

# ABF Hong Kong Bond Index Fund

31 May 2018

## Risk Disclosure

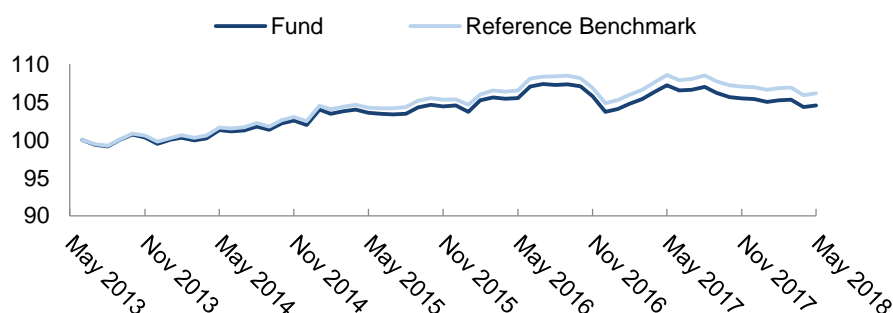
Investments involve risks. Investors are advised to consider their own investment objectives and circumstances in determining the suitability of an investment in the Fund. An investment in the Fund may not be suitable for everyone. If you are in any doubt about the contents of this document, you should consult your stockbroker, bank manager, solicitor, accountant or other financial adviser. Investors should note:

- The Fund is an exchange traded bond fund. The Fund's market price on the stock exchange may be different from its net asset value per unit.
- The listing of the Fund on the stock exchange in Hong Kong does not guarantee a liquid market and the Fund may be delisted.
- The Fund invests primarily in Hong Kong dollar government and quasi-government bonds with an aim to track the performance of the underlying index.
- The Fund may pay dividends out of capital or pay dividends gross of expenses. Dividend is not guaranteed and will result in capital erosion and reduction in net asset value.
- Investing in the Fund involves substantial credit, counterparty, market, volatility and liquidity risks. In the case of turbulent market situation, investors may suffer substantial loss.
- Investors should not invest in the Fund solely based on the information provided in this document and should read the Prospectus of the Fund for details.
- Unit trusts are NOT equivalent to time deposits. Investors should not invest in the Fund solely based on the information provided in this document. The Fund differs from a typical trust and investors should read the offering document of the Fund for details.

## Fund Objective and Strategy

This Fund seeks to provide investment results that correspond closely to the total return of the Markit iBoxx ABF Hong Kong Index, before fees and expenses.

## Performance (%)



Performance (%)	YTD	1M	3M	1Y	3Y <sup>1</sup>	5Y <sup>1</sup>
Fund	-0.79	0.21	-0.66	-2.49	0.93	3.12
Reference Benchmark	-0.77	0.24	-0.66	-2.21	1.80	4.59

Calendar Year Performance (%) <sup>2</sup>	2013	2014	2015	2016	2017
Fund	-3.51	2.48	2.54	-0.83	1.62
Reference Benchmark	-3.02	2.70	2.79	-0.47	2.03

**Past performance is not an indicator of future returns. The figures are calculated in the share class base currency, NAV to NAV basis with dividend reinvested, net of fees. If investment performance is not denominated in HKD or USD, HKD or USD based investors are exposed to exchange rate fluctuations.**

Source: HSBC Global Asset Management, data as at 31 May 2018

## Fund Details

UCITS V Compliant	No
Distribution Type	Distributing
Distribution Frequency	Semi-annually
Dealing Frequency	Daily
Min. Initial Investment	Not Applicable
Max. Initial Charge	0.00%
Management Fee	First HKD 1,560 million 0.15%, thereafter 0.12%
Base Currency	HKD
Domicile	Hong Kong
ISIN	HK2819031405
Inception Date	17 Jun 2005
NAV per Share	HKD 96.76
Fund Size	HKD 2,781,347,686
Bloomberg Ticker	2819 HK
Reference Benchmark	Markit iBoxx ABF Hong Kong TR HKD
Manager	Ming Leap

<sup>1</sup>Result is cumulative when calculation period is over one year.

<sup>2</sup>The calendar year return of the first year is calculated between share class inception date and calendar year end of first year if the share class has less than 5-year history.

Fund change that may have material impact on performance: 11 Dec 2017 - charges of creating units increased. 29 Jan 2018 – dividend distribution policy changed. Performance is calculated according to net asset value per unit. The Fund's trading price on the stock exchange may be different from its net asset value per unit.

3-Year Risk Measures	Fund	Reference Benchmark
Volatility	2.3%	2.3%
Sharpe Ratio	-0.20	-0.08
Tracking Error	0.2%	-
Information Ratio	-1.46	-

5-Year Risk Measures	Fund	Reference Benchmark
Volatility	2.4%	2.3%
Sharpe Ratio	0.00	0.12
Tracking Error	0.2%	-
Information Ratio	-1.58	-

Characteristics	Fund	Reference Benchmark	Relative
Number of Holdings ex Cash	61	80	-
Average Coupon	1.95	1.96	-0.01
Effective Duration <sup>3</sup>	4.20	4.20	0.00
Portfolio Yield	2.07	2.14	-0.07
Average Yield to Maturity	2.07	2.14	-0.07

Characteristics	Fund	Reference Benchmark	Relative
Current Yield (Gross)	1.97	1.98	-0.02
Average Credit Quality <sup>4</sup>	AA+/AA	AA+/AA	-
Maturity Average	4.55	4.69	-0.14
Number of Issuers	9	18	-

Credit Quality Rating Allocation (%)	Fund	Reference Benchmark	Relative
AAA	-	1.97	-1.97
AA	97.74	92.22	5.52
A	2.18	0.76	1.42
NR	-	5.05	-5.05
Cash	0.08	-	0.08

Sorted from highest to lowest rating. Cash is not included in any rating.

Sector Allocation (%)	Fund	Reference Benchmark	Relative
Treasuries	77.53	75.71	1.82
Sovereign	5.36	3.03	2.33
Agencies	5.22	3.36	1.87
Industrial	5.03	5.70	-0.67
Supranational	4.19	7.45	-3.26
Financial Institutions	2.58	4.75	-2.17
Cash	0.08	-	0.08

Sorted from largest to smallest per market values of weight.

Maturity Breakdown (Effective Duration)	Fund	Reference Benchmark	Relative
Bonds < 1 year	0.01	-	0.01
Bonds 1-2 years	0.44	0.46	-0.03
Bonds 2-3 years	0.23	0.31	-0.08
Bonds 3-4 years	0.54	0.58	-0.04
Bonds 4-5 years	0.53	0.49	0.05
Bonds 5-10 years	1.30	1.26	0.03
Bonds > 10 years	1.15	1.09	0.05
<b>Total</b>	<b>4.20</b>	<b>4.20</b>	<b>0.00</b>

Sorted from shortest to longest per the length of maturity.

<sup>3</sup>Effective Duration, excludes interest rate futures, bond futures and excess return from interest rate swaps.

<sup>4</sup>Average credit rating uses 'Index rating' which is an average of the vendors: S&P, Fitch, Moody's. The average fund and benchmark rating does not include securities rated NR or NA.

## Monthly Performance Commentary

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### Market Review

US treasury yield curve bull flattened in May, as yields declined by 1-10 bps for maturities greater than or equal to 1 year. The benchmark 10Y US treasury yields once hit their highest levels since 2011, breaching 3.1% on 17 May amid signs of US economic strength. However, subsequently, US treasuries rallied as demand for safe haven assets heightened with the Italian political turmoil. This sent the 10Y US treasury yield down to 2.86% at the end of the month. Separately, the Fed left policy rates on hold in May and reiterated their “symmetric” inflation target, suggesting that they could tolerate a modest inflation overshoot. Largely tracking the direction of the movements in US treasury yields, Hong Kong sovereign yield curve flattened, with the change in yields for maturities greater than or equal to 1 year ranging from -7 bps to 6 bps. Broadly tracking Hong Kong sovereign yields, HK dollar swap yield curve also flattened, as the change in yields for maturities greater than or equal to 1 year ranged from -9 bps to 10 bps.

### Economic Review

General US economic data remain broadly strong, with annual retail sales growth remaining on an upward trend. Meanwhile, the latest estimate of Q1 GDP at 2.2% quarter-on-quarter (qoq) annualised is roughly in line with 2017’s growth rate. The US May employment report showed that nonfarm payrolls came in slightly weaker than expected at 164K, while the unemployment rate dropped to an 18-year low of 3.9%. Overall PCE core inflation held at an annual rate of 1.8% year-on-year. Hong Kong’s 1Q18 GDP growth beat expectation at 4.7%ooya, as private consumption was the key contributor benefitting from the tightening labor market and elevated asset prices. Meanwhile, Hong Kong retail sales sustained double digit growth over a year earlier in April, amid strong local consumer spending and inbound tourism. The April retail sales grew by 12.3% and 11.1% in value terms and in volume terms respectively year-on-year. Separately, exports maintained a solid year-on-year growth in April, thanks to robust global demand. Exports to most major markets registered visible growth from a year earlier. Inflationary pressure remained largely moderate in April. The underlying inflation rate after netting out the effect of all government’s one-off relief measure declined to 2.2% year-on-year from 2.6% in March, due to the smaller increases in the charges for package tours and the prices of fresh vegetables. Headline CPI also eased to 1.9% year-on-year in April from 2.6% in March.

### Economic/Market Outlook

25bps hike in the June FOMC meeting remains a nailed on certainty, unless dramatic events intervene. With so much unanimity within the market over the June meeting, it seems unlikely that this hike itself will move the market- the accompanying statement and press conference will be watched much more closely though. The US treasury market now reflects a realistic profile for future interest rates, unlike in the last few years. In the short term, we expect US treasuries to trade range-bound with more near term volatility. We still believe that the US hiking cycle will be gradual and measured, and that treasury yields are not too far away from delivering value compared to the economic environment. Although US money rates rose with continued gradual increases in US Fed fund rates, ample liquidity has allowed Hong Kong’s money rates to stay low relative to the US. This has driven a widening differential between the US and Hong Kong money rates, which drove the HKD to its multi-decade lows. However, we believe that in the near term, Hong Kong money rates are likely to be subject to some upside pressure. The Hong Kong Monetary Authority’s aggregate balance has dropped to defend the HKD peg, since the weak-side Convertibility Undertaking (CU) was triggered for the first time in 13 years on 12 April 2018. The aggregate balance should further decline and lead to tighter monetary conditions, if there is further demand from banks to buy USD against HKD at 7.85. However, there are still several moving parts affecting HKD money market liquidity, which are worthwhile to pay attention to. These include the HKD-denominated asset market performance, the southbound flows via the Stock Connect, the prospect of IPOs and etc. In the medium to long term, if the peg is sustained (which is our base scenario), we expect the Hong Kong dollar bond curve to remain correlated with the US interest rates and hence, expect the Hong Kong dollar bond yields to follow similar movements in US treasury yields. As for the Hong Kong economy, the favorable job and income conditions and sustained growth in inbound tourism should continue to provide support for retail sales. Meanwhile, the sustained expansion of the global economy remains supportive to Hong Kong exports in the near term. However, uncertainty in the external trade environment amid trade negotiations between the US and other major economies, needs to be monitored closely. Separately, we continue to hold the belief that inflation pressure should remain moderate but may face some mild upside pressure in the near term, if the robust economic conditions continue.

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## Terms of Glossary

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**Convertible bond**, is a type of bond that the holder can convert into a specified number of shares of common stock in the issuing company or cash of equal value.

**Corporate bond**, is bond issued by a company in order to raise financing.

**Coupon**, the annual interest rate paid on a bond, expressed as a percentage of the face value.

**Credit quality**, one of the principal criteria for judging the investment quality of a bond or bond mutual fund.

**Developed markets**, countries that are most developed in terms of its economy and capital markets.

**Duration**, a measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates.

**Emerging markets (EM)**, nations' economies in the process of fast economic growth. Investments in emerging markets are generally considered to be with higher risk.

**Government bond or Gilt**, a loan to a national government in return for regular payments (known as the coupon) and a promise that the original investment (principal) is paid back at a specified date. Gilts are loans to the UK government.

**High yield bond**, is fixed income security with a low credit rating from a recognised credit rating agency. They are considered to be at higher risk of default, but have the potential for higher rewards.

**Information ratio**, is a ratio of portfolio returns above/under the returns of a benchmark to the volatility of those returns.

**Investment grade bond**, is considered investment grade or IG if its credit rating is BBB- or higher by Standard & Poor's or Baa3 or higher by Moody's.

**Maturity**, the period of time for which a financial instrument remains outstanding.

**Effective Duration**, is a duration value based on the probability of early redemption call by the bond issuer.

**Sharpe ratio**, a measure for calculating risk-adjusted return, and this ratio has become the industry standard for such calculations.

**Tracking error**, a measure of how closely a portfolio follows the index to which it is benchmarked.

**Volatility**, a measure of how much a fund's price goes up or down as a percentage of its average performance.

**Yield to maturity**, the total return anticipated on a bond if the bond is held until the end of its lifetime.

**Portfolio Yield**, the lowest potential yield that can be received on a bond without the issuer actually defaulting.

# ABF Hong Kong Bond Index Fund

Supplement Information Sheet

31 May 2018

	Base Currency	Distribution Frequency	Dividend ex-date	Dividend Amount	Annualised Yield (Distribution is not guaranteed and may be paid out of capital)
Fund	HKD	Semi-annually	30 Jan 2018	0.570000	1.17%
Fund	HKD	Semi-annually	28 Jul 2017	0.740000	1.49%

The above table cites the last dividend paid within the last 12 months only. Dividend is not guaranteed and may be paid out of capital, which will result in capital erosion and reduction in net asset value. A positive distribution yield does not imply a positive return. Past payout yields and payments do not represent future payout yields and payments. Historical payments may be comprised of both distributed income and capital.

The calculation method of annualised yield:  $(\text{dividend value} / \text{NAV per share or unit as of ex-dividend date}) \times n$ , n depends on the distributing frequency. Annually distribution is 1; semi-annually distribution is 2; quarterly distribution is 4; monthly distribution is 12. The annualised dividend yield is calculated based on the dividend distribution on the relevant date with dividend reinvested, and may be higher or lower than the actual annual dividend yield.