

HSBC CHINA DRAGON FUND
Interim Report 2008



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Investment Advisor's Report

Interim period ended 30 September 2008

Review

China shares recovered in April after experiencing significant declines in 1Q08 on the announcements of better than expected 2007 earnings results and easing inflation concern. CPI inflation fell to 8.3% in March from 8.7% the previous month. The reduction in stamp duty from 0.3% to 0.1%, as well as the announcement of new regulations restricting the sale of non-tradable shares in the domestic A-share market in April, also provided market support.

However, China shares fell again in May and June amid rising oil prices and rapid global inflation. The earthquake in Sichuan on 12 May and its economic effects caused further uncertainties in the market. On 24 May, the Chinese government announced its long-awaited telecom sector restructuring plan, with 3G mobile networks expected to roll out nationwide upon the completion of restructuring. China shares recovered in July on the back of easing inflation and the anticipation of credit relaxation in 2H08.

Towards the third quarter, the market experienced more volatility, with China shares falling in August and September due to a worsening credit crisis and further global economic slowdown. The Beijing Olympics were successfully held in August which helped boost the market. Consumer stocks outperformed on better-than-expected 1H08 results, stemming from continuing robust domestic consumption.

On the other hand, telecom stocks declined on rising capital expenditure and potential competition in 2009 after the industry restructuring. The property sector underperformed due to slowing sales volume and concerns of price cuts. The Chinese government announced several supportive measures to stabilise the domestic stock market, including a 50% reduction in stamp duty on stock transactions by eliminating charges on stock purchases, and charging 0.1% stamp duty on sell transactions only. The government also authorised China's sovereign fund to directly purchase stocks of China's three largest banks in the A-share market and encouraging state-owned enterprises to buy back their own shares in the market. Lending rates were also cut by 27 basis points to 7.2% for one-year loans as part of the government's efforts to ease credit.

CPI inflation continued its downward trend to 4.9% year-on-year (yoy) in August. Retail sales growth remained steady at 23.2%

yoy in August compared to 23.3% yoy in July. Money supply growth further moderated in August to 16.0% yoy from 16.4% yoy in July. China's fixed asset investment growth remained robust at 27.4% yoy in August. Export growth slowed in August to 21.1% yoy from 26.9% yoy in July. Similarly, import growth also fell from 33.7% yoy in July to 23.1% yoy in August, leading to a total trade surplus of US\$28.7 billion in August.

Market outlook

We expect the market to remain volatile in the near term due to the uncertain global economic outlook and the continuing credit crisis. After the successful completion of the Beijing Olympics, we believe the Chinese government will be more focused on introducing policies to stimulate the economy and revive stock market confidence over the coming months.

The government may introduce policies to deal with the state share sell down overhang in the A-share market, ease credit to small and medium-sized enterprises, increase personal income tax threshold, and grant VAT tax rebates to corporations for equipment purchases to promote investments and production upgrades. Domestic credit will likely be relaxed further as CPI inflation pressure eases. We expect infrastructure spending to remain strong across China.

However, market sentiment may be adversely affected by the recent sluggish property sales. We expect 3Q08 economic growth in China to experience some weakness due to distortions related to the Olympics but should rebound in 4Q08 when operations return to normal. Renminbi should remain stable for the balance of 2008.

**For and on behalf of
Halbis Capital Management (Hong Kong) Limited**

31 October 2008

Interim statement of assets and liabilities

As at 30 September 2008

	Note	30 September 2008 (Unaudited) HK\$	31 March 2008 (Audited) HK\$
Assets			
Investments	7	2,130,610,398	3,228,821,569
Dividend receivables		1,835,529	–
Interest and other receivables		2,407,573	2,420,309
Amounts receivable from sales of investments		31,974,038	–
Cash and cash equivalents		106,326,809	169,925,839
Total assets		<u>2,273,154,347</u>	<u>3,401,167,717</u>
Liabilities			
Taxation	6	27,612,565	24,554,349
Amounts payable on purchases of investments		32,287,857	715,846
Accrued expenses and other payables		3,947,087	5,705,128
		<u>63,847,509</u>	<u>30,975,323</u>
Net assets attributable to unitholders		<u>2,209,306,838</u>	<u>3,370,192,394</u>
Total number of units in issue	10	<u>371,910,000</u>	<u>371,910,000</u>
Net asset value per unit		<u>5.94</u>	<u>9.06</u>

The notes on pages 6 to 21 form part of these interim financial statements.

Interim income statement

For the period ended 30 September 2008

		Period from 1 April 2008 to 30 September 2008 (Unaudited) HK\$	Period from 20 June 2007 (date of inception) to 30 September 2007 (Unaudited) HK\$
Dividend income		40,151,844	3,725,510
Interest income on deposits	3	327,147	7,994,703
Gains on investments	4	294,406,869	1,268,051,478
Losses on investments	4	(1,457,909,111)	(28,415,214)
Net foreign exchange gain/(loss)		853,884	(3,408,561)
		<hr/>	<hr/>
Net investment (loss)/income		(1,122,169,367)	1,247,947,916
		<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
Expenses			
Management fees	8(a)	(22,986,866)	(11,563,013)
Transaction costs	8(e)	(9,963,974)	(30,405,315)
Trustee's fees	8(b)	(1,641,409)	(801,533)
Custodian fees	8(c)	(963,886)	(272,269)
Auditors' remuneration		(179,832)	–
Preliminary expenses	5	–	(128,385,708)
Other operating expenses		(500,797)	(56,000)
		<hr/>	<hr/>
Operating expenses		(36,236,764)	(171,483,838)
		<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
Changes in net assets attributable to unitholders before taxation		(1,158,406,131)	1,076,464,078
Taxation	6	(2,479,425)	(7,449,634)
		<hr/>	<hr/>
Changes in net assets attributable to unitholders from operations		(1,160,885,556)	1,069,014,444
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Interim statement of changes in net assets attributable to unitholders

For the period ended 30 September 2008

	Period from 1 April 2008 to 30 September 2008 (Unaudited) HK\$	Period from 20 June 2007 (date of inception) to 30 September 2007 (Unaudited) HK\$
Subscriptions received from units issued	–	3,719,100,000
Changes in net assets attributable to unitholders from operations	(1,160,885,556)	1,069,014,444
	<u>(1,160,885,556)</u>	<u>4,788,114,444</u>
Net assets attributable to unitholders, beginning of period	3,370,192,394	–
	<u>3,370,192,394</u>	<u>–</u>
Net assets attributable to unitholders, end of period	<u><u>2,209,306,838</u></u>	<u><u>4,788,114,444</u></u>

Interim cash flow statement

For the period ended 30 September 2008

	Period from 1 April 2008 to 30 September 2008 (Unaudited) HK\$	Period from 20 June 2007 (date of inception) to 30 September 2007 (Unaudited) HK\$
Operating activities		
Interest received	392,319	7,819,623
Dividends received	38,316,315	1,262,863
Management fees paid	(24,447,466)	(6,465,664)
Trustee's fees paid	(1,766,162)	(449,784)
Preliminary expenses paid	–	(128,385,708)
Other operating expenses paid	(11,781,177)	(30,724,607)
	<u>713,829</u>	<u>(156,943,277)</u>
Cash flows generated from/(used in) operating activities	-----	-----
Investing activities		
Proceeds from sales of investments	1,569,437,834	791,690,188
Payment in purchases of investments	(1,635,131,990)	(4,267,887,453)
	<u>(65,694,156)</u>	<u>(3,476,197,265)</u>
Cash flows used in investing activities	-----	-----
Financing activities		
Proceeds from issue of units	–	3,719,100,000
	<u>–</u>	<u>3,719,100,000</u>
Cash flows generated from financing activities	-----	-----
Net (decrease)/increase in cash and cash equivalents	(64,980,327)	85,959,458
Cash and cash equivalents at the beginning of the period	169,925,839	–
Effect of foreign exchange rates changes	1,381,297	(3,408,561)
	<u>106,326,809</u>	<u>82,550,897</u>
Cash and cash equivalents at the end of the period	=====	=====

Notes on the unaudited interim financial statements

For the period ended 30 September 2008

1. Background

HSBC China Dragon Fund ("the Fund") is a closed-end unit trust governed by its Trust Deed dated 20 June 2007 ("the Trust Deed"), as amended. The Fund is authorized by the Hong Kong Securities and Futures Commission ("the SFC") under Section 104 of the Hong Kong Securities and Futures Ordinance. The Fund is also listed on The Stock Exchange of Hong Kong Limited ("the Stock Exchange") (a subsidiary of the Hong Kong Exchanges and Clearing Limited). The period fixed for the duration of the Fund is eighty years after the date of inception.

The investment objective of the Fund is to achieve long-term capital growth by investing primarily in listed companies established or operating in the People's Republic of China (PRC) or listed companies that are positioned to benefit from the strong economic growth potential and promising investment opportunities in the PRC, including but not limited to A Shares, B Shares, H Shares and shares issued by Red Chip Companies and other companies which carry out a significant proportion of their business activities in the PRC.

Under the prevailing regulations in the PRC, foreign investors can invest in the PRC A-Share market through institutions that have obtained qualified foreign institutional investor (QFII) status in the PRC. The Fund itself is not a QFII, but may invest directly in A Shares via the US\$200 million QFII investment quota obtained by the Manager.

2. Significant accounting policies

(a) Statement of compliance

These interim financial statements have been prepared in accordance with Hong Kong Accounting Standard ("HKAS") 34 "Interim Financial Reporting", issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

The interim financial statements have been prepared in accordance with the same accounting policies adopted in the annual financial statements for the year ended 31 March 2008.

The preparation of interim financial statements in conformity with HKAS 34 requires management to make judgements, estimates and assumptions that affect the application of accounting policies to and reported amounts of assets and liabilities, income and expenses on a year to date basis. Actual results may differ from these estimates.

The financial information relating to the financial year ended 31 March 2008 that is included in the interim financial statements as being previously reported information does not constitute the Fund's statutory financial statements for that financial year but is derived from those financial statements. The auditors have expressed an unqualified opinion on the financial statements for the year ended 31 March 2008 in their report dated 24 July 2008.

Notes on the unaudited interim financial statements

For the period ended 30 September 2008

(b) Basis of preparation of the financial statements

The functional and presentation currency of the Fund is Hong Kong dollars reflecting the fact that the units of the Fund are issued in Hong Kong dollars.

The measurement basis used in the preparation of the financial statements is the historical cost basis except that investments are stated at their fair value as explained in the accounting policies set out below.

The preparation of financial statements in conformity with HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

(c) Financial instruments

(i) Classification

The Fund designated all its equity investments into the financial assets at fair value through profit or loss category upon initial recognition.

Financial instruments are designated at fair value through profit or loss upon initial recognition when:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis;
- the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise;
- the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract; or
- the separation of the embedded derivative(s) from the financial instrument is not prohibited.

Financial assets that are classified as receivables include amounts receivable on sales of investments, interest receivables and other receivables, and dividend receivables.

Financial liabilities that are not at fair value through profit or loss include amounts payable on purchases of investments, accrued expenses and other payables.

Notes on the unaudited interim financial statements

For the period ended 30 September 2008

(ii) Recognition

The Fund recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instruments.

A regular way purchase or sale of financial assets and financial liabilities is recognised using trade date accounting. From this date any gains and losses arising from changes in fair value of the financial assets or financial liabilities are recorded.

Financial liabilities are not recognised unless one of the parties has performed their obligation under the contract or the contract is a derivative contract not exempted from the scope of HKAS 39.

(iii) Measurement

Financial instruments are measured initially at fair value (transaction price). Transaction costs on financial assets and financial liabilities at fair value through profit or loss are expensed immediately, while on other financial instruments they are amortised.

Subsequent to initial recognition, all instruments classified at fair value through profit or loss are measured at fair value with changes in their fair values recognised in the income statement.

Financial assets classified as receivables are carried at amortised cost using the effective interest rate method less impairment loss, if any.

Financial liabilities, other than those at fair value through profit or loss, are measured at amortised cost using the effective interest rate method.

Upon termination of the Fund, all net cash proceeds derived from the sale or realisation of the assets of the Fund less any liabilities will be shared among the unitholders at the value proportionate to the unitholders' interest in the Fund at the date of termination. The unitholders' funds are therefore classified as a financial liability other than equity in accordance with HKAS 32. It is shown on the statement of assets and liabilities as the "net assets attributable to unitholders".

(iv) Fair value measurement principles

The fair value of financial instruments is based on their quoted market prices at the date of the statement of assets and liabilities without any deduction for estimated future selling costs. Financial assets are priced at current bid prices, while financial liabilities are priced at current asking prices.

If a quoted market price is not available on a recognised stock exchange or from a broker/dealer for non-exchange-traded financial instruments, the fair value of the instrument is estimated using valuation techniques, including use of recent arm's length market transactions, reference to the current fair value of another instrument that is substantially the same, discounted cash flow techniques, option pricing models or any other valuation technique that provides a reliable estimate of prices obtained in actual market transactions.

Notes on the unaudited interim financial statements

For the period ended 30 September 2008

Where pricing models are used, inputs are based on market data at the date of the statement of assets and liabilities. Fair values for unquoted equity instruments are estimated, if possible, using applicable price/ratios for similar listed companies adjusted to reflect the specific circumstances of the issuer.

Gains and losses on investments are included in the income statement. Realised gains and losses include net gains or losses on contracts which have been settled or for which offsetting contracts have been entered into.

(v) Impairment

Financial assets that are stated at cost or amortised cost are reviewed at each date of the statement of assets and liabilities to determine whether there is objective evidence of impairment. If any such indication exists, an impairment loss is recognised in the income statement as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate.

If in a subsequent period the amount of an impairment loss recognised on a financial asset carried at amortised cost decreases and the decrease can be linked objectively to an event occurring after the write-down, the write-down is reversed through the income statement.

(vi) Derecognition

A financial asset is derecognised when the contractual rights to receive the cash flows from the financial asset expire, or where the financial asset together with substantially all the risks and rewards of ownership have been transferred.

Assets held for trading that are sold are derecognised and corresponding receivables from the brokers are recognised as of the date the Fund commits to sell the assets.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expires.

The Fund uses the weighted average method to determine realised gains and losses to be recognised in profit or loss on derecognition.

(vii) Offsetting

Financial assets and liabilities are offset and the net amount is reported in the statement of assets and liabilities when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(viii) Cash and cash equivalents

Cash and cash equivalents comprise current deposits with banks. Cash equivalents are short-term highly liquid investments that are readily convertible to known amounts of cash, are subject to an insignificant risk of changes in value, and are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes.

Notes on the unaudited interim financial statements

For the period ended 30 September 2008

(d) Revenue recognition

Provided it is probable that the economic benefits will flow to the Fund and the revenue and costs if applicable, can be measured reliably, revenue is recognised in the income statement as follows:

Interest income

Interest income is recognised in the income statement as it accrues, by using the effective interest rate method. Interest income on debt securities is included in gains on investments.

Dividend income

Dividend income from listed investments is recognised when the share price of the investment goes ex-dividend. Dividends from other investments are recognised in the income statement as dividend income when declared.

In some cases, the Fund may receive or choose to receive dividends in the form of additional shares rather than cash. In such cases, the Fund recognises the dividend income for the amount of the equivalent cash dividend with the corresponding debit treated as an additional investment.

(e) Preliminary expenses

Preliminary expenses of the Fund are charged to the income statement as incurred.

(f) Expenses

All expenses are recognised in the income statement on an accruals basis.

(g) Taxation

Taxation comprises current tax and deferred tax. Current tax and movements in deferred tax assets and liabilities are recognised in the income statement.

Current tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantively enacted at the date of statement of assets and liabilities.

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that is probable that future taxable profits will be available against which the asset can be utilised, are recognised.

Notes on the unaudited interim financial statements

For the period ended 30 September 2008

(h) Translation of foreign currency

Foreign currency transactions during the period are translated into Hong Kong dollars at the foreign exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the foreign exchange rates ruling at the date of statement of assets and liabilities. Exchange gains and losses are recognised in the income statement.

(i) Related parties

For the purposes of these financial statements, a party is considered to be related to the Fund if:

- (i) the party has the ability, directly or indirectly, through one or more intermediaries, to control the Fund or exercise significant influence over the Fund in making financial and operating policy decisions, or has joint control over the Fund;
- (ii) the Fund and the party are subject to common control;
- (iii) the party is an associate of the Fund;
- (iv) the party is a member of key management personnel of the Fund or the Fund's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;
- (v) the party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals; or

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the Fund.

(j) Subscriptions

The Fund recognises unitholders' subscriptions and allots units upon receipt of a valid subscription application.

(k) Foreign exchange gains and losses

Foreign exchange gains and losses on financial assets and financial liabilities at fair value through profit or loss are recognised together with other changes in the fair value. Included in the profit or loss line item *Net foreign exchange gain/(loss)* are net foreign exchange gains and losses on monetary financial assets and financial liabilities other than those classified at fair value through profit or loss.

3. Interest income

During the period, the Fund earned all its interest income from cash and cash equivalents.

Notes on the unaudited interim financial statements

For the period ended 30 September 2008

4. Gains and losses on investments

	Period from 1 April 2008 to 30 September 2008 HK\$	Period from 20 June 2007 (date of inception) to 30 September 2007 HK\$
Realised gains	95,484,605	147,431,433
Unrealised gains	198,922,264	1,120,620,045
Total gains on investments	<u>294,406,869</u>	<u>1,268,051,478</u>
Realised losses	(560,911,852)	(8,281,733)
Unrealised losses	(896,997,259)	(20,133,481)
Total losses on investments	<u>(1,457,909,111)</u>	<u>(28,415,214)</u>
Net (losses)/gains on investments	<u>(1,163,502,242)</u>	<u>1,239,636,264</u>

Gains and losses presented above exclude dividend income.

5. Preliminary expenses

The preliminary establishment expenses of the Fund, including the Stock Exchange initial listing fees, legal and other professional fees, underwriting commission, the SFC application fee, the SFC authorisation fee and printing and other expenses relating to the Global Offering and establishment of the Fund, which amounted to HK\$128 million, were borne by the Fund and were written off immediately on the first Valuation Day of the Fund.

6. Taxation

No provision for Hong Kong Profits Tax has been made in the financial statements as the Fund is exempted from taxation under section 26A (1A) of the Hong Kong Inland Revenue Ordinance.

Under current tax law in the PRC, as a foreign company which does not have an establishment in the PRC, the Fund is subject to PRC withholding tax at the rate of 10% in respect of its receipt of PRC-sourced income, including capital gains, dividend income and interest income.

Pursuant to Article 13 of the Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income ("PRC-HK DTA"), the taxing right in respect of gains derived by a Hong Kong tax resident from the alienation of shares of a PRC company, in which the assets of the PRC company comprised less than 50% of immovable property within three years prior to the transfer and the Hong Kong tax resident directly or indirectly holds less than 25% interest in the PRC company within a year prior to the transfer, are allocated to Hong Kong.

Notes on the unaudited interim financial statements

For the period ended 30 September 2008

Pursuant to the tax notice *Guo Shui Fa [1993] No. 45* ("Notice 45"), effective prior to 1 January 2008, a foreign company was exempt from withholding tax in respect of realised capital gains and dividend income derived from investment in B shares and H shares.

The PRC-HK DTA provides withholding tax rate for interest income derived from deposit with the custodians in the PRC to be reduced to 7%.

The Offering Circular of the Fund gives the Manager the right to provide for withholding tax on such gains or income and withhold the tax for the account of the Fund. In the absence of any precedent on the actual tax treatment of such gains to holders of QFII quota, but on the basis of the available information, the Manager has determined that it is appropriate to provide for realised gains on A-shares at the rate of 10% in the financial statements.

7. Investments

	As at 30 September 2008 HK\$	As at 31 March 2008 HK\$
Listed equity securities		
– in Hong Kong	1,164,716,064	1,644,646,984
– outside Hong Kong	961,554,507	1,584,174,585
	<u>2,126,270,571</u>	<u>3,228,821,569</u>
Listed bonds		
– outside Hong Kong	4,339,827	–
	<u>2,130,610,398</u>	<u>3,228,821,569</u>

8. Related parties transactions

The following is a summary of transactions with related parties for the year. All such transactions were entered into in the ordinary course of business and on normal commercial terms.

(a) Management fee

The fee payable to the Manager is calculated at the rate of 1.5% per annum of the net asset value of the Fund payable monthly in arrears. Any fees payable to the Investment Adviser should be borne by the Manager. The management fee charged by the Fund in respect of the period and payable at the end of the period amounted to HK\$22,986,866 (for the period from 20 June 2007 (date of inception) to 30 September 2007: HK\$11,563,013) and HK\$3,046,120 (as at 31 March 2008: HK\$4,506,720) respectively.

The Fund has invested directly in A Shares via the US\$200 million QFII investment quota obtained by the Manager.

Notes on the unaudited interim financial statements

For the period ended 30 September 2008

(b) Trustee's fee

The fee payable to the Trustee is calculated at the rate of 0.125% per annum for the first HK\$390 million of the net asset value, and 0.1% per annum thereafter. The trustee fee is accrued daily and payable in arrears on a monthly basis. The trustee fee charged by the Fund in respect of the period and payable at the end of the period amounted to HK\$1,641,409 (for the period from 20 June 2007 (date of inception) to 30 September 2007: HK\$801,533) and HK\$247,822 (as at 31 March 2008: HK\$372,575) respectively.

(c) Custodian fee

The custodian fee is calculated at the rate of 0.1% per annum of the net asset value of the assets held by the QFII custodian as determined by the QFII custodian (based on the actual number of calendar days in a year). The custodian fee charged by the Fund in respect of the period and payable at the end of the period amounted to HK\$963,886 (for the period from 20 June 2007 (date of inception) to 30 September 2007: HK\$272,269) and HK\$13,469 (as at 31 March 2008: HK\$61,884) respectively.

(d) Bank balances

Bank balances are maintained with the Trustee. The bank balances held with the Trustee as at 30 September 2008 amounted to HK\$34,882,472 (as at 31 March 2008: HK\$91,602,582). During the period, interest earned on the above bank balances was HK\$71,453 (for the period from 20 June 2007 (date of inception) to 30 September 2007: HK\$7,994,703).

(e) In its purchases and sales of investments, the Fund utilises the brokerage services of The Hongkong and Shanghai Banking Corporation Limited. Details of transactions effected through this company are as follows:

	The Hongkong and Shanghai Banking Corporation Limited	
	Period from 1 April 2008 to 30 September 2008 HK\$	Period from 20 June 2007 (date of inception) to 30 September 2007 HK\$
Commission paid for the period	1,683	569,452
Average rate of commission	0.20%	0.13%
Total aggregate value of such transactions for the period	841,457	452,844,440
Percentage of such transactions in value to total transactions for the period	<u>0.03%</u>	<u>8.56%</u>

Notes on the unaudited interim financial statements

For the period ended 30 September 2008

9. Soft dollar practices

The Manager, the Investment Adviser or any of its related parties may effect transactions by or through the agency of another person (or person connected with him) with whom it has an arrangement under which that party will from time to time provide it with or procure for it goods, services or other benefits (such as research and advisory services, portfolio analysis or computer hardware and software incidental to such goods or services) the nature of which is such that their provision is of demonstrable benefit to the unitholders as a whole and for which no direct payment is made but instead the Manager, the Investment Adviser or any of its related parties undertake to place business with that party. For the avoidance of doubt, such goods and services do not include travel, accommodation, entertainment, general administrative goods or services, general office equipment or premises, membership fees, employee salaries or direct money payments.

10. Units in issue

	Period from 1 April 2008 to 30 September 2008	Period from 20 June 2007 (date of inception) to 30 September 2007
Number of units in issue brought forward	371,910,000	–
Units issued during the period	<u>–</u>	<u>371,910,000</u>
Number of units in issue carried forward	<u><u>371,910,000</u></u>	<u><u>371,910,000</u></u>

The Fund is a closed-end unit trust. There was no redemption of units during the period.

11. Financial instruments and associated risks

The Fund maintains investment portfolio in a variety of listed financial instruments as dictated by its investment management strategy. The investment objective of the Fund is to achieve long-term capital growth by investing primarily in listed companies established or operating in the PRC or listed companies that are positioned to benefit from the strong economic growth potential and promising investment opportunities in the PRC, including but not limited to A Shares, B Shares, H Shares and shares issued by Red Chip Companies and other companies which carry out a significant proportion of their business activities in the PRC. The risk exposures inherent in the Fund as at 30 September 2008 are summarised below. Details of such investments held as at 30 September 2008 are shown in the investment portfolio.

The Fund's investing activities expose it to various types of risks that are associated with the financial instruments and markets in which it invests. The Manager and the Trustee have set out below the most important types of financial risks inherent in each type of financial instruments. The Manager and the Trustee would like to highlight that the following list of associated risks only sets out some of the risks but does not purport to constitute an exhaustive list of all the risks inherent in an investment in the Fund. Investors should note that additional information in respect of risks associated with investment in the Fund can be found in the Fund's offering document.

During the period, the Manager invested in financial instruments which the Manager considered are commensurate with the risk level of the Fund in accordance with its investment objective.

The nature and extent of the financial instruments outstanding at the balance sheet date and the risk management policies employed by the Fund are discussed below.

Notes on the unaudited interim financial statements

For the period ended 30 September 2008

(a) Market risk

(i) Price risk

Price risk is the risk that value of the instrument will fluctuate as a result of changes in market prices, whether caused by factors specific to an individual investment, its issuer or all factors affecting all instruments traded in the market.

The Fund is exposed to price risk arising from changes in market price of equity instruments. Price risk is managed by a diversified portfolio of investments across different industries in accordance with the investment objective of the Fund.

Price sensitivity

The impact on a 5% increase in value of the investments at 30 September 2008, with all other variables held constant, is shown below. An equal change in the opposite direction would have reduced the net asset value by an equal but opposite amount. The analysis is performed on same basis for 31 March 2008.

As at 30 September 2008

	Market exposure HK\$	Change in net assets if investment value increased by 5% HK\$
Investment assets		
Listed equity investments:		
– in Hong Kong	1,164,716,064	58,235,803
– outside Hong Kong	961,554,507	48,077,725
	<u>2,126,270,571</u>	<u>106,313,528</u>

As at 31 March 2008

	Market exposure HK\$	Change in net assets if investment value increased by 5% HK\$
Investment assets		
Listed equity investments:		
– in Hong Kong	1,644,646,984	82,232,349
– outside Hong Kong	1,584,174,585	79,208,729
	<u>3,228,821,569</u>	<u>161,441,078</u>

Notes on the unaudited interim financial statements

For the period ended 30 September 2008

(ii) Interest rate risk

Interest rate risk arises from change in interest rates which may inversely affect the value of debt instruments and therefore result in potential gain or loss to the Fund. The Fund's interest rate risk is managed on an ongoing basis by the Manager in accordance with policies and procedures in place.

The following table indicates the expected next repricing dates (or maturity dates whichever are earlier) for interest bearing assets and liabilities at the date of statement of assets and liabilities.

	30 September 2008				
	1 year or less HK\$	Over 1 year to 5 years HK\$	Over 5 years HK\$	Non-interest bearing HK\$	Total HK\$
Assets					
Investments	–	282,291	4,057,536	2,126,270,571	2,130,610,398
Dividend receivables	–	–	–	1,835,529	1,835,529
Interest and other receivables	–	–	–	2,407,573	2,407,573
Amounts receivable from sales of investments	–	–	–	31,974,038	31,974,038
Cash and cash equivalents	106,326,809	–	–	–	106,326,809
Total assets	<u>106,326,809</u>	<u>282,291</u>	<u>4,057,536</u>	<u>2,162,487,711</u>	<u>2,273,154,347</u>
Liabilities					
Taxation	–	–	–	(27,612,565)	(27,612,565)
Amounts payable from purchases of investments	–	–	–	(32,287,857)	(32,287,857)
Accrued expenses and other payables	–	–	–	(3,947,087)	(3,947,087)
Total liabilities	<u>–</u>	<u>–</u>	<u>–</u>	<u>(63,847,509)</u>	<u>(63,847,509)</u>
Total interest sensitivity gap	<u>106,326,809</u>	<u>282,291</u>	<u>4,057,536</u>		

Notes on the unaudited interim financial statements

For the period ended 30 September 2008

	31 March 2008				
	1 year or less HK\$	Over 1 year to 5 years HK\$	Over 5 years HK\$	Non-interest bearing HK\$	Total HK\$
Assets					
Investments	–	–	–	3,228,821,569	3,228,821,569
Interest and other receivables	–	–	–	2,420,309	2,420,309
Cash and cash equivalents	91,602,582	–	–	78,323,257	169,925,839
Total assets	<u>91,602,582</u>	<u>–</u>	<u>–</u>	<u>3,309,565,135</u>	<u>3,401,167,717</u>
Liabilities					
Taxation	–	–	–	(24,554,349)	(24,554,349)
Amounts payable on purchases of investments	–	–	–	(715,846)	(715,846)
Accrued expenses and other payables	–	–	–	(5,705,128)	(5,705,128)
Total liabilities	<u>–</u>	<u>–</u>	<u>–</u>	<u>(30,975,323)</u>	<u>(30,975,323)</u>
Total interest sensitivity gap	<u>91,602,582</u>	<u>–</u>	<u>–</u>		

Interest rate sensitivity

At the date of statement of assets and liabilities, assuming all other factors unchanged, it is estimated that an increase in interest rates of 50 basis points would result in an increase in the net assets attributable to the unitholders and changes in net assets attributable to unitholders from operation of the Fund by HK\$424,386 (31 March 2008: HK\$458,013); an equal change in the opposite direction would result in a decrease in the net assets attributable to unitholders by an equal amount. The analysis is performed on the same basis for 31 March 2008.

(iii) Currency risk

The Fund may invest in financial instruments and enter into transactions denominated in currencies other than its functional currency. Consequently, the Fund is exposed to risks that the exchange rate of its functional currency relative to other foreign currencies may change in a manner that has an adverse effect on the value of that portion of the Fund's assets or liabilities denominated in currencies other than the Hong Kong dollar.

Notes on the unaudited interim financial statements

For the period ended 30 September 2008

The fluctuations in the rate of exchange between the currency in which the asset or liability is denominated and the functional currency could result in an appreciation or depreciation in the fair value of that asset or liability. The Manager may attempt to mitigate this risk by using financial derivative instruments.

In accordance with the Fund's policy, the Manager monitors the Fund's currency exposures on an ongoing basis.

At the date of statement of assets and liabilities the Fund had the following exposure:

	Assets HK\$	Liabilities HK\$	Net exposure HK\$
30 September 2008			
Renminbi	962,276,641	(27,953,110)	934,323,531
31 March 2008			
Renminbi	1,550,836,171	(24,776,308)	1,526,059,863

Amounts in the above table are based on the carrying value of the assets and liabilities.

Currency sensitivity

At 30 September 2008, had the HKD strengthened by 5% in relation to Renminbi, with all other variables held constant, net assets attributable to unitholders would have decreased by the amounts shown below.

30 September 2008		HK\$
Renminbi		46,716,177
Total		46,716,177
31 March 2008		HK\$
Renminbi		76,302,993
Total		76,302,993

A 5% weakening of the HKD against the Renminbi would have resulted in an equal but opposite effect on the above financial statement, on the basis that all other variables remain constant.

Notes on the unaudited interim financial statements

For the period ended 30 September 2008

(b) Credit risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Fund. The Fund's exposure to credit risk is monitored by the Manager on an ongoing basis.

At 30 September 2008, all of the Fund's financial assets were exposed to credit risk. These include investments and cash and cash equivalents placed with banks and Bank of Communications Co., Ltd (the "QFII Custodian").

Credit risk arising on transactions with brokers relates to transactions awaiting settlement. Risk relating to unsettled transactions is considered small due to the short settlement period involved and the high credit quality of the brokers used.

Substantially all of the assets of the Fund are held by the Trustee or the QFII Custodian. Bankruptcy or insolvency of the Trustee or the QFII Custodian may cause the Fund's rights with respect to securities held by the Trustee or the QFII Custodian to be delayed or limited.

The majority of the cash held by the Fund is deposited with Bank of Communications Co., Ltd and The Hongkong and Shanghai Banking Corporation Limited (the "banks"). Bankruptcy or insolvency of the banks may cause the Fund's rights with respect to the cash held by the banks to be delayed or limited. The Fund monitors the credit rating of the banks on an ongoing basis.

The carrying amounts of financial assets best represent the maximum credit risk exposure at the date of statement of assets and liabilities.

At both 30 September 2008 and 31 March 2008, there were no significant concentrations of credit risk to counterparties except to the Trustee and the QFII Custodian.

(c) Liquidity risk

Liquidity risk arises from the risk that the Manager may not be able to convert investments into cash to meet liquidity needs in a timely manner.

The Fund's policy is to regularly monitor current and expected liquidity requirements to ensure that it maintains sufficient reserves of cash and readily realisable marketable securities to meet its liquidity requirements in the short and longer term.

The Fund's equity investments are considered to be readily realisable under normal market condition as they are all listed on stock exchanges in Hong Kong or the PRC.

As at 30 September 2008 and 31 March 2008, the Fund's financial liabilities are due within three months.

Notes on the unaudited interim financial statements

For the period ended 30 September 2008

12. Fair value information

The major methods and assumptions used in estimating the fair values of financial instruments were disclosed in note 2(c)(iv).

The carrying amounts of all the financial assets and financial liabilities at the date of statement of assets and liabilities approximated their fair values. For listed investments, the fair values were determined directly, in full or in part, by reference to published price quotations. Unlisted investments are stated at fair values estimated by the Manager. For other financial instruments, including amounts due from/to brokers, other account receivables and accounts payables, the carrying amounts approximate fair value due to the immediate or short-term nature of these financial instruments.

Investment portfolio (unaudited)

As at 30 September 2008

HSBC China Dragon Fund

			<i>% of total net assets attributable to unitholders</i>
<i>Holdings</i>	<i>Market value HK\$</i>		
Listed investments			
The People's Republic of China			
Baoshan Iron and Steel Co Ltd	7,179,309	59,193,283	2.68
Chengdu B-Ray Media Co Ltd	3,376,581	46,910,346	2.12
China Merchants Bank Co Ltd	1,957,500	39,161,176	1.77
China Railway Construction Corp	2,504,100	26,382,913	1.19
China Shenhua Energy Co Ltd	1,381,910	42,910,994	1.94
China Shipping Development Co Ltd	2,440,100	34,702,482	1.57
China South Locomotive & Rolling	2,577,000	10,229,110	0.46
China Vanke Co Ltd	7,488,000	55,454,193	2.51
Chongqing Changan Automobile Co Ltd	4,716,354	21,448,955	0.97
Fujian Septwolves Industry Co Ltd	956,186	13,403,438	0.61
Guangxi Liugong Machinery Co Ltd	1,574,000	28,972,009	1.31
Hangzhou Steam Turbine Co	2,729,991	19,028,037	0.86
Harbin Pharm Group Co Ltd	1,707,400	16,923,964	0.77
Huadong Medicine Co Ltd	3,181,059	34,345,041	1.55
Huangshan Tourism Development	1,949,015	31,763,425	1.44
Jiangsu Huachang Chemical Co Ltd	1,500	31,506	0.00
Offshore Oil Engineering Co Ltd	1,751,108	30,841,803	1.40
Ping An Insurance Group Co	866,500	32,674,999	1.48
Qingdao Mesnac Co Ltd	1,192,300	16,131,745	0.73
Shandong Gold Mining Co Ltd	967,016	41,411,505	1.87
Shanghai Int'l Airport Co Ltd	1,959,500	38,601,169	1.75
Shanghai Pudong Development Bank Co	5,628,984	99,716,360	4.52
Shanghai Zhixin Electric Co Ltd	679,249	12,964,880	0.59
Shanxi Meijin Energy Co Ltd	1,409,071	16,587,678	0.75
TBEA Co Ltd	2,093,571	39,295,341	1.78
Tsingtao Brewery Co Ltd	1,323,265	25,242,257	1.14
Yantai Changyu Pioneer Wine Co Ltd	1,688,775	58,431,615	2.64
Zhejiang Tianma Bearing Co Ltd	868,815	40,595,687	1.84
ZTE Corp	832,688	28,198,596	1.28
		961,554,507	43.52

Investment portfolio (unaudited)

As at 30 September 2008

HSBC China Dragon Fund

			<i>% of total net assets attributable to unitholders</i>
	<i>Holdings</i>	<i>Market value HK\$</i>	
Listed investments			
Hong Kong			
Bank of China Ltd	11,000,000	32,340,000	1.46
Beijing Enterprises Holdings Ltd	1,000,000	28,900,000	1.31
Catic International Holdings Ltd	50,992,000	5,609,120	0.25
China Agri-Industries Holdings Ltd	3,632,000	14,636,960	0.66
China Comm Construction Co Ltd	2,100,000	13,923,000	0.63
China Communications Services Corp Ltd	8,740,000	45,797,600	2.07
China Construction Bank	8,500,000	42,840,000	1.94
China High Speed Transmission Equip	2,200,000	30,800,000	1.39
China Life Insurance Co Ltd	3,340,000	95,190,000	4.31
China Mengniu Dairy Co Ltd	730,000	5,774,300	0.26
China Mobile Ltd	1,764,500	135,601,825	6.14
China Overseas Land & Investment Limited	2,095,001	19,169,259	0.87
China Petroleum & Chemical Corp	7,508,000	45,273,240	2.05
China Railway Construction Corp	2,369,000	23,737,380	1.07
China Resources Power Holdings Co Ltd	2,000,000	32,960,000	1.49
China Shipping Development Co Ltd	3,000,000	29,790,000	1.35
China Unicom Ltd	5,422,000	62,678,320	2.84
China Yurun Food Group Limited	8,575,000	85,750,000	3.88
Chongqing Iron & Steel Co Ltd	1,756,000	2,598,880	0.12
CNOOC Ltd	4,617,000	40,814,280	1.85
Gome Electrical Appliances Holdings Ltd	5,200,000	11,700,000	0.53
Industrial and Comm Bank of China	25,000,000	114,250,000	5.18
Jiangxi Copper Company Ltd	2,000,000	15,140,000	0.69
Maanshan Iron & Steel Co Ltd	6,000,000	14,220,000	0.64
Petrochina Co Ltd	8,300,000	66,317,000	3.00
Ping An Insurance (Grp) Co of China	1,400,000	61,390,000	2.78
Tencent Holdings Ltd	600,000	33,060,000	1.50
Want Want China Holdings Ltd	4,804,000	13,259,040	0.60
Xtep International Holdings Ltd	8,000,000	15,040,000	0.68
Zijin Mining Group Co Ltd	2,278,000	8,815,860	0.40
ZTE Corp	600,000	17,340,000	0.78
		<u>1,164,716,064</u>	<u>52.72</u>
Equities (Total)		<u><u>2,126,270,571</u></u>	<u><u>96.24</u></u>

Investment portfolio (unaudited)

As at 30 September 2008

HSBC China Dragon Fund

Holdings	Market value HK\$	% of total net assets attributable to unitholders
Bond		
Listed investments		
Tsingtao Brewery Co Ltd 0.8% 2 April 2014	2,382,000	0.10
China Vanke Co Ltd 5.5% 5 September 2013	238,100	0.01
Guangxi Liugong Step Cpn CB 18 April 2014	1,574,000	0.09
	<u>4,339,827</u>	<u>0.20</u>
Total investments	2,130,610,398	96.44
(Total cost of investments: HK\$3,319,559,078)		
Other net assets	<u>78,696,440</u>	<u>3.56</u>
Total net assets attributable to unitholders	<u><u>2,209,306,838</u></u>	<u><u>100.00</u></u>

Statement of movements in portfolio holdings (unaudited)

For the period ended 30 September 2008

	% of total net assets attributable to unitholders	
	30 September 2008	31 March 2008
Equities	96.24	95.81
Bonds	0.20	–
Total investments	<u>96.44</u>	<u>95.81</u>
Other net assets	<u>3.56</u>	<u>4.19</u>
Total net assets attributable to unitholders	<u><u>100.00</u></u>	<u><u>100.00</u></u>

Performance table (unaudited)

For the period ended 30 September 2008

(a) Total net asset value

Period end

31 March 2008	HK\$3,370,192,394
30 September 2008	HK\$2,209,306,838

(b) Total net asset value per unit

Period end

31 March 2008	HK\$9.06
30 September 2008	HK\$5.94

(c) Price record

The Fund is a closed-end fund listed on The Stock Exchange of Hong Kong Limited and no unitholders may demand redemption of their units. In general, closed-end funds may trade on the exchange at a discount or at a premium to their net asset value. There is no assurance that the units will be traded at a price that is equal to the Net Asset Value. As the market price of the units may be determined by factors such as the Net Asset Value and market supply and demand for the units, there is a risk that the units will be traded at a discount to its Net Asset Value. In times of market disruption or when there is an insufficient number of buyers and/or sellers of the units, the bid/ask spread of the market price of the units may widen significantly.

Period	Net asset value per unit	
	Lowest	Highest
	HK\$	HK\$
20 June 2007 (date of inception) to 31 March 2008	8.62	13.94
1 April 2008 to 30 September 2008	5.55	10.22

Administration and management

Directors of the Manager

Executive Directors:

APENBRINK, Rudolf Eduard Walter

CONXICOEUR, Patrice Pierre Henri

(appointed on 1 August 2008)

LAM, Po Yee

STOKES, Edmund Richard

LOUIE, Ngar Yee (resigned on 5 May 2008)

AU, King Lun (resigned on 1 August 2008)

Non-Executive Directors:

CHENG, Hoi Chuen Vincent

CHEANG, Wai Wan Louisa

ENGEL, Conrado

FRIED, David Lawrence

LEECH, Paul Ernest

LEUNG, Ko May Yee Margaret

LEUNG, Wing Cheung William

McCOMBE, Mark Seumas

AMANDINI, Peter James (appointed on 5 May 2008)

Trustee

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Halbis Capital Management (Hong Kong) Limited

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Bank of Communications Co., Ltd

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The People's Republic of China

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KPMG

Certified Public Accountants

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Central

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