



Interim Report 2008

ABF Hong Kong Bond Index Fund

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# Investment Adviser's Report

## **ABF Hong Kong Bond Index Fund**

Declining interest rates helped the Trust to deliver a total return of 9.89 percent for the six month period ending January 2008.

During the review period, the U.S. Federal Reserve aggressively cut Fed funds rate to restore confidence and liquidity in the market from fear plagued by U.S. sub-prime related losses. The Fed funds rate fell to 3 percent at the end of January from 5.25 percent in July, where the FOMC cut rates at each meeting since September and surprised the market by an inter-meeting cut of 75 basis points early this year. U.S. Treasuries rallied with a curve steepening bias on further rate cut expectations, slower economic growth concerns and investors demand for quality. The yield on the ten-year benchmark note fell to 3.59 percent in January from 4.74 percent in July and the yield on the two-year note fell by 243 bps since the summer to end at 2.09 percent in January. Concerted effort by global central banks helped ease the credit situation in December when they flushed the market with over US\$64 billion, the biggest liquidity injection since the 2001 terrorist attacks. Subsequently we saw U.S. swap spreads tightening back in, with the ten-year swap spread falling by -12 basis points to end January at 62 basis points.

Hong Kong dollar interest rates also posted stellar performance during this period; bullish steepening trend was seen in both government and swap curves. The confluence of the market flushed with liquidity, banks needing to satisfy statutory liquidity requirement and rally in U.S. Treasuries all help drive local rates lower. The Hong Kong dollar swap rates outperformed U.S. swap rates on the long end where the one- and five-year Hong Kong dollar swap rates fell by -244 and -200 basis points versus U.S. swaps falling -239 and -176 basis points respectively. Government exchange funded bills and notes (EFB/EFNs) outperformed swaps; the Hong Kong dollar five-year swap spreads tested their historical wides at 180-190 basis points in January.

For three weeks in December, Hong Kong's money market rates went into negative territory as there was strong technical demand from banks needing to square their short front-end positions to satisfy statutory liquidity requirements. The one week EFBs traded as low as -2.5

percent while the one month EFBs reached -1.15 percent. Hong Kong Monetary Authority (HKMA), the territory's de facto central bank, normalized the situation after they issued HK\$6 billion of three month EFBs in early January. During October, we saw the 12-month Hong Kong dollar TT forward briefly reaching par since October 2005, however, HKMA intervened aggressively and bought U.S. dollars to defend the currency peg; the forward subsequently fell back to a discount of -400 pips by the end of January. Rate cuts in the U.S. spurred Hong Kong banks to follow suit, HSBC, the bank with the biggest network in Hong Kong, cut its prime lending rate six times since September to 5.75 percent. Funding costs have also lowered with the three-month HIBOR (daily fixings) falling 205 basis points over the period and ended January at 2.33 percent.

Fundamentally, the Hong Kong economy continues to post strong economic growth albeit slowing signs from overseas. High inflation persisted as the year-on-year CPI reached 3.8 percent in December. Inflation is expected to remain at lofty levels from imported inflation (e.g. food), higher rents and wage growth. The labor market remained tight as the unemployment rate reached another long-time low of 3.4 percent in December.

Despite a robust economic backdrop, we expect Hong Kong interest rates to move lower alongside with the U.S. in the short run. Further rate cuts are likely to materialize and Hong Kong banks will lower rates in the mortgage market. Fiscal stimulus should lend support to consumption and growth if the government is forthcoming in returning to the public the large fiscal surplus estimated at HKD110 billion in the fiscal year ending March. However, Hong Kong yields are getting rich which offer little room to match the rate easing by long run, given to the domestic inflation environment.

# Statement of Assets and Liabilities

## ABF Hong Kong Bond Index Fund

	31 January 2008 HKD	31 July 2007 HKD
<b>ASSETS</b>		
Investments	2,463,199,510	2,136,047,869
Accounts receivable	88,925,197	63,963,972
Cash at banks	303,942	3,726,821
	<hr/> 2,552,428,649	<hr/> 2,203,738,662
<b>LIABILITIES</b>		
Accounts payable	24,528,781	381,216
Distribution payable	42,144,962	47,136,602
	<hr/> 66,673,743	<hr/> 47,517,818
<b>TOTAL NET ASSETS</b>	<hr/> 2,485,754,906	<hr/> 2,156,220,844
<b>Number of units outstanding</b>	<hr/> 23,946,001	<hr/> 22,446,001
<b>Net asset value per unit</b>	<hr/> 103.81	<hr/> 96.06

# Portfolio Statement

## ABF Hong Kong Bond Index Fund

as at 31 January 2008

	Holdings	Market value HKD	% of NAV		Holdings	Market value HKD	% of NAV
<b>Bonds</b>				HK GOVERNMENT BOND			
ASIA DEVELOPMENT BK				7108 3.93% 26AUG2011	13,550,000	14,506,146	0.58
4.28% 21SEP2009 EMTN	30,000,000	30,940,581	1.25	HK GOVERNMENT BOND			
EUROFIMA 4.18% EMTN				7111 3.12% 25NOV2011	13,550,000	14,142,002	0.57
8JUN2015	56,500,000	59,978,100	2.41	HK GOVERNMENT BOND			
HK GOVERNMENT				7202 3.14% 24FEB2012	72,550,000	75,844,960	3.05
4.49% 26NOV2012 7211	30,000,000	33,266,862	1.34	HK GOVERNMENT BOND			
HK GOVERNMENT BOND				7205 3.61% 28MAY2012	10,500,000	11,190,087	0.45
1012 7.01% 6DEC2010	31,300,000	35,866,388	1.44	HK GOVERNMENT EX FD			
HK GOVERNMENT BOND				NT 1006 7.31% 21JUN10	24,300,000	27,497,985	1.11
1412 3.51% 8DEC2014	37,000,000	39,621,894	1.59	HK GOVERNMENT EX FD			
HK GOVERNMENT BOND				NT 1206 6.13% 20JUN11	70,200,000	80,035,273	3.22
3.63% 19DEC2011 5112	24,000,000	25,509,600	1.03	HK GOVERNMENT EX FD			
HK GOVERNMENT BOND				NT 1112 5.92% 5DEC11	42,500,000	48,747,479	1.96
3.78% 6DEC2016 1612	22,000,000	24,120,351	0.97	HK GOVERNMENT EX FD			
HK GOVERNMENT BOND				NT 1206 5.8% 19JUN12	106,800,000	123,618,148	4.97
3.9% 18MAY2009	50,000,000	51,529,575	2.07	HK GOVERNMENT EX FD			
HK GOVERNMENT BOND				NT 1212 4.5% 4DEC12	41,800,000	46,383,826	1.87
4% 16FEB2009	65,550,000	67,253,907	2.71	HK GOVERNMENT EX FD			
HK GOVERNMENT BOND				NT 1306 3.73% 5JUN13	46,300,000	49,903,640	2.01
4.13% 22FEB2013 7302	27,000,000	29,571,340	1.19	HK GOVERNMENT EX FD			
HK GOVERNMENT BOND				NT 1312 4.32% 2DEC13	38,400,000	42,760,700	1.72
4.33% 7DEC2015 1512	18,000,000	20,382,894	0.82	HK GOVERNMENT EX FD			
HK GOVERNMENT BOND				NT 1406 4.82% 2JUN14	10,500,000	12,044,504	0.49
4.83% 7JUN2016 1606	13,000,000	15,263,290	0.61	HK GOVERNMENT EX FD			
HK GOVERNMENT BOND				1906 7.21% 9JUN09	99,800,000	107,388,692	4.32
5003 3.52% 22MAR2010	5,000,000	5,198,351	0.21	HK GOVERNMENT EX FD			
HK GOVERNMENT BOND				NT 5903 2.52% 24MAR09	61,250,000	61,963,630	2.49
5012 4.26% 20DEC2010	41,300,000	44,218,671	1.78	HK GOVERNMENT EX FD			
HK GOVERNMENT BOND				NT 7005 3.19% 28MAY10	13,550,000	14,022,612	0.56
5906 3.7% 23JUN2009	13,550,000	13,955,000	0.56	HK GOVERNMENT EX FD			
HK GOVERNMENT BOND				NT 7011 3.95% 26NOV10	55,550,000	58,927,968	2.37
5909 3.18% 28SEP2009	51,150,000	52,502,104	2.11	HK GOVERNMENT EX FD			
HK GOVERNMENT BOND				NT 7102 3.27% 25FEB11	84,950,000	88,726,028	3.57
5912 2.69% 21DEC2009	13,550,000	13,829,336	0.56	HK GOVERNMENT EX FD			
HK GOVERNMENT BOND				NT 7105 4.5% 27MAY11	96,800,000	105,103,001	4.23
7002 3.8% 26FEB2010	65,550,000	68,449,263	2.75	HK GOVERNMENT EX FD			
HK GOVERNMENT BOND				NT 7911 3.96% 30NOV09	13,550,000	14,130,132	0.57
7008 3.92% 20AUG2010	68,550,000	72,355,601	2.91	HK GOVERNMENT NOTE			
				1912 7.47% 8DEC2009	11,300,000	12,510,172	0.50

# Portfolio Statement

## ABF Hong Kong Bond Index Fund

as at 31 January 2008

	Holdings	Market value HKD	% of NAV
HK GOVERNMENT SER 1506 3.5% 22JUN2015	36,100,000	38,704,351	1.56
HK GOVERNMENT SER 5009 3.79% 20SEP2010	40,700,000	42,883,160	1.73
HK GOVERNMENT SER 7208 4% 27AUG2012	15,000,000	16,263,575	0.65
HK MORTGAGE CORP 3.8% 6APR2011 EMTN	1,000,000	1,034,202	0.04
HKSAR GOVERNMENT 3.75% 23JUL2009	17,000,000	17,388,032	0.70
HKSAR GOVERNMENT 5.125% 23JUL2019	13,500,000	15,612,824	0.63
HONG KONG (GOVT OF) 3.52% 5DEC2017	18,000,000	19,375,619	0.78
HONG KONG (GOVT OF) 4.65% 29AUG2022	21,000,000	25,706,100	1.03
HONG KONG (GOVT OF) 4.85% 27JUN2017	13,000,000	15,430,613	0.62
HONG KONG MTG CORP 3.53% 23JUL2009	83,500,000	84,977,950	3.42
HONG KONG MTG CORP 3.8% 6APR2011	32,500,000	33,595,250	1.35
HONG KONG MTG CORP 4.1% 9JAN2012 MTN	7,000,000	7,330,866	0.30
INTER-AMERICAN DEV BANK 4.2% 24MAR2014	39,000,000	41,624,665	1.67
INTL FINANCE CORP 4.45% 1SEP2009	100,000,000	103,367,640	4.16
KOWLOON-CANTON RAILWAY 4.65% 10JUN2013	12,000,000	12,882,028	0.52
MTR CORP (C.I.) 4.5% 11MAY2015	33,500,000	36,033,893	1.45
MTR CORP (C.I.) 4.6% 3JUN2013	25,500,000	27,402,300	1.10
MTR CORP (C.I.) 4.75% 11MAY2020	76,000,000	83,425,990	3.36
MTR CORP (C.I.) 5.25% 21MAY2013	500,000	552,850	0.02
MTR CORP (C.I.) 4.15% 13NOV2009	38,000,000	39,175,735	1.58

	Holdings	Market value HKD	% of NAV
MTR CORP (C.I.) 4.28% 6JUL20 EMTN	10,000,000	10,511,393	0.42
NORDIC INVESTMENT BANK 3.77% 12JUL2010	74,500,000	76,660,381	3.08
<b>Total Investments</b>		2,463,199,510	99.09
<b>Other Net Assets</b>		22,555,396	0.91
<b>Total Net Assets</b>		2,485,754,906	100.00
<b>Total Cost of Investment</b>		2,352,317,613	

# Statement of Movements in Portfolio Holdings

## ABF Hong Kong Bond Index Fund

	<b>% of NAV 31 January 2008</b>	<b>% of NAV 31 July 2007</b>
<b>Bonds</b>	99.09	99.06
<b>Total Investments</b>	99.09	99.06
<b>Other Net Assets</b>	0.91	0.94
<b>Total Net Assets</b>	100.00	100.00

# Performance Record

## ABF Hong Kong Bond Index Fund

	Net asset value per unit	
	Lowest HKD	Highest HKD
2006	95.52 <sup>(a)</sup>	100.33 <sup>(a)</sup>
2007	96.10 <sup>(a)</sup>	100.69 <sup>(a)</sup>
1 August 2007 to 31 January 2008	96.32 <sup>(a)</sup>	105.99 <sup>(a)</sup>
	<b>31 January 2008 HKD</b>	<b>31 July 2007 HKD</b>
<b>Total net asset value</b>	2,485,754,906	2,156,220,844
<b>Net asset value per unit</b>	103.81	96.06

In accordance with chapter 8.6(l) of the Code on Unit Trusts and Mutual Funds, the Trust is required to provide a comparison of the Trust performance and the actual index performance over the relevant period.

	6 months ended 31 January 2008	12 months ended 31 July 2007
ABF Hong Kong Bond Index Fund	9.89% <sup>(a),(b)</sup>	4.15% <sup>(a),(b)</sup>
iBoxx ABF Hong Kong Index	10.05% <sup>(c)</sup>	4.45% <sup>(c)</sup>

- (a) The net asset value presented in the financial statements and that quoted for pricing and performance calculation purposes ("Dealing NAV") are different due to the principles for calculating the Dealing NAV as set out in the prospectus being different from that required for financial reporting purposes under Hong Kong Financial Reporting Standards. The following reconciliation provides details of these differences:

	As at 31 January 2008 HKD	As at 31 July 2007 HKD
Net asset value as reported in the financial statements	2,485,754,906	2,156,220,844
Adjustments for different bases adopted by the Trust in arriving at the Dealing NAV:		
– Deferred formation expenses	1,481,096	1,783,561
– Others	(567,026)	(967,652)
Dealing NAV	<u>2,486,668,976</u>	<u>2,157,036,753</u>

- (b) The Trust's returns are calculated on NAV-to-NAV basis, dividends reinvested.
- (c) The benchmark returns are stated on a total return basis. Unlike the Trust, the benchmark returns do not include the impact of Trust expenses or Trust transaction costs.

Investor should note that investment involves risk and past performance may not be indicative of future performance. Investors should refer to the Trust's prospectus before making any investment decision.

# Distribution Disclosure

## ABF Hong Kong Bond Index Fund

	<b>Date of Ex-distribution</b>	<b>Date of Payment</b>	<b>Distribution Per Unit HKD</b>	<b>Total Distribution HKD</b>
2008 Interim Distribution	30 January 2008	12 February 2008	1.76	42,144,962
2007 Final Distribution	30 July 2007	7 August 2007	2.10	47,136,602
2007 Interim Distribution	30 January 2007	7 February 2007	1.98	43,948,082

# Administration

## **ABF Hong Kong Bond Index Fund**

### **Manager and Listing Agent**

HSBC Investment Funds (Hong Kong) Limited  
HSBC Main Building  
1 Queen's Road Central  
Hong Kong

### **Directors of the Manager**

King Lun Au  
Po Yee Lam  
Ngar Yee Louie  
Rudolf Apenbrink  
Edmund Stokes (appointed on 21 September 2007)  
Simeon Brown (resigned on 21 September 2007)

### **Members of Supervisory Committee**

Anthony Yuen  
Andrew Malcolm  
Carmen L K Chu  
Stephen Y L Cheung (appointed on 30 October 2007)

### **Investment Adviser**

HSBC Investments (Hong Kong) Limited  
HSBC Main Building  
1 Queen's Road Central  
Hong Kong

### **Investment Sub-Adviser**

Halbis Capital Management (Hong Kong) Limited  
HSBC Main Building  
1 Queen's Road Central  
Hong Kong

### **Trustee, Administrator, Custodian, Receiving Agent and Registrar**

HSBC Institutional Trust Services (Asia) Limited  
HSBC Main Building  
1 Queen's Road Central  
Hong Kong

### **Processing Agent**

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### **Legal Adviser**

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### **Auditors**

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