



“The U.S. is in for a long, hard slog as it comes to terms with its debt load and addresses the excesses of past years.”



Trends to watch in 2011

We've entered a world that is increasingly being shaped by policy makers and not financial markets.

The global economic recovery remains fragile and equity market volatility continues as we head into 2011, leaving many investors feeling uncertain. In this interview, Stephen King, Chief Economist at HSBC, highlights the key factors at play and sheds some light on the road ahead.

Has the U.S. emerged from recession or is a “double dip” still possible?

Neither, actually. It's not a question of the U.S. either bounding ahead or falling back. The U.S. is in for a long, hard slog as it comes to terms with its

debt load and addresses the excesses of past years.

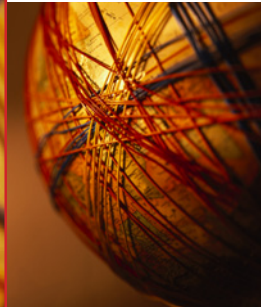
Traditional government policy levers, such as interest rate cuts, fiscal stimulus, and quantitative easing, have been less effective than they have in the past for three main reasons: too much debt; deleveraging, with both companies and households working to pay down their debt; and massive government borrowing at low long-term rates. At the same time, inflation is low and growth in money supply is weak.

All these factors are combining and the result is stagnation. Still, had government policies not been initiated, things could have been far worse.

It's very different from the typical recession-recovery scenario. In the 1970s and '80s, we saw deep recessions followed by very buoyant recoveries. In the '90s and earlier this decade, we saw modest recessions and modest recoveries. What we're seeing now in the U.S. is an extremely deep recession and the recovery is extremely shallow.

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“The emerging markets — led by China — are the primary drivers of global growth as they catch up with the developed world.”

How has the European debt crisis affected the global economy and how will this play out in the months ahead?

As the debt crisis in Greece spread to other EU economies (Ireland, Portugal, Spain, and others) in 2010, it pushed the euro down to unusually low levels. The U.S. dollar rose as a result, hampering the U.S. recovery just as it was getting under way.

Within the Eurozone, the result was uncertainty, extending from policy makers right down to the household level, with consumers spending less and focusing instead on saving and paying down their own debt.

Some analysts see deflation as a pressing concern, while others warn against inflation. What is your view?

We’re seeing a split in the world as a whole, with inflation in some regions and deflation in others. Nations that are encumbered by debt — primarily

the western world and Japan — are facing deflationary risk. The emerging markets, on the other hand, are seeing inflationary trends.

What regions do you see driving growth in 2011?

The emerging markets — led by China — are the primary drivers of global growth as they catch up with the developed world. Without much debt, emerging nations have been able to benefit from global stimulus. Capital inflows are likely to continue to these regions, where labour is cheap.

It’s also important to note that trade between emerging nations is increasing — and increasing in importance. Whereas, in the past, trade might have been primarily between emerging markets and the U.S. or Europe, we’re seeing more emerging markets trading with one another, whether it’s China with Brazil or the Middle East with India.

What sectors do you expect to outperform?

Based on emerging-market growth, commodities should continue to do well. This has the effect of redistributing global income to countries that are net commodity producers (which include many emerging regions such as Latin America) from countries that are net commodity consumers. In the developed world, Canada, Australia, and New Zealand stand to benefit as well.

Gold is also likely to perform well. As governments issue currency to promote economic growth, paper money loses value. Gold, of course, is the one currency that cannot be printed.



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A message from Rick Kelln

In a year marked by tentative economic progress at home, HSBC InvestDirect took decisive steps to enhance your experience and better equip you to take advantage of the best investments the world has to offer.

First and foremost, we worked to improve site performance to consistently deliver the stability of service you demand, and our efforts were recognized with a top-three rating for performance and stability as measured by an industry-recognized web-solutions company specializing in this area.

In addition, we have expanded our service offering to include:

- ▶ Access to the opportunities available on the Hong Kong Stock Exchange for a flat commission of just HK\$288, and for within 24 “ticks” of the last traded price.
- ▶ A refreshed public website that makes it easier than ever before to learn about how we can help you succeed.
- ▶ The ability to make even more informed investment decisions by being able to view your accounts in real-time – including cash balances, positions, equity and same-day North American trade executions – with our new Real-Time Holdings feature. (To view your account in real-time go to ‘Holdings’ > ‘As of today’.)
- ▶ The flexibility of trading earlier or later. With before and after hours trading you now have the power to respond to and take advantage of market changes outside regular market hours.
- ▶ An expanded GIC offering and *FundWatch*, a list of funds our mutual fund experts consider likely to deliver relatively strong and consistent results over the long term.

For more information on any of these new services and features, feel free to call one of our Investment Representatives at 1-800-760-1180.

Finally, thank you for the privilege of being your online broker of choice, and thanks to all of you who took the time to complete our annual client survey. Your feedback allows us to assess how well we’re meeting your expectations and what needs to be done to further improve the experience we provide you.

Sincerely,

Rick Kelln | Senior Vice President & Head of HSBC InvestDirect



Hong Kong – Market and economic snapshot

The Hong Kong market experienced significant volatility in November with the Hang Seng Index (HSI) swinging 8% from peak to trough during the month. The market started the month well, reaching a 29-month high of 24,964 in early November before profit taking set in, triggered by renewed concerns over the EU sovereign debt issues and the introduction of tightening measures in China and Hong Kong. Bargain hunting returned at month's end and caused the index to rebound. Utilities were the best performer during a volatile market with the sector down 1.5%. This was followed by the Commercial/Industrial and Finance sectors. Property stocks were hit hard on the back of the government's policies in Hong Kong and China to rein property price increases.

Economic profile

The Hong Kong economy sustained robust growth in 3Q10. Real GDP expanded 6.8% YoY, or 0.7% QoQ (+2.8% annualized), reaccelerating from the 6.5% YoY gain in 2Q10. Service exports and household consumption

were the key growth drivers in 3Q10 which were supported by the strength in external markets and buoyant asset markets amidst QE2. Retail sales growth numbers were also buoyed by robust inbound tourism. However, while the retail market remains healthy, growth may start to slow given the high base effects.

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As expected, underlying inflation headed up further in October to 2.3% YoY due to three main components: private housing costs, food for home consumption and transportation costs. However, contrary to widely felt concern about rising inflation, Hong Kong has been seeing slower gains in prices than the rest of the region. Hong Kong's mature consumption structure is heavily weighted in services as opposed to food and goods, so higher import costs of food and consumer goods do not bring as significant an impact on the CPI as many may believe. Apart from imported inflation, Hong Kong sees increasing price



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pressures stemming from the buoyant property market and wage increases ahead, although these generally enter the CPI gradually with a time lag. Inflation is expected to rise further in the coming year, with half of that derived from housing costs.

Although the headline unemployment rate did not ease from its previous level with 4.2% in August-October, there was continued improvement in labour market conditions. Total employment continued its positive momentum, with YoY growth picking up to 1.2% (+0.7% in Jul-Sep) on the back of strong economic growth. As China further strengthens its ties with the rest of the world, and the developed markets stabilize and recover, Hong Kong should see ever-expanding opportunities for its service exports, which will likely remain a key growth driver in the years to come. Improvement in employment bodes well for consumption and in turn, the local economy.

Outlook

With strong commitment to the fixed exchange rate system and free capital flows, we expect little policy response on the part of the Hong Kong government to the new round of liquidity inflows on the back of QE2. Interest rates are not expected to rise until the Fed tightens which may be as late as early 2012, and Hong Kong Interbank Offer Rates (HIBOR) should stay low in the immediate future. With rising inflation, real interest rates are likely to head further south, boding well for the asset markets.

Although the global liquidity environment and technical momentum remain favourable for the market in the short term, China’s inflation trend and the resulting policy uncertainty will need to be monitored closely. It is possible that China may adopt one or more of the following: (1) direct price interventions to cap inflation; (2) further monetary tightening in terms of

raising required rates of return (RRR) or interest rate, (3) put controls on FX inflows, and (4) accelerating RMB appreciation. All of these possible measures could affect the performance of Hong Kong’s asset markets.

Source: HSBC Global Asset Management



Canada – Policy dilemma

By Stewart Hall, Canadian Economist, HSBC Securities (Canada) Inc.

Does the Bank of Canada leave the reins of monetary policy loose and focus on shielding exporters from further dollar strength while risking consumer imbalance? Or hike rates in 2011 in an effort to curb a consumer binge on cheap credit, and potentially sacrifice export growth and the overall economic recovery?

Although stagnant GDP growth has been of concern because of a widening trade deficit, it is the accumulation of



“Although stagnant GDP growth has been of a concern because of a widening trade deficit, it is the accumulation of debt at the household level that is of most concern.”

debt at the household level that is of most concern. Household credit as a percentage of disposable income hit 148%, up from 143% the quarter before. That’s higher than the current rate for US households – a historical first for Canadians.

At the federal level of government, there has been considerable talk about

using administrative measures to curb lending. It is important to remember that Canada has a fully functioning banking system. As financial institutions in other developed countries have been working down their balance sheets, Canadian banks have been doing the opposite. Year over year, total chartered bank assets

are up 4.5%, led by mortgage lending at 8.4%, and personal lines of credit at a whopping 9.7%.

But without a complementary policy at the Bank of Canada of higher rates, success becomes rather uncertain. After all, consumer behaviour is simply following the pricing signals for money in a low rate environment where there

% Year

	2010f	2011f	2012f	Q3 10f	Q4 10f	Q1 11f	Q2 11f	Q3 11f	Q4 11f
Consumer Spending	3.4	2.8	2.6	3.4	3.2	23.0	3.0	2.7	2.6
Government Consumption	3.2	0.5	-0.2	2.9	1.4	1.2	0.7	0.2	-0.2
Investment	7.4	7.5	5.9	8.3	8.8	7.8	7.7	7.5	7.1
Stockbuilding (%GDP)	1.1	1.3	1.0	1.3	1.4	1.5	1.4	1.3	1.1
Domestic demand	5.6	4.3	6.2	5.9	3.4	2.4	2.6	5.7	6.4
Exports	7.8	7.1	6.4	9.5	8.0	7.4	7.5	7.1	6.6
Imports	13.5	6.6	4.2	12.8	11.3	9.6	6.1	5.6	5.2
GDP	3.0	2.6	2.9	3.4	2.9	2.3	2.5	2.9	2.8
GDP (% quarter annualized)	-	-	-	1.0	2.7	3.3	3.1	2.5	2.3
Industrial production	5.0	3.3	2.7	8.4	6.0	4.2	2.8	2.8	3.6
CPI	1.8	1.9	2.0	1.8	2.3	2.2	2.0	1.9	1.7
Average earnings	3.7	3.6	2.7	4.1	4.7	4.4	4.1	3.3	2.7
Unemployment (%)	8.0	7.7	7.3	8.0	7.8	7.8	7.7	7.6	7.5
Current account (USDbn)	-51.1	-29.1	-2.7	-	-	-	-	-	-
Current account (%GDP)	-3.2	-1.9	-0.2	-	-	-	-	-	-
Budget balance (%GDP) *	-2.8	-1.8	-1.2	-	-	-	-	-	-
CAD/USD	1.05	1.10	1.10	1.3	1.05	1.10	1.10	1.10	1.10
3-month money (%)	1.2	2.5	3.4	1.2	1.2	1.9	2.2	2.2	2.5
10-year bond yield (%)	3.2	3.0	3.5	2.8	3.2	3.5	3.4	3.2	3.0

Note: *Fiscal year Source: HSBC

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is a strong incentive to borrow and spend and few incentives to save.

Changing this calculus requires more than administrative measures. It requires changing the pricing of money. It is that calculus driving our view of a rate hike at the end of Q1 2011.

 **Client Corner**

Question: What's the RRSP contribution limit this year and when is the deadline?

Answer: Your RRSP contribution limit is 18% of your previous year's earned income to a maximum of \$22,000 in 2010 (\$22,450 in 2011). The 2010 dollar

maximum is reached at an income level of \$122,222 (\$22,000/18%), so if you're earning more than this, the maximum you can contribute will be less than 18% of your earned income.

In order to be eligible for a tax deduction on your previous year's income tax return, contributions must be made into your RRSP no later than sixty days into the following year. In other words, any contribution made to your RRSP before Tuesday, March 1st, 2011, is eligible for a deduction on your 2010 Income Tax return. However, don't wait until the last minute to make your contribution: the sooner you contribute the funds, the sooner they can start growing in a tax-deferred manner.

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