

**From The Desk – HSBC GIF Euroland Equity**

June Review

July 9<sup>th</sup>, 2009**How did the markets perform?**

The euroland equity market slightly declined in June (-1.78%) but still managed its best quarterly gain in a long time (+19.06%). Supporting factors have been a growing recovery evidenced by inventory adjustments, improving business surveys and massive monetary stimulus.

Over the quarter, the best performing segments of the economy were the most cyclical. Financials led the charge, (+37.5%) with banks up +45.7%. Other leading indicators of the economy also outperformed; professional services (temp employment) +33.7%; materials +28%; semiconductors +23.5%. Over the month, sector leadership was mixed with a small lead from defensive sectors. The relief rally clearly took place in the first two months of the quarter: since then the market has been awaiting for news from the Q2 earnings season. The good news is that negative earnings revisions are moderating. And earnings seem to already be stabilising sequentially in relationship to Q1 earnings. On balance, the gathering momentum from an economic recovery combined with low valuation and low interest rates should provide a positive backdrop for the equity market.

**Performance Analysis****Fund Performance**

	Month <sup>2</sup> %	3 Months %	2009 YTD %	12 Months %	3 Years %	Since Inception %
<b>Fund return</b>	-1,86	25,67	9,27	-23,40	-20,07	18,46
<b>Benchmark return</b>	-1,78	19,06	2,76	-28,40	-29,34	-0,66
<b>Difference</b>	-0,08	6,62	6,51	4,99	9,27	19,12

[All returns in the table above are provided by HSBC Global Asset Management France]

Returns calculated before deduction of management fees and operating expenses TER: 1.85%

<sup>1</sup> Inception of Strategy on October 1<sup>st</sup>, 2004

<sup>2</sup> After adjusting for timing differences between publication of the fund NAV at 11:00 am CET and the Benchmark at the market close, the real gross arithmetic underperformance over the month is -0.37%.

**Over the quarter**

Over the quarter the entire outperformance was due to stock selection (+5.5% relative) while the contribution from sector exposure was negative (-2.6%) given our decision to maintain an overweight stance on high profitability companies mainly in Food Retail, Healthcare and Telecoms and our underweight stance in Financials. Stock selection was most highly positive within the transitory profitability segment of the portfolio and more specifically in the following sectors: Banks, Autos and Supplies, Consumer & Commercial Services and Media. Stock selection in Telecoms was positive even if this defensive sector significantly underperformed.



The investment team gradually selected downtrodden cyclicals throughout the crisis in late 2008 after conducting due diligence on the profitability cycles of companies such as Arcelor, Saint Gobain and Philips and BNP Paribas. The conclusion at the time was that valuations of certain cyclicals were unjustifiably discounting a permanent reduction of earnings to trough levels. This may have been normal at the time given fears of collapse of the financial system: but we believed in a gradual return to normalcy. This strategy allowed us to maintain positive relative returns when market psychology changed for the better. Currently, the portfolio has about 20% of its holdings in companies with superior and stable profitability, 45% in average and rising profitability and 35% in recovering profitability (value).

## Performance Drivers

### Stock level over the quarter

The table below shows the top positive and negative stock contributions to performance for the quarter.

Positive Stock	Return %	Relative Weight %	Impact %	Negative Stock	Return %	Relative Weight %	Impact %
BANCO SANTANDER	70,04%	1,22%	0,57%	BBVA	48,68%	-1,57%	-0,39%
BNP PARIBAS	52,55%	1,14%	0,45%	HELLENIC TELECOM	2,43%	1,90%	-0,37%
TOTAL SA	5,51%	-2,82%	0,44%	KPN NV	0,78%	1,38%	-0,33%
FRANCE TELECOM	-1,22%	-1,63%	0,41%	SANOFI-AVENTIS	4,15%	1,86%	-0,29%
ARCELORMITTAL	54,47%	1,20%	0,37%	VIVENDI	-8,48%	0,89%	-0,28%

[HSBC Global Asset Management – 31 March 2009 to 30 June 2009]

## Developments in investments

### Best contributors over the quarter

**BANCO SANTANDER:** Santander, one of the highest quality banks in the Euro zone, participated in the huge bank rally over the quarter. The main catalyst was that concerns about the cost of risk were overdone. Ample generic provisioning has offset the rise in non performing assets. And the bank's chairman reaffirmed profit guidance of €9 billion for the group in 2009, the same as for 2008. If achieved, this would be exceptional in the face of the current crisis and much better than its banking peers.

**BNP PARIBAS:** BNP rose courtesy of excellent Q1 results well above the consensus. The drivers of these good results are strong results from the Investment bank on fixed income and the fact that non performing loans have not risen above expectations. The market is now confident that Q2 earnings will be even better than Q1 thanks to strong revenues from investment banking. BNP is taking advantage of its status to grab market share while rivals are trying to build their capital back cushions. A steepening yield curve is also helping to boost profitability.



**TOTAL:** Our underweight position in Total has contributed positively to relative returns. Energy companies are having a poor earnings season because the drop in oil price in late Q2 2008 is still having a negative impact on year on year comparable earnings and sales figures. We continue to prefer smaller alternative energy companies such as OMV and Repsol because of their greater nimbleness and growth potential.

**FRANCE TELECOM:** Our underweight position in France Telecom has contributed positively to relative returns. We prefer Telefonica and KPN in the Telecom sector because of the geographical spread of their businesses and the quality of their management. We believe that FT's bloated civil servant fixed cost base; state links and lack of geographic spread hinder an accurate assessment of its profitability over the medium to long term.

**ARCELORMITTAL:** Arcelor gained because of signs that inventory de-stocking is drawing to an end. The market has also become more hopeful about a pick up in demand from China. Since Arcelor is the low cost producer in the industry it benefits the most from an increase in volumes.

### Worst contributors over the quarter

**BBVA:** Our underweight position in BBVA has been negative given the huge rally of the entire banking sector over the quarter (+46%). Within Spanish banks, we prefer Santander to BBVA because of the former's higher quality management. BBVA's LATAM exposure is also more focused on Mexico whose economy we believe is more vulnerable to the US downturn.

**HELLENIC TELECOM:** In addition to underperformance from the telecom sector this month, trends in the Greek market are more worrying than in the Euro zone in general. We own this restructuring company because of its depressed valuation.

**KPN NV:** KPN underperformed along with the entire pharmaceutical sector as investors seek to move away from late cyclical sectors where growth appears to be muted in 2010. KPN has also provided strong relative returns over the last year. Over the quarter returns were flat mainly because KPN has consistently over delivered on profitability targets such as margin and investors are starting to ask themselves if this can continue, particularly in Germany which is suffering a steep contraction in GDP.

**SANOFI-AVENTIS:** Besides the fact that pharmaceuticals underperformed as a whole over the quarter, the main piece of bad news weighing on the stock were concerns that Lantus, Sanofi's drug for diabetes may increase the risk of cancer. The latest results published in the Diabetological journal stated that the results were inconclusive and there was no evidence to support these claims of higher cancer risk for patients using Lantus.

**CREDIT SUISSE:** Our underweight position in Credit Suisse has been negative given the huge rally of the entire banking sector over the quarter (+46%). Credit Suisse has also benefited from its Investment banking status thanks to a booming corporate bond market, a steep yield curve and ample liquidity: this has outweighed the negative risks on its securitization portfolio where the losses have been largely accounted for.

**VIVENDI:** Vivendi suffered a disappointing Q1 earnings report on the back of slower than expected revenue growth in mobile. There are also concerns that about a less favorable regulatory environment as charges for roaming are down and the sale of 4<sup>th</sup> mobile license will pressure prices.



Vivendi was also affected by rumors that it may be buying either a mobile operators in Africa or Spain.

## Sector Level over the quarter

The table below shows the major sector contributions to performance for the month. The sector weightings and corresponding contributions result entirely from our stock selection approach.

Positive Sector	Return %	Relative weight %	Impact %	Negative Sector	Return %	Relative weight %	Impact %
Utilities	16.5%	-5,97%	0.20%	Pharma & Biotech	5.7%	3.0%	-0.50%
Household & PP	4.1%	-0,99%	0.17%	Telecom Services	4.20%	1.60%	-0.40%
Com Services	32.9%	0,85%	0.12%	Media	1.90%	2.0%	-0.40%
Insurance	21.5%	1,46%	0.12%	Banks	44.9%	-2.1%	-0.40%
Real Estate	10.1%	-0.80%	0.07%	Cons. Services	10.7%	2.8%	-0.20%

[HSBC Global Asset Management – 31 March 2009 to 30 June 2009]

## Portfolio Activity over the quarter

Significant purchases:

**DEUTSCHE LUFTHANSA AG:** We initiated a position in the stock because it is attractive in terms of profitability and valuation. Moreover, the entire airline sector has lagged this cyclical relief rally. And Lufthansa is also relatively well positioned financially and geographically.

**SOCIETE GENERALE:** We have recently added to our position in Société Générale because we believe that its current discount to its peers will not last indefinitely. Its French banking retail franchise is of high quality and generates recurrent revenue streams. We believe that its performance drivers (emerging markets, investment banking) was severely shaken by the crisis and will regain a firm footing once a real recovery gets underway.

**GDF SUEZ:** We have bought into GDF because of its diversified portfolio, synergy gains from its recent merger and strong balance sheet. GDF is also an excellent cash position because it refrained by investing in assets at the recent cyclical peak and can now afford to buy assets that many of its overleveraged competitors are being forced to unload at distressed prices. Moreover, recent reported results were better than expected, allaying concerns that lower gas prices would adversely impact its trading portfolio in gas and other hydrocarbons.



**VEOLIA ENVIRONNEMENT:** We purchased a position in Veolia both on valuation grounds and its commitment to turn itself around after having grown too quickly in disparate directions through debt financed acquisitions over the last several years. It has initiated a coherent plan for disposing of its non strategic assets and reducing capex in order to become cash flow positive starting this year. We believe that the company's restructuring effort will eventually pay off.

**ING GROEP:** We have added to our position in ING because its solvability and profitability profile has been significantly reinforced after the Dutch government purchased €20 billion of its most toxic assets and provided it with what essentially amounts to a €10 billion interest free loan. In addition to its attractive valuation, ING's Direct banking franchise and insurance franchise in Asia are holding up well.

### Significant sales:

**ERG SPA:** We sold part of the position because the company is highly dependent on trends in refining margins which have been poor. ERG also benefited from a disequilibrium in demand and supply in favor of diesel last year. This imbalance is going away as new refining capacity is being built in the gulf. Moreover, the heavy/light petroleum spread is also narrowing as petroleum prices have declined. Even though valuations are very attractive (ERG is on of the cheapest utilities in the sector) future profitability trends are rather on the decline.

**FORTIS GROUP:** We sold down the position because we considered that it was fully valued after reaching 2.50 euros and there were few growth prospects left after BNP was officially authorized to purchase its Belgium banking franchise and the remaining portion of its insurance operations.

**ASSICURAZIONI GENERALI:** We have liquidated our position in Generali because its slightly more defensive qualities is no longer justified by its relative valuation premium. Moreover, growth in its home market will suffer as a result of the economic slowdown.

**BANK OF CYPRUS:** We sold down the position both for valuation and fundamental reasons. Valuation became overextended after the stock was included in the MSCI indices and tracker were obliged to buy position in the stock. At the same time the bank's Q1 earnings were disappointing and management's explanation of why it has been lagging its Greek banking peers were not entirely convincing.

**BNP PARIBAS:** We have sold part of the position after the recent relief rally and the belief that the economic downturn will eventual show up as credit losses in the loan books of big banks. However, we still believe that BNP is one of the best positioned banks in the sector.



## Fund positioning

The table below shows the largest five positions at the end of the month:

Top positions	Weight %	Relative weight %
TELEFONICA	5.6%	2.0%
BANCO SANTANDER	5.4%	1.8%
SANOFI-AVENTIS	4.4%	2.1%
REPSOL YPF	4.3%	3.7%
BNP PARIBAS	3.2%	1.2%

[HSBC Global Asset Management - 30 June 2009]

**Telefonica:** A significantly higher growth profile than the sector thanks to the strength of its domestic market, its accretive acquisition policy and a growing exposure to international markets.

**Banco Santander:** A well managed Spanish bank with little sub prime exposure and a major position in retail banking in Europe. It has one of the highest levels of generic provisions in order to protect itself from the cyclical downturn in its home market.

**Sanofi:** Sanofi faces the major challenges affecting the Pharma industry. However, Sanofi benefits from a very low valuation relative to its peers, a 5.3% dividend yield, extremely strong balance sheet and high and stable margins. There is ample room to improve profitability by reducing its bloated cost structure.

**Repsol:** It is well positioned in refining after substantial investments; partial de-regulation of petrol prices in Argentina, and new and significant discoveries in Brazil.

**BNP Paribas:** BNP is a prudently managed and well capitalized bank. Its premium valuation to the sector is mainly attributable to the higher quality of its overall loan book, making it more resilient to the credit crisis than its peers.



## Sector

The table below shows the largest overweight and underweight sector positions at the end of the month:

Overweights	Weight %	Relative weight %	Underweights	Weight %	Relative weight %
Healthcare & Pharma	11,05%	5,38%	Utilities	4,55%	-6,25%
Consumer Services	4,02%	3,08%	Food & Beverage	2,36%	-2,41%
Telecom. Services	11,99%	2,62%	Autos & Components	2,20%	-2,26%

[HSBC Global Asset Management - 29 June 2009]

Although our approach resides purely in stock selection, divergent sector fundamentals may sometimes explain divergent sector weighting versus the benchmark.

**Healthcare:** resilient profitability based on rising margins (operational leverage and cost cutting), improving asset turnover (sales growth and R&D efficiency), limited financial leverage and good cash flow transformation

**Consumer Services:** a mix of companies with resilient business models for economic hardship (budget hotels, budget food outlets)

**Telecoms:** strong cash flows and falling capex. Stable leverage through high dividend distribution. Attractive valuation

**Utilities:** uncertain commodity-driven and highly regulated cash-flows. Ballooning debt-financed capital employed. Unattractive valuations

**Food & Beverage:** expensively valued profitability with only partial defensive characteristics

**Materials/Autos/Tech Hardware:** transitory profitability with limited valuation attractiveness

## Risk and risk-adjusted performance

Fund metric	Value	Target range/number/limit
Tracking error*	3.85%	(3 –6)
Stock specific risk (% of active risk)	80.2%	> 50%
10 riskiest stock positions (% of active risk)	56%	< 60%
Number of positions	57	Target 50 -60
Active Industry exposure (% of active risk)	11.4%	< 50%
Beta (ex ante)	1.03	(0.9 -1.1)
Information ratio** (3 years rolling)	0.78**	0.3 – 1.0

[HSBC Global Asset Management – 30 June 2009]

\* ex-ante tracking error at end June 2009

\*\* calculated using annualised excess return over 3 years divided by average monthly ex-ante tracking error over 3 years



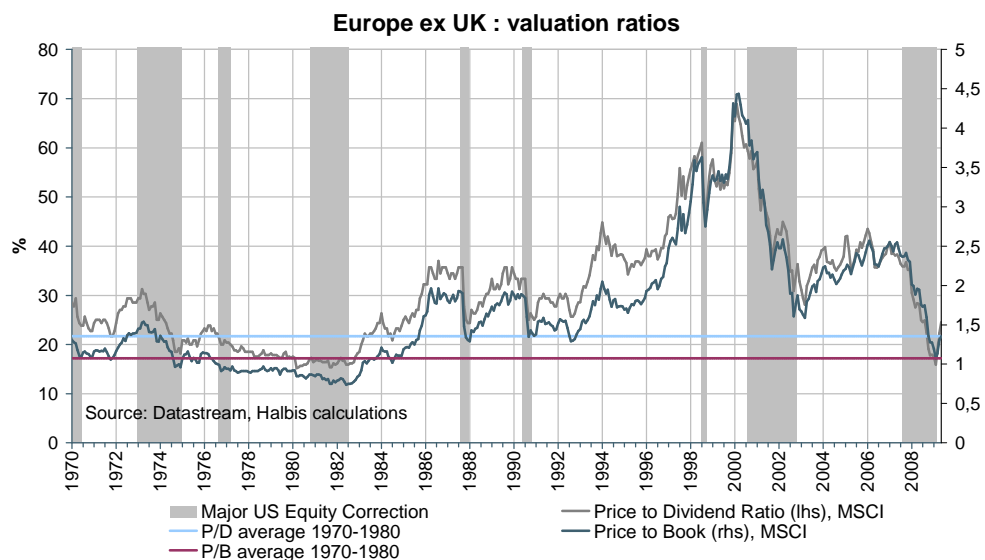
## Outlook for investments

### Economic background:

- Leading indices have bottomed : the Conference Board Leading index sharply rebounded for the second month in a row, two typical patterns of past recessions exits. The US may have actually already exited the recession based on all current data points.
- Building permits, a key leading indicator is stabilizing at extreme lows never experienced before.
- Initial jobless claims are also stabilising but unemployment could continue to increase 3-6 months into the recovery until GDP growth reaches trend/above trend levels. Halbis (France) forecasts GDP growth in the US of 2.4% in 2010.
- However, some other concerns remain on the earnings front: US operating margins have been rather well preserved for now due to aggressive cost cutting but can this last ? As households remain thrifty, further risks of to earnings cannot be discarded.
- The bottoming process is also evident in Europe ex UK but recovery will be more subdued as adjustment mechanisms (unemployment and housing) take longer to play out. The de-stocking process is only just beginning in Germany and may therefore continue to weigh on industrial activity until Q4. Halbis (France) forecasts GDP growth of only 0.9% in 2010.

### On the market front:

- Markets have paused for breath because high beta assets such as commodities and emerging equities have overshot on the upside and now are vulnerable again from a valuation standpoint
- In the US, equity valuation is back to the long term mean (fair value) for the US market while Europe ex-UK is trading at below fair value valuation and is at its steepest discount to the US in over 35 years.
- In short, the Euroland economy will probably remain soft for a longer period than the US, but the fact that it is coming out of a deeper recession (-4.2% GDP in 2009 in Euroland) versus (-3.0% GDP in 2009 in the US ) and trades at a 35% discount to the US market, bodes well for future returns.
- Moreover, the fact that Europe is still unpopular among investors relative to the US and the Emerging Markets is a good contrarian indicator of better times to come.





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