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- The Fund invests primarily in Indian equities.
- The Fund is subject to the concentration and emerging market risks of investing in a single emerging market.
- The Fund's investments may involve substantial market, currency, volatility, regulatory and political risks. Investors may suffer substantial loss of their investments in the Fund.
- The investment decision is yours but you should not invest unless the intermediary which sells you the Fund has advised you that the Fund is suitable for you and has explained why, including how investing in the Fund would be consistent with your investment objectives.
- Investors should not invest in the Fund solely based on the information provided in this document and should read the offering document of the Fund for details.

## One-on-One with Sanjiv Duggal

### HSBC Global Investment Funds - Indian Equity

30 April 2010

**Sanjiv Duggal, Investment Director, Equities**

Sanjiv joined HSBC in April 1996 and is responsible for the management of Indian equities. With over 15 years of investment experience, Sanjiv has been involved in running the flagship HSBC GIF Indian Equity Fund since April 1996. Prior to joining HSBC, Sanjiv worked for the Hill Samuel Group where he spent nearly five years, initially in internal audit and latterly as an Emerging Markets fund manager.

**Q: The stock market has continued to rise despite the recent interest rate hikes and high inflation concern. What is driving the market?**

A: The Indian market rose steadily and strongly in March (Sensex +6.7%) due to foreign liquidity inflow. More importantly, the market responded positively to the budget announcement at the end of February. The key reason was that the budget aims to reduce the government's fiscal deficit to 5.5% of GDP for the fiscal year ending March 2011 from 6.8% for 2010. This is in line with what we had been expecting, but not the market. In a Bloomberg interview last year, I had said that we expected India's fiscal deficit to fall. India's bid to reduce the fiscal deficit is a sharp contrast to the current concerns about worsening public finances and high government debt levels in various European countries and the US. As a result, we have seen about US\$4 billion in foreign investor inflows into India.

In March, Standard & Poor's Ratings Services upgraded India's debt-rating outlook from negative to stable, citing the nation's improving economy. We had anticipated the change but it is nonetheless a positive upgrade by the rating agency.

From a global perspective, positive economic data in both developed and emerging markets has also been a factor pushing up the Indian market.

**Q: Were the two interest rate hikes in as many months a surprise?**

A: India has raised interest rates twice so far this year, once in March and then again in April. It has also increased the bank reserve requirement ratio twice this year, first in January, then again in April.

The interest rate hike in March was a surprise, as the government had said that it would not raise interest rates before the quarterly monetary policy review meeting in April. Nonetheless, the market responded very well to the hike in March as it declined by only about 50 basis points on the day when it was announced.

The interest rate hike in April was broadly in line with our expectation. The Reserve Bank of India (RBI) is clearly worried on inflation and has said inflation is no longer only a supply side issue and that demand aggregates too have started to contribute to inflation. The policy stance is aimed at anchoring inflation expectations while managing liquidity to ensure demand for credit is not impacted. The policy also

aims to have an interest rate regime that is more consistent with price, output and financial stability. The RBI is expecting a baseline GDP growth of 8% with upside bias. RBI's WPI Inflation target for FY11 is 5.5% (31 March 2011 point target).

The RBI has continued with its measures to facilitate fund flows to infrastructure sectors by allowing banks to hold long-term bonds of infrastructure companies in the Hold-to-Maturity category. It has also allowed right to tolling or receiving annuity from a highway as a valid security for a secured loan from bank.

Going forward we expect the RBI to keep raising interest rates in a gradual manner, including out-of-policy changes. We expect another 100-125bps of rate hikes over the course of the fiscal year. Sectors that benefit are industrials and financials. Real estate rallied in the absence of any measures on the sector following the policy review meeting in April.

**Q: Will the monetary tightening have a significant impact on India's growth?**

A: We see the monetary tightening is more of a normalisation of policy conditions and interest rates following unprecedented measures last year to support the economy amid the global financial crisis. We do not think this will have a significant impact on growth.

If you look at the GDP growth forecast for the year FY2010, it is about 7.5%, FY2011 at about 8.5%, and FY2012 at even 9%. The trend of growth is still upwards and accelerating. This is why we don't think the normalisation of interest rates will have a significant impact on growth.

**Q: Can you talk briefly about the expected oil sector reform and what likely impact it would have?**

A: Debate surrounding the proposed reform of the oil sector has been ongoing for a number of years. As such, it is difficult to make a meaningful assessment until the reform has been finalised.

But regarding the likely reform, basically the government is looking to link up domestic gasoline and diesel prices with international prices within a particular band. This should help reduce government subsidies to the oil and gas companies in India, as well as the public-sector companies. This should reduce the pressure on government finances. Should the reform happen, it would be positive for the market.

**Q: What were the major portfolio changes in March and what was the rationale for the changes?**

A: Overall, we continue to favour domestic-focused sectors against global sectors, in line with the strong growth we have seen in India and the rising trend, notwithstanding the monetary policy normalisation that I mentioned earlier. We continue to favour domestic cyclicals and sectors that can benefit from the growth stories in India, including consumer discretionary and industrials. We also prefer real estate and some of the domestic defensive sectors. We are looking to add in the consumer staples and utilities sectors.

On the contrary, we are less inclined to invest in global cyclicals, and materials in particular, where we are bringing down the overweight and moving to a neutral position in metals. We prefer domestic sectors to global sectors as we have more confidence in India's growth outlook over the short to medium term compared to the global growth outlook.

In terms of the fund, one-year performance to the end of March is still very strong, due to the positioning during the market rally. However, the performance is slightly disappointing over the past three months, mainly due to the fund's holdings in consumer discretionary. The fund's key holding, Indian automaker Maruti Suzuki, which accounts for about 7% of the portfolio, has not performed well against the market, costing the fund about 100 basis points of performance, which is also the single biggest drag on performance. Still, Maruti remained strong and better than expected over the quarter, despite rising competition, which we see in all the sectors in India. In terms of valuation, we think it is extremely cheap, which is unusual in India, with the adjusted one-year forward PE at about 11-11.5x. Results will come out later this month and it should surprise positively.

The other factor for the underperformance of Maruti is that the stock has reached its foreign investor limit, meaning foreign investors can no longer buy the stock freely from the market. Going back to the first point about the US\$4 billion in foreign investor inflows, that money cannot buy Maruti. Investors can only buy from another foreign investor, resulting in the stock's lackluster performance, but we continue to add to that position.

Another sector that hurt performance is real estate, which was a big underperformer in March. Our holdings like Unitech in particular and Indiabull Real Estate did not perform well. We see significant value in these stocks, and again we are different from the consensus view. As a result, we have been adding to our positions in real estate, and in Unitech in particular. However, real estate cost the fund another 100 basis points of performance.

But up to about 15 April, the fund has closed the gap and it is only about 11 basis points below the benchmark's performance. April has been a good month for the fund so far.

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