

Managing The Exchange Fund

THE EXCHANGE FUND

The Exchange Fund was established in 1935 with the primary objective to safeguard the exchange value of the Hong Kong dollar. Holding Hong Kong's foreign currency reserves, the Exchange Fund is the cornerstone of maintaining the stability and integrity of monetary and financial systems in Hong Kong, and provides the backing to maintain the Linked Exchange Rate system.

The Exchange Fund Ordinance stipulates the establishment, control and management of the Exchange Fund. According to the Ordinance, the Exchange Fund is under the control of the Financial Secretary, who delegates the management responsibilities of the Exchange Fund to the Monetary Authority, based on the powers and duties conferred on him under the Ordinance. In consultation with the Exchange Fund Advisory Committee, the Financial Secretary determines the investment policies and strategies for the Exchange Fund with its day-to-day management responsibilities rested with the Monetary Authority.

INVESTMENT OBJECTIVES

The investment objectives of the Exchange Fund are

- (a) to preserve capital;
- (b) to ensure that the entire Monetary Base at all times will be fully backed by highly liquid US dollar-denominated securities;
- (c) to ensure sufficient liquidity for the purpose of maintaining monetary and financial stability; and
- (d) subject to (a) - (c) above, to achieve an investment return that will preserve the long-term purchasing power of the Fund.

INVESTMENT PROCESS

The Exchange Fund is divided into two main portfolios - the Backing Portfolio and the Investment Portfolio. The Backing Portfolio is used to hold US dollar denominated assets for the purpose of providing full backing for the Monetary Base of Hong Kong. The Investment Portfolio is used to hold different asset classes aiming at preserving the value and long-term purchasing power of the Fund. Under the Linked Exchange Rate system, all Exchange Fund assets in the Backing Portfolio and the Investment Portfolio can be used to support the Hong Kong dollar exchange rate.

The long-term asset allocation strategy of the Fund is governed by the investment benchmark, which is set by the Financial Secretary on the advice of the Exchange Fund Advisory Committee. The benchmark represents the optimal mix of assets designed to meet the investment objectives.

USE OF EXTERNAL MANAGERS

The Exchange Fund employs global external managers to manage about one third of its total assets, including all of its equity portfolios and other specialised assets. The purpose of appointing external managers is to add value to the investment process by tapping the best of the investment expertise available in the market, to capture a diverse mix of investment styles within the global investment field, and, if possible, to help transfer market knowledge and information to in-house professionals.