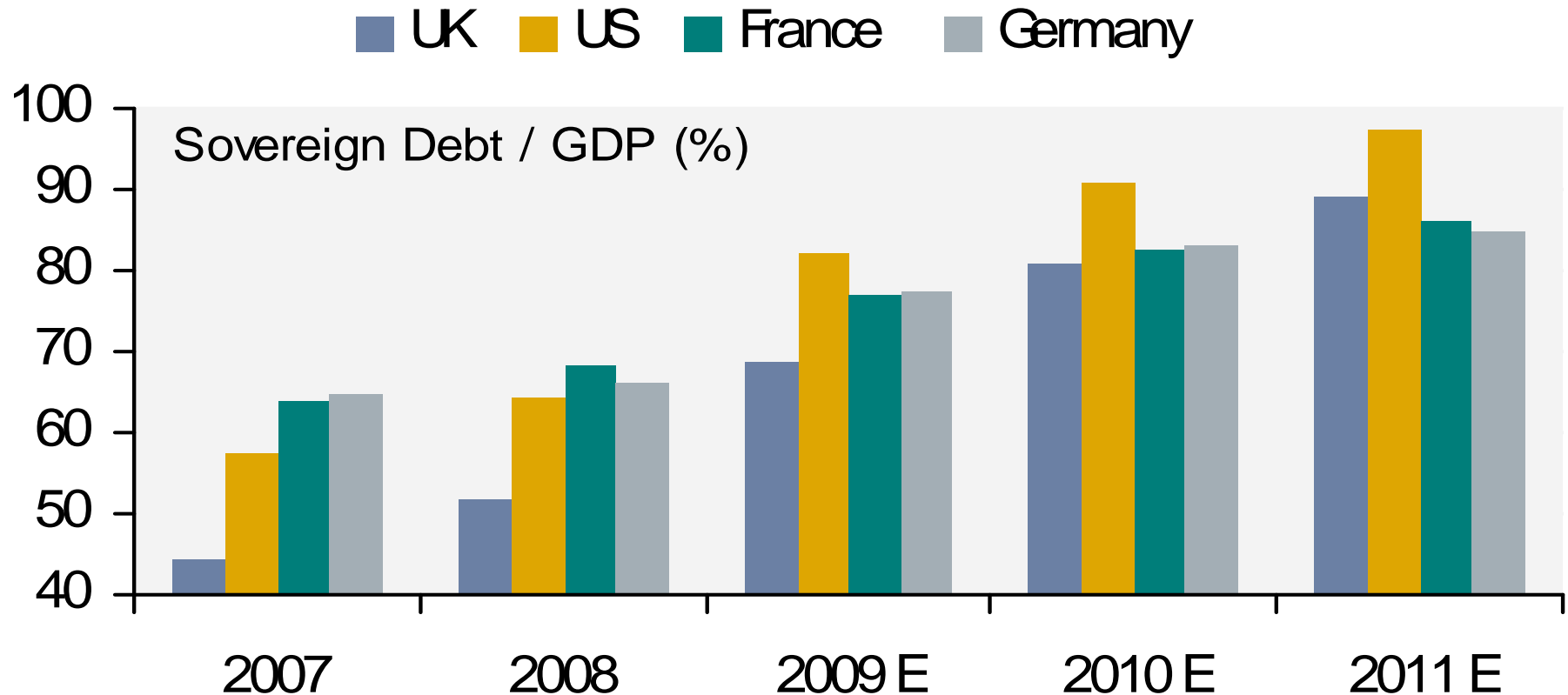
## Loans from financial institutions

- ▶ Structural story intact
- ▶ Strong earning growth expectations
- ▶ However, markets not focussing on fundamentals
- ▶ Valuations are expensive
  - Delivered P/E: 32.8
  - 12m fwd P/E: 17.9
  - EPS growth: 83%
- ▶ Bubble concerns are likely to throttle appetite in the short-term



Source: China Economic Information Net, Bloomberg, HSBC Private Bank  
as at 20 January 2010

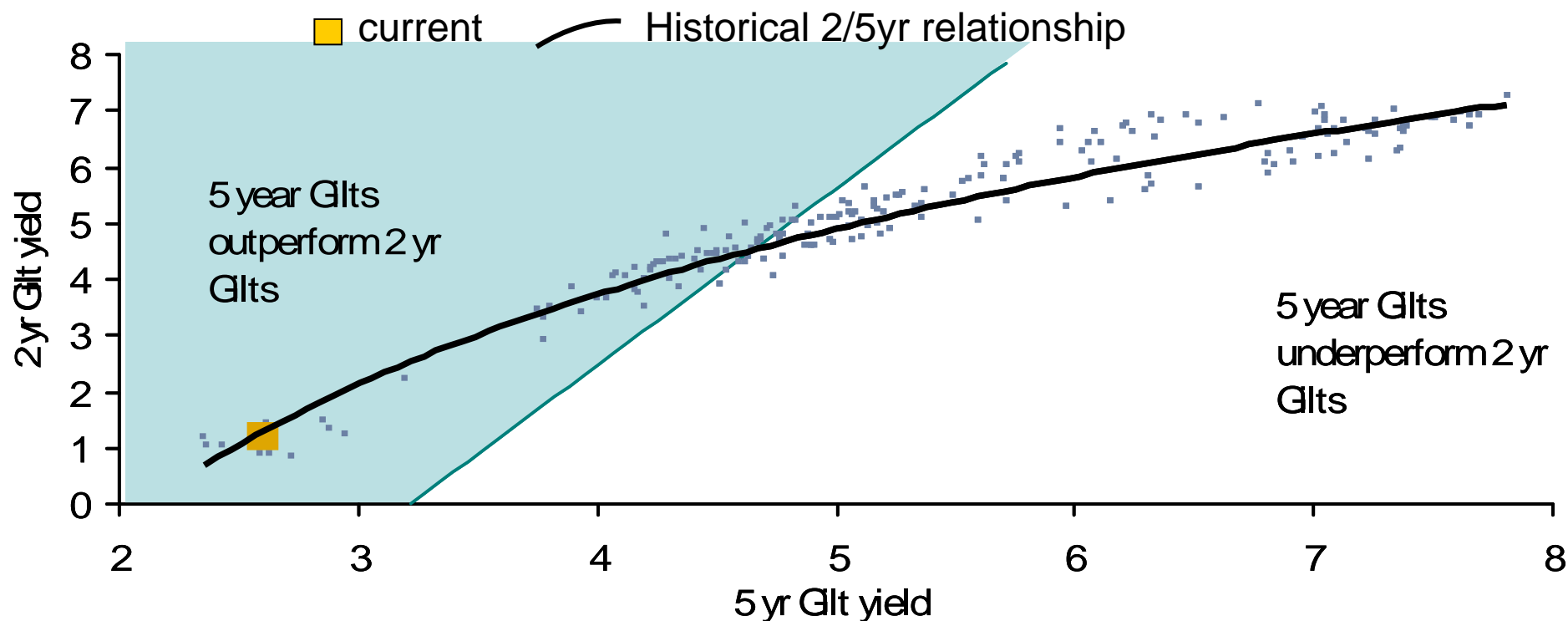
# Most sovereign borrowers will continue to deteriorate in quality for some time



Source: Standard & Poor's, HSBC Private Bank as at 20 January 2010

# Why we prefer 5 year over 2 year Gilts

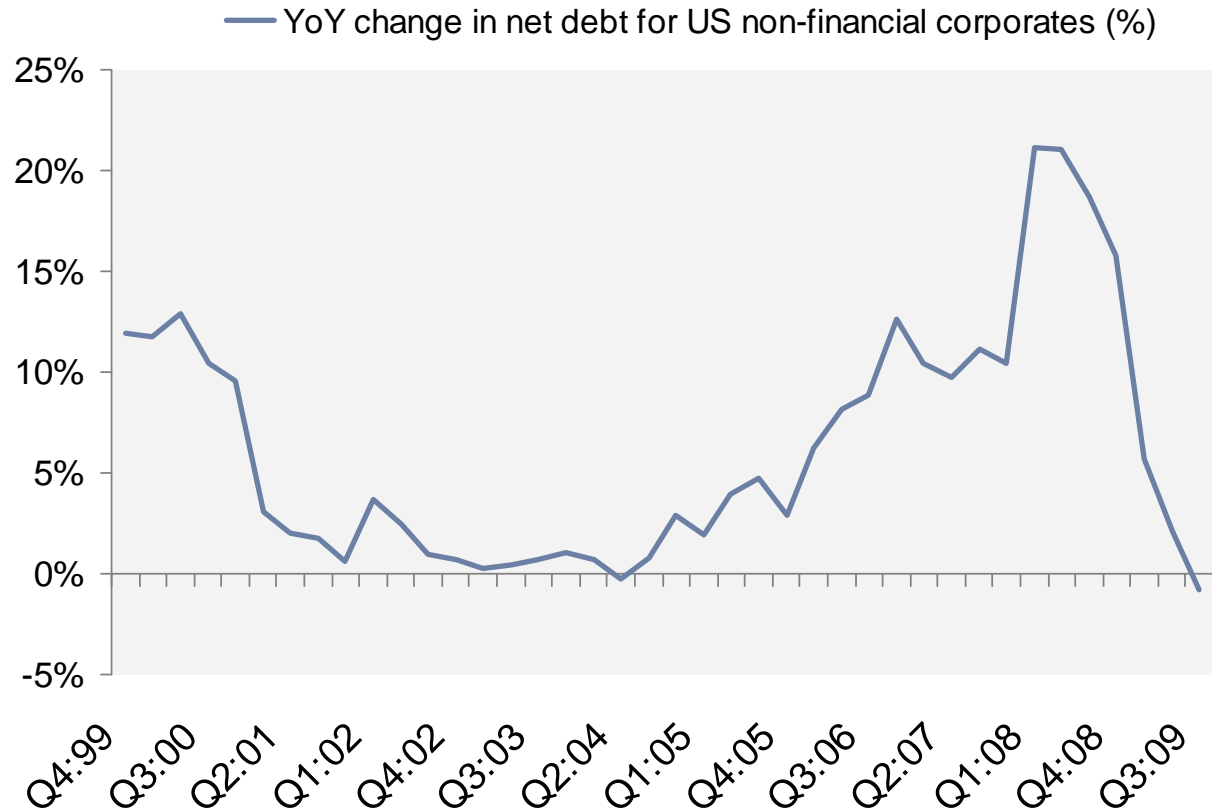
- ▶ The yield pickup between 5 and 2 year Gilts is near historical records
- ▶ The curve roll down effect for a 5 year bond is very significant
- ▶ Can yields back up enough to make 5 year bonds underperform 2 year bonds in the next 12 months?



Source: Bloomberg, HSBC Private Bank as of 20 January 2010

# Corporates have quickly put their house in order

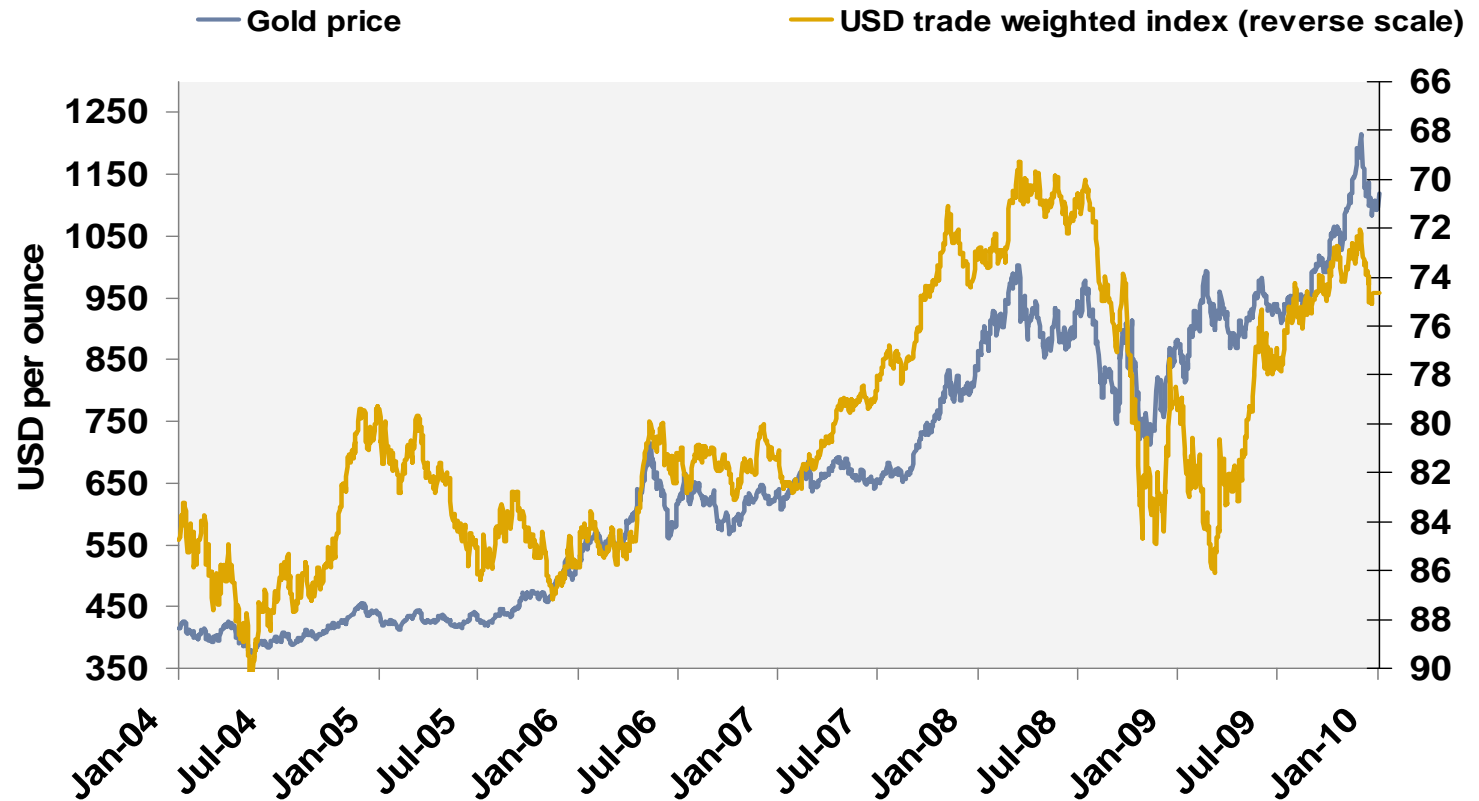
- ▶ **Quick deleveraging is well under way**
- ▶ **Extending corporate financing duration**
- ▶ **Bond issuance replacing loans not creating higher leverage**



Source: Federal Reserve as at 20 January 2010

# Gold price remains correlated to USD

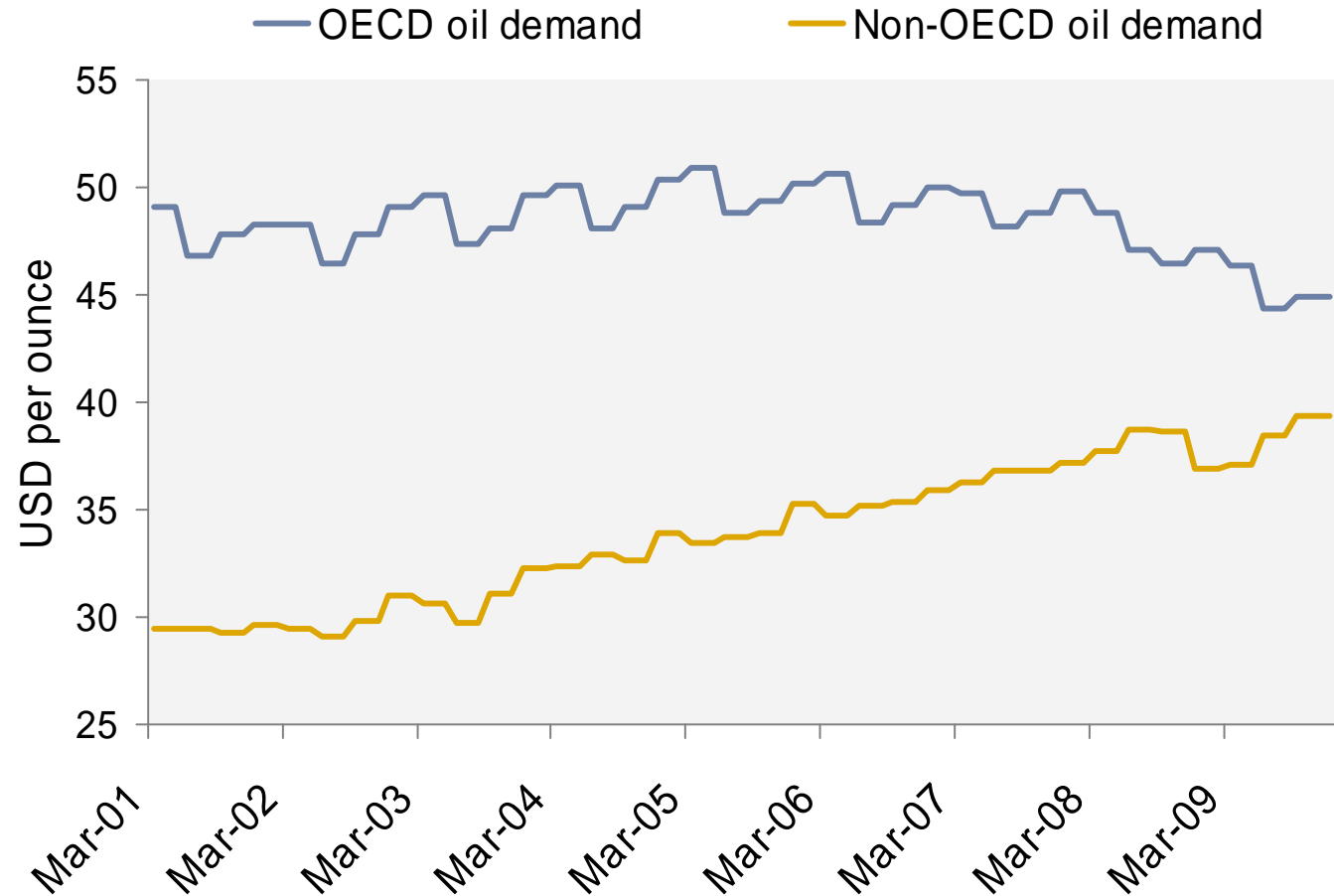
- ▶ Liquidity driven
- ▶ Government risks rising
- ▶ Neutral view
- ▶ Portfolio allocation: 2% - 5%



Source: Bloomberg, HSBC Private Bank as at 20 January 2010

# Current oversupply keeps oil range-bound

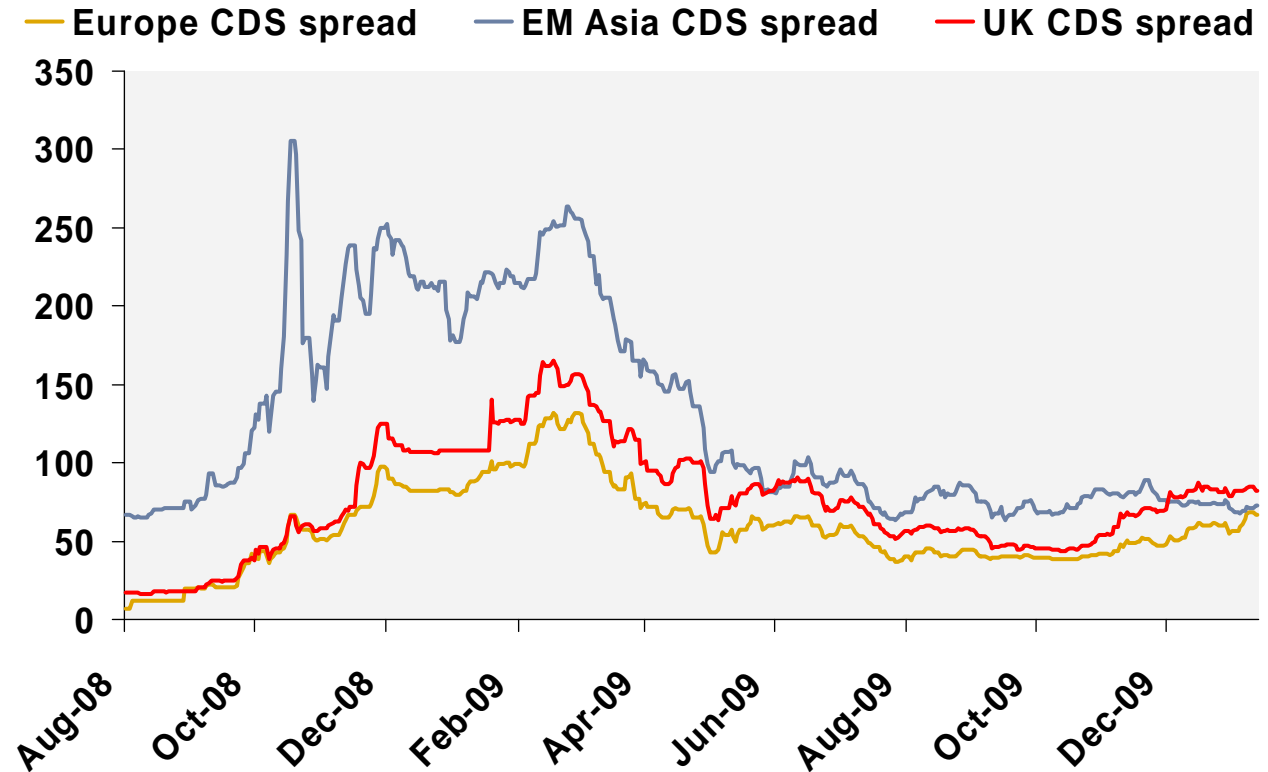
- ▶ **EM demand**
- ▶ **High inventories**
- ▶ **Long-term view: positive bias**



Source: US Department of Energy, Bloomberg, HSBC Private Bank as at 20 January 2010

# EM currencies remain attractive

- ▶ **EM appreciation to continue**
- ▶ **Choice between USD, EUR and GBP = Pest, Cholera or Ebola**
- ▶ **Renewed USD support**
- ▶ **EUR challenged**



Source: Bloomberg, HSBC Private Bank as at 20 January 2010

# Asset allocation

We are buyers of risk on a 12-month basis. However, our return assumptions have moderated in line with tighter credit spreads, more demanding valuations and structural headwinds.

Asset class	View	Comments
Liquid assets	-	Cash is no longer king, carry has taken the throne.
Fixed income	=	We favour investment grade credit and emerging market debt while we prefer to avoid long dated government debt.
Equities	+	We have down graded China to a neutral. Take less risks.
Real estate	=/+	Focus on prime western assets or long term emerging market exposure.
Hedge funds	+	We expect managers to take advantage of persisting market dislocations.
Private equity	=	Distressed opportunities rising but leverage still an issue.
Commodities	=/+	The global recovery should continue to provide support to rising prices in line with growing demand from emerging markets and investor interest.

Source: HSBC Private Bank as at 20 January 2010  
Please see page 28 for guide to symbols.

# Practical considerations

- ▶ **Do not sit on too much cash and government bonds!**
- ▶ **Take some profits in the riskiest positions**
  - Chinese equities
  - High yield credit
  - Cyclical sectors
- ▶ **Implementation is key**
  - Hedge funds
  - Structured products – steep curve, low volatility
  - Core/satellite
- ▶ **Long term themes**
  - EM assets
  - Energy
  - Agricultural commodities
- ▶ **Short term trades**
  - Carry trade
  - Exploiting low base rates
  - Small & mid cap equities
  - US equities (focus on tech)

# HSBC Private Bank views

February 2010

	View
Cash	-
Fixed income	=
Sovereign	-
Corporate Investment Grade	+
Emerging Markets	=/+
High Yield	=
Equities	+
US	+
Europe ex UK	=
United Kingdom	-
Japan	=/-
Pacific ex Japan	+
Canada	=/+
Emerging Markets	=/+
Alternatives	
Hedge funds	+
Private equity	=
Real estate	+
Commodities	=/+

	3 months	6-12 months
Commodities detail		
Precious Metals (GOLD)	=/-	=
Energy (OIL)	=	=/+
Agricultural	=/+	=/+
Industrial Metals	=/+	=/+

	3 months	6-12 months
Foreign exchange		
USD	=/+	=/+
EURUSD	=/-	=/-
GBPUSD	=	=
USDJPY	=/+	+
EM CCY vs USD	=/+	+

# HSBC Private Bank views

February 2010

## Equity detail

	View		View		View
<b>Eurozone</b>	=/-	<b>EM Asia Pacific</b>	=/+	<b>Sectors</b>	
France	+	China	=	Consumer Discretionary	=
Germany	+	India	=	Consumer Staples	=/-
Italy	-	Indonesia	=	Energy	+
Spain	-	Malaysia	=	Financials	+
		South Korea	+	HealthCare	=
<b>Other Developed Europe</b>		Pakistan	-	Industrials	=/+
Switzerland	-	Philippines	-	Technology	=/+
UK	-	Taiwan	+	Materials	=/+
		Thailand	=	Telecomm	=
<b>Pacific ex Japan</b>	+			Utilities	=
Australia	+	<b>EM Europe</b>	=		
HongKong	+	Russia	=		
New Zealand	=				
Singapore	=	<b>EM Latin America</b>	=/+		
		Brazil	+		
		Mexico	=		
		<b>EMEA</b>	-		
		South Africa	-		

# HSBC Private Bank views

February 2010

## Fixed income detail

	View	Target duration
<b>USD</b>		
Sovereign	-	Short to Medium
Corporate Investment Grade	+	Short to Medium
High Yield	=	Short to Medium
<b>EUR</b>		
Sovereign	=/-	Short to Medium
Corporate Investment Grade	=/+	Short to Medium
High Yield	=	Short to Medium
<b>GBP</b>		
Sovereign	=	Short to Medium
Corporate Investment Grade	=/+	Short to Medium
High Yield	=	Short to Medium
<b>JPY</b>		
Sovereign	-	Short
Corporate Investment Grade	=/+	Short
High Yield	=	Short

	View	Target duration
<b>AUD</b>		
Sovereign	=	Short to Medium
Corporate Investment Grade	=/+	Short to Medium
<b>NZD</b>		
Sovereign	=	Short to Medium
Corporate Investment Grade	=/+	Short to Medium
<b>CAD</b>		
Sovereign	=	Short to Medium
Corporate Investment Grade	=/+	Short to Medium
<b>Emerging Markets</b>		
Sovereign (local currency)	=/+	Short to Medium
Sovereign (foreign currency)	=	Short to Medium
Corporate (local currency)	=/+	Short to Medium
Corporate (foreign currency)	=/+	Short to Medium

# Guide to Symbols

- no clearly identifiable positive or negative trend is apparent and/or expected
- ↑ strongly positive trend is apparent and/or expected
- ↓ strongly negative trend is apparent and/or expected
- ↗ positive trend is apparent and/or expected
- ↘ negative trend is apparent and/or expected
- - - negative view with a high conviction level
- - negative view with a medium conviction level
- negative view with a low conviction level
- =/- neutral view with a negative bias
- = neutral view
- =/+ neutral view with a positive bias
- + positive view with a low conviction level
- ++ positive view with a medium conviction level
- +++ positive view with a high conviction level

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