Remarks by Mr Norman T.L. Chan,
Chief Executive of the Hong Kong Monetary Authority
on 26 January 2015
at the announcement of
Exchange Fund's investment results for 2014

Investment performance of the Exchange Fund for 2014

In 2014, the Exchange Fund achieved an investment income of HK$43.6 billion. In 2014, the Exchange Fund's bond holdings recorded a gain of HK$47.3 billion. Equity holdings earned HK$40.2 billion, with HK$33.7 billion coming from overseas equities and HK$6.5 billion from Hong Kong equities. Other investments generated an income of HK$8.8 billion. However, the Exchange Fund incurred an exchange loss of HK$52.7 billion. The overall rate of return of the Exchange Fund in 2014 was 1.4%. Specifically, the Investment Portfolio, which does not include the Long-Term Growth Portfolio, achieved a rate of return of 2%; while the rate of return on the Backing Portfolio was 0.4%.

2. At the end of 2014, the aggregate market value of the investments under the Long-Term Growth Portfolio amounted to HK$115.2 billion, made up of HK$80.5 billion in private equity and HK$34.7 billion in real estate. Outstanding investment commitments totalled HK$79.9 billion. The overall performance of our private equity and real estate investments remains satisfactory, registering an annualised, since-inception internal rate of return of 13.5%.

3. In 2014, fee payable to the Fiscal Reserves was HK$27.5 billion, while the fees paid to other Government and public funds placements totalled HK$8.6 billion. The Accumulated Surplus of the Exchange Fund decreased by HK$2 billion to HK$635.5 billion.

Review of 2014

4. Looking back, 2014 was clearly not an easy year for the Exchange Fund. At the beginning of last year, we faced the challenges posed by the imminent exit of QE by the US Fed and by the likely rise of the USD interest rates and of the strengthening of the USD. We took several defensive moves during the year by holding more cash, reducing the average duration of our bond holdings and reducing the allocation to bonds in favour of equities. We also reduced the Exchange Fund’s holding of Euro and Yen. At the end, what actually happened surprised the market. Instead of moving up, US interest rates actually went down, with 10-year Treasuries yield falling from 3% to 2.17% during the year. USD did strengthen but its speed and magnitude caught many people by surprise, with a sharp rise of 12.8% in 2014, the largest one year rise in 17 years.

Investment Outlook for 2015

5. Looking ahead, the investment environment in 2015 will be even more complex and difficult than 2014. There is considerable uncertainty arising from the timing and pace of the US interest rate normalisation, which is then complicated by the implementation of QQE by Japan and the launch of a full scale QE by the ECB. The recent sharp rise in the USD, big drop in oil prices and the market turbulence following the surprise move by the SNB to drop the one way peg of the Swiss Franc against Euro were just some of the more notable manifestations of the market reaction to a very abnormal global financial and macroeconomic environment. Faced with these challenges in the months ahead, we will continue to exercise prudence and discipline in managing the Exchange Fund in line with its investment objectives, which are to safeguard the principal and to provide abundant liquidity buffers to meet the Exchange Fund’s statutory purposes as and when it is necessary.

6. Thank you.