

**Remarks by Mr Norman T.L. Chan,  
Chief Executive of the Hong Kong Monetary Authority  
on 23 January 2014  
at the announcement of  
Exchange Fund's investment results for 2013**

(Translation)

Investment performance of the Exchange Fund in 2013

I am going to announce the investment results of the Exchange Fund in 2013. I anticipated in January 2013 that the global financial and investment environment last year would be rather volatile, with significant uncertainties in the debt markets and interest rate movements. As a matter of fact, the financial markets reacted vigorously in May and June 2013 to the US Federal Reserve's first hint of a possible reduction in asset purchases and a tapering schedule. US bond yields surged, with 10-year US Treasury yield once rising more than 100 basis points. As a result, the Exchange Fund recorded a loss of HK\$4.2 billion in the first half of the year. However, an investment income of HK\$54.7 billion was recorded in the third quarter as market sentiments improved. In the fourth quarter, the Exchange Fund further reported an investment income of HK\$25.4 billion on the back of continued gains in equity markets. For the whole year, the Exchange Fund achieved an investment income of HK\$75.9 billion.

2. Equities were the biggest contributor to the Exchange Fund's performance in 2013 and recorded a gain of HK\$81.7 billion, with HK\$71.6 billion coming from overseas equities and HK\$10.1 billion from Hong Kong equities. Bonds recorded a loss of HK\$19.1 billion due to the rise in interest rates in 2013. Other investments and foreign exchange investments recorded gains of HK\$11.7 billion and HK\$1.6 billion respectively.

3. The Exchange Fund's overall rate of return in 2013 was 2.7%. Specifically, the Investment Portfolio, which does not include the Long-Term Growth Portfolio, achieved a rate of return of 4.9%; while the Backing Portfolio recorded a small loss of 0.4 % as a result of the rise in bond yields.

4. In 2013, fee payments to the Fiscal Reserves amounted to HK\$36.8 billion, while the fee payments to placements by HKSAR government funds and statutory bodies amounted to HK\$9.3 billion. The Accumulated Surplus of the Exchange Fund increased by HK\$13.4 billion to HK\$637.3 billion.

#### Latest developments in investment diversification

5. Let me now turn to the latest developments regarding investment diversification of the Exchange Fund. The Exchange Fund has been diversifying its investments and building the Long-Term Growth Portfolio since 2008. Starting from 2013, emerging market and renminbi bonds and equities in the Long-Term Growth Portfolio had been transferred to the Investment Portfolio. The Long-Term Growth

Portfolio now holds private equity and real estate investments. Its total investments are capped at one-third of the Accumulated Surplus of the Exchange Fund.

6. At the end of 2013, the aggregate market value of the investments made under the Long-Term Growth Portfolio amounted to HK\$88.6 billion, comprising HK\$64.2 billion of private equity and HK\$24.4 billion of real estate. Outstanding investment commitments totalled HK\$81.3 billion. Regarding the investment performance of the Long-Term Growth Portfolio, I have to emphasise that these are medium- to long-term investments with relatively low liquidity. We therefore should not focus too much on its short-term results. Having said that, overall performance of the Long-Term Growth Portfolio has been quite satisfactory so far. By end 2013, the annualised internal rate of return on private equity and real estate was around 15.9% since the inception of the Long-Term Growth Portfolio. This is a significantly higher return than the 10% return recorded at end 2012. In 2013, the Long-Term Growth Portfolio benefited from the exceptionally good performance of several investment projects in the Portfolio as well as the overall good performance in overseas equity markets. Therefore, one cannot take such a high rate of return for granted.

#### Investment outlook for 2014

7. Looking ahead in 2014, the global financial environment and asset markets will no doubt be driven by the pace and scale of the US Federal Reserve's exit from Quantitative Easing and the consequential reactions of the US and global interest rates. While the US is on the path of economic recovery, its speed and

sustainability remain uncertain. Turning to Europe, although economic contraction in countries that are seriously hit by the European debt crisis has stopped, their private and public sector indebtedness as well as unemployment rates remain very high, and we expect huge challenges ahead for the European economies. As the US gradually exits from Quantitative Easing and the interest rates normalise, we cannot rule out the risk of another round of outflow of funds from emerging markets to the US, like what we saw in May and June last year.

8. In the face of an unstable global financial and investment environment in 2014, the HKMA will continue to manage the Exchange Fund prudently, strengthen the defensive position of our US bond holdings, and step up our investment diversification with a view to enhancing medium- to long-term returns for the Exchange Fund.