HSBC PREMIER

Global Investment
Perspective

January 2010

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Global equity markets capped off a roller-coaster year with the Morgan Stanley Capital International (MSCI) World Index gaining 1.7% in December and 30.8% on the year. These gains largely reflected the ongoing sings that a recovery in economic activity was underway in both developed and emerging economies.

In the first quarter of 2009, volatility and risk aversion saw investors dump risky assets on a massive scale. As some banks sought to repair their bruised balance sheets, lending and other credit market activity slowed dramatically, which dampened economic activity. However, after the extreme events in the first quarter, global equity, credit, commodity and currency markets bounced back. Throughout the second and third quarters of the year, government and central bank support was a key driver of positive economic news. Fiscal and monetary stimulus came in the form of low taxes, lower interest rates, infrastructure spending, the government's purchase of "toxic" assets and quantitative easing – a process where central banks purchase financial assets from banks to increase the money supply and encourage lending.

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Risks and volatility to persist in 2010

The growing possibility of a withdrawal of government support measures will be a key concern in 2010. And equity valuations have moved significantly above the bargain levels of the first quarter of 2009, which means investors have less of a cushion against negative surprises.

Corporate bond valuations are less appealing given outstanding performance in 2009. But they are still attractive relative to the very low yields on government bonds.

Regional and sector opportunities

Within developed market equities, we favour defensive sectors like health care. At a regional level within emerging markets, we see potential in Latin America because of valuations and the scope for positive economic surprises. The region should also benefit from higher commodity prices as Asian demand grows. Within fixed income, we have held a positive view on corporate bonds for some time, both in investment grade and high-yield debt.

Market

US

Growth and earnings optimism calls for caution given blurred economic outlook

The growth outlook continues to improve in the US, but the sustainability of the rebound remains uncertain, as unemployment remains high, consumption subdued and government indebtedness at worrying levels. The outlook for corporate earnings remains positive, but it should be noted that challenges still lie ahead in meeting analysts' optimistic estimates.

Given the optimistic expectations for both economic and corporate growth, we maintain a moderately cautions view on equities for the US and elsewhere relative to cash.

Europe

Overly optimistic growth expectations with risk of a correction

A return to positive GDP growth for the Eurozone in the third quarter was good news from an economic perspective. However, the improvement was slightly below consensus and key headwinds remain, such as high unemployment and potential reductions in government support. Meanwhile, in the UK, GDP figures remain disappointing. Valuations reflect a somewhat overly optimistic level of economic and earnings growth for 2010. We recommend a moderately cautions stance on European equities and maintain our moderate underweight against cash.

Japan

Risks from weak consumer demand and high unemployment remain elevated

Japanese stocks lagged most other developed markets in 2009. Japan's economic outlook remains encouraging overall, but with deteriorating public finances and a deflationary environment, the risks from weak consumer demand and high unemployment are still of concern. We recommend a moderately cautions view on Japanese equities against cash and expect Japanese equities to perform in line with other developed equity markets.

Emerging Markets

Concerns over recovery and withdrawal of government support add to risk

The macroeconomic outlook for emerging market economies continues to be strong overall. But the risk of authorities reducing the level of economic support is increasing, weighing on the sustainability of the pace of recovery. Valuations are also not at bargain levels anymore. We maintain our moderately cautions view on emerging market equities in general relative to cash, and we expect them to perform in line with their developed peers.

Asia ex Japan

Positive news appears priced in; Risk of negative surprise increased

Asia ex - Japan markets rose by 4.4% in December, led by South Korea and Taiwan, which rallied 8.5% and 7.9%, respectively, during the month. The outlook for Asia – ex Japan is generally positive, with consensus 2010 GDP growth forecast at 7.7%. Valuations have returned to levels consistent with the first half of 2007 and we believe market prices are largely reflecting the positive news. We maintain a moderately underweight allocation to Asia ex – Japan equities versus cash, as we believe the risk for negative surprises has risen.

Canada

Gains across the board in 2009, but jobs data needs to improve

All 10 sub sectors of the S&P/TSX Index finished 2009 in positive territory. Financials, energy and materials all jumped by more than a third. Financials benefited from investor interest in Canada's highly regarded financial sector. Energy and materials stocks were driven higher by strong demand from rebounding economies in the developing world. Looking into 2010, we remain cautiously optimistic on Canadian equities, primarily because ongoing strength in emerging markets will likely benefit Canada's resource-heavy economy. However, jobs data will have to show sustained improvement for the economy to recover fully.

Mayor market indices
Returns to December 31, 2009

Index	Dec.	Year-to-date
S&P 500	1,9%	26,5%
S&P/TSX	2,9%	35,1%
MSCI EAFE	1,5%	32,5%
MSCI Europe	1,5%	36,8%
MSCI Pacific ex-Japan	2,2%	73,0%
MSCI Japan	0,8%	6,4%
MSCI Emerging Markets	4,0%	79,0%

Source: TD Newcrest
All returns are calculated in US$ except for the S&P/TSX Composite Index, which is calculated in C$.

Currency

US Dollar (USD)

Neutral stance given lack of fundamentals to justify gains

In December, the dollar reversed its recent negative trend against mayor currencies and rallied on the improving US economy. Whether the dollar's strength is sustainable will depend on whether the global economy enters into a double-dip recession. If it does, the dollar would benefit from its "safe haven" status. Our central view is that a double-dip recession will be avoided.

Euro (EUR)

Despite recent dip the euro still looks solid long term

We continue to relieve the European Central Bank will err on the side of caution and delay raising interest rates because inflation is low and the recovery remains fragile given weak consumer consumption. With negative factors for the pound, like the deteriorating UK public sector finances, the euro is likely to continue to be more attractive over the long term.

UK Sterling

Worsening public sector finances keep pound out of favour

Fourth quarter 2009 GDP growth suggests a possible return to growth, but the consumer sector remains weak. There is probably no immediate downside threat to the UK's sovereign rating but the general election and the new government policy measures to address government debt will be critical. The pound is likely to suffer against other mayor

Japanese Yen (JPY)

Retain neutral position because fundamentals remain nuclear

The yen was weaker in December. Japan's finance minister said appropriate action would be taken to counter yen appreciation. This could make the yen less attractive. However, Japan's current account surplus results in a favourable comparison with other currencies backed by economies running deficits. The net impact of these factors is uncertain and we retain our neutral recommendation.

Canadian Dollar

Oil prices support loonie versus US dollar

Spiking oil prices helped the loonie give less ground to the US dollar than most f its counterparts. The Canadian dollar remains primarily tied to the fortunes of Canada's commodity-heavy stock market. The loonie has a chance to break par with the US dollar, but we see fair value at closer to 90 cents US. More volatility is likely in 2010.

Currencies at a glance
At December 31, 2009

Currency	US$ exchange rate	1-month change in US$ terms
Canadian dollar	1,05	1,0 %
Euro	0,70	6,1 %
UK pound	0,62	3,2 %
Japanese yen	93,11	7,5 %

Source : Bank of Canada

Commodity

Oil

Subdued demand and varying risk appetite likely mean prices will be rangebound

The price of oil increased by 2.7% in December to US$79.36 per barrel, because of record cold weather and political tension in Iran. On the whole, although supply and demand fundamentals are slowly improving, there continues to be evidence of weak demand and excess supply. We maintain our US$60-$80 target range for oil. If the dollar weakens it could push oil prices higher as producers demand more dollars per barrel to compensate for the dollar's lower value.

Sources: Barclays Capital, Bloomberg, HSBC Global Asset Management and Thomson Reuters Datastream

(December 2009)

Interest Rate / Fixed Income

US

Corporate debt still preferred over treasuries

US government bonds posted losses of 2.6% during December. We don’t expect any increase in US interest rates for the first half of 2010, and possibly for longer. We believe that the US Federal Reserve will likely err on the side of caution and wait for more sustainable signs of growth, like improved jobs data, before raising rates. Given the low yields offered by government bonds, we prefer corporate debt over Treasuries.

Eurozone

Still prefer corporate debt on valuation grounds

Eurozone government bond prices fell in December on concerns over the credit ratios reassessments of Greece and other smaller Eurozone nations. There are also oversupply concerns based on how many bonds governments are issuing to fund deficits. The asset class slipped 0.6% on the month. We retain our preference for corporate bonds because they offer good value.

Canada

Corporate bonds still more attractive than government bonds

Us dollar-denominated sovereign emerging market debt posted a positive return of 0.1% during December. From a valuation perspective, sovereign emerging market debt continues to look less attractive than developed market corporate bonds, both investment grade and high yield. Overall, we believe there is better value in high-yield corporate debt than US-dollar-denominated emerging market debt.

Emerging Markets

Valuations still less attractive than developed market corporate bonds

US dollar- denominated sovereign emerging market debt posted a positive return of 0.1% during December. From a valuation perspective, sovereign emerging market debt continues to look less attractive than developed market corporate bonds, both investment grade and high yield. Overall, we believe there is better value in high-yield corporate debt than US-dollar-denominated emerging market debt.

Investment Grade

Underlying conditions and attractive yields still supportive

Investment grade corporate bonds slipped 0.6% during December. Meanwhile, demand is expected to remain robust, as investors search for yield in what will remain a low interest rate environment in 2010. We retain our positive view on the asset class, although we emphasize that liquidity risk remains a potential issue.

High Yield

Liquidity, risk appetite and demand remain supportive

High yield corporate bonds posted further gains in December, returning 3%. This represents the tenth straight month of gains for the asset class, bringing the year-to-date returns to an impressive 60.5%. But investors should not expect a repeat of these extremely strong gains in 2010. Heading into 2010, we reiterate our positive view on the asset class, although we stress that liquidity risks remain.
