

HSBC Asian Local Bond Index (ALBI)

Asia

Frequently Asked Questions (FAQ)

1. Could you briefly describe what the ALBI is and what countries are included?

The ALBI stands for the HSBC Asian Local Bond Index which tracks the total-return performance of a portfolio consists of local currency denominated, high quality and liquid bonds in Asia ex-Japan. The index returns for each country-based sub-indices are calculated in the respective local currencies and the return for the overall ALBI index is measured in US dollar. Nine countries/regions are currently included in the ALBI. They are Korea (37.51%), the Hong Kong SAR (18.35%), India (16.73%), Singapore (14.23%), Taiwan (5.14%), Malaysia (4.61%) Thailand (2.35%), the Philippines (1.08%) and China (0%).

2. Why do investors need the ALBI? And how does the ALBI differentiate from the ADBI?

There are two aspects to this question, namely: a) why an index is useful, and b) what's special about the ALBI. In any developed market, whether debt or equity, market indices are indispensable tools that allow investors to track, measure and improve their investment performances. The ALBI provides a diagnostic tool for identifying value added or lost in an investment process exclusively focused on the Asian local bond market.

The ALBI adds value to our existing HSBC Asian US Dollar Bond Index (the ADBI) for the following reasons:

- I) The local currency debt markets in Asia ex-Japan, which the ALBI represents, are very different from the Asia ex-Japan external debt markets represented by the ADBI across all countries. With a total size of more than one trillion US dollars, the domestic bond markets are much larger than the external debt markets with a total size around USD180 billion. In 2001, the gross issuance of domestic debt tops USD200 billion US while that of the external debt is around USD21 billion.
- II) While all external bonds issued to international investors must satisfy a set of standard criteria, locally issued bonds vary significantly in terms of tenor distribution, size, credit quality, fungibility and issue frequency. Additionally, the infrastructures of the secondary markets, in terms of taxation (including tax withholding), currency convertibility and the availability of derivatives trading, vary across each country and remain under-developed relative to the secondary markets for external debt. Consequently, The country weightings within the ALBI differ from the ADBI as summarised in the following table.

Fixed Income

HSBC Fixed Income Research is available online:
 Internet www.markets.hsbc.com
 Bloomberg HKBR

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Country weightings as of Jan 02

Country	ALBI	ADB I	Difference
China	0.00%	10.73%	-10.73%
Hong Kong SAR	18.35%	20.98%	-2.63%
India	16.73%	0.00%	16.73%
Indonesia	0.00%	0.45%	-0.45%
Korea	37.51%	27.32%	10.19%
Malasia	4.61%	19.51%	-14.90%
Philippines	1.08%	11.93%	-10.85%
Singapore	14.23%	7.24%	6.99%
Taiwan	5.14%	0.00%	5.14%
Thailand	2.35%	1.84%	0.51%
Total	100.00%	100.00%	0.00%

Source: HSBC

Historical data shows the risk/return profiles of the ALBI and its sub-indices are different from the ADBI and its respective sub-indices, representing a different set of investment opportunities.

3. How do you decide the weightings of individual bonds and country in the ALBI?

The weightings of individual bonds within each local country index are determined by their market capitalisation. However, their weightings in the overall ALBI are jointly determined by their market capitalisation and the individual country weightings. Because the local bond markets vary so much across each country, standard metrics, such as total market size or market capitalisation of each country index, fail to provide an approximation of investment opportunities available to international investors. For example, the size of the China domestic markets dwarfs that of the Hong Kong SAR, yet the reverse is true in terms of tradable amount available to international investors.

HSBC sets the country weightings for the ALBI to insure the underlying portfolio represents an investment opportunity accessible to qualified international investors. The weightings of each country, subject to semi-annual review, are derived based on the following factors:

- 1) Total size of each domestic debt market and the total market capitalisation of each country index;
- 2) Liquidity of the secondary bond market in each country, measured by bid-offer spreads, daily turnovers, and availability of price quotes;
- 3) Accessibility to foreign investors in terms of currency convertibility, withholding taxes, ease of setting up and operating foreign-owned investment funds, ease of repatriating of funds and profits;
- 4) Development of infrastructure conducive for fixed-income investments and trading, such as availability of domestic benchmark yield curves, interest rate derivative products (swaps and futures), and availability of reliable credit rating system for non-government issues.

4. Why does China, a country that may quickly have the largest domestic bond market in Asia ex-Japan, have zero country weighting?

China's domestic bonds are currently trading in two largely separated markets with majority of the issues trading in the OTC markets among banks and the rest trading on the Shanghai Stock Exchange. Although a few foreign financial institutions, including HSBC, are qualified to trade bonds in the OTC markets, liquidity is extremely poor. Indeed, one can only obtain regular quotes for bonds listed on the Shanghai Stock Exchange. With listed bonds as its constituents, the ALBI China index represents a portfolio of bonds inaccessible to foreign investors, and therefore carries zero weighting in the overall ALBI. However, as China's domestic markets open up, the China index may become the largest sub-index in the ALBI.

5. Where can investors find ALBI updates?

Daily ALBI updates, which include the levels of the ALBI and its sub-indices, can be found on Bloomberg (type HSLI <Go>) and HSBC web page at (www.markets.hsbc.com).

6. How can investors perform analyses using the ALBI?

HSBC will give selected clients access to more index information on Bloomberg. These clients can find the following:

- a) Monthly update of index constituents and their weightings in the ALBI and in sub-indices;
- b) Daily update of index duration, yield, country weightings and price performance;
- c) Customised total return performances in alternative currencies, such as US dollar, and relative performances of different sectors and historical volatility.

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