

ANNUAL REPORT 2005

Stock Code: 2800

TraHK

Tracker Fund of Hong Kong



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STATEMENT OF RESPONSIBILITIES OF THE MANAGER AND THE TRUSTEE

Manager's responsibilities

The Manager of Tracker Fund of Hong Kong (the "Fund") is required by the Code on Unit Trusts and Mutual Funds established by the Securities & Futures Commission of Hong Kong (the "SFC Code") and the Trust Deed dated 23rd October 1999 (the "Trust Deed") to prepare financial statements for each annual accounting year which give a true and fair view of the financial position of the Fund at the end of that year and of the transactions for the year then ended. In respect of these financial statements the Manager is required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are prudent and reasonable; and
- prepare or arrange for the preparation of the financial statements on the basis that the Fund will continue in operation unless it is inappropriate to presume this.

The Manager is also required to manage the Fund in accordance with the Trust Deed and take reasonable steps for the prevention and detection of fraud and other irregularities.

Trustee's responsibilities

The Trustee of the Fund is required to:

- ensure that the Fund is managed by the Manager in accordance with the Trust Deed and that the investment and borrowing powers are complied with;
- satisfy itself that sufficient accounting and other records have been maintained;
- safeguard the property of the Fund and rights attaching thereto; and
- report to the Unitholders for each annual accounting year on the conduct of the Manager in the management of the Fund.

REPORT OF THE TRUSTEE TO THE UNITHOLDERS OF TRACKER FUND OF HONG KONG

We hereby confirm that, in our opinion, the Manager of the Fund has, in all material respects, managed the Fund in accordance with the provisions of the Trust Deed, dated 23rd October 1999 for the year ended 31st December 2005.

State Street Bank and Trust Company

31st March 2006

REPORT OF THE AUDITORS TO THE UNITHOLDERS OF TRACKER FUND OF HONG KONG

We have audited the financial statements on pages 4 to 17 which have been prepared in accordance with the relevant disclosure provisions of the Trust Deed dated 23rd October 1999, the relevant disclosure requirements set out in Appendix E of the Code on Unit Trusts and Mutual Funds established by the Securities & Futures Commission of Hong Kong (the "SFC Code") and accounting principles generally accepted in Hong Kong.

Respective responsibilities of the Manager and the Auditors

The Manager of the Tracker Fund of Hong Kong (the "Fund") is responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently. In addition, the SFC Code requires the financial statements of the Fund to contain the relevant disclosures set out in Appendix E of such SFC Code.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the Manager in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Fund's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the financial statements of the Fund give a true and fair view of the financial position of the Fund at 31st December 2005 and of its transactions and cash flows for the year then ended in accordance with accounting principles generally accepted in Hong Kong and have been properly prepared in accordance with the relevant disclosure provisions of the Trust Deed dated 23rd October 1999, and the relevant disclosure requirements set out in Appendix E of the SFC Code.

PricewaterhouseCoopers

Certified Public Accountants

Hong Kong, 31st March 2006

STATEMENT OF OPERATIONS

For the year ended 31st December 2005

	Note	2005 HK\$	2004 HK\$
Revenue			
Dividends		1,017,229,096	978,332,840
Bank interest	8(c)	7,032,291	309,753
Transaction fee	5(a)	300,000	240,000
Other income	5(b)	7,275,833	8,096,602
Net gain on investments	4	<u>1,183,438,411</u>	<u>3,674,774,116</u>
Total investment income		<u>2,215,275,631</u>	<u>4,661,753,311</u>
Expenses			
Management fee	8(a)	13,385,160	13,781,293
Trustee fee	8(b)	13,385,160	13,781,293
Index license fee	9(c)	4,227,942	4,353,949
Transaction costs on investments		1,505,726	1,287,641
Registrar fee	9(a)	2,341,714	2,665,961
Publication and printing expenses		1,847,155	2,099,948
Conversion agent fee	9(b)	440,000	428,000
Audit fee		109,000	104,000
Legal and professional fees		50,000	–
Bank charges		43,874	28,133
Amortization set-up costs		–	468,388
Other operating expenses		<u>788,167</u>	<u>1,265,339</u>
Total operating expenses		<u>38,123,898</u>	<u>40,263,945</u>
Net operating profit		<u>2,177,151,733</u>	<u>4,621,489,366</u>
Finance costs			
Distributions to unitholders		(947,796,250)	(941,080,865)
Dividend equivalent amount on units issued		–	2,715,692
Dividend equivalent amount on units redeemed		–	(9,637,718)
Adjustments from bid market prices to last traded market prices	6	<u>58,590,272</u>	<u>–</u>
		<u>(889,205,978)</u>	<u>(948,002,891)</u>
Increase in net assets attributable to unitholders		<u>1,287,945,755</u>	<u>3,673,486,475</u>
Earnings per unit for profit attributable to unitholders (expressed in HK\$ per unit)	11	<u>\$1.12</u>	<u>2.08</u>

The notes on pages 9 to 17 form part of these financial statements.

STATEMENT OF ASSETS AND LIABILITIES

As at 31st December 2005

	Note	2005 HK\$	2004 HK\$
Assets			
Investments		26,842,037,452	30,573,715,525
Bank balances	8(c)	68,329,644	61,533,682
Dividends receivable		87,524,500	96,838,223
Other accounts receivables and prepayments		182,688	169,396
		<u>26,998,074,284</u>	<u>30,732,256,826</u>
Liabilities			
Trustee fee payable		3,302,002	3,592,032
Management fee payable		3,302,002	3,592,032
Index license fee payable		1,034,305	1,138,631
Registrar fee payable		182,113	211,500
Other accounts payable and accruals		805,790	938,313
		<u>8,626,212</u>	<u>9,472,508</u>
Liabilities (excluding net assets attributable to unitholders)			
		<u>8,626,212</u>	<u>9,472,508</u>
Net assets attributable to unitholders (at bid market prices)		26,989,448,072	30,722,784,318
Adjustments from bid market prices to last traded market prices	6	58,590,272	–
		<u>27,048,038,344</u>	<u>30,722,784,318</u>

Approved by the Trustee and the Manager on 31st March 2006

State Street Bank and Trust Company

State Street Global Advisors Asia Limited

The notes on pages 9 to 17 form part of these financial statements.

STATEMENT OF CHANGES IN NET ASSETS ATTRIBUTABLE TO UNITHOLDERS

For the year ended 31st December 2005

	Note	2005 HK\$	2004 HK\$
Balance at the beginning of the year		30,722,784,318	27,854,424,604
Effect of change in accounting policy	3	(101,263,081)	—
		<u>30,621,521,237</u>	<u>27,854,424,604</u>
In-kind proceeds on issue of units	10	—	727,707,495
In-kind payments on redemption of units	10	(4,861,452,507)	(1,541,439,627)
Net further cash amount received on redemption and issue of units		<u>23,859</u>	<u>1,356</u>
Net redemption of units		<u>(4,861,428,648)</u>	<u>(813,730,776)</u>
		25,760,092,589	27,040,693,828
Increase in net assets attributable to unitholders		1,287,945,755	3,673,486,475
Amount transferred from the statement of distributions		<u>—</u>	<u>8,604,015</u>
Balance at the end of the year		<u><u>27,048,038,344</u></u>	<u><u>30,722,784,318</u></u>

The notes on pages 9 to 17 form part of these financial statements.

STATEMENT OF CASH FLOWS

For the year ended 31st December 2005

	Note	2005 HK\$	2004 HK\$
Operating activities			
Sale of investments	10	544,320,267	480,046,432
Purchase of investments	10	(541,938,003)	(477,898,669)
Dividends received		1,026,542,819	975,229,453
Other income received		7,275,833	8,096,602
Bank interest received		7,018,617	309,669
Transaction fee received		300,000	180,000
Management fee paid		(13,675,190)	(13,622,545)
Trustee fee paid		(13,675,190)	(13,622,545)
Index license fee paid		(4,332,268)	(4,296,733)
Registrar fee paid		(2,371,101)	(2,922,896)
Publication and printing expenses paid		(1,996,640)	(2,315,031)
Transaction costs on investment paid		(1,505,726)	(1,287,641)
Conversion agent fee paid		(440,000)	(432,000)
Bank charges paid		(43,874)	(27,754)
Other operating expenses		(50,911,191)	(9,766,885)
Net cash inflow from operating activities		<u>954,568,353</u>	<u>937,669,457</u>
Financing			
Net further cash amount received on issue and redemption of units		23,859	1,443
Interim distribution paid		(359,638,650)	(377,228,725)
Final distribution paid		(588,157,600)	(555,248,125)
Net cash outflow from financing		<u>(947,772,391)</u>	<u>(932,475,407)</u>
Increase in cash and cash equivalents		6,795,962	5,194,050
Cash and cash equivalents at the beginning of the year		<u>61,533,682</u>	<u>56,339,632</u>
Cash and cash equivalents at the end of the year		<u><u>68,329,644</u></u>	<u><u>61,533,682</u></u>
Analysis of balances of cash and cash equivalents			
Bank balances		<u><u>68,329,644</u></u>	<u><u>61,533,682</u></u>

Please refer to note 10 on page 15 for details of major non-cash transactions.
The notes on pages 9 to 17 form part of these financial statements.

STATEMENT OF DISTRIBUTIONS

For the year ended 31st December 2005

	2005 HK\$	2004 HK\$
Amount transferred from the statement of operations	947,796,250	941,080,865
Interim distribution		
– HK\$0.17 on 2,218,992,500 units paid on 24th May 2004	–	(377,228,725)
– HK\$0.18 on 1,997,992,500 units paid on 24th May 2005	(359,638,650)	–
Final distribution		
– HK\$0.25 on 2,220,992,500 units paid on 22nd November 2004	–	(555,248,125)
– HK\$0.32 on 1,837,992,500 units paid on 22nd November 2005	(588,157,600)	–
Amount transferred to the statement of changes in net assets attributable to unitholders	<u>–</u>	<u>8,604,015</u>

The notes on pages 9 to 17 form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1 General information

Tracker Fund of Hong Kong (the "Fund") is a unit trust which is governed by its Trust Deed dated on 23rd October 1999 (the "Trust Deed"). The Fund is authorized by the Securities & Futures Commission of Hong Kong under Section 104(1) of the Hong Kong Securities and Futures Ordinance. The Fund is also listed on the Stock Exchange of Hong Kong Limited (a subsidiary of The Hong Kong Exchanges and Clearing Limited).

The Fund's objective is to provide investment results that closely correspond to the performance of the Hang Seng Index (the "Index").

2 Basis of preparation and accounting policies

The financial statements have been prepared in accordance with accounting principles generally accepted in Hong Kong and comply with accounting standards issued by the Hong Kong Institute of Certified Public Accountants. The financial statements are prepared under the historical cost convention as modified by the revaluation of investments.

The Fund has changed certain of its accounting policies following its adoption of new/revised Hong Kong Financial Reporting Standards ("new HKFRS") and Hong Kong Accounting Standards ("HKAS") which became effective for accounting periods commencing on or after 1st January 2005. Key changes in accounting policies are as follows:

HKAS 32 Financial Instruments: Disclosure and Presentation

HKAS 32 has affected the presentation of net assets attributable to unitholders, now classified as a financial liability. Refer to Note 6.

HKAS 39 Financial Instruments: Recognition and Measurement

The adoption of HKAS 39 resulted in some changes to the Fund's accounting policies. In summary:

- In accordance with HKAS 39, long investment positions are valued at the closing bid price, rather than at last available price. The valuation of investments is after excluding transaction costs for the purpose of complying with the adoption of the new/revised HKAS 39. The effect of adopting these new policies is set out in note 3 below.

The presentation and classification of certain items in the financial statements have also changed as a result of the adoption of the new/revised accounting standards.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

2 Basis of preparation and accounting policies (Continued)

(a) Investments

In accordance with HKAS39 financial instruments with prices quoted, listed or normally dealt in on the Stock Exchange of Hong Kong Limited (the "Stock Exchange") are stated at the Stock Exchange's bid prices, excluding transaction costs which are expensed as incurred.

Purchases and sales of investments are accounted for on a trade date basis.

Realized gains and losses on sale of investments and unrealized gains and losses on revaluation of investments are recognized in the statement of operations as they arise.

Transaction costs on purchase and sale of investments are accounted for in the Statement of Operations.

(b) Income

Dividend income on equity securities is recorded on the ex-dividend date. Dividend income on equity securities where no ex-dividend date is quoted are accounted for when the Fund's right to receive payment is established.

Bank interest and other income are recognized on an accruals basis.

(c) Expenses

All expenses are accounted for on an accruals basis.

(d) Dividend equivalent amount

Dividend equivalent amount represents the amount included in the issue price or redemption proceeds (as the case may be) of the units issued or redeemed, representing the net undistributed dividends and other income received and held or receivable by the Fund.

(e) Further cash amount

Further cash amount represents the amount included in the issue price or redemption proceeds (as the case may be) of the units issued or redeemed, representing the difference between the net asset value per Creation Unit as calculated by the Manager as of that date, and the value of the Index Basket (based on the nominal closing prices as of that date) and the dividend equivalent amount per Creation Unit.

(f) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents comprise bank balances.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

2 Basis of preparation and accounting policies (Continued)

(g) Translation of foreign currencies

Functional and presentation currency

Items included in the financial statements are measured using the currency of the primary economic environment in which the Fund operates ("the functional currency"). The financial statements are presented in Hong Kong dollars, which is the Fund's functional and presentation currency.

Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions.

(h) Proceeds and payments on allotment and redemption of units

The net asset value per unit is computed for each dealing day. The price at which units are allotted or redeemed is calculated by reference to the net asset value per unit as at the close of business on the relevant dealing day. Units in the Fund are classified as a financial liability in the Statement of Assets and Liabilities and are stated at fair value representing the last traded market prices at which unitholders can redeem the units from the Fund.

(i) Segmental information

In the opinion of the Manager, all activities of the Fund are in the single business of investment activities conducted mainly in Hong Kong. Geographical information is provided in the investment portfolio.

(j) Set-up costs

Set-up costs borne by the Fund are amortized over a period of the first five years of the Fund. This amortization finished during 2004.

(k) Use of estimates

The preparation of accounts in conformity with Hong Kong Financial Reporting Standards requires management to make estimates and assumptions that affect the amounts reported in the accounts and accompanying notes. Actual results could differ from those estimates.

(l) Comparative figures

Due to the adoption of the new/revised accounting standards during the year, the preparation of certain items and balances in the accounts have been revised to comply with the new requirements. Accordingly, certain comparative amounts have been reclassified to conform to the current year's presentation.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 Effect of adoption of new/revised accounting standards

The adoption of new/revised accounting standards applicable to the Fund on total net assets attributable to unitholders are as follows:

Impact on the net assets attributable to unitholders brought forward:

	Note	31.12.2005 HK\$
Balance at 1st January 2005 previously reported		30,722,784,318
Changes in valuation of investments	(a)	<u>(101,263,081)</u>
Adjusted balance at the beginning of the year under new/revised accounting standards		<u><u>30,621,521,237</u></u>

(a) In accordance with HKAS 39 - Financial Instruments: Recognition and Measurement the valuation of investments has been changed to take into account the valuation at bid price rather than at the closing price.

4 Net gain on investments

	Note	2005 HK\$	2004 HK\$
Unrealized gain on investments			
At the beginning of the year		8,891,523,047	5,558,924,440
Adjustments:			
Effect of change in accounting policy	3	(101,263,081)	–
Transaction cost		<u>(641,814)</u>	<u>–</u>
		8,789,618,152	5,558,924,440
At the end of the year		<u>8,598,320,878</u>	<u>8,891,523,047</u>
Change in unrealized gain/loss in value of investments		(191,297,274)	3,332,598,607
Realized gain on sale of investments		<u>1,374,735,685</u>	<u>342,175,509</u>
		<u><u>1,183,438,411</u></u>	<u><u>3,674,774,116</u></u>

NOTES TO THE FINANCIAL STATEMENTS (Continued)**5 Income***(a) Transaction fee*

For each application for the creation of units or for the redemption of units, the Fund is entitled to receive a transaction fee of HK\$30,000 per application.

(b) Other income

Other income represents registrar charges levied on unitholders (other than HKSCC Nominees) who hold units registered in their own names as at each Record Date for the relevant distribution. Currently, these charges amount to HK\$80 per year per unitholder. Such charges are deducted on a half-yearly basis from the half-yearly distributions payable to the relevant unitholders.

6 Number of units in issue and net assets attributable to unitholders per unit

In accordance with the provisions of the Fund's Trust Deed, listed investments and investments with prices quoted in over the counter markets or by market makers are stated at the last traded price on the valuation day for the purpose of determining net asset value per unit for subscriptions and redemptions and for various fee calculation. However, as stated in note 2(a) the accounting policy of the Fund for the purpose of compliance with HKAS 39 and for reporting purpose is to value its investments at the relevant bid market prices on the Statement of Assets and Liabilities date. The difference between the valuation stated in the financial statement of investments and the valuation methodology indicated in the Fund's Trust Deed, results in a decrease in value of investment by HK\$58,590,272.

Net assets attributable to unitholders at last traded market prices represent a liability in the balance sheet, carried at the redemption amount that would be payable at the balance sheet date if the unitholder exercised the right to redeem the unit to the Fund.

	Number of units	
	2005	2004
Units in issue at the beginning of the year	2,140,992,500	2,195,992,500
Issue of units in-kind	–	58,000,000
Redemption of units in-kind	(339,000,000)	(113,000,000)
Units in issue at the end of the year	<u>1,801,992,500</u>	<u>2,140,992,500</u>
	<i>HK\$</i>	<i>HK\$</i>
Net assets attributable to unitholders	<u>27,048,038,344</u>	<u>30,722,784,318</u>
Net assets attributable to unitholders per unit	<u>15.01</u>	<u>14.35</u>
Net asset value per Creation Unit (1 Creation Unit is equivalent to 1,000,000 units)	<u>15,010,073</u>	<u>14,349,786</u>

NOTES TO THE FINANCIAL STATEMENTS (Continued)

7 Taxation

No provision for Hong Kong profits tax has been made as the interest, dividend income and realized gains on disposal of investments of the Fund are excluded from the charge to profits tax under Section 14, Section 26 or Section 26A of the Hong Kong Inland Revenue Ordinance.

8 Transactions with the Manager and its Connected Persons

Connected Persons of the Manager are those as defined in the Code on Unit Trusts and Mutual Funds established by the Securities and Futures Commission of Hong Kong (the "SFC Code"). All transactions entered into during the year between the Fund and the Manager and its Connected Persons were carried out in the normal course of business and on normal commercial terms. To the best of the Manager's knowledge, the Fund does not have any other transactions with Connected Persons except for what is disclosed below.

The directors and officers of the Manager may transact in the units of the Fund as principal provided that prior written notice is obtained from the Trustee. As of 31st December 2005, the directors and officers of the Manager together held 27,820 units in the Fund (2004: 97,540 units).

(a) Management fee

The fee payable to the Manager is calculated at the following annual rates of the net asset value of the Fund on the last dealing day in the relevant quarter:

For first HK\$15 billion of the net asset value	0.050%
For next HK\$15 billion of the net asset value	0.045%
For next HK\$15 billion of the net asset value	0.030%
Any amount by which the net asset value exceeds HK\$45 billion	0.025%

The management fee is accrued daily and is payable quarterly in arrears.

(b) Trustee fee

The fee payable to the Trustee is calculated at the following annual rates of the net asset value of the Fund of the last dealing day in the relevant quarter:

For first HK\$15 billion of the net asset value	0.050%
For next HK\$15 billion of the net asset value	0.045%
For next HK\$15 billion of the net asset value	0.030%
Any amount by which the net asset value exceeds HK\$45 billion	0.025%

The trustee fee is accrued daily and payable quarterly in arrears.

(c) Bank balances

Bank balances are maintained with the Trustee. Bank balances held with the Trustee as at 31st December 2005 was HK\$68,329,644 (2004: HK\$61,533,682). During the year, interest earned on the above bank balances was HK\$7,032,291 (2004: HK\$309,753).

NOTES TO THE FINANCIAL STATEMENTS (Continued)**9 Other fees***(a) Registrar fee*

The fee payable to the Registrar is calculated based on the number of unitholders on the register on the first business day of the relevant month at the following fee scale, subject to a monthly maximum aggregate registrar fee of HK\$1,000,000. With effect from 1st May 2005, the registrar fee has been revised at the following rates:

	With effect from 1st May 2005 HK\$ (per month)	Prior to 1st May 2005 HK\$ (per month)
For first 2,000 Unitholders	9,500	9,500
For every additional 1,000 Unitholders up to 70,000 Unitholders	2,000	–
For every additional 1,000 Unitholders up to 100,000 Unitholders	1,700	2,000
For every additional 1,000 Unitholders up to 200,000 Unitholders	1,800	1,800
For every additional 1,000 Unitholders up to 300,000 Unitholders	1,500	1,500
For every additional 1,000 Unitholders above 300,000 Unitholders	1,200	1,200

In addition, the Registrar is reimbursed for all of its out-of-pocket expenses incurred in connection with performing its services.

The registrar fee is accrued daily and is payable monthly in advance.

(b) Conversion agent fee

The Conversion Agent receives the higher of a monthly retainer fee of HK\$16,000 plus a transaction fee of HK\$12,000 for each creation and redemption application, and a minimum monthly fee of HK\$36,000.

The conversion agent fee is accrued daily and payable monthly in arrears.

(c) Index license fee

The index license fee is calculated at the rate of 0.015% per annum on the daily average net asset value of the Fund, subject to a minimum of US\$10,000 per annum.

The index license fee is accrued daily and is payable quarterly in arrears.

10 Major non-cash transactions

In accordance with the Fund's Trust Deed and since the termination of the Tap agreement, units can only be issued through an in-kind creation of an Index Basket and not through a cash subscription. For each Creation Unit (of 1,000,000 units), the Fund receives an Index Basket consisting of constituent shares as determined by the Manager on a daily basis. During the year, the Fund did not issue any units (2004: 58,000,000 units which were valued at a total of HK\$727,707,495 at the time of issue) in exchange for Index Baskets by the Manager.

In accordance with the Fund's Trust Deed, units can only be redeemed in-kind and are not redeemable for cash. During the year, the Fund redeemed 339,000,000 units (2004: 113,000,000 units) in exchange for Index Baskets consisting of investments valued at HK\$4,861,452,507 (2004: HK\$1,541,439,627) by the Manager.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

11 Earnings per unit

Earnings per unit is calculated by dividing the profit attributable to unitholders of the Fund by the weighted average of outstanding units during the year.

	2005	2004
Profit attributable to unitholders of the Fund	<u>2,177,151,733</u>	<u>4,621,489,366</u>
Weighted average number of outstanding units	<u>1,939,803,459</u>	<u>2,221,628,116</u>
Earnings per unit (<i>HK\$ per unit</i>)	<u>1.12</u>	<u>2.08</u>

12 Soft dollar practices

The Manager may effect transactions, provided that any such transaction is consistent with standards of "best execution", by or through the agency of another person for the account of the Fund with whom the Manager or any of its Connected Persons have an arrangement under which that party will from time to time provide to or procure for the Manager or any of its Connected Persons goods, services or other benefits (such as research and advisory services, computer hardware associated with specialized software or research services and performance measures) the nature of which is such that their provision can reasonably be expected to benefit the Fund as a whole and may contribute to an improvement in the performance of the Fund. For the avoidance of doubt, such goods and services may not include travel, accommodation, entertainment, general administrative goods or services, general office equipment or premises, membership fees, employees' salaries or direct money payments.

Since the inception of the Fund, the Manager had not participated in any soft dollar arrangements in respect of any transactions for the account of the Fund.

13 Investment limitation and prohibitions under the SFC Code

The SFC Code allows the Fund to invest in constituent securities issued by a single issuer for more than 10% of the Fund's net asset value provided that the investment is limited to any constituent securities that each accounts for more than 10% of the weighting of the Index and the Fund's holding of any such constituent securities may not exceed their respective weightings in the Index (except as a result of changes in the composition of the Index and the excess is transitional and temporary in nature).

Constituent stocks that account for more than 10% of the net asset value of the Fund as at 31st December 2005 were as follows:

	Respective weighting in the Index (%)		% of net asset value	
	2005	2004	2005	2004
HSBC Holdings plc	30.1	33.5	29.9	33.4
China Mobile (Hong Kong) Ltd.	<u>15.5</u>	<u>11.7</u>	<u>15.4</u>	<u>11.6</u>

NOTES TO THE FINANCIAL STATEMENTS (Continued)

14 Financial risk management

The objective of the Fund is to provide investment results that closely correspond to the performance of the index. The risk exposures inherent in the Fund as at 31 st December 2005 are summarized below.

(a) *Market price risk*

The Fund's investments are subject to the securities price risk inherent in all securities i.e. the value of holdings may fall as well as rise. The Fund's market risk is managed through diversification of investment portfolio.

(b) *Credit risk*

Credit risk is the risk that an issuer or counterparty will be unable or unwilling to pay amounts in full when due.

The Fund's financial assets which are potentially subject to concentrations of credit risk consist principally of securities and bank balances.

The Fund limits its exposure to credit risk by transacting the majority of its securities and contractual commitment activity with well established broker-dealers, banks with high credit ratings and regulated exchanges that the Fund considers to be well established.

All transactions in securities are settled/ paid for upon delivery using approved and reputable brokers. The risk of default is considered minimal since delivery of securities sold is only made once the broker has received payment. On a purchase, payment is made once the securities have been received by the broker. If either party fails to meet its obligation, the trade will fail.

Accordingly, the Fund has no significant concentration of credit risk.

(c) *Interest rate risk*

The Fund is exposed to a minimal interest rate risk as the Fund invests mainly in equity securities and only the bank balances are exposed to interest rate risk which is considered to be minimal.

(d) *Currency risk*

Currency risk is the risk that the value of financial instruments will fluctuate due to the changes in foreign exchange rates.

The Fund has no significant currency risk because substantially all assets and liabilities are denominated in Hong Kong Dollars, the Fund's reporting currency.

(e) *Fair values of financial instruments*

The Fund's carrying amounts of securities, other assets and liabilities approximate to their fair values. Other assets and liabilities include bank balances, accruals and other payables which are realized or settled within a short period of time.

15 Approval of financial statements

The financial statements were approved by the Trustee and the Manager on 31 st March 2006.

INVESTMENT PORTFOLIO

As at 31st December 2005

	Holdings	Market value HK\$	% of net assets
Hong Kong			
Listed investments (99.24%)			
Equities (99.24%)			
Properties (11.01%)			
Cheung Kong (Holdings) Ltd.	13,327,012	1,061,496,506	3.92
Hang Lung Properties Ltd.	21,218,817	256,747,686	0.95
Henderson Land Development Co. Ltd.	10,459,000	381,230,550	1.41
Sino Land Co Ltd.	24,852,756	233,615,906	0.86
Sun Hung Kai Properties Ltd.	13,804,947	1,045,724,735	3.87
		2,978,815,383	11.01
		2,978,815,383	11.01
Finance (38.08%)			
Bank of East Asia, Ltd., The	8,666,391	202,793,549	0.75
BOC Hong Kong (Holdings) Limited	60,790,048	905,771,715	3.35
Hang Seng Bank Ltd.	11,002,612	1,114,564,596	4.12
HSBC Holdings plc	64,922,643	8,076,376,789	29.86
		10,299,506,649	38.08
		10,299,506,649	38.08
Utilities (6.00%)			
CLP Holdings Ltd.	13,844,817	621,632,283	2.30
Hong Kong Electric Holdings Ltd.	12,296,355	472,180,032	1.74
Hong Kong & China Gas Co. Ltd., The	32,082,596	529,362,834	1.96
		1,623,175,149	6.00
		1,623,175,149	6.00

INVESTMENT PORTFOLIO (Continued)

As at 31st December 2005

	Holdings	Market value HK\$	% of net assets
Commerce and Industry (44.15%)			
Cathay Pacific Airways Ltd.	19,485,766	263,057,841	0.97
Cheung Kong Infrastructure Holdings Ltd.	12,988,601	313,674,714	1.16
China Merchants Holdings (International) Co. Ltd	12,356,820	206,976,735	0.76
China Mobile (Hong Kong) Ltd.	113,511,962	4,154,537,809	15.36
China Resources Enterprises, Ltd.	12,668,214	173,554,532	0.64
China Unicom Ltd.	72,481,953	453,012,206	1.67
CITIC Pacific Ltd.	12,638,659	270,467,303	1.00
CNOOC Limited	236,253,438	1,216,705,206	4.50
COSCO Pacific Limited	12,639,467	177,584,511	0.66
Denway Motors Ltd.	43,288,402	110,385,425	0.41
Esprit Holdings Ltd.	6,914,398	380,637,610	1.41
Hutchison Whampoa Ltd.	24,510,634	1,810,110,321	6.69
Johnson Electric Holdings Ltd.	21,187,359	155,727,089	0.58
Lenovo Group Ltd.	48,489,134	173,348,654	0.64
Li & Fung Ltd.	16,864,455	250,437,157	0.93
MTR Corporations Ltd.	31,056,041	473,604,625	1.75
New World Development	19,990,768	212,901,679	0.79
PCCW Limited	38,708,065	183,863,309	0.68
Swire Pacific Ltd. (A shares)	5,358,883	372,442,369	1.38
Wharf (Holdings) Ltd., The	14,099,935	386,338,219	1.43
Yue Yuen Industrial (Holdings) Limited	9,335,172	201,172,957	0.74
		<u>11,940,540,271</u>	<u>44.15</u>
Total listed investments		26,842,037,452	99.24
Other net assets		<u>206,000,892</u>	<u>0.76</u>
Net assets at 31 at December 2005		<u>27,048,038,344</u>	<u>100.00</u>
Total investments, at cost		<u>18,243,716,574</u>	

STATEMENT OF MOVEMENTS IN INVESTMENT PORTFOLIO

For the year ended 31st December 2005

	Holdings			2005
	2004	Additions	Disposals	
Hong Kong				
Listed investments				
Equities				
Properties				
Cheung Kong (Holdings) Ltd.	16,023,212	14,000	2,710,200	13,327,012
Hang Lung Properties Ltd.	22,830,808	2,560,000	4,171,991	21,218,817
Henderson Investment Ltd.	19,488,116	–	19,488,116	–
Henderson Land Development Co. Ltd.	12,557,411	–	2,098,411	10,459,000
Sino Land Co. Ltd.	–	26,912,000	2,059,244	24,852,756
Sun Hung Kai Properties Ltd.	16,610,620	24,000	2,829,673	13,804,947
Wheelock & Co. Ltd.	14,058,028	–	14,058,028	–
Finance				
Bank of East Asia Ltd., The	10,242,884	53,600	1,630,093	8,666,391
BOC Hong Kong (Holdings) Limited	73,143,136	50,500	12,403,588	60,790,048
Hang Seng Bank Ltd.	13,227,114	20,100	2,244,602	11,002,612
HSBC Holdings plc	77,055,958	268,800	12,402,115	64,922,643
Utilities				
CLP Holdings Ltd.	16,658,585	11,500	2,825,268	13,844,817
Hong Kong Electric Holdings Ltd.	14,763,189	–	2,466,834	12,296,355
Hong Kong & China Gas Co. Ltd., The	38,596,957	29,000	6,543,361	32,082,596

STATEMENT OF MOVEMENTS IN INVESTMENT PORTFOLIO (Continued)

For the year ended 31st December 2005

	Holdings			2005
	2004	Additions	Disposals	
Commerce and industry				
Cathay Pacific Airways Ltd.	23,306,172	40,000	3,860,406	19,485,766
Cheung Kong Infrastructure Holdings Ltd.	15,594,453	–	2,605,852	12,988,601
China Merchants Holdings (International) Co. Ltd	14,809,600	30,000	2,482,780	12,356,820
China Mobile (Hong Kong) Ltd.	135,686,905	161,000	22,335,943	113,511,962
China Resources Enterprises, Ltd.	14,562,706	456,000	2,350,492	12,668,214
China Unicom Ltd.	86,905,779	60,000	14,483,826	72,481,953
CITIC Pacific Ltd.	15,151,486	–	2,512,827	12,638,659
CNOOC Limited	283,995,396	431,000	48,172,958	236,253,438
COSCO Pacific Limited	14,911,043	108,000	2,379,576	12,639,467
Denway Motors Ltd.	49,645,600	1,930,000	8,287,198	43,288,402
Esprit Holdings Ltd.	8,253,342	9,000	1,347,944	6,914,398
Hutchison Whampoa Ltd.	29,381,840	45,000	4,916,206	24,510,634
Johnson Electric Holdings Ltd.	25,417,661	69,500	4,299,802	21,187,359
Lenovo Group Ltd.	51,700,906	5,494,000	8,705,772	48,489,134
Li & Fung Ltd.	20,165,561	30,000	3,331,106	16,864,455
MTR Corporation Ltd.	37,055,556	–	5,999,515	31,056,041
New World Development	–	21,439,000	1,448,232	19,990,768
PCCW Limited	37,156,923	8,424,000	6,872,858	38,708,065
Swire Pacific Ltd. (A shares)	6,433,560	–	1,074,677	5,358,883
Wharf (Holdings) Ltd., The	16,928,776	–	2,828,841	14,099,935
Yue Yuen Industrial (Holdings) Limited	11,206,558	–	1,871,386	9,335,172

PERFORMANCE RECORD

Net asset values

	Net asset value per unit <i>HK\$</i>	Net asset value of the Fund <i>HK\$</i>
At end of financial period dated		
31st December 2003	12.68	27,854,424,604
31st December 2004	14.35	30,722,784,318
31st December 2005	15.01	27,048,038,344

Highest and lowest net asset value per unit

	Highest net asset value per unit <i>HK\$</i>	Lowest net asset value per unit <i>HK\$</i>
Financial period ended		
31st December 2000 (since inception)	18.39	13.75
31st December 2001	16.24	9.12
31st December 2002	12.07	9.06
31st December 2003	12.70	8.62
31st December 2004	14.39	11.08
31st December 2005	15.80	13.50

Fund performance

During the year, the Hang Seng Index increased by 4.54% while the net asset value per unit of the Fund increased by 4.60%.

ADMINISTRATION AND MANAGEMENT

Directors of the Manager

Mr. Bernard Reilly
Ms. Yan-Yan Li

Members of the Supervisory Committee

Mr. Marvin Cheung
Mr. Fong Hup
Ms. Karen Kemp
Mr. Lawrence Fok
Prof. Tsang Shu-ki

Trustee and custodian

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Manager

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Promoter

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Auditors

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22nd Floor, Prince's Building
Central
Hong Kong