

▶ Alternatives: Key Trends and Investment Ideas



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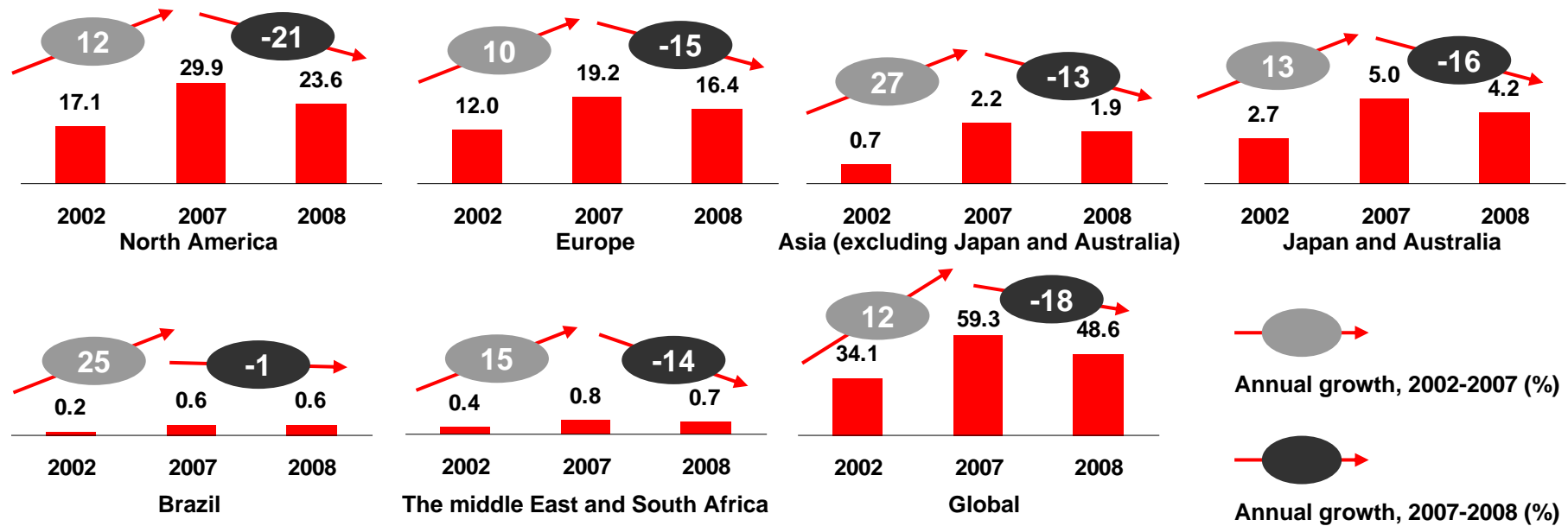
Three investment ideas

Section 4

Where the money was

- ▶ North America, Europe, Japan and Australia dominated the marketplace
- ▶ With the nadir of the financial crisis behind us, flows have started to show continued improvement
- ▶ Major driver of growth will be a gradual yet substantial increase in allocations
- ▶ Where is the money now?

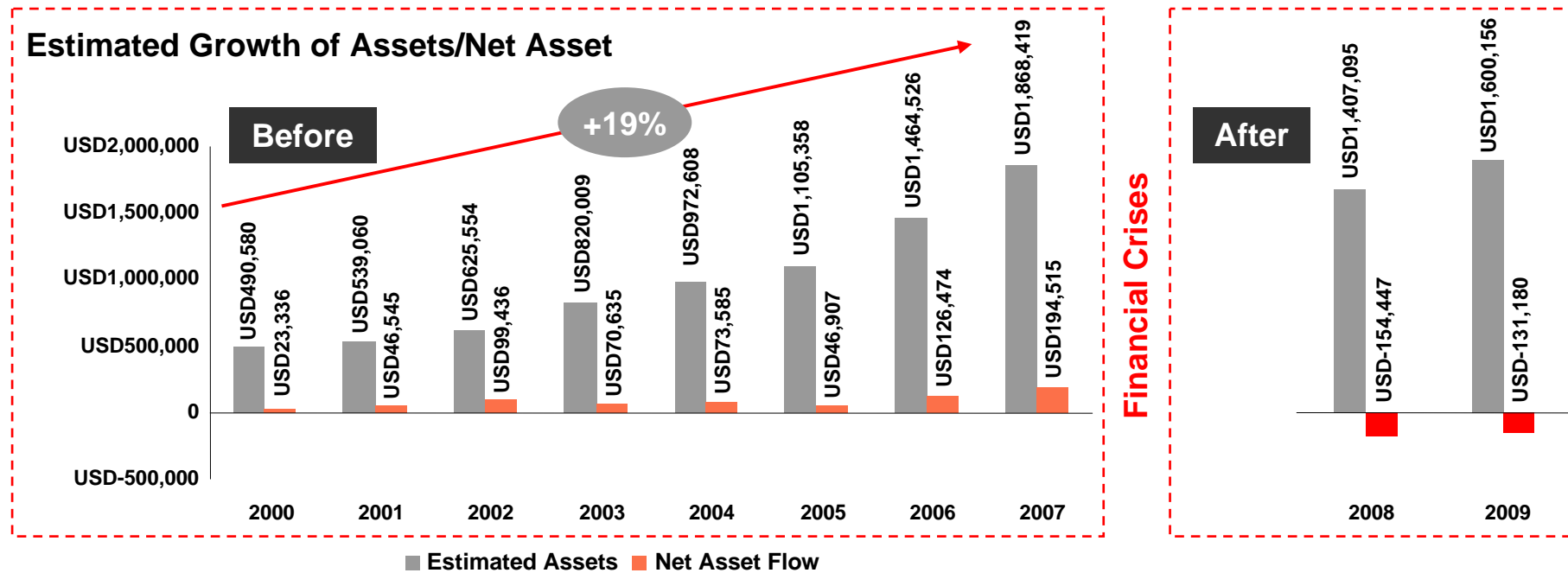
Asset under Management, 2002-2008 (USD trillions)



Source: BCG Global Asset Management Markets Sizing database, 2009

Asset flows and AUM: Hedge Fund Industry Pre- and Post-Crisis

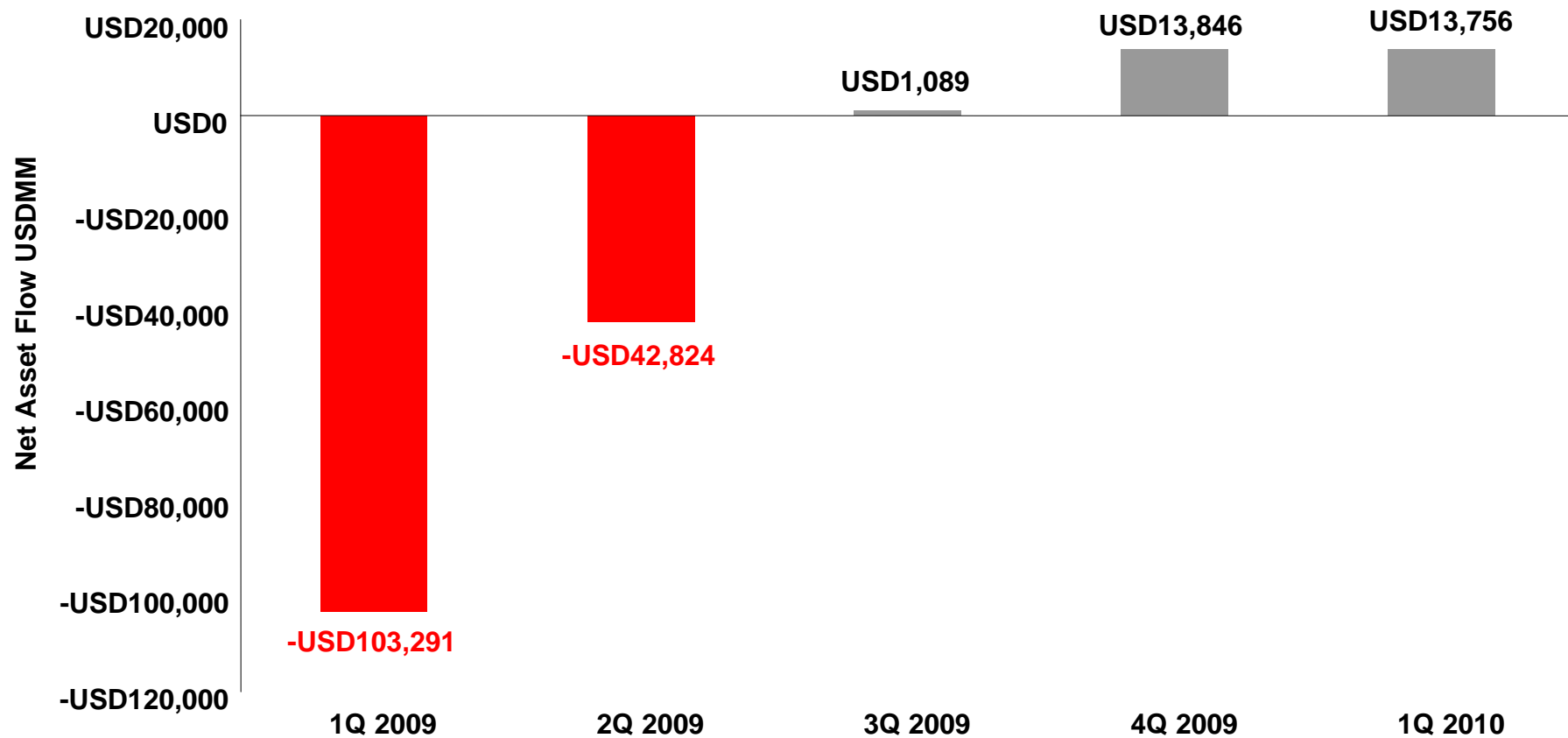
- ▶ The industry saw large redemptions (-25% in AUM) during the recent financial crisis
- ▶ Pre and post crisis, over 1000 hedge funds closed – a record number, which reduced the total by more than 10%
- ▶ Reasons such as investor confidence, liquidity, poor performance, lack of transparency, uncompetitive fees and lack of due diligence were some that were frequently cited



Source: HFR Global Hedge Fund Industry Report – Year End 2009.

Asset flows: Hedge Fund Industry 1Q08 – 4Q09

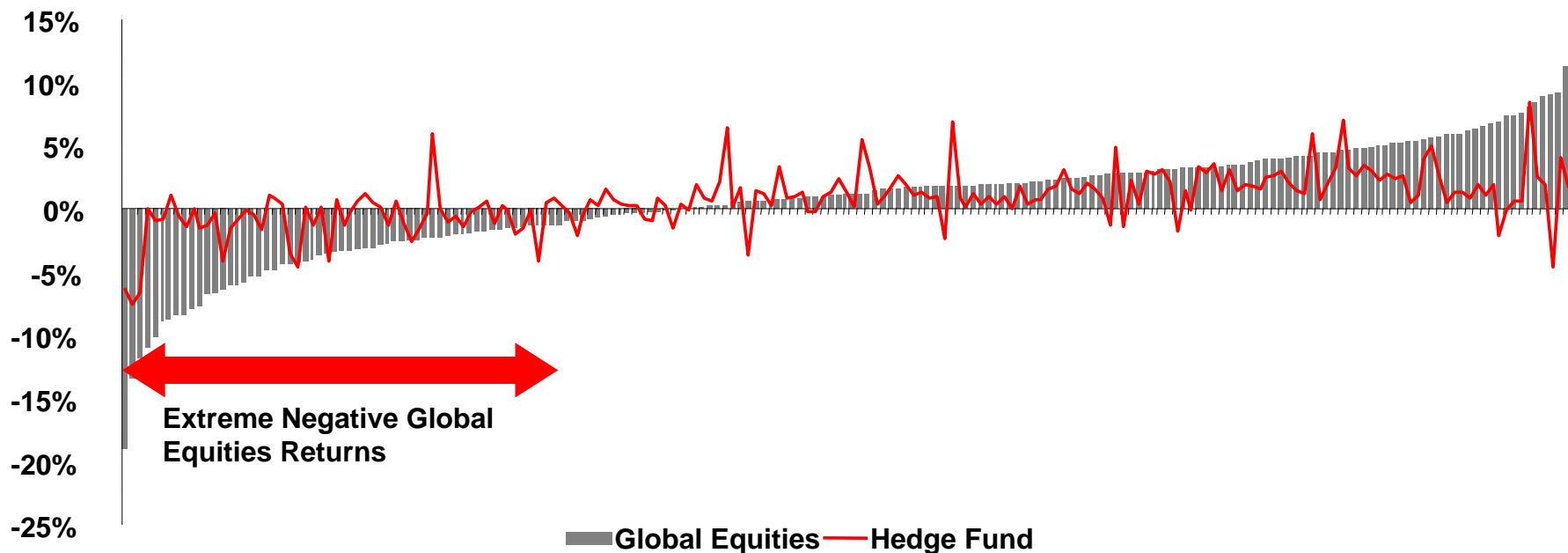
- ▶ Recent steady increases of flows back into the industry suggest investors continue to find merit for investing in Alternative Investments



Source: HFR Global Hedge Fund Industry Report – 1Q 2010.

We have always known of the benefits of diversification

- ▶ In periods of extreme returns of global equities, hedge funds have been shown to provide relatively stable returns
- ▶ Significant diversification value can be added in a portfolio through the systematic implementation of alternatives, both at the strategic and tactical levels



Source: Datastream. Global Equities – MSCI World Total Return (USD), Hedge Fund – Credit Suisse Tremont Hedge Fund Index (USD) Any performance information shown refers to the past and should not be seen as an indication of future returns.

We are now empowered with the lessons learnt from the crisis

Why has confidence returned to the industry?

- ▶ UCITS III passport has been key to offer assurance to investors
- ▶ Provide greater transparency, regular access to money, assurance over asset valuation and counterparty risk
- ▶ Weekly liquidity, mark-to-market pricing, leverage and concentration limits
- ▶ Due diligence has always been important in the industry. What this crisis has revealed is... **It is not just about doing it right but doing it well**

Reinforcement of due diligence

Fund of Hedge Funds:

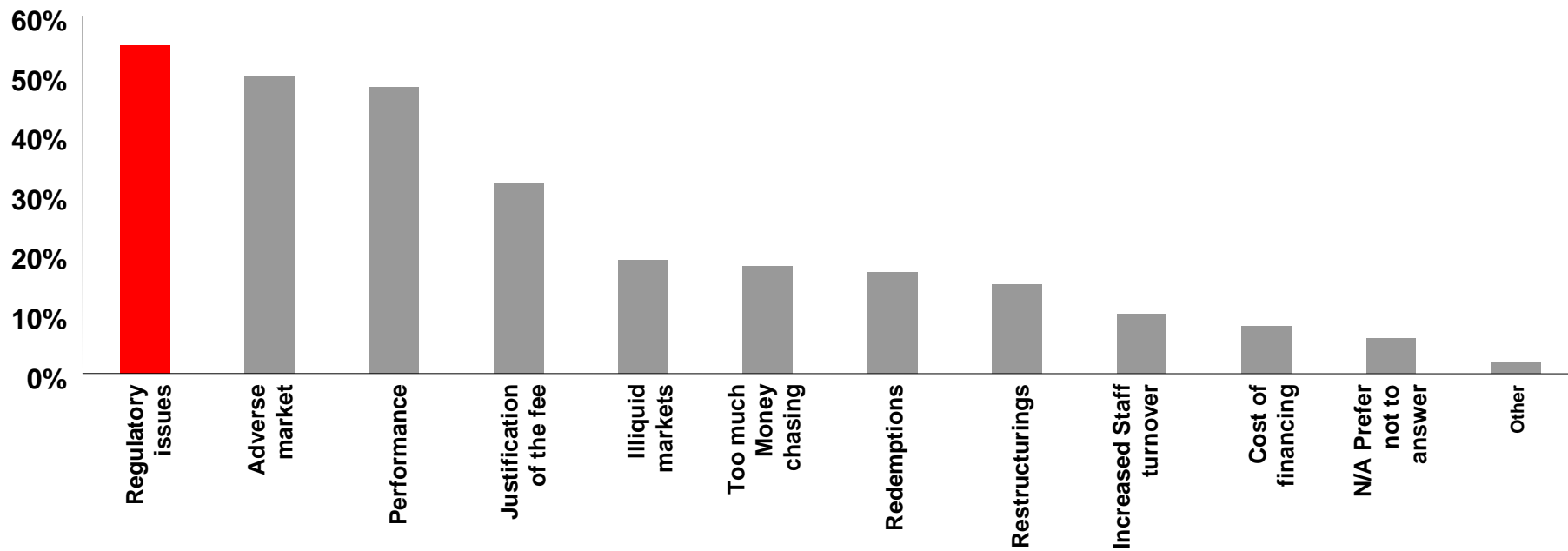
- ▶ The crisis exposed the limitations of their research platforms, credit facilities and investment processes
- ▶ Surviving providers will reap the rewards from their more robust platforms in 2010

Hedge Funds:

- ▶ Exposed style drifters, outliers, un-economic business models, lack of transparency, amongst other things
- ▶ Surviving hedge funds have higher risk standards, discipline, process and quality

Despite challenges confronting the industry

▶ What are the biggest challenges that your managers face over the next 12 months?

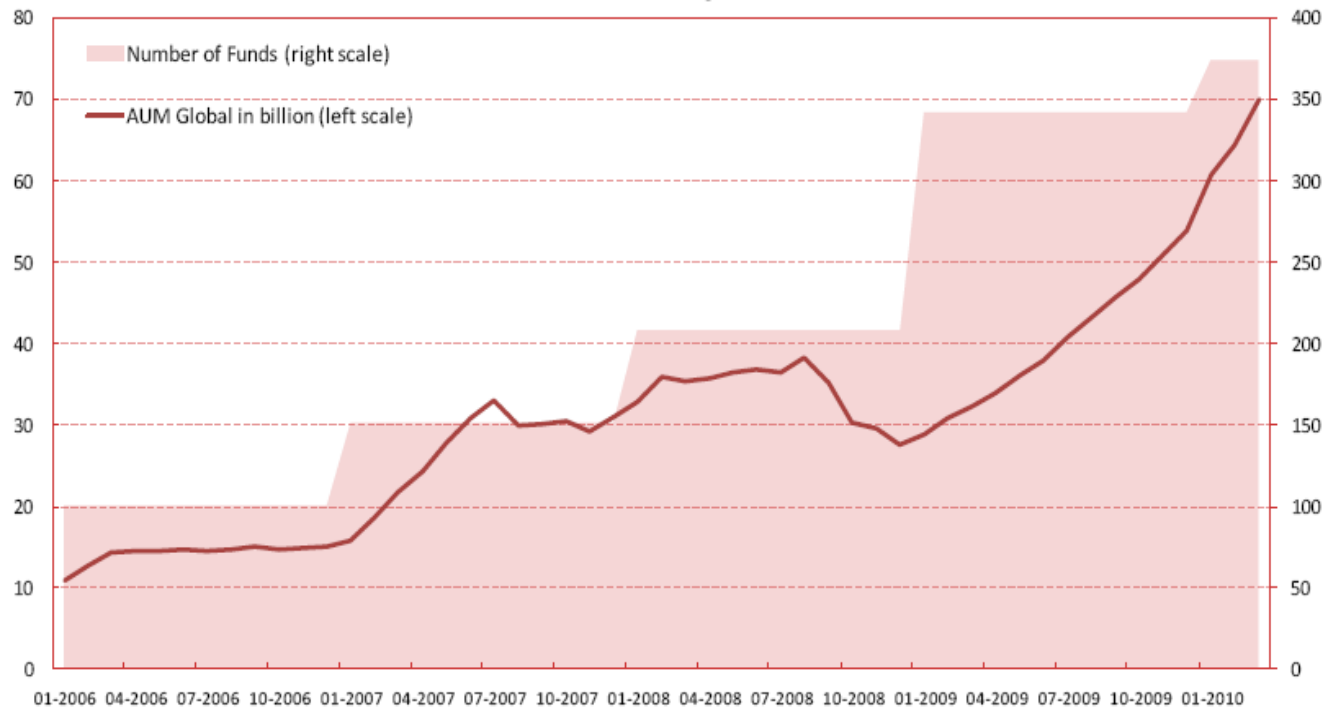


▶ Over 50% of investors surveyed by Deutsche Bank reported that regulatory issues would be the key consideration for hedge fund managers in 2010 – up from 20% in 2009

Growing significance of UCITS III absolute return vehicles

- ▶ UCITS: an Undertaking for Collective Investment in Transferable Securities
 - Regulated, liquid, and transparent

UCITS Alternative Index Global Growth of AUM (in billion EUR) and Number of Funds since January 2006

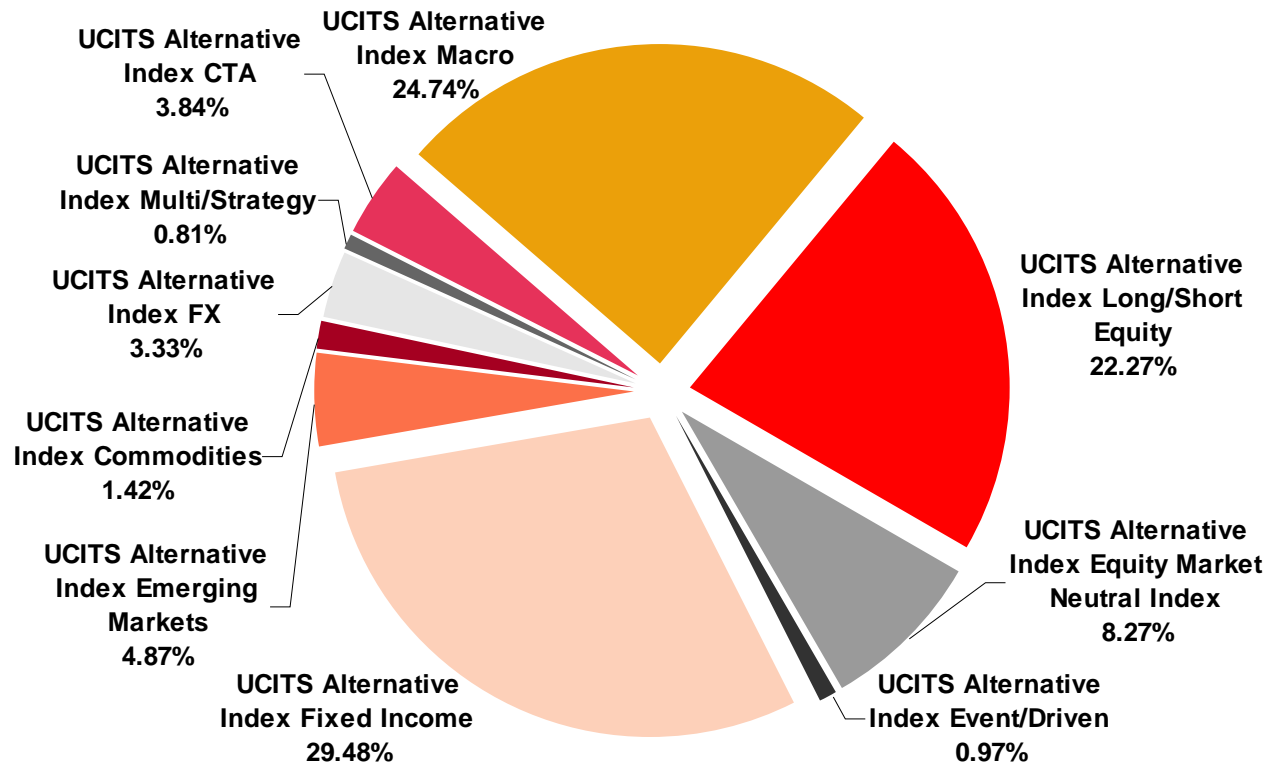


Source: UCITS Alternative Report – Q1 2010

Expanding opportunity set within UCITS

- ▶ A broad array of strategies are suitable for UCITS compliance – but not all

Distribution of AUM by Strategy Q1 2010

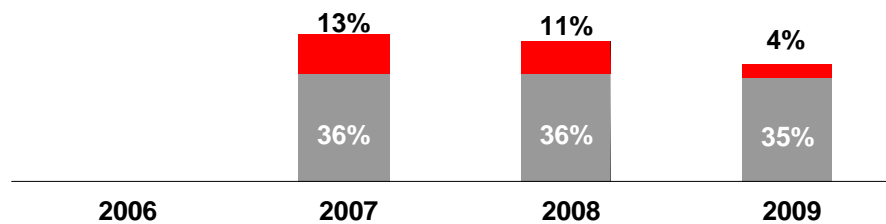


Source: HSBC Global Asset Management

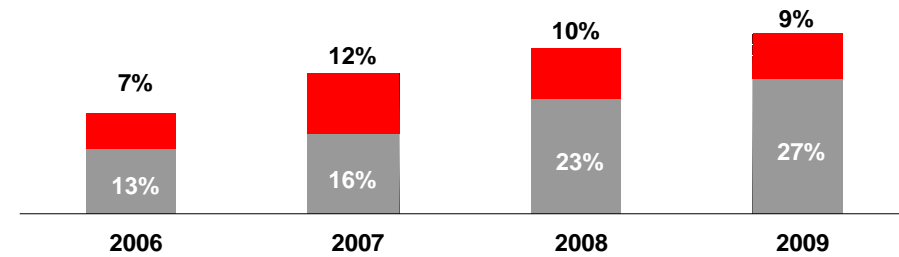
Demand for Hedge Fund Investments remains healthy...

- ▶ Demand growing/stable in UK, US and Japan
- ▶ Decline in expectancy to hire in Continental Europe can be attributed in part to regulatory issues
 - Likely to change with UCITS III

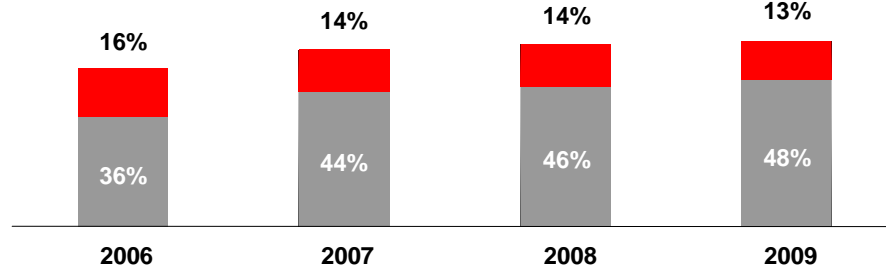
Demand for Hedge Fund Investments in Continental Europe



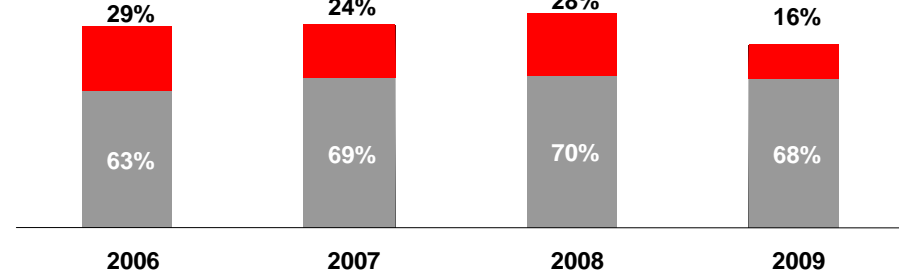
Demand for Hedge Fund Investments in UK



Demand for Hedge Fund Investments in US



Demand for Hedge Fund Investments in Japan

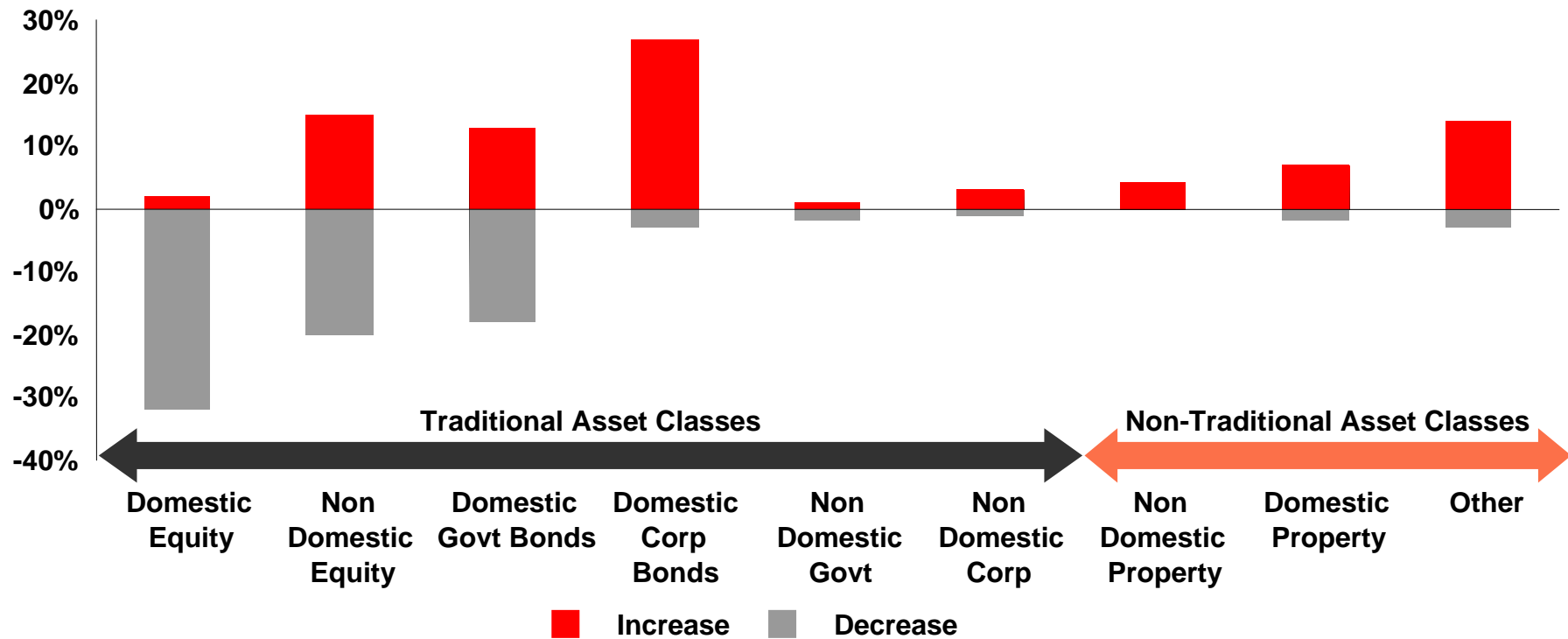


■ Now use ■ Expected to hire

Source: Greenwich Associates 2009

Trends in asset allocation

- ▶ It would appear a large percentage of pension schemes are looking to decrease allocations to traditional asset classes ▶ where will assets be allocated to?
- ▶ Likely increase allocation to non-traditional asset classes



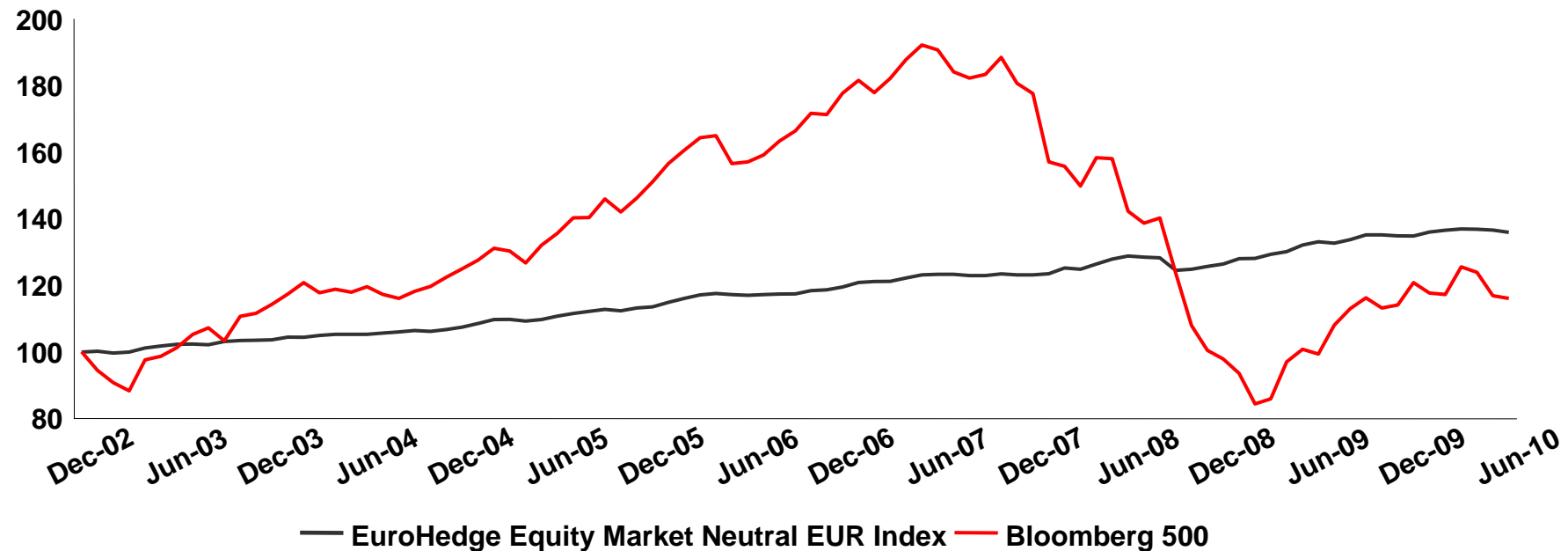
Source: Mercer, "European Investment Forum". Asset allocation survey covers 11 countries within Europe and the UK

Tips for investors: common considerations

- ▶ **What were cumulative returns for this strategy in 2008 – 2009? High water mark sniff test**
- ▶ **Did a manager gate or side-pocket investors? If so, why and were fees still charged?**
- ▶ **How does a manager monitor liquidity conditions? Is bigger better?**
- ▶ **What type of infrastructure (operational & risk management) supports the business?**

Investment idea: market neutral

Cumulative return of the EuroHedge Market Neutral Index versus the Bloomberg 500 equity index



- ▶ Conservative, stable, uncorrelated with conventional investments
- ▶ Dependent on pure alpha generative skill (so hedge fund fees are justified)

Source: Bloomberg, HSBC Global Asset Management. Performance information above refers to the past and should not be seen as a guide to the future

Investment idea: Global Macro

- ▶ Global Macro outperformed other alternative strategies and conventional asset classes over the past decade
- ▶ The strategy was one of the only safe havens in 2008

Historic Index Returns - HFR Alternative Indices vs. Traditional Indices

HFR Indices	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	Annualised
Relative Value Index	2.8	14.7	13.4	8.9	5.4	9.7	5.6	6.0	12.4	8.9	-16.8	26.0	7.6
Merger Arbitrage Index	7.2	14.3	18.0	2.8	-0.9	7.5	4.1	6.3	15.7	7.1	-4.6	11.6	7.2
Macro Index	6.2	17.6	2.0	6.9	7.4	21.4	4.6	6.8	8.5	11.1	5.2	4.2	8.4
Hedge Fund of Funds Index	-5.1	26.5	4.1	2.8	1.0	11.6	6.9	7.5	10.4	10.3	-21.4	20.1	5.5
Event Driven Index	1.7	24.3	6.7	12.2	-4.3	25.3	15.0	7.3	15.3	6.6	-21.3	25.9	8.7
Equity Market Neutral Index	8.3	7.1	14.6	6.7	1.0	2.4	4.2	6.2	7.3	5.3	-6.2	1.7	4.8
Equity Hedge Index	16.0	44.2	9.1	0.4	-4.7	20.5	7.7	10.6	11.7	10.5	-26.2	25.0	9.1
Distressed Securities Index	-4.2	16.9	2.8	13.3	5.3	29.6	18.9	8.3	15.8	5.1	-24.9	29.2	8.6
Convertible Arbitrage Index	7.8	14.4	14.5	13.4	9.1	9.9	1.2	-1.9	12.2	5.3	-34.7	60.2	7.4

Traditional Indices	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	Annualised
Barclays Govt/Credit	12.0	-2.4	13.3	9.4	12.1	5.1	4.5	2.6	4.1	7.8	6.1	4.8	6.5
S&P 500	28.6	21.0	-9.1	-11.9	-22.1	28.7	10.9	4.9	15.8	5.5	-37.0	26.5	2.9
MSCI World USD	23.6	23.6	-14.1	-17.8	-21.1	30.8	12.8	7.6	18.0	7.1	-42.1	27.0	1.9

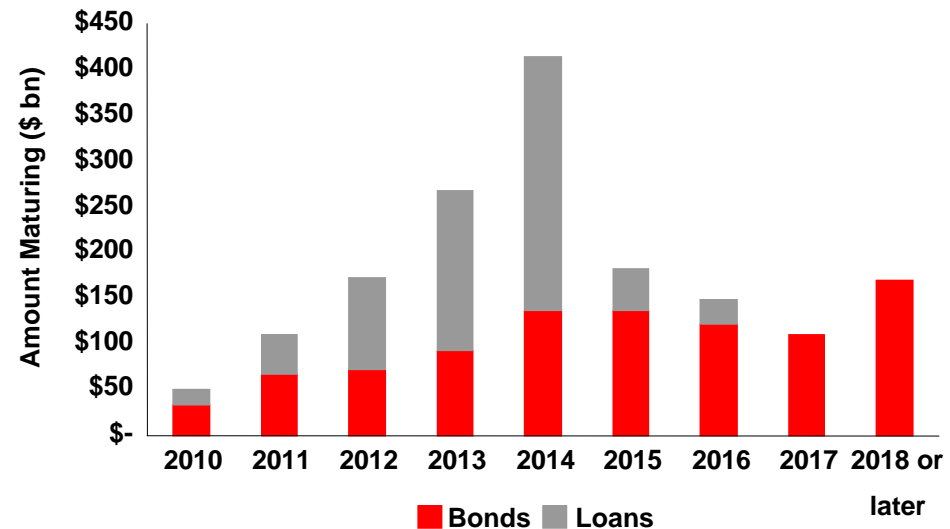
- ▶ A stable performer, one that's held up in the crisis and is timely in today's market context
- ▶ Also offers, like market neutral, strong diversification benefits

Source: HFR Global Hedge Fund Industry Report Year End 2009 – As at 31/12/2009 - Performance information above refers to the past and should not be seen as a guide to the future. The HFRI Monthly Indices ("HFRI") are a series of benchmarks designed to reflect hedge fund industry performance by constructing equally weighted composites of constituent funds, as reported by the hedge fund managers listed within HFR Database. The HFRI range in breadth from the industry-level view of the HFRI Fund Weighted Composite Index, which encompasses over 2000 funds, to the increasingly specific-level of the sub-strategy classifications.

Investment idea: distressed debt

The current opportunity

- ▶ Over \$1 trillion of debt will mature from now until 2014
 - Issuers unable to deal with the maturities will have to de-lever through restructuring and bankruptcy action
 - This will create many idiosyncratic opportunities for our strategy



Data: 18 November 2009 / Source: JP Morgan

Why invest in distressed debt?

- ▶ A 'spicy' directional strategy
- ▶ Not suitable for all investors, which creates opportunities
- ▶ One of the best performing strategies in 2009 and 2010
- ▶ Despite this outperformance, we remain optimistic on the outlook

The views and opinions above are those of the HSBC Distressed Opportunities Team, based on data as of June 2010 and is subject to change without notice.

Conclusion

- ▶ **Investors have often looked to the alternatives market to provide them with diversification and absolute returns which are not available in equity or bond markets**
- ▶ **Following the financial crisis in 2008, another benefit has emerged – a consolidation of the industry, leaving behind the highest calibre of managers and service providers**
- ▶ **The recent crisis was a survival of the fittest – presently, it is not just about doing it right but doing it well**
- ▶ **The UCITS III passport is likely to have a significant positive impact on the future of the hedge fund industry**
- ▶ **Market research shows an increasing trend towards allocation to Alternative Investments. Evidence can be seen in major global markets**

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