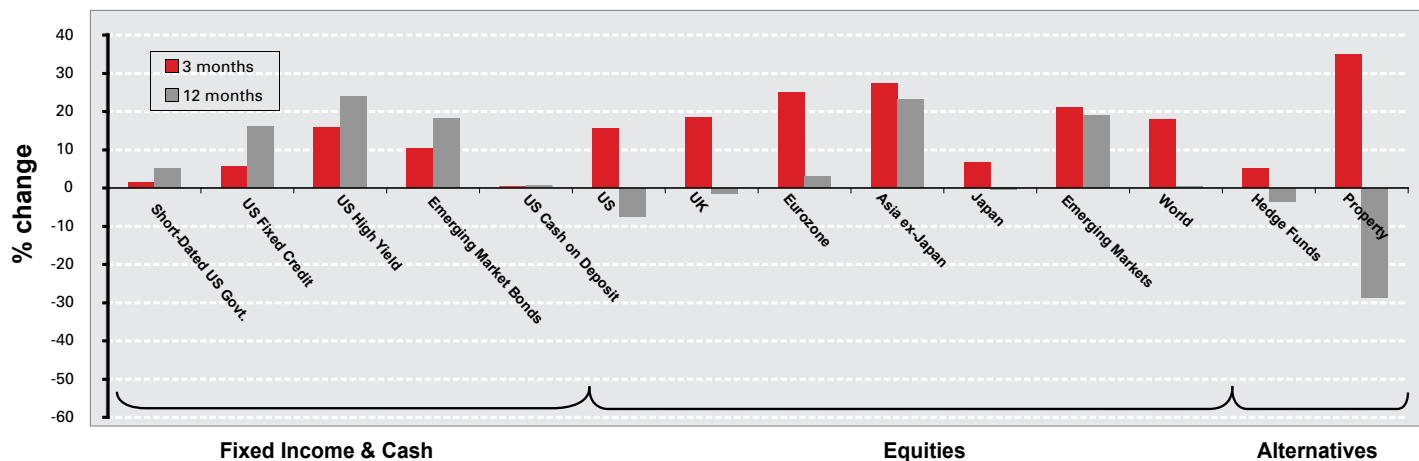


HSBC Customised Portfolio Management Service

Third Quarter 2009 Review and Outlook – USD

Performance of World Financial Markets in USD – 3 & 12 months to 30th September 2009



Source: Bloomberg, all figures total return and in US Dollars.

Chart indices: FIXED INCOME: Short-Dated US Govt. (Bloomberg/Effas Bond Indices US Govt 1 to 7 years), US Corp. Bonds (CGBI Euro\$ Bond Index – TR), US High Yield (Barclays Global High Yield), Emerg. Mkt Bonds (JPM EMBI+ Composite – TR), USD on deposit (US Interbank 3 Month (LDN:BBA) Offered Rate), EQUITIES: US (MSCI USA TR Net), UK (MSCI UK TR Net), Europe (MSCI Europe ex UK TR Net), Asia ex-Japan (MSCI Pacific Ex JP TR Net), Japan (MSCI Japan TR Net), Emerging Markets (MSCI Emerging Markets TR Net), World (MSCI World TR Net); ALTERNATIVES: Hedge Funds (HFRX Global Hedge Fund), US Property (FTSE Epra/NAREIT United States).

Equity Markets

Aside from the presence of one or two ‘hiccups’ midway during the period, the third quarter of 2009 looks to have been the turning point for the global economy. Whereas uttering the expression “green shoots” to talk about developed market performance during the second quarter might have been met with a sceptical response, the third quarter has been markedly different. A series of upward revisions to existing economic growth figures (indeed which officially drew France and Germany out of recession); more robust forecasts for ongoing expansion, combined with a gradual improvement in other key economic indicators – such as house prices – supported strong equity market performance.

Alongside the improvements on the macroeconomic side, developments at a company level have also provided a considerable catalyst for the appetite for equities. Corporate earnings for the second quarter were on the whole met with a positive response from analysts and investors, while news of a resumption of merger and acquisitions activity also provided a considerable fillip for equity investors.

Worldwide, shares rose with considerable strength during the quarter, with the major indices building month-on-month to end the period with double digit gains. There was a concerted rebound in the performance of cyclical stocks, as investors digested better consumer and business confidence figures and forecast improvement in corporate capital expenditure and retail sales activity. The strong performance of commodities – oil, gas, base metals and precious metals in particular – benefited the returns of mining and natural resource based companies, which proved a valuable contribution to the returns of the major equity indices. Banking and financial services stocks also produced strong gains, as many institutions which had suffered sharp sales during the early part of 2009 begun to repair their balance sheets, often through the issuance of new shares, and profited from the renewed investor interest.

Bonds, Commodities and Alternative Investments

The environment of improving equity markets and a widespread appetite for riskier assets was not broadly positive for government bonds over

the quarter. In spite of this however, government bond indices ended the period in slight positive territory, or at worst flat. Owing to the continued outlook for very low interest rates, combined with the still-weak economy, investors continue to purchase government securities in order to satisfy the need for a safe-haven investment with a yield greater than cash on deposit. However, the outlook for greater issuance of government debt, necessary for the developed market governments to finance their spending plans, is not supportive for the asset class. From a performance standpoint this quarter belonged to corporate debt, which continued to provide strong returns and outperform government securities. Earlier in the year, the yield offered by the overall asset class in excess of government debt had reached historic levels, as the market priced in a high risk of companies defaulting upon their debt obligations. As economic and corporate conditions have improved, this level has narrowed, as the price has risen although the yields still available continue to look attractive.

Commodity markets have added much to the momentum of global equity markets throughout the period. The rally in the price of base metals alone has been in part responsible for the strong performance of many of the mining and natural resource stocks within the major UK, European and US indices. The spot prices of copper, nickel, and aluminium have each risen 24.2%, 16.5% and 16.2% in USD terms during the quarter under review, recovering from the sharp lows they each experienced in the wake of the financial crisis and global slowdown. Indeed, the copper price has leapt 130% from its low in December 2008 to the high it reached in early August. Precious metals have also performed well, with the gold price rising 8.7% from June to end September. The improvement in the price reflected the value of gold as a safe-haven asset in the face of continued headwinds to economic recovery and the weakness of the US Dollar as a currency.

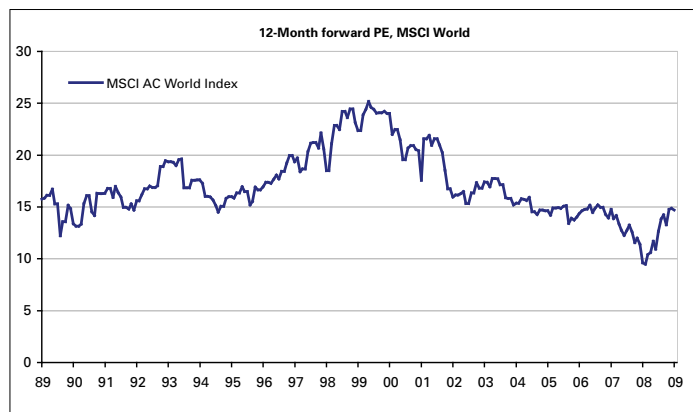
Hedge funds also recovered over the quarter. The broad-based rally has lifted the performance of most sectors, which in the main benefited those funds which operated within the 'special situations' areas, more so than those which operated short-selling strategies. Within property, although capital values worldwide are still weak, rental yields are attractive and this is gradually improving the outlook.

Expectations and Outlook

Despite the advances made during the quarter it remains too soon to consider that we are now completely 'out of the woods'. For developed markets in particular there are significant imbalances that still need to be addressed. Public and household balance sheets are in a poor state overall, with a lack of savings, sizeable non-performing loans and still-high gearing in the financial sector.

While equity, commodity and credit markets have recovered during the second and third quarters of 2009, questions are starting to be asked as to whether there is a gap between the performance of financial markets and that of the real economy. Whilst there has been some disappointing data, economies rarely move from good to bad in a linear fashion and the important point to note is that the overall direction is still positive. Similarly, global monetary policy remains very accommodative and low interest rates will support riskier assets given the low returns on cash. Valuations are no longer cheap, but neither are they expensive historically and hence on balance we think a significant downturn is unlikely in the near-term (albeit acknowledging that a pull-back and some profit taking is possible following the extent of recent performance). The core risk is that we are entering uncharted territory and many of the measures that have been used by central banks have not been tried before. Equally, the downturn was so extreme that a simple, straight line recovery seems rather too much to hope for. Even so, on balance we remain pre-disposed to equities and corporate debt over more defensive assets such as government bonds or cash.

We would also expect to see some rotation in equity markets in the type of companies that might lead markets higher. To-date, the best performing companies have been highly cyclical and financially distressed. In the future we would expect greater focus on companies that are geared into a recovery but with higher quality earnings and dividends.



Portfolio Activity

As we gained greater confidence in the rally this quarter we gradually increased our exposure to cyclical stocks, including Asian and emerging markets stocks. In the US during the period we have added to our banking holdings, whilst in Europe we reduced the exposure to defensive holdings by adding to the resources sector.

We have maintained an underweight position in property, but added some exposure during the quarter as we felt that yield levels relative to cash are likely to attract investors and demand is slowly returning within prime areas of the market.

Strategic Asset Allocation Review and Benchmark Changes

The periodic review of our asset allocations and benchmarks is a key part of our process in order to deliver the highest long-term return for each given level of risk. Indeed, changes in long-term expected returns and volatility affect optimal asset allocations. Over the last eighteen months we have experienced extremely challenging market conditions and in order to take into account the extraordinary changes in world financial markets and growth expectations we recently decided to conduct a full re-optimisation of all our models. This also gave us the opportunity to review our investable universe to make sure that our clients' portfolios benefit from the ever changing investment landscape and exploit new investment opportunities. As a result, some important changes were made to our strategic asset allocations, and trading was carried out on portfolios to reflect these:

- 1) Within equities the relative weighting of developed markets versus developing markets and Asia was decreased. This reflects the significant change in growth assumptions for the World's economies, with emerging economies expected to drive global gross domestic product (GDP) growth for the foreseeable future.
- 2) We added commodities to our investable universe. Commodities, like most asset classes, are correlated to the economic cycle; however their correlation pattern is different from that of equities and bonds. Until recently commodities were not easily accessible for private investors. However, with the introduction of new financial instruments this asset class is now accessible to most investors at a reasonable cost.

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