Global Investment Perspective
September 2011

Highlights

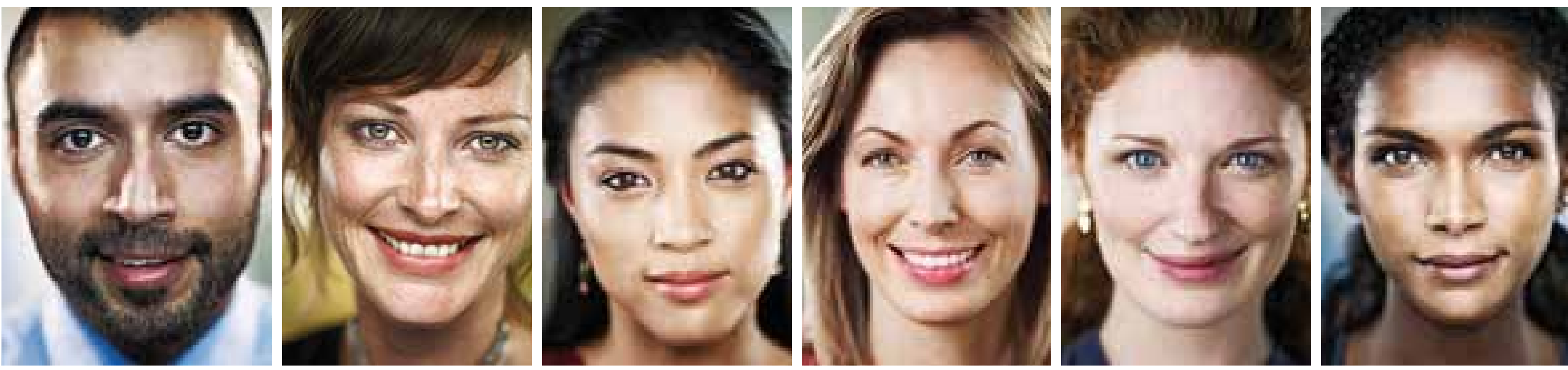
Data releases have continued to suggest that the pace of global economic activity is slowing. US numbers were mixed in August. Manufacturing activity decelerated and business outlook surveys indicated a sharp fall in the outlook for business activity in the world's largest economy. Meanwhile, consumer confidence was down. However, the economic news during the month was not unequivocally poor. The US ISM non manufacturing index beat expectations, rising to 53.3 in August from 52.5 in July. But economic figures in the eurozone continued to disappoint. Data from Germany lacked lustre. Although, as expected, the European Central Bank maintained interest rates at 1.50%, further rate hikes now look unlikely given the fragile growth picture, with pressures from peripheral countries having started to affect economic activity in core countries. In the UK, economic data also pointed to slower economic activity.

Conversely, economic numbers from Japan have been showing clear signs of a pick-up in activity as the supply side constraints on the country ease further. Growth in emerging markets has also remained robust. China's exports rose year-on-year in July, above expectations. Imports were also impressive.

Market Recap

The month was notable for the unprecedented downgrade in US sovereign debt by S&P, which reduced its rating on US Treasures from AAA to AA+. Nevertheless, this did not have a negative impact on US treasuries. Instead, fears of a global economic slowdown saw investors continue to favour the 'safer havens' of bonds. As a result, US Treasuries returned 2.8% during August, outperforming the majority of other asset classes. Eurozone government bonds, with the exception of Greece, were also positive in August, posting returns of 2.9% for the month.

The flight to quality was detrimental to the performance of equities. The S&P 500 declined by 5.4% in August, although it outpaced all other major developed markets. European equities suffered significantly alongside other risky assets in August, falling by 13.0%, following further fiscal issues and poor economic data releases. Asia ex-Japan equities declined sharply during August, as investors questioned the resilience of the global growth outlook. The MSCI China index posted -9.3%, while the MSCI indices of Taiwan, Singapore, Korea and India registered returns of -8.4%, -9.5%, -12.3% and -8.6%, respectively. In spite of encouraging economic figures, the MSCI Japan index lost 9% over the month.



HSBC Advance

HSBC
The world's local bank

Outlook & Strategy

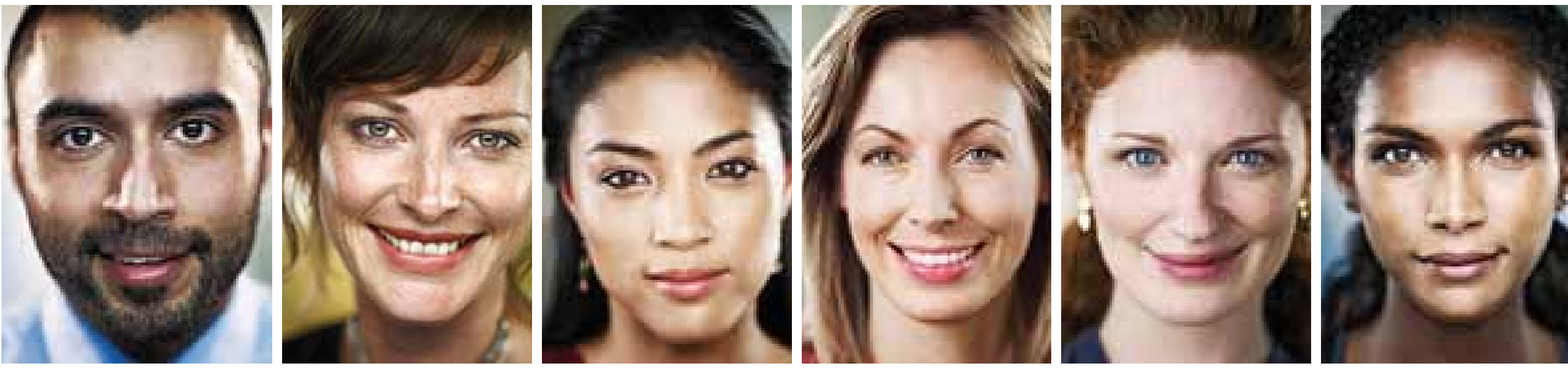
In spite of negative macroeconomic data, we retain our constructive view on risky assets, though we are cognisant of the persistent levels of uncertainty precipitated by the eurozone debt crisis and the signs of a slowdown in global growth. After the recent sell-off, we believe the heightened risks are now reflected in markets, leading to attractive valuations. In this light, although we remain comfortable with a tilt towards risky assets, we continue to emphasise the importance of diversification amid the significant volatility and uncertainty in risk markets.

Our central scenario remains: sub-trend growth in the major developed markets, with stronger growth in the emerging economies. Market expectations for economic growth have shifted over the course of the year to come more in line with this view. We therefore continue to believe that the recent set of lacklustre economic data is more indicative of a soft patch than a potential contraction. Nonetheless, we acknowledge that the downside risks to growth are now higher than earlier in the year.

The recent market turmoil is the result of a number of concerns that are both fundamental and long term in nature. In the near term, it is possible, indeed likely, that volatility will continue. However, valuations for riskier asset classes, especially equities, have corrected to reflect this more challenging environment. Therefore, although risks have risen of late, valuations have adjusted as well. Developed market government bond yields are at extremely low levels and are already pricing in a weak economic scenario and low interest rates. It is difficult to see much value at these levels. Corporate bonds offer some value and are preferred over government bonds, with higher yielding corporate bonds particularly favoured. In contrast, equities are generally trading on forward PE ratios of 15 or under, with sub 10 levels in many markets (such as Europe, Russia China). With earnings growth still looking positive next year, these valuations, particularly relative to bonds and cash, are extremely compelling.

Within the context of developed market equities, we maintain a moderate preference for Japanese equities on a currency-hedged basis. Although there may be short-term volatility, we believe this market offers an attractive opportunity as the current price-to-earnings ratio is still trading below the historic average. Within emerging markets, we continue to favour Russia based on attractive stock valuations on both a relative and absolute basis, and signs of improving economic conditions. The major risk to the Russian equity market is another decline in oil prices due to weaker potential global economic activity, which is not our central view. Furthermore, we have retained a tactical overweight position in China. Chinese equities look particularly attractive, trading at a discount to other emerging countries and relative to their own history. In addition, inflation in China exhibits signs of peaking amid further central bank tightening and an end to the cycle may provide the catalyst for supportive inflows.

In other fixed income, we continue to believe that while US dollar-denominated emerging market debt continues to look favourable relative to developed government bonds, the asset class still looks less attractive than developed high-yield and other developed corporate debt. Furthermore, we also have a moderately negative view on global developed inflation-linked bonds, largely because inflation in the developed world remains manageable, despite recent increases. As a result, global developed market inflation-linked bonds look expensive in relation to nominal bonds.



Short-Term Investment Outlook (6-12 months)

	ASSET CLASS	CURRENT VIEW*	REASONING
EQUITY	Global Developed Market Equity	Neutral	• Equity valuations relative to cash and especially government debt remain attractive, plus liquidity remains supportive. There continue to be risks to the economic recovery, but our core scenario is for positive, although sub-trend growth.
	US Equity	Neutral	• Whilst corporate earnings have been encouraging, unemployment remains elevated at over 9%.
	Europe Equity (including the UK)	Neutral	• Economic conditions remain mixed. UK growth has slowed, austerity measures are in the process of being rolled out in parts of Europe and the economic health of peripheral eurozone countries remains uncertain. That said, liquidity remains supportive, and corporate earnings news in Europe has been encouraging.
	Japan Equity	Positive	• Within equities, we maintain our overweight to Japanese equities. We believe this offers an attractive opportunity due the pick up in economic activity following the devastating earthquake and tsunami in March. In addition, the current price-to-earnings ratio is still trading far below the historic average.
	Asia ex-Japan Equity	Neutral	• From a macroeconomic perspective, the outlook remains generally positive with strength in both the manufacturing and consumer sectors. At a country level, we prefer Chinese equities relative to other Asian emerging markets. Valuations are favourable and inflation is exhibiting early signs of peaking amid further central bank tightening.
	Global Emerging Markets	Neutral	• Emerging countries are likely to continue to lead the economic recovery, due to robust domestic consumption and strong intra-regional trade. That said, like developed markets, emerging market equities are exposed to volatility stemming from the question marks around the sustainability of the global economic recovery, exacerbated by the monetary tightening cycle that has already begun in a number of key emerging economies.
	Latin America Equity	Neutral	• The economic performance of Latin American countries remains strong and earnings growth estimates for 2011 look reasonable. Nonetheless, the good news seems to be well reflected in market prices and relative valuation measures show no strong signals. We, therefore, retain our neutral stance.
	Middle East Equity	Neutral	• Given the political unrest within the region, in the short-term we expect volatility to persist affecting the overall performance. The investment potential will be largely dependent on oil prices and supply uncertainties.
	Eastern Europe Equity	Neutral	• Manufacturing data has varied within the different countries. At a country level, we favour Russian equities. Russia's economic activity has been encouraging, while valuations for Russian equities are attractive in both absolute and relative terms.
	Indonesian Equity	Neutral	• While macroeconomic numbers show good strengh on economy resilience, GDP in particular showed a so-so result. The market altough relies heavily on domestic consumption can not avoid the heavy pressure from regional crisis.
FIXED INCOME	US government bonds	Negative	• Excess capacity in developed markets and the commitment of the Fed to remain accommodative are generally supportive for low yields. However, the market is still offering little value relative to history and, downside risks remain, particularly in relation to fiscal policy. Within fixed income, we prefer to own corporate debt, where we see greater total return opportunities.
	Euro government bonds	Negative	• We have a negative stance on eurozone government bonds relative to cash. This is due to uncertainties regarding the economic health of eurozone peripheral countries. In addition, valuations of these bonds do not look particularly attractive; they offer limited protection against negative surprises.
	Investment Grade Corporate	Positive	• Strong corporate earnings results, the view that major central banks will keep interest rates low and strong demand for yield have boosted investment grade corporate bonds. With momentum likely to remain positive, we continue to be positive on the asset class. That said, considering the heightened uncertainty regarding the Greek debt crisis, we have trimmed our exposure to reduce volatility.
	High Yield	Positive	• High yield bonds continue to look attractive on a total return basis. We have retained our positive view on the asset class given better-than-expected corporate results, declining default rates and growing expectations that interest rates could remain at low levels due to global economic growth uncertainties. That said, considering the heightened uncertainty regarding the Greek debt crisis, we have slightly trimmed our exposure to reduce volatility.
	Sovereign USD-denominated Emerging Markets Debt	Neutral	• While sovereign US dollar-denominated emerging market debt continues to look less attractive on valuation grounds than developed market corporate debt, and high yield in particular – they remain more attractive relative to government bonds.
	Global Developed Inflation-linked Bonds	Negative	• Despite recent increases, inflation looks manageable in developed markets. As a result global inflation linked bonds look expensive in comparison with nominal bonds.
	Indonesian Bonds	Positive	• The dovish stance by Bank Indonesia to maintain growth momentum remained a key aspect for potential gains on Rupiah bonds. In the other hand USD bonds also remained attractive as Indonesia's growth forecast is the only one held positive in the region.
CURRENCY	Euro, British pound sterling, Japanese yen and the US dollar	Neutral	• Valuation indicators are not sending any clear signals at present. We see both event-driven and sentiment-driven risks contributing to ongoing volatility. We thus continue to have a neutral view on currency exposures.
	Indonesia Rupiah against USD	Negative	• As Bank Indonesia moved into a dovish move to maintain growth momentum, a tolerance against inflation would be an expected move. The stance would create weakening sentiment for Rupiah against US Dollar.

*within the broad asset class

Summary

Overall, we have maintained a moderately overweight position in global equities relative to both government bonds and cash on valuation grounds. Within the context of developed market equities, we remain moderately positive on Japan. We continue to see valuations and policy support as a favourable backdrop for Japanese equities. Within emerging market equities, our favoured markets are China and Russia based on attractive valuations.

In fixed income, we have a negative view on government bonds relative to cash. We have a positive stance on corporate debt due to attractive valuations and favourable issuer fundamentals. Within corporate debt, we prefer high yield as their extra yield has the potential to offer some protection should government bond yields rise. Our central economic scenario is for slow but positive growth in the major developed markets, a backdrop that is typically positive for credit markets.

With regard to the four major developed market currencies, it is likely that heightened volatility will continue. Valuation measures are not currently providing strong signals and we therefore have a neutral stance on currency positions.

The environment of heightened uncertainty around growth and the adjustments to government fiscal balances is likely to persist and fuel volatility in the markets. Our key recommendation continues to be to remain well diversified.

Macro Assesment

US

A further run of disappointing releases has affected sentiment but they are evidence of a slowdown, not necessarily a contraction

- S&P downgraded the rating of long-term US sovereign debt to AA+, citing the ongoing difficulties in producing a credible strategy to stabilise the debt dynamics over the medium-term.
- In manufacturing activity, the Institute for Supply Management manufacturing index declined to 50.6 in August, from 50.9 in July.
- In addition, the August Federal Reserve Bank of Philadelphia business outlook survey came in far lower than expected at -30.7, falling from +3.2 last month, indicating a sharp fall in the outlook for business activity in the region.
- With overall moderation in economic activity, consumer confidence (as measured by the University of Michigan Index) was affected negatively and dropped to 54.9 in August, from 63.8 in July.
- However, the economic news during the month was not unequivocally poor. US industrial production came in at a stronger-than-expected 0.9% month-on-month in July and US durable goods orders came in better than expected at 4% month-on-month in July against a -1.3% month-on-month decline reported a month earlier.
- Perhaps more significantly, the US Conference Board Leading Economic Index increased by 0.5% m-o-m in July, suggesting that the economic environment could improve in the months ahead.
- The US all items Consumer Price Index remained steadfast at a two-year high of 3.6% year-on-year in July, higher than expected. The core Consumer Price Index, excluding food and energy related goods, came in at 1.8% year-on-year in July from 1.6% year-on-year in the previous month, indicating underlying inflationary pressures remain somewhat constrained despite the headline number.
- The US Federal Reserve Bank decided formally to lengthen 'the extended period' for an exceptionally low funds rate to mid-2013, a move that supports growth but could create further inflationary pressures.
- Consensus Economics GDP growth forecasts for 2011 and 2012 were downgraded significantly to 1.8% (-0.7%) and 2.4% (-0.6%), respectively.

Europe ex-UK

Economic data in the eurozone continued to disappoint. Pressures from peripheral countries have started to affect the economic activity in core countries.

- Germany reported second-quarter Gross Domestic Product growth of 0.1% quarter-of-quarter, significantly lower than the revised 1.3% quarter-on-quarter in the first quarter, while overall eurozone Gross Domestic Product grew at similarly weak rate of 0.2% quarter-on-quarter in the second quarter.
- Manufacturing activity slowed down in the region. The eurozone manufacturing Purchasing Managers Index was reported at 49.0 in August, down from 50.4 in July. In addition, the unemployment rate remains high (9.9% in June).
- With bad news in many sectors, eurozone consumer confidence dropped to -16.6 in August from -11.2 in July.
- However, there was better news on the consumption front. Eurozone retail sales beat expectations, rising 0.9% month-on-month in June, after falling -1.1% month-on-month in May.
- Following an increase in bond yields in Italy and Spain, the European Central Bank intervened to buy Spanish and Italian bonds to reduce the probability of a vicious spiral of higher yields that, in turn, could worsen the debt position and lead to even higher yields.
- As expected, the European Central Bank maintained interest rates at 1.50% and further rate hikes now look unlikely given the fragile growth picture and signs of moderating inflationary pressures.
- The eurozone Consumer Price Index rate fell to 2.5% year-on-year in July from 2.7% year-on-year in June, and the core Consumer Price Index fell to 1.2% year-on-year in July from 1.6% year-on-year in June.
- The Consensus Economics inflation forecasts for 2011 and 2012 remain unchanged at 2.6% and 1.9% in August, respectively.
- The Consensus Economics forecasts for 2011 and 2012 eurozone Gross Domestic Product growth were both revised down by 0.1% in August to 1.9% and 1.5%, respectively.

UK

Economic data releases have been somewhat mixed but overall point to slower economic activity

- The British economy expanded by a modest 0.2% quarter-on-quarter in the second quarter of 2011 in line with expectations, while the minutes from the Monetary Policy Committee's June meeting suggest a further round of quantitative easing as an option, if growth does not pick up.
- In manufacturing activity, the Institute for Supply Management manufacturing index remained in contractionary territory in August, coming in at 49.0, while industrial production came in at -0.2% month on month having come in flat in June.
- Labour data also disappointed. The unemployment rate rose to 7.9% in June from 7.7% last month, while monthly jobless claims in July increased for the fifth straight month.
- In contrast, in the services sector, the services Purchasing Managers Index in July moved upwards to 55.4 in July from 53.9 in June, beating expectations.
- In consumer activity, retail sales ex auto fuel increased by 0.2% month-on-month in July from 0.8% month-on-month in June, missing expectations.
- In the housing market, house prices saw a rise of 0.3% month-on-month in July from 1.2% month-on-month in June.
- UK inflation increased in July to 4.4% year-on-year from 4.2% year-on-year in June. The core Consumer Price Index also increased, rising to 3.1% year-on-year from 2.8% year-on-year in June.
- The August Monetary Policy Committee was unanimous in maintaining rates at all-time lows of 0.5%.
- The Consensus economics August inflation forecast for 2011 was unchanged at 4.4% while the 2012 forecast was increased slightly to 2.7% (+0.1%).
- Overall, the Consensus Economics 2011 Gross Domestic Product growth forecast was revised downwards to 1.3% from 1.5%, while the 2012 forecast was revised down to 2.0% (-0.2%) in August.

Japan

Economic data from Japan is showing a clear signal of a pick-up in economic activity as the supply side constraints ease further.

Macro Assesment

- Japan is an exception to the decline in business outlook and reported an increase in small business confidence at 47.1 in July against 43.1 in June.

- Also, Japanese industrial production for July came in lower than the market forecast (0.6% month-on-month versus 1.4% month-on-month), but still illustrates a continued recovery.

- Indeed, August's manufacturing Purchasing Managers Index remained in expansionary territory, coming in at 51.9, down from 52.1 in August.

- Second-quarter Gross Domestic Product growth in Japan remained negative but was better than expected, coming in at -0.3% quarter-on-quarter. Exports were also encouraging, expanding by 5.4% month-on-month in June. This resulted in the monthly trade balance returning to surplus after two months of deficits.

- In consumer activity, real household spending rose by 0.8% month-on-month in June, but was weak in annual terms (-4.2% year-on-year), while retail sales in July came in at 0.7% year-on-year, down from a revised 1.2% year-on-year in June, but still positive.

- In the labour market, the jobless rate increased slightly to 4.6% in June, from 4.5% in May.

- The government's second disaster relief budget of Y2 trillion was approved at the end of July, while on 4 August the Bank of Japan expanded its asset-purchase program and Tokyo intervened to weaken the yen to shore up the external sector.

- Japan's Consumer Price Index rose by 0.2% year-on-year in July, following a revised 0.4% decline in June, while the core Consumer Price Index (excluding fresh food and energy) fell by 0.5% year-on-year, slightly less than expectations.

- In August, the Consensus Economics forecast for inflation in 2011 and 2012 remain unchanged at 0.3% and 0.2%, respectively.

- The August Consensus Gross Domestic Product growth forecasts for 2011 and 2012 remain unchanged at -0.7% and 3.1%, respectively.

Emerging Markets

Emerging markets continue to display impressive economic performance, despite signs of moderation.

- China's export growth came in at 20.4% year-on-year in July, higher than last month's 17.9% and also above expectations. Imports were also impressive, rising 22.9% year-on-year in July.

- Chinese retail sales increased by 17.2% year-on-year in July although this was slightly less than June's figure of 17.7%.

- China's manufacturing Purchasing Managers Index rose to 50.9 in August from 50.7 in July and remains in expansionary territory. However, the HSBC manufacturing Purchasing Managers Index level for August suggests a marginal moderation in activity, coming in at 49.9.

- India reported better-than-expected second-quarter year-on-year GDP growth of 7.7%, slightly less than the first-quarter figure of 7.8%.

- In Brazil, the latest economic data releases suggest that the manufacturing sector displayed renewed weakness, whilst domestic demand continued to show strength.

- The manufacturing Purchasing Managers Index declined in July, coming in at 47.8, while industrial production also fell on a month-on-month basis, falling -1.6% in June. In contrast, retail sales increased by 7.1% year-on-year in June and the unemployment rate fell to 6.2% in the same month, from 6.4% in May.

- In Eastern Europe, slower growth in Germany has impacted the region's economic expansion. As an example, Estonia's exports increased by 43% year-on-year in June, compared to 53% year-on-year in May.

- In Russia, manufacturing, consumption and labour market activity showed signs of moderation. Industrial production came in at 5.2% year-on-year in July, missing expectations, and retail sales went up by 5.6% year-on-year in the same month, also missing expectations. The Russian unemployment rate rose to 6.5% in July, from 6.1% in June.

- In emerging markets, inflation remained elevated. In China, the Consumer Price Index increased again to 6.5% year-on-year in July, well above the People's Bank of China's target of 4%. Upward price pressures remain across Asia with the latest inflation reports showing high levels in Philippines, India and South Korea as well. Food inflation increased in China and was reported at 14.8% year-on-year in July compared with 14.4% last month.

- Russia's year-on-year Consumer Price Index dropped slightly to 9.0% in July, from 9.4% in June, but remains elevated. In Brazil, the year-on-year Consumer Price Index increased to 6.9% (+0.2%) year-on-year in July.

- No central banks tightened rates this month, although Turkey reduced rates by 50 basis points.

- Overall, the Consensus Economics forecasts for Gross Domestic Product growth for emerging markets remained solid but moderated somewhat.

- Consensus Economics inflation forecasts for August declined significantly for Latin America for both 2011 and 2012, as industry and manufacturing feel the effects of tighter monetary conditions. The Asia ex Japan region and Eastern Europe have seen small increases in forecasts.

Indonesia

World market start to affect Indonesian trade balance, however domestic resilience remains to show strength.

- The last few months' macroeconomics data showed that the nation has strong potential to maintain business resilience as well as maintain the purchasing power of the consumers from manageable inflation.

- August Inflation was recorded grew at 0.93% month-to-month, relatively high compared to previous months due to Ramadhan holiday, start of school-year and the upward pressure from gold-based jewelry.

- Net export in the last few months also showed strong growth, reaching records and showing that business is good, even though regional economy is worrying. In August Indonesia's exports year-on-year grew 39.5% also signalling a good growth level although declined compared to previous months due to diminished demand from business partners.

- Overall a manageable inflation at 4.79% year-on-year is a healthy indication that the government is doing a good job on maintaining purchasing power and balancing the economy on a sustainable pace.

- Indonesia as another rising star in the world economy also shows promising performance over the last few months, in the midst of global crisis. A true mark of a strong contender to be merited by "investment grade" sovereign rating.

- Asian Development Bank downgraded the region's GDP growth forecast. However particular for Indonesia, ADB actually upgraded the forecast, signalling a good sentiment towards an "investment grade" opportunity.

Equity Markets

Global Developed Markets:

US

- The S&P 500 declined by 5.4% in August, outperforming all other major developed markets, despite S&P's downgrade of long-term US sovereign debt to AA+.

- In manufacturing activity, the Institute for Supply Management manufacturing index declined by more than expected, to 50.9 in July, from 55.3 in June. In addition, the August Federal Reserve Bank of Philadelphia Business Survey came in far lower than expected at -30.7, falling from +3.2 last month, indicating a sharp fall in the outlook for business activity in the region.

- US durable goods orders rose in July to 4.0% month-on-month after an unexpected decline in June of -1.1%. Also, US factory orders rose to 2.4% month-on-month in July after a -0.4% month-on-month decline in June.

- Economic data releases are showing that the US is experiencing a longer-than-expected 'soft patch' and we therefore expect monetary policy to remain accommodative for some time to come, which is supportive for equities.

- Despite the macroeconomic slowdown, the microeconomic picture remains good as US earnings continue to report strong results. Of the 469 S&P 500 companies that have reported thus far, 76% have beaten earnings expectations for the second quarter of 2011, higher than the 72% that did so in the first quarter of the year.

- Earnings growth estimates at 16.8% for 2011 and 14.9% for 2012 for US companies remain attractive and, as noted above, results have been stronger compared to Q1 2011.

- US equity valuation measures, such as the 12 month forward price/earnings ratio of about 10.5x, continue to look undemanding. Moreover, government bond and cash yields are low, increasing the attraction of equities by comparison.

- Overall, we maintain a modest overweight allocation to the US and other equity markets relative to government bonds and cash, while we remain neutral on the US versus other equity markets.

Europe

- Eurozone equities suffered significantly alongside other risky assets in August. Eurozone equities fell by 13.0%, following further fiscal issues and poor economic data releases. UK equities were down 6.7%.

- Within the eurozone, one notable aspect of the market turmoil at the start of the month was the increase in bond yields in Italy and Spain. However, the European Central Bank intervened to buy Spanish and Italian bonds to reduce the probability of a vicious spiral of higher yields.

- In addition, France, Spain, Italy and Belgium imposed bans on short selling certain financial stocks to stabilise markets after eurozone banks hit their lowest levels since the credit crisis. National regulators imposed the ban following speculation that European banks may be struggling to fund themselves.

- August Purchasing Manager Indices fell, moving into contractionary territory. The manufacturing Purchasing Manager Index in the eurozone fell to 49.0 from 50.4 last month while in the UK, the index fell marginally to 49.0

- The ZEW survey of eurozone economic sentiment indicated a major decline in expectations of economic growth, falling to -40.0 in August from -7.0 in July.

- Unemployment rates remain elevated, at 7.9% and 10.0% in the UK and eurozone, respectively, while inflation remains above target for both regions, at 4.4% year-on-year in the UK and 2.5% year-on-year in the eurozone in July.

- As expected, the European Central Bank and Bank of England maintained interest rates at 1.50% and 0.5%, respectively. Rate hikes now look unlikely for the rest of the year given the fragile growth picture.

- Although peripheral fiscal eurozone issues remain a concern and recent economic data releases have been weaker, overall, economic activity remains mildly positive. The UK and eurozone reported second-quarter Gross Domestic Product growth of 0.2% quarter-on-quarter, in line with expectations. We continue to expect slow but moderate growth in 2011 in both regions.

- In corporate news, takeover activity remained prevalent. For example, UK software company, Autonomy was bought by US technology giant Hewlett Packard for £7.1 billion.

- Valuations for riskier asset classes, especially equities, have corrected to reflect this more challenging environment. Therefore, although risks have risen of late, valuations have adjusted as well. Current valuation levels are at attractive levels, particularly relative to government bonds and cash. The eurozone and UK 12 month forward price / earnings ratios are 8.0x and 8.6x, respectively.

- In addition, our central view is still for rates to remain accommodative in 2011 due to the potential impact on fragile growth in the region.

- Therefore, with earnings growth still looking positive next year, these valuations, particularly relative to bonds and cash, are compelling and we still favour equities as a long-term investment.

Japan

- Equity markets were marred with poor sentiment over the month, as investors remain anxious about global recession, central banks' currency interventions and the associated cross-border price actions. In August, the MSCI Japan index lost 9%. Despite the near-term volatility, we are confident that Japan will perform relatively better in the longer term, given strong support from the government on the after-quake reconstruction.

- Recent data indicate that the pace of recovery in Japan has been faster than expected; real Gross Domestic Product declined only -0.3% quarter-on-quarter in the second quarter, smaller than the expected -0.6% quarter-on-quarter. We expect the Bank of Japan to maintain accommodative monetary policy to support the recovery.

- Although supply constraints have eased, the higher yen and slower global demand are still creating a drag in export recovery. Merchandise trades export growth dropped to -3.3% year-on-year in July from -1.6% in June. However, the trade balance improved from 68.6 billion yen in June to 72.5 billion yen in July.

- Industrial production growth also declined to -2.8% year-on-year in July (versus -1.7% in June).

- Retails trade came off a little, after a strong rebound of 1.2% year-on-year last month, to 0.7% in July. The threat of deflation emerged once again as core Consumer Price Index turned negative to -0.5% year-on-year in July (against 0.1% in June).

- Moody's downgraded Japan's sovereign rating from Aa2 to Aa3, with a stable outlook.

- Japan's Prime Minister Naoto Kan resigned on 26 August after parliament passed the two bills on renewable energy and deficit-bonds. Finance Minister Yoshihiko Noda was then elected as the new leader for the Democratic Party of Japan and accordingly the new Prime Minister.

- We continue to prefer equities over government bonds and cash because their returns in real terms are at historical low or even negative. Within equities, we favour Japan due to the positive prospects from reconstruction and attractive valuations.

Equity Markets

Global Emerging Markets

- Emerging markets closed the month with negative performance of -7.3% on a total return basis, underperforming developed equities by 0.6%.
- Within emerging markets, Latin America was the relative outperformer, returning -2.9%, weighed down by the negative performance from Brazil (-4.6%) and Chile (-3.1%). Asia and Eastern Europe were the relative laggards, returning -9.5% and -10.2%, respectively. Within Asia, negative performance from South Korea, China and India were the main contributors to poor performance, while Russia was the main drag on returns in Europe.
- Economic data remain supportive, albeit at moderating levels, despite monetary tightening. For example, China's export growth came in at 20.4% year-on-year in July, higher than last month's 17.9% and also above expectations, while imports rose to 22.9% year-on-year in July. Retail sales also increased (rising 17.2% year-on-year in July), though less so than last month, as both growth expectations and consumer confidence feel the squeeze from rising prices and monetary tightening. China's manufacturing Purchasing Managers Index fell to its lowest level since February 2009, coming in at 50.7 in July, but remains in expansionary territory. Brazil fared less well, with the Purchasing Managers Index in contractionary territory for the second month.
- India's second-quarter 2011 Gross Domestic Product growth eased marginally to 7.7% year-on-year from 7.8% the previous quarter and export growth has also held up despite the global slowdown. Consumption-driven growth in Brazil and Russia remains strong with retail sales increasing by 7.1% year-on-year in June in Brazil and by 3.8% year-on-year in July in Russia. The Consensus Economic forecasts for Gross Domestic Product growth also remain strong, if somewhat moderated, underpinned by strong industrial output and domestic retail activity, underscoring the resilience of growth in these markets.
- While fundamentals remain robust, valuations attractive and interest rates in developed world remain at record lows, emerging market equities continue to look favourable.
- At a country level, we maintain our preference for Chinese and Russian equities relative to other emerging markets on valuation grounds.

Asia ex-Japan

- Asia ex-Japan equities declined sharply during August, as investors questioned the resilience of the global growth outlook. MSCI China (-9.3%), MSCI Taiwan (-8.4%), MSCI Singapore (-9.5%), MSCI Korea (-12.3%) and MSCI India (-8.6%) all fell notably.
- Industrial production growth in China eased to 14.0% year-on-year in July against 15.1% year-on-year in June. Retail sales in July also grew slightly slower at 17.2% year-on-year (compared with 17.7% year-on-year in June). However, China's exports in July expanded and exceeded expectations, growing by 20.4% year-on-year (better than the expected 17.0% year-on-year).
- China's Consumer Price Index rose slightly to 6.5% year-on-year in July from 6.4% year-on-year last month and, as monetary tightening starts to make an impact, prices are expected to increase at a slower pace.
- Singapore's Gross Domestic Product growth in the second quarter turned negative, registering -6.5% quarter-on-quarter. The underperformance is largely attributed to poor exports especially for electronics.
- South Korea saw a sharp rebound in exports to 27.3% year-on-year in July from 11.2% year-on-year in June. In Taiwan, exports also came back and grew 17.6% year-on-year in July (versus 10.8% year-on-year in June).
- In India, monthly wholesale price rises eased to 9.22% year-on-year in July (against 9.44% year-on-year in June). The Consumer Price Index in South Korea continued to climb higher to 4.7% year-on-year in July (4.4% year-on-year in June) while Taiwan's Consumer Price Index slowed to 1.32% year-on-year in July, from 1.93% year-on-year last month.
- Economic performance in Asia continues to moderate partly due to the slowdown in global demand. On a relative basis, the growth outlook in Asia still looks better than in developed countries. We also expect Asian countries to enjoy more flexibility in planning their fiscal policies amid a slower growth situation compared with those in developed countries which are undertaking strict austerity measures to tackle heavy sovereign debt problems.
- We believe current earnings expectations are largely reflecting the slower growth scenario and, therefore, the impact of further downside earning surprise should be limited.
- Overall, given equity valuations are at low levels, we expect equities to outperform low-yielding developed market government bonds and cash and so recommend an overweight relative to these asset classes. Within equities, we continue to favour Chinese equities because of the supportive economic fundamentals and valuation levels.

Latin America

- In a poor month for the broader emerging market universe, Latin American markets performed relatively better but still fell over the month, returning -2.9%. The key markets of Brazil and Chile registered returns of -4.6% and -3.1% respectively.
- Brazil's manufacturing Purchasing Managers Index fell for the second consecutive month. Nonetheless, consumption-driven growth in the country continued to be robust with retail sales increasing by 7.1% year-on-year in June.
- Indeed, the economic performance of Latin American countries as a whole remains strong and earnings growth estimates for 2011 look encouraging and in line with our assessment of the business and consumption environment globally.
- In addition, significant progress in bringing inflation under control is not expected to occur until the final quarter of this year.
- The economic news seems to be reflected in market prices and relative valuation measures show no strong signals.

Middle East

- The situation in the Middle East and North Africa remains uncertain, following the civil unrest in many countries in the region. Periods of risk off sentiment are likely to adversely affect equities in the region.
- In post-revolution states, there is no real clarity on the future economic outlook. For example, in Egypt, the economy continues to struggle despite the country agreeing its 2011/12 budget and terms for an International Monetary Fund financing deal.
- However, where political pressures have been negligible, such as in the United Arab Emirates, Kuwait and Qatar, the economic ramifications of unrest have been positive. This is due to the partial shift in economic activity from the troubled nations to the neighboring Middle Eastern countries, less affected or not affected at all by the turmoil. We continue to monitor events in the region very carefully.
- Valuations continue to look undemanding and 12 month forward price to earnings ratios are attractive relative to history.

Equity Markets

Eastern Europe

- Russian equities had a lackustre month albeit within a broader drop in emerging market bourses as a whole.
- Nonetheless, consumption-driven growth in Russia remains strong with retail sales increasing by 5.6% year-on-year in July.
- At the regional level, while economic activity has clearly moderated, there continues to be encouraging data coming from the broader Eastern European region.
- At a country level, we maintain our preference for Russian equities relative to other emerging markets. Russia's economic activity has been encouraging, while valuations for Russian equities are attractive in both absolute and relative terms.

Indonesia

- The equity market started to receive hits from global equity routs as the regional crisis start to destroy expectation of growth.
- As regional market is expecting a decline in GDP forecast, it is the opposite for Indonesia. The Asian Development Bank actually upgraded Indonesia's GDP prospects from 6.4% to 6.6% in the midst of global economic crisis.
- Expectation of global market regarding this GDP growth was primarily based on the prospects of huge domestic consumption capacity of local market.
- While earning for companies remained strong, the central bank, Bank Indonesia also did a dovish stance as the officials set the operational floor rate from 100bps below BI rate to 150bps below BI rate.
- The Indonesia market tend to follow the regional decline as the market crisis still not showing a "cure-all" magic, however the prospects from the local market promises sweet return when "risk-on" mood is back in the finance world.

Fixed Income

US dollar Government Bonds

- Despite Standard & Poor's US sovereign downgrade and fiscal issues, US Treasuries returned 2.8% during August bringing their year-to-date returns to 6.8%.

- Data softness, suggesting a slowdown in economic momentum, kept risk-aversion high during the month, allowing US Treasuries to outperform the majority of other asset classes.

- S&P downgraded the rating of US sovereign debt to AA+, citing the ongoing difficulties in producing a credible strategy to stabilise the debt dynamics over the medium-term.

- A number of economic indicators came in beneath expectations over the month. Most starkly, the August Federal Reserve Bank of Philadelphia Business Survey came in far lower than expected at -30.7, falling from +3.2 last month, indicating a sharp fall in the outlook for business activity in the region.

- However, the economic news during the month was not unequivocally poor. The US ISM non manufacturing index beat expectations, rising to 53.3 in August from 52.5 in July.

- Aside from the economic data releases, investor attention was focused on the US Federal Reserve Chairman Ben Bernanke's Jackson Hole address for any signs of another round of quantitative easing to stimulate the flagging economy. Bernanke said that the central bank 'is prepared to employ its tools as appropriate to promote a stronger recovery.' However, there were no further details or signals as to when or where these tools may be deployed.

- Given the low-growth outlook, we continue to expect the Federal Funds rate to remain at the current low levels for some time. Indeed, the US Federal Reserve decided formally to lengthen 'the extended period' for an exceptionally low funds rate to mid 2013, a move that is likely to pin short-dated Treasury yields at fairly low levels for many more months.

- Indeed, the release of the Federal Reserve Open Market Committee minutes in mid-August showed that some Fed members had pushed for even stronger action but were willing to accept the mid 2013 guidance as 'a step in the direction of additional accommodation.'

- Despite a slowdown in the pace of economic recovery and an anaemic growth outlook, US Treasury yields appear unattractive both relative to history and to other asset classes. Government bond yields are at extremely low levels (5 year yields are 0.97% in the US 1.31% in Germany, 0.34% in Japan) and are already pricing in a weak economic scenario. It is difficult to see much value at these levels. Therefore, we re-iterate our cautious view on the asset class and maintain our preference for corporate bonds within fixed income.

Eurozone Government Bonds

- Eurozone government bonds were positive in August, posting returns of 2.9% for the month.

- Almost all countries were up with the notable exception of Greece. Greek bonds fell 12.1% amid continued debate over the terms of their second bailout package.

- Several countries including Finland, demanded collateral as a pre-condition to participate in the second bail out. The German government is opposed to any such deal. Reflecting this uncertainty, yields on 2 year Greek bonds rose from 32.9% at the end of July to 42.7% at the end of August.

- Another notable aspect of the market turmoil at the start of the month was the increase in bond yields in Italy and Spain caused by concern over possible contagion from peripheral countries. For example, the 10 year yield on both Italian and Spanish bonds rose above 6% at one point.

- However, the European Central Bank intervened to buy Spanish and Italian bonds to reduce the probability of a vicious spiral of higher yields that could worsen the debt position, and lead to even higher yields.

- The European Central Bank's intervention successfully took away some of the heat from the worrying developments in the periphery with yields for both Spanish and Italian bonds falling by over 100bps.

- As expected, the European Central Bank maintained interest rates at 1.50% and further rate hikes now look unlikely given the fragile growth picture and easing price pressures.

- The eurozone Consumer Price Index rate fell to 2.5% year-on-year in July from 2.7% year-on-year in June, and the core Consumer Price Index fell to 1.2% year-on-year in July, from 1.6% year-on-year in June. suggesting inflationary pressures may be easing.

- Reflecting this and the 'risk off' environment, the eurozone yield curve shifted down significantly across all maturities in August. For example, the 10 year Bund yield fell from 2.54% to 2.22%.

- The Consensus Economics forecasts for 2011 and 2012 eurozone Gross Domestic Product growth were both revised down in August by 0.1% to 1.9% and 1.5%, respectively.

- Despite the respite brought about by the European Central Bank intervention, the overriding mood in the financial markets is still volatile and long-term uncertainties regarding the economic health of eurozone peripheral countries remain. We do not believe we have seen the last of market volatility resulting from peripheral eurozone fiscal difficulties.

- Government bond yields are at very low levels (5 year yields are 1.31% in Germany, 0.97% in the US and 0.34% in Japan) and are already pricing in a weak economic scenario. It is difficult to see much value at these levels.

- Therefore, against this backdrop, we maintain a cautious outlook for eurozone government bonds against cash. Overall, within fixed income, we believe corporate bonds offer better value and are preferred over government bonds, with higher yielding corporate bonds particularly favoured.

Investment Grade Corporate

- Global investment grade corporate debt returned -0.37% during August, according to the Bank of America Merrill Lynch index data.

- Negative performance was driven by an increase in credit spreads as major developed market government bond yields fell during the month.

- The option-adjusted credit spread increased over the month from 1.70% at the end of July to 2.27% at the end of August (according to the Bank of America Merrill Lynch data for the Global Broad Market Corporate index), as August saw a sharp increase in risk-aversion, reflecting investor concern around slowing economic momentum and the risk of a double-dip recession.

- Despite this increase in risk-aversion, the fundamental backdrop for investment grade corporate bonds remains strong. For example, in the US, ratings upgrades from Standard & Poor's have exceeded downgrades this year by a ratio of 2.07-to-1, the fastest pace in over a decade, according to data compiled by Bloomberg.

- Companies are continuing to take advantage of historically low financing rates by issuing significant amounts of debt. For example, US investment grade companies have raised over $631 billion in bond issues year-to-date, versus a total of $536 billion during the same period in 2010. This month, AT&T sold $5 billion of bonds with the lowest coupon rates ever for the company.

Fixed Income

- The backdrop of low interest rates is likely to continue to fuel investor demand for yield. The current yield of 3.79% for a diversified index of global investment grade corporate bonds (as measured by Bank of America Merrill Lynch data as at 31 August) remains attractive in comparison to cash or government bonds.
- Although economic momentum is slowing, corporate balance sheets remain, on the whole, very healthy at a time when government balance sheets are seen as deteriorating.
- The second-quarter earnings environment remains supportive for corporate bonds. In the US, of the 469 S&P 500 companies that have reported so far, 76% have beaten earnings expectations, a better result than for the first quarter.
- However, given the economic slowdown, we recognize that positive earnings surprises might not be as forthcoming and that some weaker companies might find their funding conditions tougher and more expensive than previously envisaged.
- Overall, we believe that the current environment is still favourable for credit and, therefore, we continue to prefer investment grade bonds relative to government bonds. Within credit, we favour high-yield bonds over investment grade, as their extra yield offers greater protection should government bond yields rise.

High Yield

- In August, global high-yield corporate bonds posted the biggest monthly negative performance of -4.4% since the -8.0% drop in November 2008. This takes the year-to-date return down to 1.2%.
- The negative performance was caused by spread widening due to increased risk-aversion. Global high-yield option-adjusted credit spreads increased to 7.48% in August, from 5.67% at the end of July, reaching their highest level since the financial crisis of 2008-09.
- The negative performance was caused by spread widening due to increased risk-aversion. Global high-yield option-adjusted credit spreads increased to 7.48% in August, from 5.67% at the end of July, reaching their highest level since the financial crisis of 2008-09.
- High-yield issuance slowed down as well. In August, only, $1.8 billion of high-yield debt was issued compared to $26.4bn issued during the same time last year. However, the year-to-date figures still indicate a better issuance this year ($261.9 billion) compared to the issuance ($207.5 billion), during the same time last year.
- Although economic growth remains lacklustre in the major developed economies, corporate balance sheets continue to be in good health and, in the main, companies are continuing to meet their debt payments. We believe this will continue.
- The global annualized speculative grade (i.e. high-yield) default rate fell to 1.9% in July, down from 2.2% in June, as measured by Moody's. This remains very low relative to history, and reinforces our positive view on the asset class.
- Our central scenario for an environment of low inflation and modest growth in developed economies is likely to keep interest rates in these countries low and so demand for high-yield bonds, which have relatively attractive yields (8.7%), should remain high.
- Overall, we retain our positive view on the asset class. This view reflects our continued expectation that the economic recovery will prove durable, monetary policy will remain accommodative, and yield-seeking fund flows will continue to be supportive.

Sovereign US dollar-denominated Emerging Markets

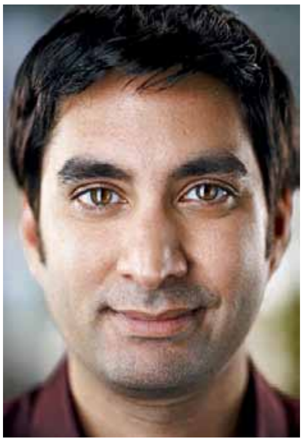
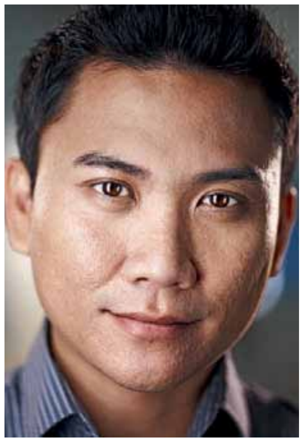
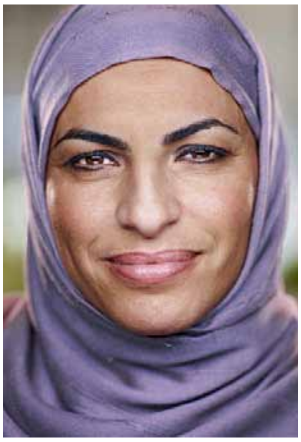
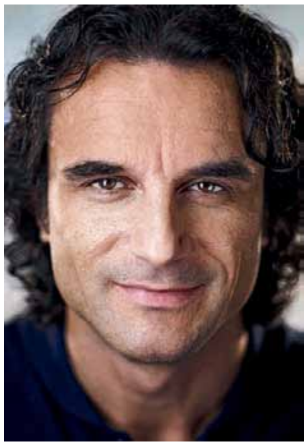
- US dollar-denominated emerging market debt was positive for the seventh consecutive month in August. The asset class returned 0.8% during the month, on a total return basis and 0.2% on a price basis.
- The Merrill Lynch US Dollar Emerging Market Sovereign Plus index option-adjusted spread peaked at around 349bps during the first half of the month, scaling heights not seen since April 2009, on the back of Moody's downgrade of US sovereign debt.
- Spreads narrowed over the remainder of the month and ended the month at 337bps, amid expectations of additional support from the US Federal Reserve to stall the ongoing deterioration in global growth
- The cost of insuring against default for certain emerging markets (e.g. Hungary, Brazil and Indonesia) remains at similar (or lower) levels to many developed countries, such as Spain and Italy, as the latter continue to be negatively impacted by their debt troubles, and emerging markets are rewarded for their fiscal health and resilient growth prospects.
- Investor sentiment continues to be weighed down by the persistent slowdown in global growth and lack of resolution to the European debt crisis. The US sovereign debt downgrade and strict austerity measures imposed by developed economies continue to underscore the relative strength of emerging economies' balance sheets and improved credit worthiness.
- Investor confidence year to date in the asset class has been buoyant and this was highlighted by increased fund flows into emerging market dedicated bond funds this month. Local currency rather than hard currency investments are currently preferred, however, on the back of deflating inflation expectations.
- Long-term trends of structural fundamentals remain favourable and, while emerging market debt spreads are low by historical standards, they still appear attractive relative to yields available in alternative investments, such as developed market bonds.
- Though we have a constructive stance on the asset class, we continue to prefer developed market corporate debt (particularly high yield) to US dollar-denominated emerging market sovereign debt, since the former provides better cushioning in case of further adverse news-flow.

Indonesian Bonds

- In the midst of global crisis, Bank Indonesia's dovish stance certainly has become a refreshing air for the bonds market in Rupiah denomination. A dovish move from the lowered floor rate of daily banking operation from the central bank showed such sentiment.
- Global sukuk issuance as much as 1bio USD is expected in the upcoming month. If it goes according to the plan, the sukuk issuance would be Indonesia's second in the global market, after it sold 0.65 bio USD of such securities in April 2009.
- While in the basis of all Indonesia-issued bonds, the prospect of Indonesia reaching investment grade is better emphasized as ADB highlighted this issue. Although regional GDP growth is expected to decline, ADB is positive for Indonesia domestic consumption and the relatively small export-to-GDP ratio (around 25% compared to other countries 50-60%). As such, benefitting from domestic economy, Indonesia has higher likelihood to reach the grade soon enough.

Currency

- After a month of exceptional volatility for many financial markets, the US dollar ended virtually unchanged against the euro (+0.17%) and Japanese yen (-0.13%). Against other currencies, it benefited from its traditional safe haven status in the face of a general increase in risk aversion and rose by 1.07% against sterling, 2.68% against the Australian dollar and 2.60% against the Brazilian real.
- This happened despite the downgrade of Standard & Poor's US sovereign credit rating from AAA to AA+ and a commitment from the US Federal Reserve to maintain the 'extended period' of low rates until 2013, neither of which are supportive for the US dollar.
- As flagged as a potential risk last month, the Japanese authorities intervened aggressively to stem the rising yen. Full details of their actions have not been disclosed but it is known that the amount on one day (Y4,510bn) was more than double the previous daily record.
- Japan's new Prime Minister, Yoshihiko Noda, was previously the finance minister, in which role he oversaw recent yen intervention. This suggests the risk of further intervention to moderate any yen strength remains elevated, particularly if the currency exhibits volatility, ensuring that the market does not view the yen as a one way bet.
- Recent comments from European Central Bank president Trichet indicate that the central bank no longer views risks to inflation 'to the upside', which, combined with reduced economic forecasts from their in-house economists, probably signals previous plans to increase rates further have at least been put on hold. Although this reduces interest rate support for the euro (market rates predict a cut as early as December), this is counterbalanced by reduced concerns over the fiscal situation of peripheral eurozone countries, once again making the net impact on euro the difficult to analyse.
- Our recommendation to have neutral currency positions remains in place.

Long-Term Investment Outlook (three to five years)

ASSET CLASS	CURRENT VIEW	REASONING
Developed market equities	Positive	• Average rate of growth somewhat subdued in the developed world. Yet exposure to higher growth areas like emerging markets will benefit earnings growth and dividend growth and are likely to keep average nominal returns at high single digit levels.
Emerging market equities	Positive	• Expected to outperform developed market equities thanks to a favourable structural backdrop including improved fiscal management and trade balances, labour force expansion and rapid urbanisation.
Developed Market Sovereign Bonds	Negative	• Comparatively low level of yield and issues around public debt are likely to keep average returns relatively subdued
Developed market credit	Positive	• The level of spread continues to be attractive on a historical basis and corporate balance sheets in developed markets are generally in good shape. This is likely to keep average return for credit assets above respective government bonds.
High Yield	Positive	• The level of spread continues to be attractive on a historical basis and corporate balance sheets in developed markets are generally in good shape. This is likely to keep average return for high yield credit assets above respective government bonds.
Emerging Market Sovereign Debt	Positive	• Structural improvements such as improved fiscal management and trade balances, labour force expansion and rapid urbanisation along with reasonable valuation levels are likely to lead to outperformance of emerging market debt relative to cash and developed market sovereign debt.
Developed Market Inflation-linked bonds	Neutral / Negative	• Inflation expectations are likely to remain contained due to subdued growth in developed markets. In addition, independent central banks are focused on keeping price pressures under control. However, if higher inflation in emerging markets is not dealt with effectively, it could feed through to developed markets over the medium-term.
Commodities	Positive	• Growth in emerging markets likely to remain an element of support for this asset class.
Developed Cash Rates	Negative	• Subdued economic growth and stimulus measures are likely to keep rates at low levels for the foreseeable future.

For further information please visit your local Advance website or www.hsbcadvance.com