



HSBC Private Bank 

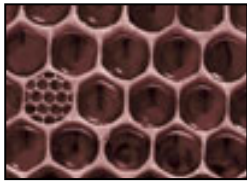
***The role of hedge funds for pension sponsors***

***Brunei, 8<sup>th</sup> March 2006***

## Asian institutions playing catch up



Hedge Funds, “the third asset class”



Options for Plan Sponsors



Trends in today's markets



## Hedge Funds, the third asset class



## What are alternative investments?

- Assets other than equities, bonds and cash including
  - Real Estate
  - Private Equity
  - Antiques
  - Art
  - Wine
  - **Hedge Funds**

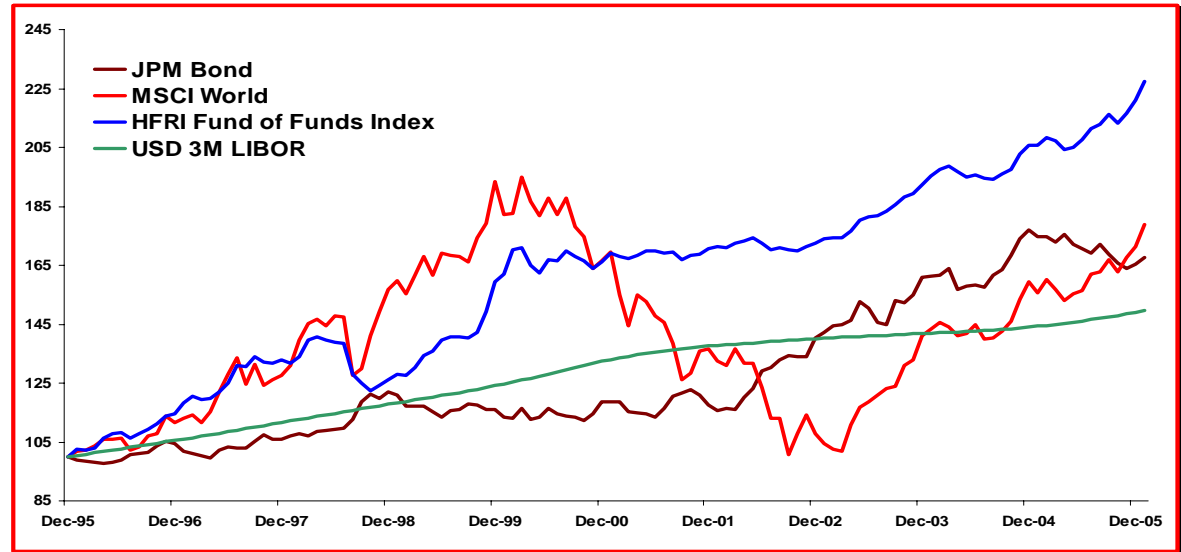


# Why invest in hedge funds?

## Historical performance

HFR Fund of Funds Index versus traditional markets

- Long term performance in line with global equities
- Lower volatility than bonds
- Limited correlation as compared to bonds and equities



### Key Statistics

	HFRI Fund of Funds Composite Index	MSCI World Index (Gross in USD)	JP Morgan Global Government Bond Index	3 Month USD-LIBOR
Annualized Returns	8.27%	4.07%	5.52%	4.04%
Volatility	6.05%	14.49%	6.50%	0.54%

### Correlations

	HFRI Fund of Funds Composite Index	MSCI World Index (Gross in USD)	JP Morgan Global Government Bond Index	3 Month USD-LIBOR
HFRI Fund of Funds Composite Index	1.00	0.59	-0.08	0.10
MSCI World Index (Gross in USD)	0.59	1.00	-0.23	0.01
JP Morgan Global Government Bond Index	-0.08	-0.23	1.00	0.09
US\$ 3 month LIBOR	0.10	0.01	0.09	1.00

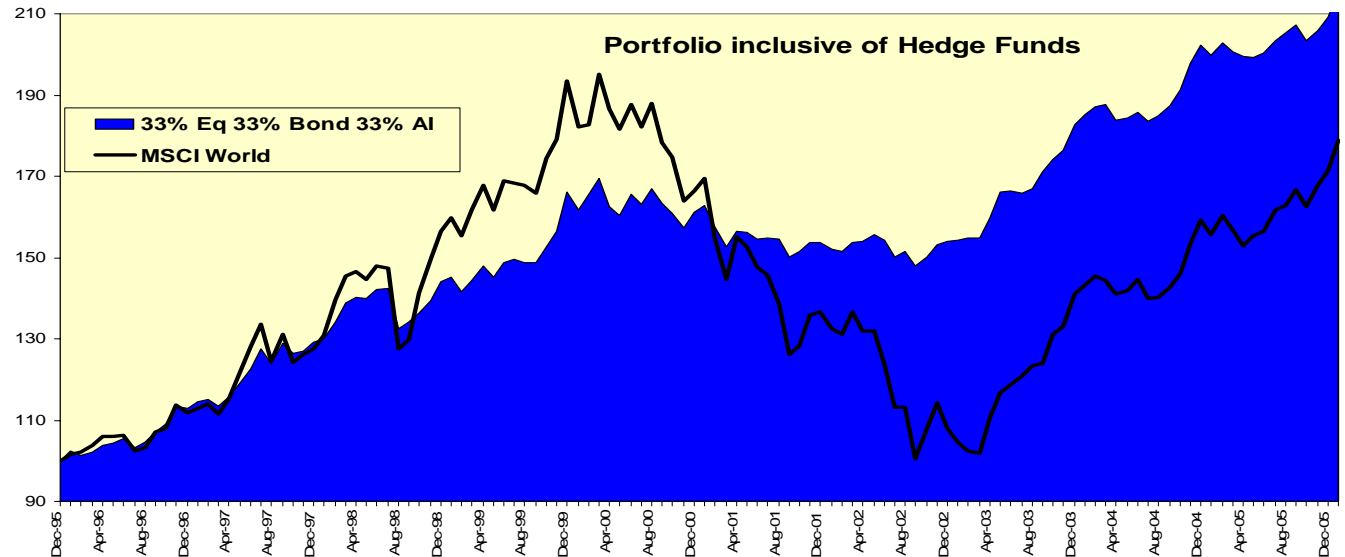
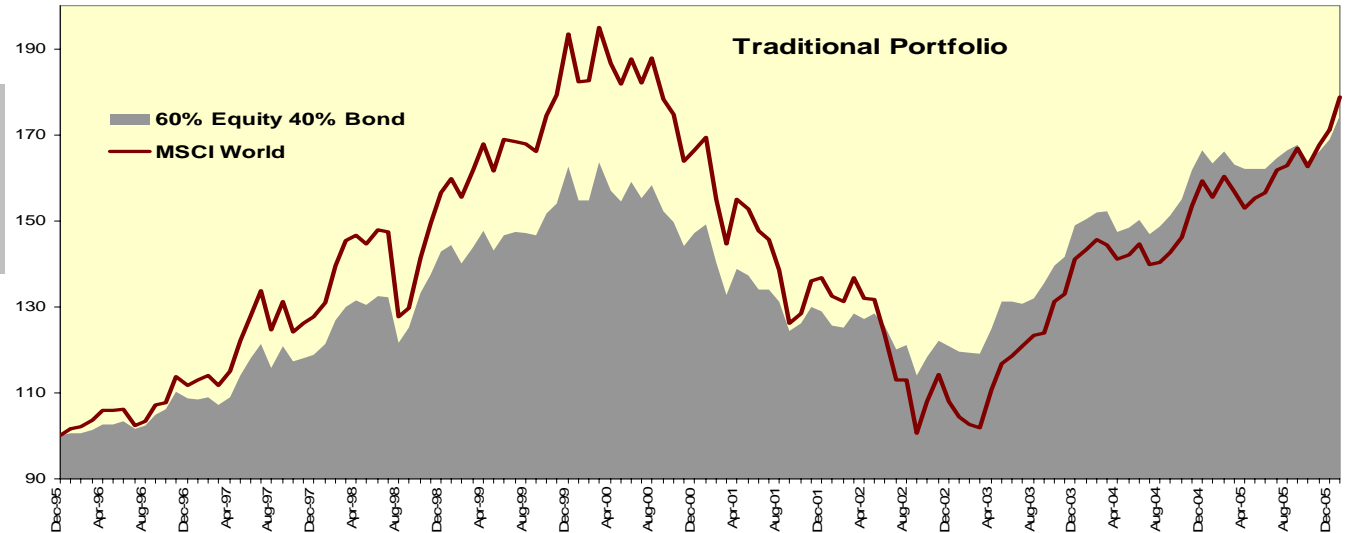
Source: HSBC Private Bank, Bloomberg  
 Data period from 31 Dec 1995 to 31 Jan 2006  
 Past performance is no indication of future performance



## Improved portfolio returns

### Hedge funds offer market independent returns

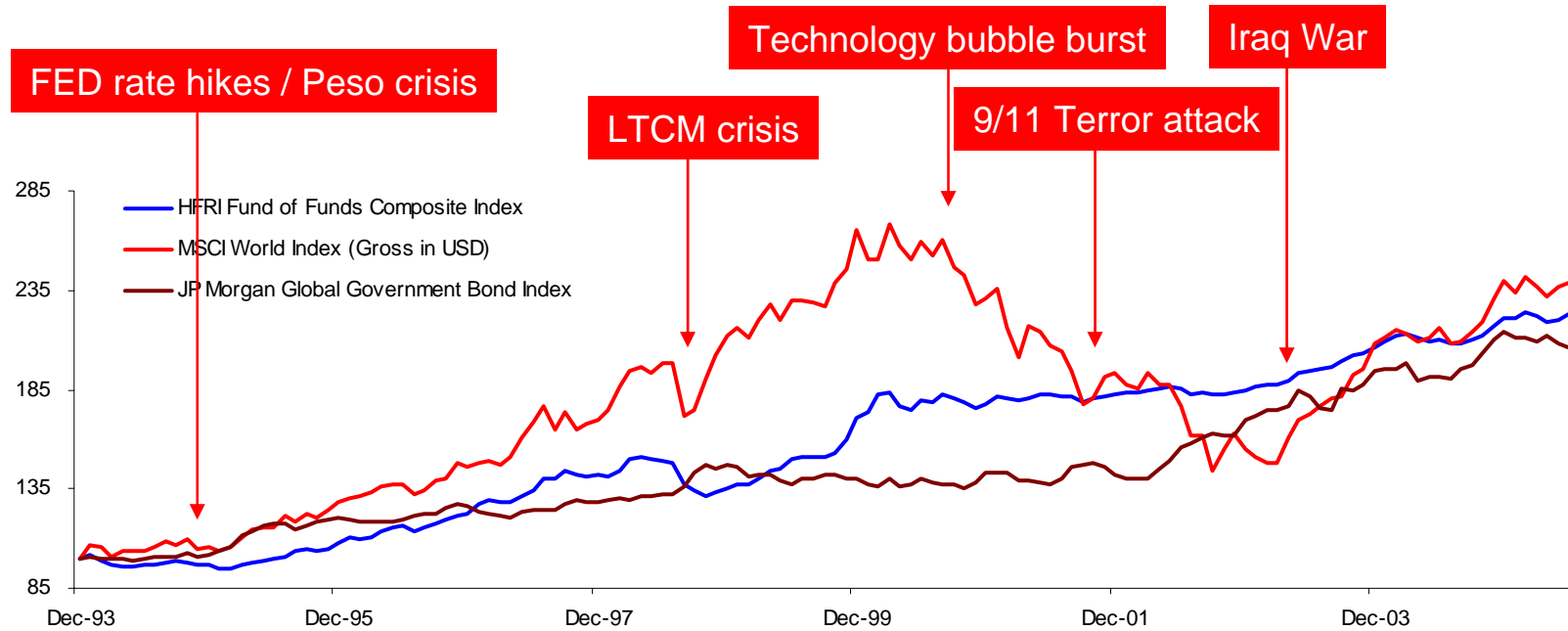
- When added to an existing portfolio of stocks and bonds, hedge funds may reduce risk while maintaining or improving returns



Source: HSBC Private Bank  
Data period from Jan 1996 – Jan 2006  
Equities are represented by the MSCI World Index,  
Bonds are represented by the JP Morgan Global  
Government Bond Index and hedge funds are  
represented by the CSFB Tremont Hedge Fund Index



# Performance of HFRI Index during major market declines

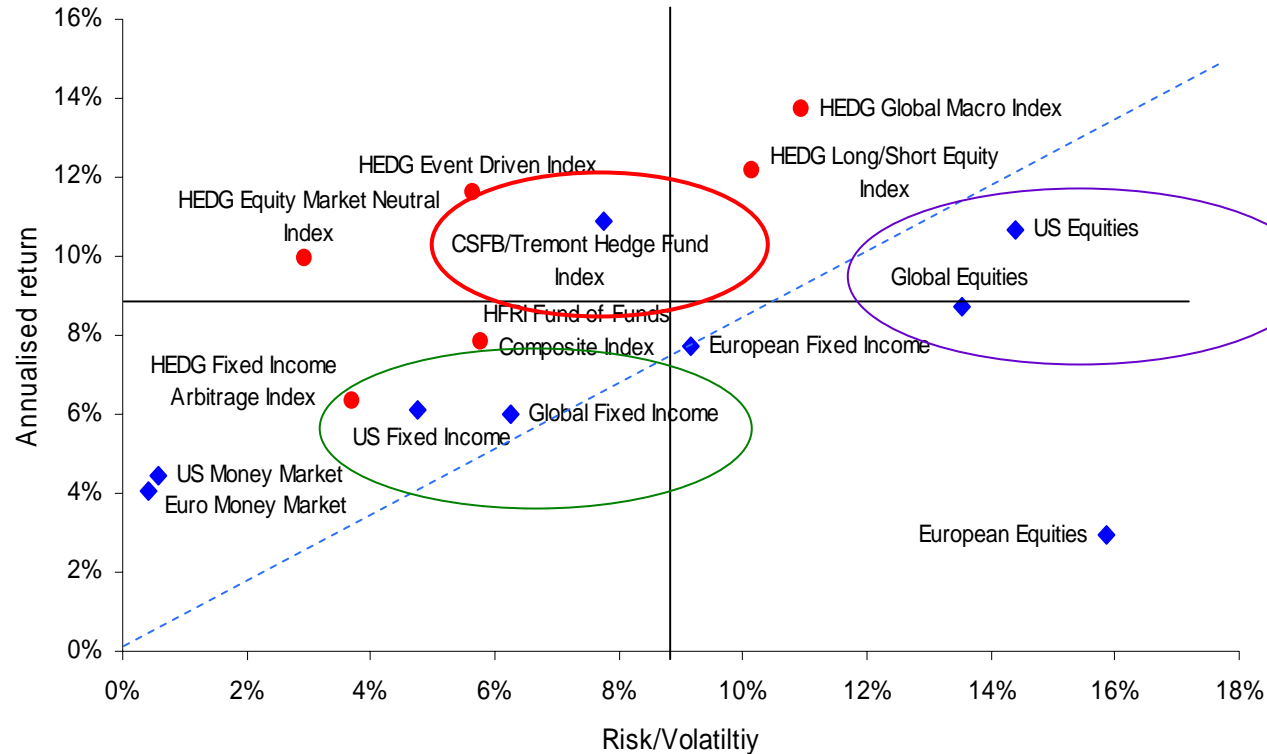


Event	Period	HFRI FoF	Event	Period	HFRI FoF
Fed raised rates	February-December 1994	-5.59%	Technology bubble-burst	July-August 2000	-3.67%
Mexican Peso crisis	December 1994	-3.75%	"9/11" terror attack	September 2001	-1.89%
Collapse of LTCM	July-August 1998	-13.08%	The Iraq War	March 2003	-0.03%

Source: HRIL  
 Data period from 31 Dec 1993 to 30 June 2005  
 Past performance is no indication of future performance



# Risk and return profile of equity, fixed income and cash markets vs various hedge strategies



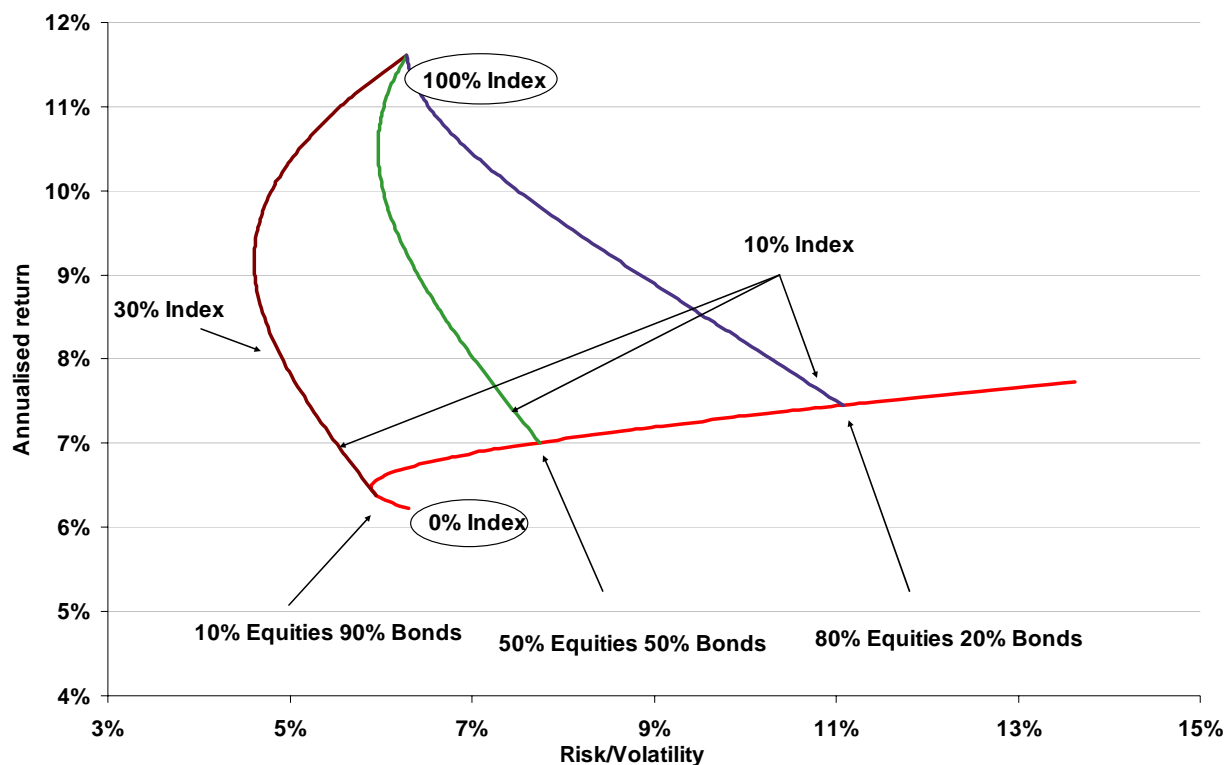
Data: 1 January 1994 to 31 January 2006

Sources: HRIL, Bloomberg





## How much in Hedge Funds?



**63% Bonds**  
**7% Equities**  
**30% Hedge Fund composite**

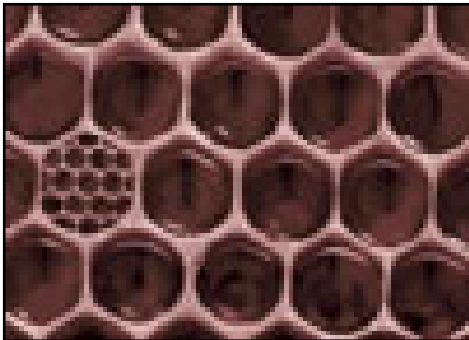
Diversified Alternative Composite (DAC) is made up of HEDG Indices in the following proportions:

40% Long/Short, 20% Event Driven, 15% Global Macro, 10% Market Neutral, 10% Convertible Arbitrage and 5% Fixed Income.

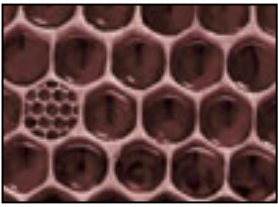
MSCI World Index (Gross in USD) for Equity and JP Morgan Global Government Bond Index in USD for Bonds.

Data from 1 January 1994 to 31 January 2006

Sources: HRIL, Bloomberg

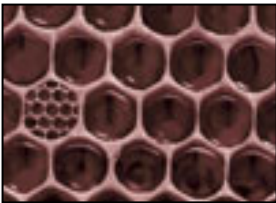


## Options for Plan Sponsors



## What options are open to institutional investors ?

- Structured Products
- Index linked investments
- Fund of Funds
- Managed Accounts



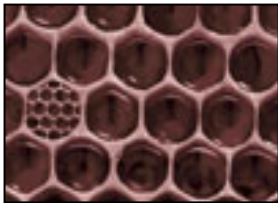
# Structured Products

## Positives

- Wide range of choice
  - Capital Guarantee
  - Income producing
- Varying structures
  - Option based
  - CPPI
  - Options on CPPI
- Easy place to start

## Negatives

- Interest rate risk
- Long lifespan
- Expensive



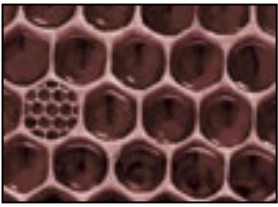
## Index linked funds

### Positives

- Transparent
- Liquid
- Lower fees
- No requirement for individual manager due diligence

### Negatives

- Does the index meet your objectives ?
- Difference in methodology
  - HFR 1400 funds
  - MSCI 431 funds
- Investibility
- Survivorship bias
- Performance



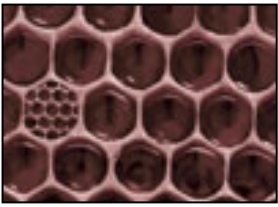
## Fund of Funds

### Positives

- Active management tends to produce index out performance
- Low entry levels
- Optimal access to managers
- Professional due diligence and monitoring

### Negatives

- Fees
- Liquidity
- Crowded market



# Managed Account

## Positives

- Diversification
- Specific mandate
- Lower costs
- Dedicated resource
  - Portfolio manager
  - Tailored reporting
- Technology Exchange

## Negative

- Higher minimums



Trends in today's market





## Evolving trends today

**Rise in Pension fund investors**

**Increase in “Hybrid” funds**

**The alpha squeeze**

**Capacity constraints**

**Divergence of performance**

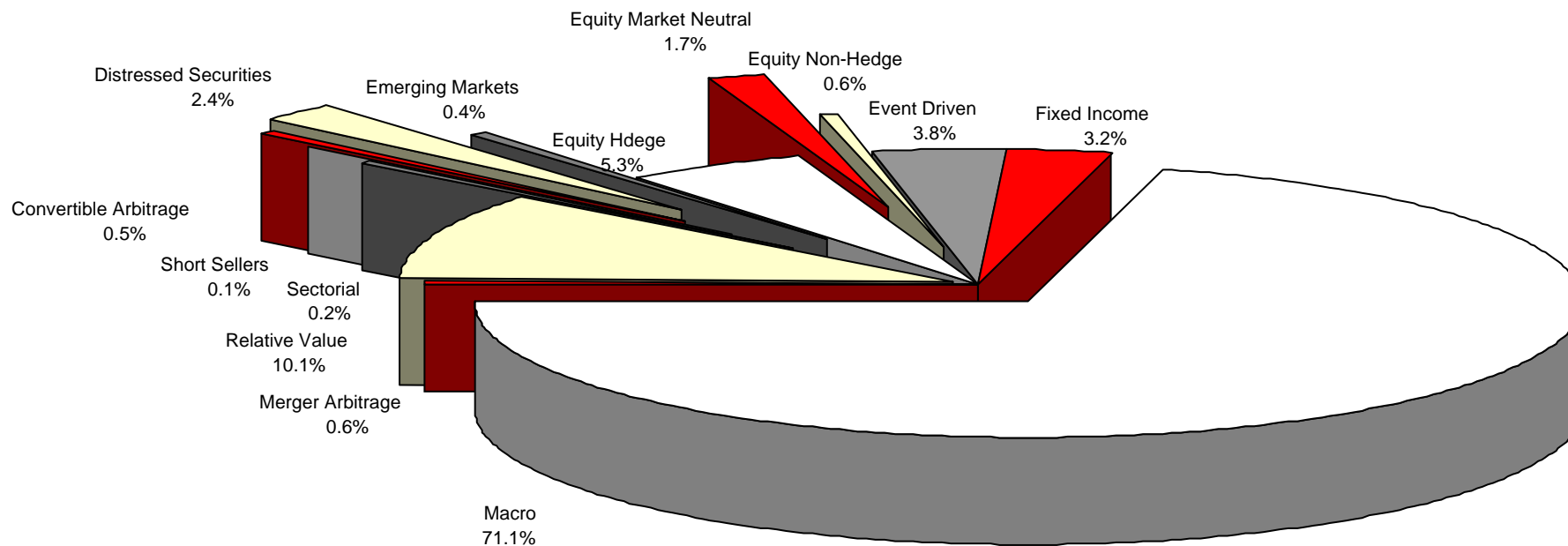
**More regulatory controls**

- The last 12 months has since the launch of 12 Hybrid funds managed by hedge fund groups investing long only on an absolute return basis
- The combination of passive index funds and portable alpha funds are squeezing traditional active managers
- Performance numbers have fallen below 10 year averages
- Increasing role of Private Equity funds in mergers
- Increase in share holder activists



## Hedge fund strategies - Change over time (1990)

### Strategy Composition (Assets) - 1990

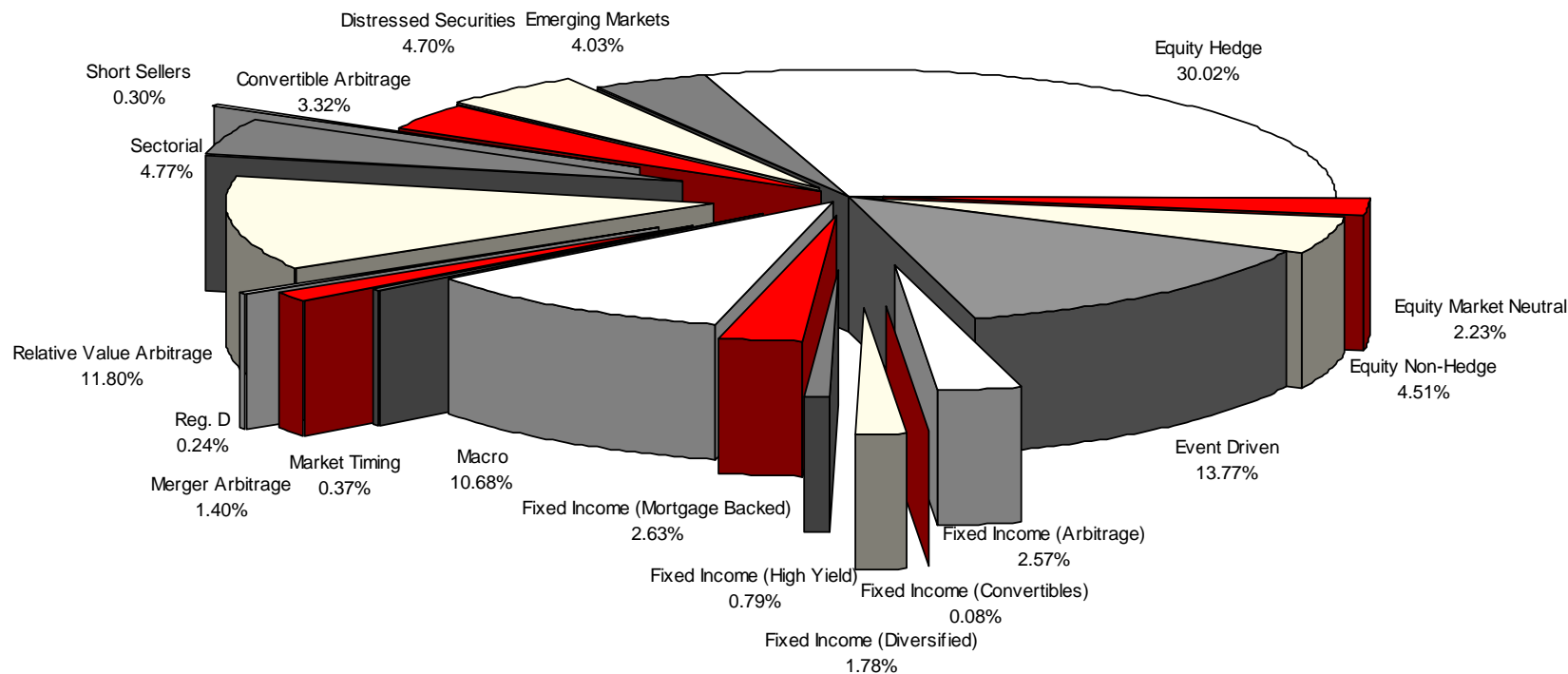


Sources: Hedge Fund Research, HRIL



# Hedge fund strategies - Change over time (Q4 2005)

## Strategy composition (Assets) - Q4 2005



Source: Hedge Fund Research



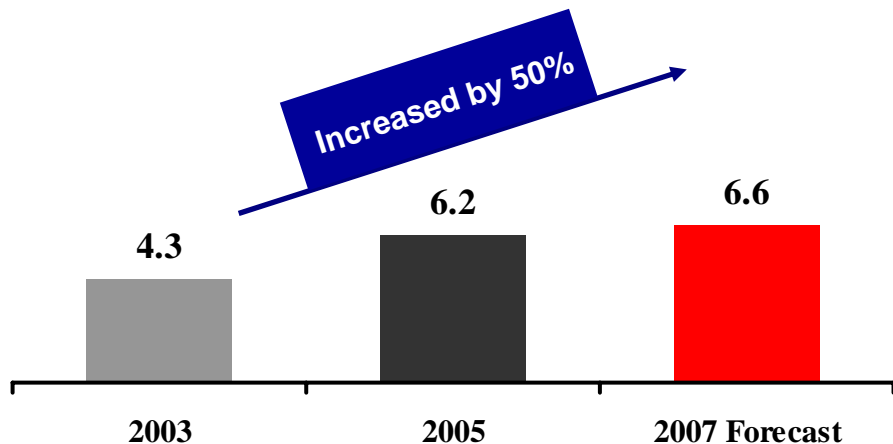
GLOBAL LEADERS IN MULTI-MANAGER INVESTING

## *2005 – 2006 Russell Survey on Alternative Investing:*

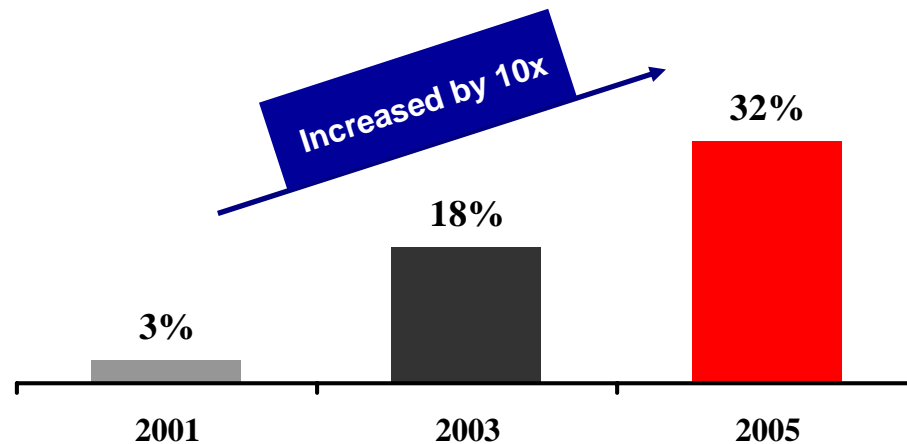
- **Growth** – clearly, alternatives are poised for rapid growth, expected to reach record levels by 2007
- **Hedge funds will dominate** – continue to garner the greatest share of increased commitments among alternatives
- **Smaller markets will invest heavily** – smaller capital markets have significantly increased their investment in alternatives compared to more mature markets, a trend that is expected to continue



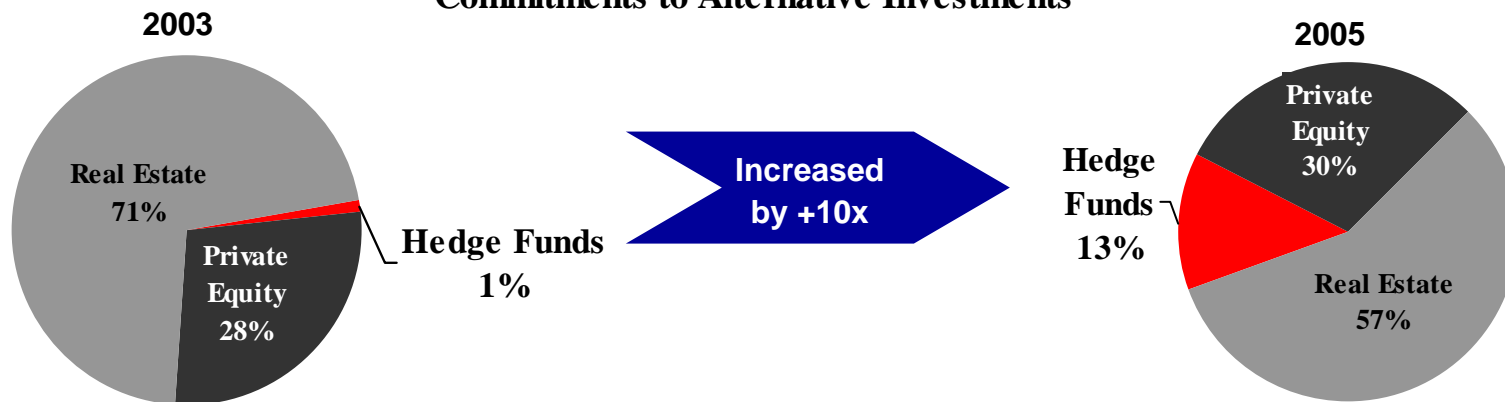
Strategic Allocations to Hedge Funds  
(% of Total Assets)



% of Respondents utilizing Hedge Funds

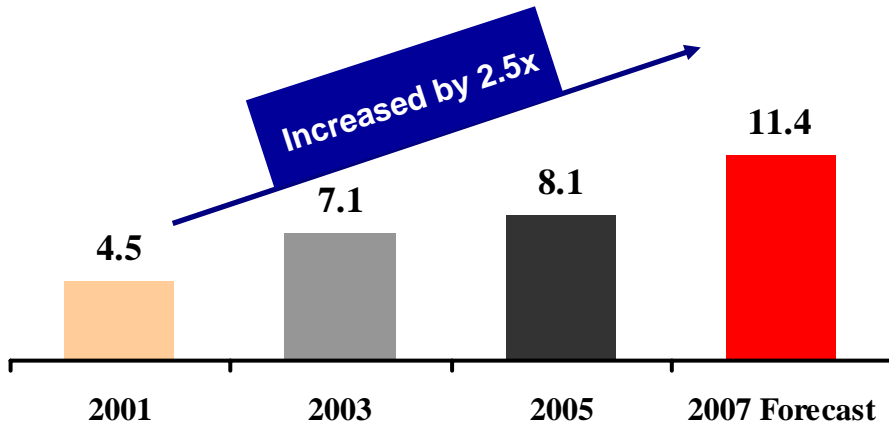


Commitments to Alternative Investments

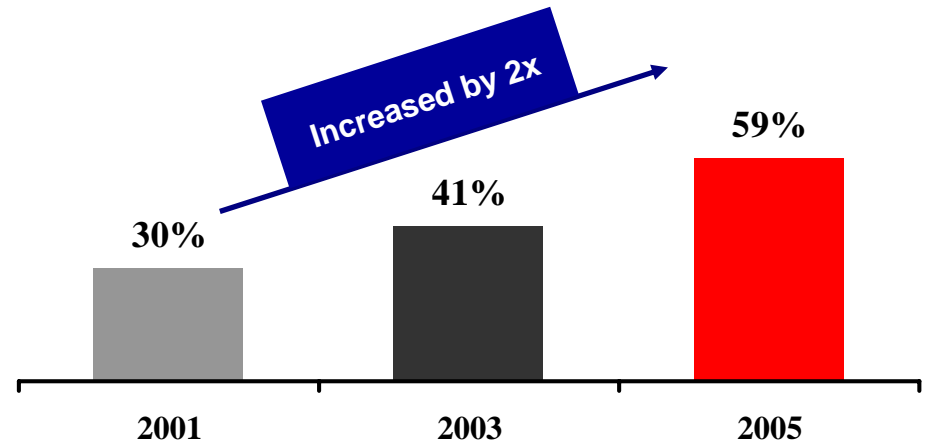




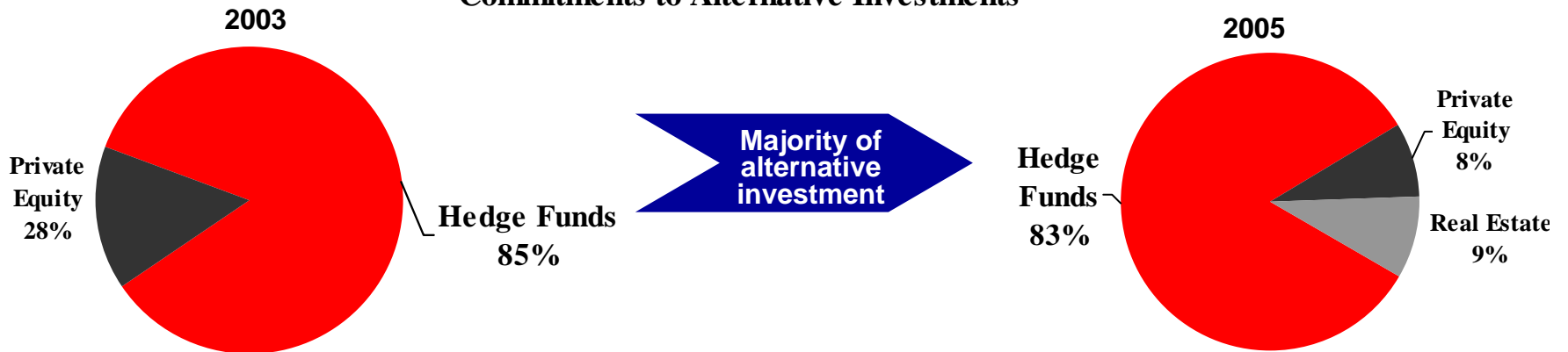
Strategic Allocations to Hedge Funds  
(% of Total Assets)



% of Respondents utilizing Hedge Funds



Commitments to Alternative Investments\*



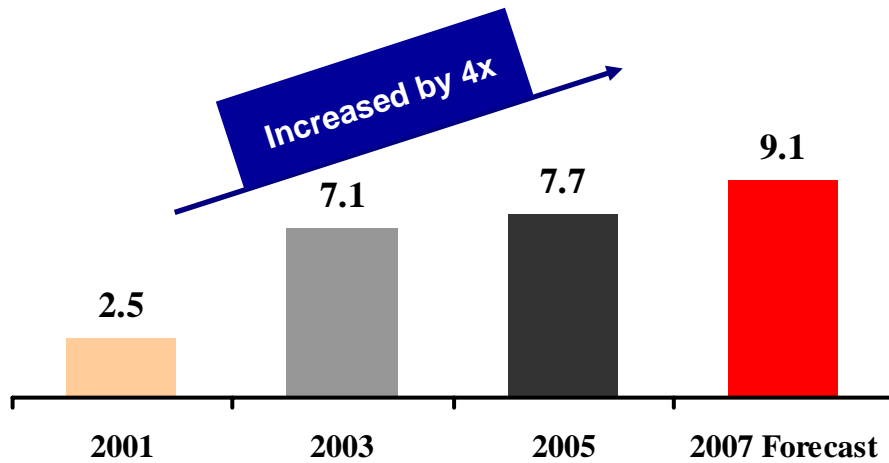
Source: The 2005-2006 Russell Survey on Alternative Investing  
Total of 327 large organizations respondents

\*Real Estate allocations were not included in 2003 survey for Japan

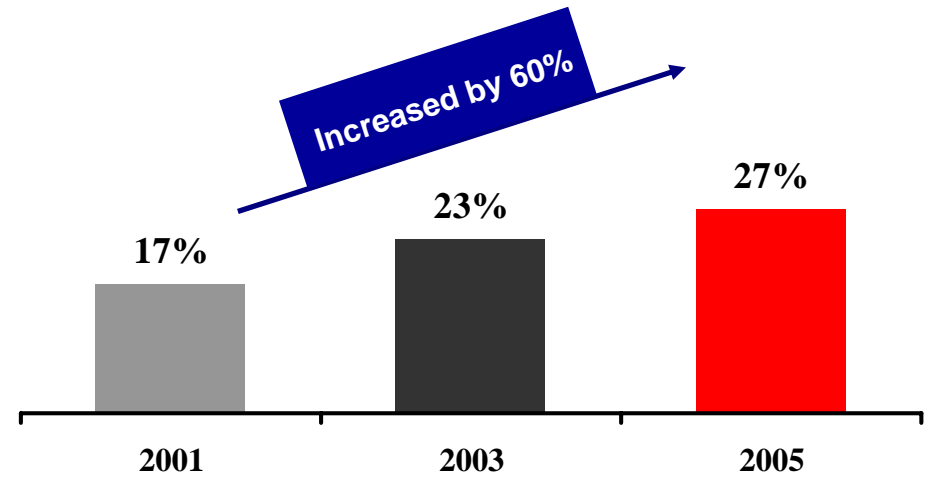


# North America

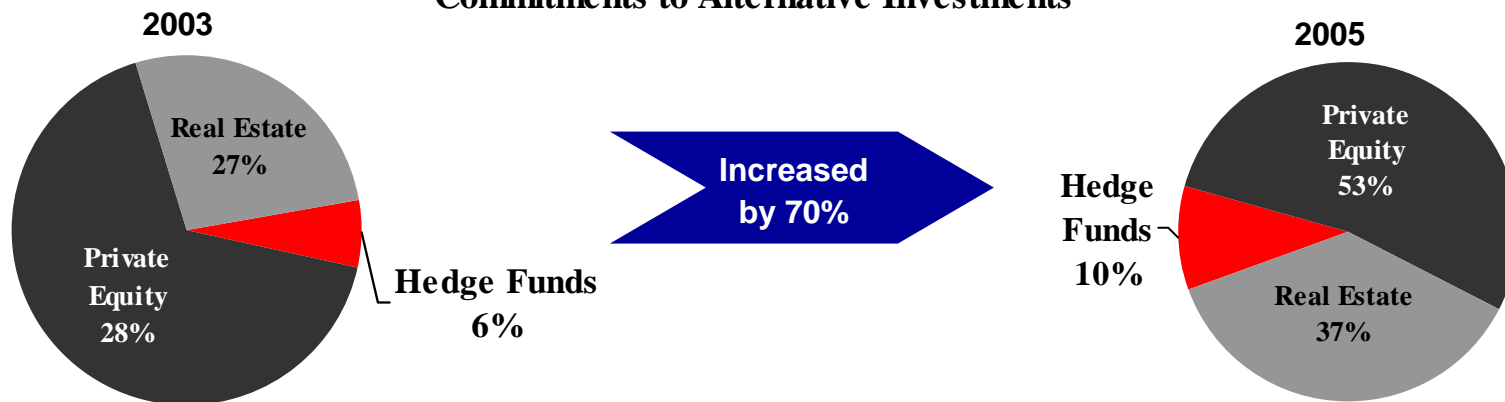
### Strategic Allocations to Hedge Funds (% of Total Assets)



### % of Respondents utilizing Hedge Funds

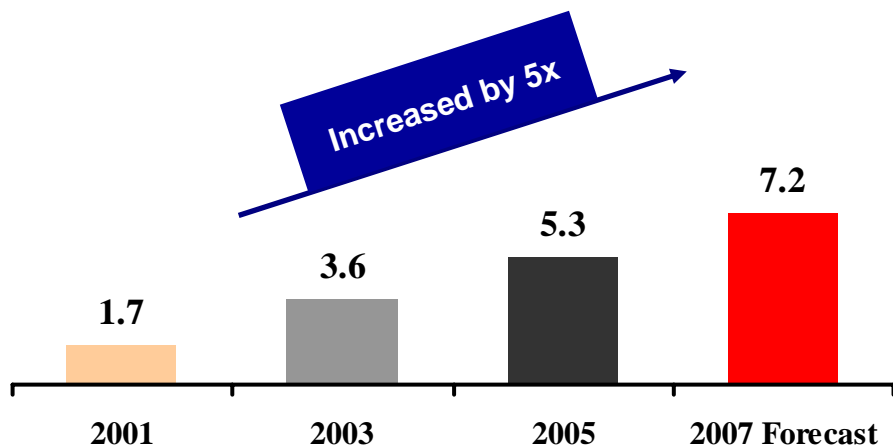


### Commitments to Alternative Investments

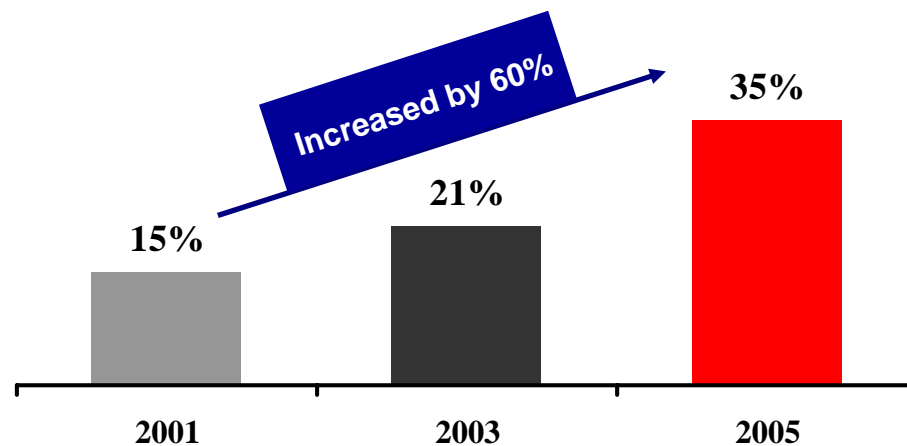




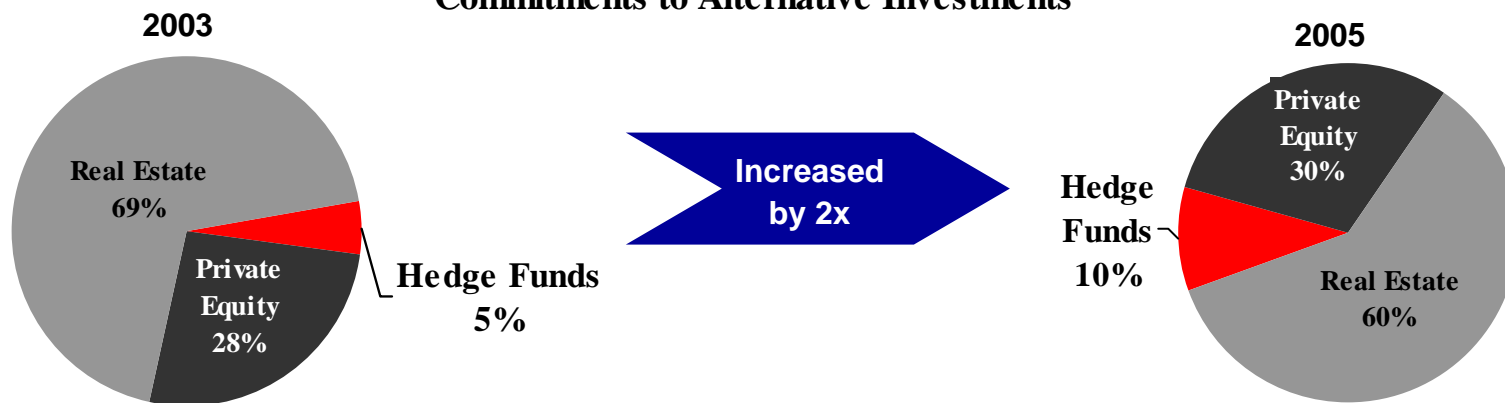
Strategic Allocations to Hedge Funds  
(% of Total Assets)



% of Respondents utilizing Hedge Funds



Commitments to Alternative Investments





## Hard times for hedge funds?

### FORTUNE

- Hedge funds are estimated to represent only 2% by assets compared to US mutual funds
- Rapid growth in the number of funds offered
- Investors disappointed by poor returns in recent bear market
- Stock exchange concerns over perceived heavy impact of hedge-fund trading on some stocks
- SEC scrutinising the sector

**“Hard Times Come to Hedge Funds”. 1970.**



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