



Summary

Emerging markets exposure across asset classes is increasingly being used in private and institutional client portfolios because these countries are set to be the engine of future global growth. HSBC, the World's Local Bank, is uniquely positioned to offer its clients products and services focused on emerging market countries. Recent developments in financial markets have shown the importance of transparency and liquidity in investment products. HSBC Optimised GEM Index has been designed to capture the performance of the biggest companies from the largest emerging markets.

Global Emerging Markets (GEM)

Since the mid 1990s, economic growth in global emerging markets has gathered speed. The most recent champions of this growth so far have been the BRIC countries – Brazil, Russia, India and China, and, prior to that, the Asian Tigers of Taiwan, Singapore, Hong Kong and South Korea. Their growth can be asserted for the most part to recent industrialisation. With industrialisation comes urbanisation (an average of 42 families a day move to Mumbai¹), and consequently with urbanisation come degrees of commercialism and materialism.

The upside potential of investing in global emerging markets is well recognised. Emerging markets have seen record growth, narrowing fiscal deficits, shrinking debt burdens, growing current account surpluses and in the top countries growing foreign exchange reserves. Emerging economies are experiencing significantly higher growth rates compared with developed countries (Table 1).

Governments of developed nations are encouraging industry to focus more on outward investments in emerging economies². Multinational companies such as Vodafone, the world's largest mobile phone operator by sales, have targeted emerging markets in their business models and in some cases it is paying off; as stated in Vodafone's interim management statement for the quarter ended 31 December 2007, the company's organic service revenue growth, excluding India and Turkey (where they have made recent acquisitions), grew 13.7% in the EMAPA region. The recent acquisitions in India and Turkey delivered strong year-on-year total revenue growth of 56% and 26% respectively³.

Table 1

Country	Expected Growth for 2008 (% change from year ago)	Expected Industrial Production (% change from year ago)
China	10.1	17.4
India	7.7	5.3
Russia	6.7	6.5
Taiwan	4.6	10.7
South Korea	4.6	10.8
Brazil	4.5	6.7
South Africa	5.1	4.4
Mexico	2.8	0.8
Poland	5.2	6.2
Czech Republic	4.8	6.7
USA	1.8	1.5

Source: The Economist, 26 January 2008

The economic growth that drives the growth in real earnings per share in turn drives share prices. There are several key drivers for the emerging markets. China is the world's largest manufacturer, with abundant labour resources and large FX reserves. India is prospering from outsourcing, IT, pharmaceuticals and the domestic rise of the consumer class. Taiwan and South Korea are being driven by high tech manufacturing. Brazil, Russia and South Africa are rich in natural resources. Brazil has large amounts of iron ore, and is the largest supplier of soft commodities. Russia has 22% of the world's gas reserves. South Africa is the world's largest producer of platinum, gold, and chromium. Mexico benefits from the North American Free Trade Agreement as well as foreign exchange remittances. Poland, the Czech Republic, Hungary and Romania are all converging towards Western Europe. Overall there is rapid industrialisation, an expanding middle class, economic reforms, infrastructure development. ... However, there is still a long way to go. HSBC, as the "World's Local Bank," understands emerging markets and has access and distribution capacities across the globe. HSBC Research has a medium-term positive outlook for emerging market equities⁴.

The HSBC Global Markets business area ("HSBC GM") has created the Optimised GEM Index from the largest emerging economic regions. The largest and most liquid, tradable securities have been picked to capture high diversification across geography and industries covered. HSBC GM has come up with a unique methodology which is rules based, but dynamic in ways to capture future trends in growth and development of the selected economies.

What is the Evidence of Global Emerging Markets Growth?

Global Emerging Markets, as their name suggests, are growing. The main theme of the World Bank Global Economic Outlook for 2008⁵ is the economic growth of the developing world and its increasing importance to the world economy. For 2007, developing countries' GDP growth was at an estimated rate of 7.4% compared to a world GDP growth rate of 3.6% and high-income countries' GDP growth of 2.6%. See also Table 1.

Table 2

Country	Annualised Return	Annualised Volatility
HSBC Optimised GEM Price Return Index	21.81%	21.42%
HSBC Optimised GEM Total Return Index	23.79%	21.42%
iShares MSCI Emerging Markets Index	18.38%	26.49%
MSCI World Index	5.14%	11.28%
S&P 500 Index	2.65%	13.80%
CSI 300 Index (China)	21.00%	33.20%
MICEX Index (Russia)	21.91%	31.21%
Bovespa Index (Brazil)	21.77%	26.97%
NSE S&P CNX Nifty Index (India)	21.32%	26.74%
KOSPI Index (South Korea)	13.99%	21.15%
Mexico Bolsa Index	25.68%	20.03%
FTSE/JSE Africa Top 40 Index (South Africa)	21.52%	20.66%
TAIEX Index (Taiwan)	2.00%	20.54%
ISE National 100 Index (Turkey)	20.57%	28.39%

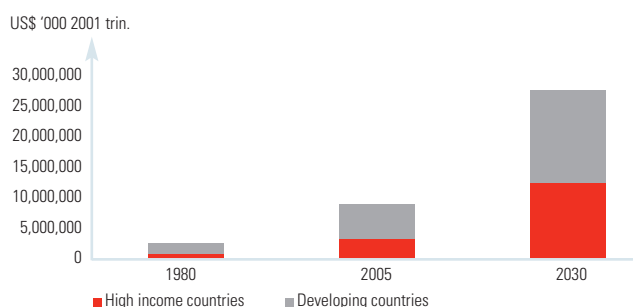
calculated for the period 30/01/04 to 20/08/08, Source: HSBC

The trend looks set to continue, with economic growth in emerging markets continuing to outperform that in developed countries. The World Bank sees developing countries' GDP growing 7.1% and 7.0% in 2008 and 2009 respectively, compared to world GDP increasing 3.3% and 3.6%, and developed countries' GDP increasing 2.2% and 2.6% in 2008 and 2009.

In an increasingly global, more integrated economy the long-term trend for convergence is evident. Developing country exports grew from 22% of global exports in 1980 to 32% in 2005. The World Bank, using simulations with Linkage models, foresees developing world exports making up a total of 45% of total worldwide exports.

While the income gap between developed and developing countries is still very large, with wider access to information and technology-laden capital and imports, developing countries have the ability, and increasingly more apparent motivation, to narrow this gap. This convergence should continue over the long term, based on knowledge and capital dispersal continuing⁶. With increasing incomes developing nations will further invest in education, research and development, which should establish a virtuous cycle of further technological progress resulting in increased per capita incomes.

Exports from developing and developed countries



Source: Bloomberg

Manufacturing output and productivity is growing in the emerging markets. Historically emerging economies have been export orientated, but this is slowly changing. New middle classes are emerging in developing countries, notably, China and India. Increased consumer spending and manufacturing is now thriving on domestic demand (exports make up only 18% of India's GDP)⁷. Despite the sub-prime crisis in the global financial markets, the emerging economies have been the least affected. In fact, throughout 2007, several economists have repeatedly had to raise their forecasts for regional real GDP. In 2007, China's economic performance exceeded even optimistic expectations; real GDP ran above 11% for the second consecutive year⁸.

Emerging banks are also expected to perform well in coming years, following an upsurge in both corporate and consumer lending; companies need funds for expansion and consumers are spending more.

As a result of robust growth and the soaring energy and commodity prices, the balance sheets of emerging economies look very sound. Inflation and deficits are broadly under control. The business climate is more constructive for investment.

Why an HSBC Optimised GEM Index?

The case for investing in Global Emerging Markets is clear from the points highlighted above.

In addition to natural resources such as oil and gas (Russia), metals, mining and agriculture (Brazil, South Africa) emerging economies are driven by cheap labour (China, India) and high quality and increasingly high tech manufacturing (Taiwan, South Korea, China) and information technology (India). The close link of some countries (Mexico to the US through NAFTA and New Europe to Europe through the EU) provides additional stimulus for growth. The fact that each economy is different in terms of its relative position on the development ladder and each has its unique drivers for economic growth means that the combination of these diversified regions should provide a more balanced exposure to emerging market risk.

To the extent that the success of individual companies depends, among other things, on availability of capital, local knowledge, human resources, economies of scale, the largest companies in emerging markets are often the best positioned.

The combination of the largest and most liquid stocks selected from geographically diversified countries, constructed in a way to capture future relative developments makes this index unique.

The importance of creating liquid, transparent, risk/return optimized reference indices is clear in the context of the current turmoil in financial markets caused by the sub-prime market and cannot be over stated.

Index Description

The HSBC Optimised GEM Index ("Index") is a market capitalisation weighted price return index comprising maximum 50 stocks. The Index gives exposure to nine countries and to New Europe. These include the BRIC (Brazil, Russia, India and China) countries, Mexico, South Korea, Taiwan, South Africa, Turkey and New Europe (Poland, Czech Republic, Hungary and Romania). New Europe has been included as one block due to its close association with Europe.

HSBC GM has established the methodology for selecting the stocks within the Index, as well as the weighting assigned to each.

The criteria that stocks must meet for inclusion into this Index are as follows:

- i) Each stock must be open to foreign investment.
- ii) Each stock must normally have a minimum Average Daily Traded Value of USD 2 million over a three-month period at each Semi-annual Review Date (however, this may be lowered under certain circumstances). When companies are newly listed on the relevant stock exchange (or relevant exchange where American Depository Receipts (ADRs) or Global Depository Receipts (GDRs) are used in their place), and 3-month data is not available, the Average Daily Traded Value over the period since trading began is used provided that at least four weeks of price and volume data is available.
- iii) Other than ordinary shares listed on the relevant exchanges for each market/region, ADRs, GDRs and equivalent issuances are also permitted.
- iv) The Index is re-balanced every six months and re-weighted every year based on changes in the market capitalisation of the regions covered. In order to ensure and maintain maximum regional diversification, the initial weights can change by maximum 20% from the initial weight distribution for each region. In the event of one or more market/region weightings being in excess of 20% of their weighting as at the Creation Date, market/region weightings are fixed at the maximum change (increase or decrease) with the excess weight pro-rated amongst remaining markets/regions. The review procedures for constituent distribution (above) are then applied.

The following companies are excluded:

- Companies with below 10% free float.
- Companies in whose shares HSBC GM is prohibited from dealing and which have been notified to the Calculation Agent by HSBC Global Banking and Markets Compliance.
- Companies where Foreign Ownership Limits (including regulation or market access as it applies to HSBC) prevent ownership.

Index Constituents which become ineligible between Semi-annual Reviews are replaced with the eligible non-constituent with the highest market capitalisation. Results of actions affecting the Index will be published on the HSBC Global Banking and Markets website for indices, www.hsbcinvestorsolutions.com.

Companies have to operate in the following regions:

- Brazil
- Mexico
- New Europe
- Russia
- South Korea
- Turkey
- India
- Taiwan
- China
- South Africa

Company Selection

- i) Companies must have a minimum Average Daily Traded Value over a three-month period of USD 2,000,000.
- ii) The maximum number of constituents in the index is 50 and the minimum is 30.
- iii) At the Creation Date of the Index and on each Review Date, the weights and number of constituents allocated to each market/region shall be those as shown in the table in the section entitled Initial Index Composition.
- iv) If there are fewer eligible companies than the numbers shown in the table in any market/region then the number available is used.
- v) If the total number of companies is consequently lower than 30 then the liquidity criterion is lowered by USD 100,000 progressively until at least 30 companies are eligible.
- vi) If during the above process a market/region is not represented then its weight is distributed pro-rata amongst remaining markets/regions and its constituents are re-distributed into one market/region at a time starting with the remaining market/region with the most constituents and repeating from the start if necessary until all the excluded market's/region's allocation has been reallocated.

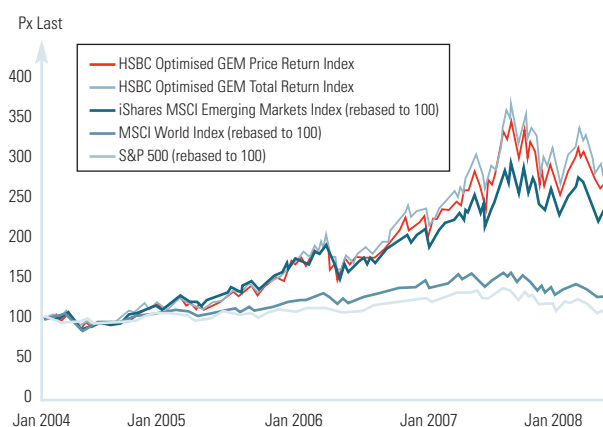
- vii) In the event of two markets/regions having the same number of constituents, preference is given to the market/region with the highest market capitalisation.
- viii) Although the largest stocks by full market capitalisation in each market/region are selected for the Index, the maximum number of Financial Stocks is limited to 40% of the number of constituents for the market/region (rounded down). Further, if Financial Stocks represent more than 30% of the constituents in any market/region then such Financial Stocks are equally weighted with a total weight of 30% of the weight of the market/region whilst non-Financial Stocks are equally weighted with a total weight of 70% of the weight of the market/region.

Each index series' base date is 31 January 2008, with an initial value of 100. Historic index values are provided from 31 January 2004.

The Index is calculated independently by HSBC Research's Quantitative Techniques (QT) business in Edinburgh. QT is a division of HSBC and an independent Calculation Agent which provides data and calculates indices for parts of HSBC Group, including to the Global Research Department and to organisations outside of HSBC. HSBC GM reviews its indices policies and coverage before each review date. Whilst, it is not envisaged that the Rules will change, any modification to the Rules will be published by QT on Bloomberg ({{HSIP <GO>}}, with 1-month notice period prior to the proposed change. This review process is internal to HSBC GM.

What does the Index capture?

Historical Theoretical Performance (USD Version)



Sources: Bloomberg, backtesting by HSBC Quantitative Techniques.

As can be seen from the table below, the energy sector is the largest. This can be understood, as the whole population has demand for energy and every other sector is dependent upon it. With economic growth the demand for energy is only going to increase.

In all countries the soundness of the Financial Sector is a key to economic growth. This is particularly true in emerging markets where capital is often a scarce commodity. Looking at this from a different perspective, through exposure to the Financial Sector, particularly in emerging markets, investors can obtain diversified exposure to the whole economy. The degree to which banks in each country lend to sector players depends on their importance to the economy. The largest financial institutions also have access to the cheapest credit as they can borrow only at home, but can tap international markets.

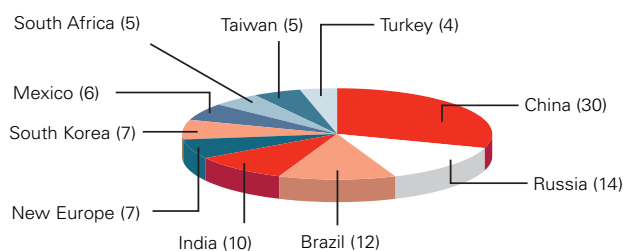
Whilst the demand for telecommunication can be seen across countries, India uniquely has developed its information technology sector.

The 50 stocks represented in the HSBC Optimised GEM Index represent companies with a total market capitalisation of USD 3,502,065,120,000 as of March 17, 2008. The smallest company had a market capitalisation of USD 7.017 bn.

Initial Index Composition

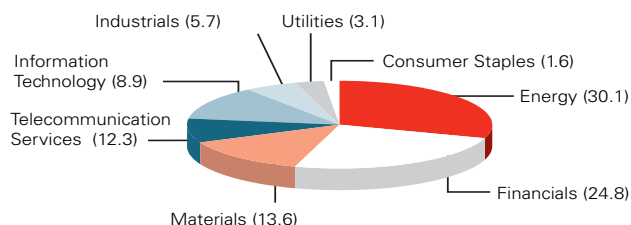
The initial weight of each region has been fixed following extensive analysis. China, by far the largest economy with the largest companies, comprises 30% of the Index weight, followed by Russia with 14%, Brazil with 12% and India with 10%.

Market/Region Distribution (by Total Index Weight)



GICS (Global Industry Classification Standard)

Sector Distribution (by Total Index Weight)



Indices at HSBC

About HSBC Optimised Indices

HSBC Optimised Indices have been promoted by HSBC GM to provide reference underlying indices for creating structured products which either track the index performance or provide pay-offs linked to the specified index. These indices have been optimised to take into account the unique characteristics of each underlying theme or strategy and the availability of the universe of companies which best captures this. The number of eligible constituents varies in each case in accordance with the objectives for each index. The aim of HSBC GM is to provide liquid, transparent, tradable instruments which can act as robust references for a variety of investment products.

HSBC combines its expertise in indices with its knowledge both of local markets and investment products in its provision of HSBC Optimised Indices.

About HSBC Indices

HSBC, through the HSBC Global Research department, started publishing indices in 1993 with the launch of the HSBC (formerly James Capel) Smaller European Companies Indices. Other Indices followed, such as HSBC Dragon 300 (June 1996), HSBC Latin America 100 (May 1994), and HSBC Subcontinent of India (February 1996). HSBC has remained focused on smaller companies indices, emerging markets indices, and custom indices. HSBC calculates a total of 5,471 indices covering 69 countries and territories worldwide.

The HSBC Indices are maintained and distributed by HSBC Quantitative Techniques (QT). QT is part of HSBC's Global Research business, which in turn is part of HSBC's Global Banking and Markets division. QT provides advisory services, indices and data products to customers on a commercial basis. QT is both structurally and physically separated from other parts of HSBC and hence provides an independent service to users of the HSBC Indices and its other customers.

Investors should be aware that the HSBC Optimised GEM Index is constituted by HSBC GM and is not an independent research index operated by the Global Research Department.

The HSBC Global Markets Indices are a distinct series of indices from the range offered by HSBC Global Research, of which the Calculation is a part. HSBC Global Research operates as a separate business within HSBC from HSBC Global Markets.

Contacts

For general information about the HSBC Optimised GEM Index and other HSBC Global Markets Indices please contact your local HSBC GM representative or contact HSBC Global Markets Third Party Structured Products Development on +44 (0)20 7992 6002, email structured.investments@hsbcib.com.

For more information concerning these Ground Rules and the calculation of the HSBC Global Markets Indices please contact the calculation agent, QT, on + 44 8455 847360 or email qt-inquiries@hsbcib.com.

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¹ <http://timesofindia.indiatimes.com/articleshow/45424416.cms>

² <http://www.emids.uktradeinvest.gov.uk/news/default.asp?nwSC=&viewArticle=657>

³ Vodafone news release, 31 January 2008 http://www.vodafone.com/etc/medialib/attachments/interim_statement.Par.75585.File.dat/KPIs_Jan_2008-%20FINAL.pdf

⁴ HSBC: The Year Ahead: CEMEA, 3 December 2007

⁵ The World Bank Global Economic Prospects 2008: Technology Diffusion in the Developing World, p. 22

⁶ The World Bank Global Economic Prospects 2008: Technology Diffusion in the Developing World, p. 44

⁷ The Analyst: Look to India as the New Powerhouse, The Independent,

2 February 2008, <http://www.independent.co.uk/money/invest-save/the-analyst-look-to-india-as-the-new-powerhouse-777050.html>

⁸ HSBC: The View: Asia's Bond Markets, December 2007/January 2008, p.40