HSBC

Investment Monthly

Earnings support risk assets despite potential rate cut delays

May 2024

Key takeaways

- As markets are now pricing in a delayed and slower Fed rate cut path due to sticky US inflation and a more hawkish Fed tone, we continue to deploy cash in bonds by locking in the current attractive yields from major government bonds and investment grade credit amid geopolitical uncertainties.
- Thanks to strong earnings and a resilient cyclical outlook in the US, we continue to adopt a pro-cyclical stance, broadening our exposure to IT, communications, consumer discretionary, financials, industrials and healthcare. In Europe, higher wages and good performance from European consumer discretionary companies, with half of the sector's revenue coming from the US, support our upgrade of the sector to overweight.

Willem Sels
Global Chief Investment Officer
HSBC Global Private Banking and Wealth

Lucia Ku
Global Head of Wealth Insights
HSBC Wealth and Personal Banking

- In Asia, we continue to diversify our exposure into Japan, India, Indonesia and South Korea. Robust industrial production and supporting policies in India and China warrant an upgrade of Asian industrials to overweight. Given strong wage growth, a sustained reflationary trend and an uptick of core inflation (excluding fresh food) forecast, we now expect a hike to 0.25% in Q3 2024 by the Bank of Japan. We remain bullish on Japanese equities.

Asset class	6-month view	Comment
Global equities	▲	Despite the risk of high-for-longer rates and inflation, the better-than-expected global economic outlook and a bottoming of activity in Europe and Japan have led us to broaden our geographical and sector exposure.
Government bonds	▶	Rate cuts should still materialise in the West in the coming months, pushing DM government bond yields lower overtime. Japanese government bonds remain unattractive.
Investment grade (IG) corporate bonds	▲	As interest rate risk is more attractively priced than credit risk, we continue to favour quality bonds and lock in the current yield levels with a focus on 5-7 year maturities.
High yield (HY) corporate bonds	▶	Credit spreads are too tight to compensate even for the small pickup in defaults that we expect to see. We maintain our preference for investment grade over high yield bonds.
Gold	▶	The impact of ongoing geopolitical uncertainties and central bank buying is offset by high real yields and USD strength.

▲ "Overweight" implies a positive tilt towards the asset class, within the context of a well-diversified, typically multi-asset portfolio.
▼ "Underweight" implies a negative tilt towards the asset class, within the context of a well-diversified, typically multi-asset portfolio.
▶ "Neutral" implies neither a particularly negative nor a positive tilt towards the asset class, within the context of a well-diversified, typically multi-asset portfolio.
Icons: ↑ View on this asset class has been upgraded; ↓ View on this asset class has been downgraded.

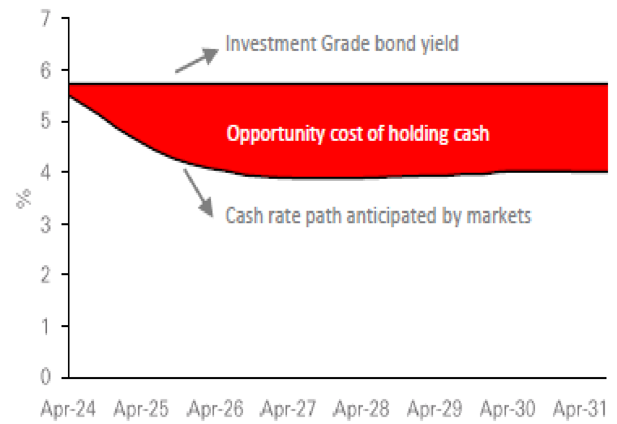
Talking points

Each month, we discuss 3 key issues facing investors

1. What is the impact of a delay in rate cuts on bonds?

- Continued surprises on US inflation and a more hawkish tone from the Fed that they need greater confidence to start policy easing have caused markets to reprice the Fed rate path. Markets have changed from being over-enthusiastic three months ago to over-conversative now, pricing in 0.4% cuts only by December (previously 1.6% of cuts).
- While there is now a significant risk that the Fed may delay rate cuts till after June, we think they will cut several times this year, as core PCE (the preferred Fed gauge) has shown significant progress, and current policy rates have been in restrictive territory for much longer than usual. The ECB and Bank of England appear to be ready to start policy easing in June as inflation is closer to their targets.
- As markets already price in a later start of Fed cuts and may have gone too far, we continue to deploy cash in bonds by locking in the current attractive yields from major government bonds and investment grade. Cash returns are expected to decline and, if they fall more than expected, the opportunity cost will be even greater. Quality bonds remain in favour amid rate and geopolitical uncertainties.

Chart 1: Estimating the opportunity cost of holding cash

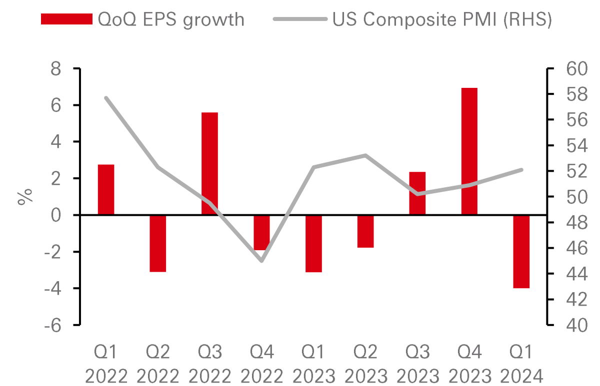


Source: Bloomberg, HSBC Global Private Banking and Wealth as at 23 April 2024. Past performance is not a reliable indicator for future performance.

2. What is our sector stance given a better cyclical outlook in the West?

- As most US economic data surprise on the upside, consensus continues to upgrade GDP growth. We believe equity analysts' negative Q1 earnings growth forecast of -4% compared to Q4 will be exceeded, with communication services, IT and consumer discretionary delivering the fastest earnings growth. For 2024 as a whole, earnings expectations are constructive and remain well above historical averages at 11% for 2024.
- We continue to adopt a pro-cyclical stance in the US amid rising global PMIs, improving trade and resilient labour markets, broadening our sector exposure to IT, communications, consumer discretionary, financials, industrials and healthcare.
- In the UK and Europe, we believe economic growth in Q4 2023 marked the low of the economic cycle. Backed by higher wages and good performance from European consumer discretionary companies, with half of the sector's revenue coming from the US, we upgrade the sector to overweight. Our other overweight positions in IT, financials, energy and healthcare reflect our more balanced sector approach in Europe compared to the US.

Chart 2: Earnings expectations are too low, given the solid US PMI

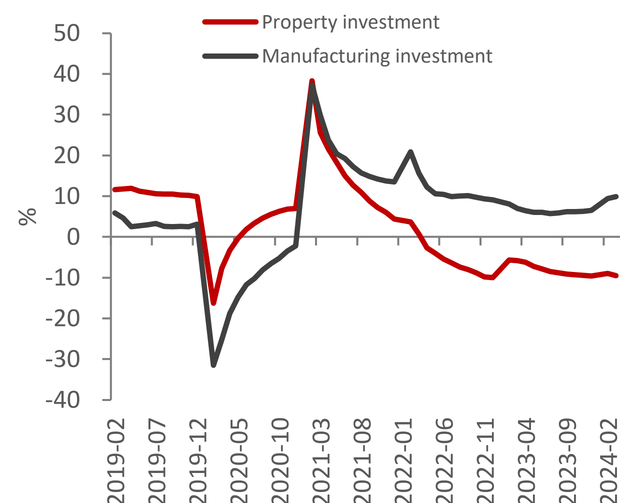


Source: Bloomberg, HSBC Global Private Banking and Wealth as at 23 April 2024. Past performance is not a reliable indicator of future performance.

3. Is Asia in good shape with mixed economic data from China?

- With divergent growth across the region, we continue to diversify our exposure into Japan, India, Indonesia and South Korea.
- India's April Flash PMIs indicated the fastest growth in economic output since June 2010, with strong momentum from manufacturing and services activities. The industrials sector is benefitting from a multi-year investment capex cycle, supply chain diversification, as well as increased manufacturing and industrial spending boosted by government incentives. In China, despite mixed economic data, its Q1 GDP growth of 5.3% was driven partly by acceleration in manufacturing investment. The government's ongoing policy push for high-end manufacturing provides upgrade support. The robust industrial production in these two markets supports our upgrade of Asian industrials to overweight.
- In Japan, while the Bank of Japan kept its rates on hold at its April meeting, we now expect a hike to 0.25% in Q3 2024 because of strong wage growth, a sustained reflationary trend and an uptick of core inflation (excluding fresh food) forecast to 2.8% for 2024. This will take the upper bound interest rate from 0.1% to 0.25%, followed by two 0.25% hikes in 2025. We remain bullish on Japanese equities.

Chart 3: Property investment vs manufacturing investment in China



Source: Wind, HSBC Global Private Banking and Wealth, as at 24 April 2024.

Asset Class Views

Our latest house view on various asset classes

Asset class	6-month view	Comment
Global equities		
Global	▲	Despite the risk of high-for-longer rates and inflation, the better-than-expected global economic slowdown and a bottoming cyclical outlook in Europe and Japan have led us to broaden our geographical and sector exposure.
United States	▲	The prospect of rate cuts, continued disinflation and an improving earnings outlook have provided a boost to equity fundamentals. We prefer a broader exposure including IT, communications, consumer discretionary and healthcare.
United Kingdom	▶	Valuations are relatively cheap but local sentiment remains mixed.
Europe ex-UK	▶	The economic cycle appears to have bottomed out and we find value in companies with strong earnings power, especially those that can benefit from improving global growth. Valuations remain below their historical average.
Japan	▲	The reflationary trend, corporate governance reforms and the AI investment boom are positives for Japanese stocks.
Emerging Markets (EM)	▶	We expect more emerging markets to cut rates following some of the Latin American countries. Corporate earnings growth is expected to rebound sharply for EM Asian markets in 2024.
EM EMEA	▼	The region is impacted by high energy prices and global interest rates, as well as geopolitical uncertainty.
EM LatAm	▶	While Brazil's earnings and price momentum are falling, we remain positive on Mexico largely due to the North American re-industrialisation.
Asia ex Japan equities		
Asia ex-Japan	▲	Asia is on track to deliver above global average growth supported by exceptional growth in India, stable performance of ASEAN and more decisive policy stimulus from China. We continue to diversify our exposure to capture the opportunities.
Mainland China	▶	Cheap valuations and policy stimulus are positive although economic momentum remains mixed. We prefer service consumption leaders, high-end manufacturing winners driven by AI and EV innovation, and beneficiaries of SOE reforms.
India	▲	We prefer large-cap quality stocks backed by India's strong economic fundamentals, supply chain diversification, a rising middle class and young demographics. An NDA victory – as suggested by polls - would help policy continuity and stability.
Hong Kong	▶	We remain neutral amid attractive valuations with a preference for the insurance, telecom and utility sectors.
Singapore	▶	A rebound in industrial production and travel-related services suggest stronger GDP growth this year.
South Korea	▲	We see solid momentum in South Korea's tech exports thanks to strong AI-driven demand and ongoing memory upcycle globally. The Corporate Value-up Program is also a long-term positive driver.
Taiwan	▶	The increasing AI and tech-related demand continues to support the equity market but much has already been priced in and geopolitical uncertainty remains a headwind, so we maintain a neutral stance.
Government bonds		
Developed markets (DM)	▶	Rate cuts should still materialise in the West in the coming months, pushing DM government bond yields lower overtime. Japanese government bonds remain unattractive.
United States	▲	10-year Treasury yield rose on a hawkish shift in the Fed rhetoric. We continue to lock in current yields with medium-to-long duration exposures.
United Kingdom	▲	The continued disinflation trend provides room for the Bank of England to deliver the first rate cut in June. We remain positive on UK gilts.
Eurozone	▶	The recent cut from the Swiss National Bank paves the way for the ECB to cut rates this summer, which should provide some relief to European bond yields, where we maintain a neutral stance as absolute yield levels are lower than in the US.
Japan	▼	We expect the BoJ to hold policy rate at the upcoming meeting and would watch closely on the potential guidance of rate and economic outlook, as well as on the purchases of Japanese government bonds, which remain unattractive in our view.
Emerging Markets (Local currency)	▼	The stronger USD puts pressure on several EM currencies. While we remain underweight on EM local currency bonds, we continue to favour Indian local currency bonds due to the country's robust structural and cyclical growth outlook.
Emerging Markets (Hard currency)	▶	We prefer developed market investment grade on a relative basis. However, we still find opportunities in selected quality issuers in emerging markets, where the yields remain appealing.
Corporate bonds		
Global investment grade (IG)	▲	As interest rate risk is more attractively priced than credit risk, we continue to favour quality bonds and lock in the current yield levels with a focus on 5-7 years' maturities.
USD investment grade (IG)	▲	USD investment grade credit offers attractive spreads with the deepest liquidity.
EUR and GBP investment grade (IG)	▲	Although spreads have tightened, yields remain attractive and should be supported by the prospect of rate cuts this summer. Our preference for quality warrants our overweight on EUR and GBP investment grade credit.
Asia investment grade (IG)	▲	We believe Asian IG credit can deliver higher total returns versus high yield and favour Asian financials, Indian local currency bonds, Indonesian quasi-sovereign bonds, Macau gaming and Chinese IT, media and telecom.
Global high-yield (HY)	▶	Credit spreads are too tight to compensate even for the small pickup in defaults that we expect to see. We maintain our preference for investment grade over high yield bonds.
US high-yield (HY)	▶	Although defaults remain low and refinancing risk is manageable, risk premia are too low in our view, so we continue to prefer investment grade on a relative basis.
EUR and GBP high-yield (HY)	▶	European high yield issuers often have lower leverage than in the US, but economic growth is lower, hurting cash flows. Our neutral stance reflects our preference for quality, even though growth may have bottomed at the end of last year.
Asia high-yield (HY)	▶	We stay highly selective in the China credit space and prefer quality issuers for better risk-adjusted returns.
Commodities		
Gold	▶	The impact of ongoing geopolitical uncertainties and central bank buying is offset by high real yields and USD strength.
Oil	▶	While geopolitics provide support for oil, spare capacity limits the upside. We expect oil prices to trade sideways.

Sector Views

Global and regional sector views based on a 6-month horizon

Sector	Global	US	Europe	Asia	Comment
Consumer Discretionary	▲	▲	▲↑	▲	Easing inflation and higher wages have improved consumer sentiment and spending, supporting our upgrade of European consumer discretionary to overweight. The outlook for hospitality and tourism looks particularly constructive. Apparel sales pick-up is patchy with unpredictable weather disrupting seasonal buying patterns. Despite weak EV demand hurting auto stock sentiment, ICE-powered vehicles are seeing steady growth in demand.
Financials	▲	▲	▲	▶	An improving economic and corporate outlook combined with solid fundamentals and low valuations should support the sector, in particular, capital markets which have had a good start to the year with a pick-up in trading volumes, M&A activity, IPOs and bond issuance. Interest rates look set to decline only slowly with a modest impact on earnings in 2024. Regional banks with significant exposure to the real estate sector are experiencing some challenges.
Industrials	▲	▲	▶	▲↑	We upgrade Asian industrials on tentative signs of an improvement in the macro-economic outlook and early signs of a demand pick-up. US industrials are benefitting from both robust domestic demand and reshoring/near-shoring initiatives fuelled by the US's Inflation Reduction Act (IRA) and CHIPS Act. In other regions, Q4/Q1 results, and management guidance provide some optimism of a demand pick-up. Aerospace, defence and automation remain potential bright spots.
Information Technology	▲	▲	▲	▲	Big tech stocks have seen some pull-back as the rally broadens. AI will be the key driver for the sector as the technology becomes increasingly embedded leading to product and service capability enhancements, productivity gains and competitive differentiation. The next wave of AI development should benefit digital infrastructure companies focused on cloud, data centres, software and cooling technologies.
Communications Services	▶	▲	▼	▲	US Communications continue to deliver stellar earnings growth as fundamentals and prices remain attractive. In Asia, the stabilising regulatory environment and low valuations offer an attractive risk-return profile. In contrast, Europe's telecom services sector has little room for optimism.
Materials	▶	▶	▶	▶	Since the beginning of March, copper and aluminium prices have started to rebound with iron ore and steel prices also off their lows. Mining stocks have recovered somewhat in tandem. Markets are anticipating demand pick-up from the renewables sector, electrical and digital infrastructure, selected real estate segments and some inventory restocking. Chemicals stocks remain range bound.
Real Estate	▼	▼	▶	▼	The outlook for commercial real estate is mixed with retail and office segments still looking unattractive, while warehousing is seeing improved demand and prices after a sustained period of weakness. The housing sector in some markets is showing tentative signs of improving sentiment in anticipation of lower interest rates. Chinese real estate remains problematic. Easing inflation and interest rates may lift sentiment and activity.
Consumer Staples	▶	▶	▶	▲	Cost margins appear secure as cost pressures have somewhat eased. The sector should benefit from strong seasonal demand with solid results going forward despite tough YoY comparables. The sector trades in line with historical valuations. We focus on quality stocks with strong brands and more resilient pricing power.
Energy	▶	▶	▲	▶	Low valuations, strong cashflow and high dividends appear to be insufficient to change sentiment towards the sector as energy prices remain range-bound. On a seasonally adjusted basis, supplies appear plentiful and inventories adequate, helped by the relatively mild winter in Europe. In 2024, energy prices may not benefit from geopolitical uncertainties as they have over the last two years.
Healthcare	▲	▲	▲	▼	New product launches, a less hostile pricing environment and the ebbing wave of major product patent expirations should help lift the sector after a period of under-performance. Healthcare sales growth should start to benefit from easier comparables and new pharma products should lift sentiment and expectations. In Asia, valuations remain elevated, trading well above historical levels.
Utilities	▶	▼	▶	▲	The outlook for European and US renewable energy projects continues to improve as governments have started to adopt more realistic pricing for new project auctions following a period of unprecedented cost increases. Interest rate cuts could provide a tailwind and improve sentiment further. Utilities may benefit as interest rates fall and investors look to high dividend paying stocks.

Disclaimer

This document or video is prepared by The Hongkong and Shanghai Banking Corporation Limited ('HBAP'), 1 Queen's Road Central, Hong Kong. HBAP is incorporated in Hong Kong and is part of the HSBC Group. This document or video is distributed and/or made available, HSBC Bank (China) Company Limited, HSBC Bank (Singapore) Limited, HSBC Bank Middle East Limited (UAE), HSBC UK Bank Plc, HSBC Bank Malaysia Berhad (198401015221 (127776-V))/HSBC Amanah Malaysia Berhad (20080100642 1 (807705-X)), HSBC Bank (Taiwan) Limited, HSBC Bank plc, Jersey Branch, HSBC Bank plc, Guernsey Branch, HSBC Bank plc in the Isle of Man, HSBC Continental Europe, Greece, The Hongkong and Shanghai Banking Corporation Limited, India (HSBC India), HSBC Bank (Vietnam) Limited, PT Bank HSBC Indonesia (HBID), HSBC Bank (Uruguay) S.A. (HSBC Uruguay is authorised and oversought by Banco Central del Uruguay), HBAP Sri Lanka Branch, The Hongkong and Shanghai Banking Corporation Limited – Philippine Branch, HSBC Investment and Insurance Brokerage, Philippines Inc, and HSBC FinTech Services (Shanghai) Company Limited and HSBC Mexico, S.A. Multiple Banking Institution HSBC Financial Group (collectively, the "Distributors") to their respective clients. This document or video is for general circulation and information purposes only.

The contents of this document or video may not be reproduced or further distributed to any person or entity, whether in whole or in part, for any purpose. This document or video must not be distributed in any jurisdiction where its distribution is unlawful. All non-authorised reproduction or use of this document or video will be the responsibility of the user and may lead to legal proceedings. The material contained in this document or video is for general information purposes only and does not constitute investment research or advice or a recommendation to buy or sell investments. Some of the statements contained in this document or video may be considered forward looking statements which provide current expectations or forecasts of future events. Such forward looking statements are not guarantees of future performance or events and involve risks and uncertainties. Actual results may differ materially from those described in such forward-looking statements as a result of various factors. HBAP and the Distributors do not undertake any obligation to update the forward-looking statements contained herein, or to update the reasons why actual results could differ from those projected in the forward-looking statements. This document or video has no contractual value and is not by any means intended as a solicitation, nor a recommendation for the purchase or sale of any financial instrument in any jurisdiction in which such an offer is not lawful. The views and opinions expressed are based on the HSBC Global Investment Committee at the time of preparation and are subject to change at any time. **These views may not necessarily indicate HSBC Asset Management's current portfolios' composition. Individual portfolios managed by HSBC Asset Management primarily reflect individual clients' objectives, risk preferences, time horizon, and market liquidity.**

The value of investments and the income from them can go down as well as up and investors may not get back the amount originally invested. Past performance contained in this document or video is not a reliable indicator of future performance whilst any forecasts, projections and simulations contained herein should not be relied upon as an indication of future results. Where overseas investments are held the rate of currency exchange may cause the value of such investments to go down as well as up. Investments in emerging markets are by their nature higher risk and potentially more volatile than those inherent in some established markets. Economies in emerging markets generally are heavily dependent upon international trade and, accordingly, have been and may continue to be affected adversely by trade barriers, exchange controls, managed adjustments in relative currency values and other protectionist measures imposed or negotiated by the countries with which they trade. These economies also have been and may continue to be affected adversely by economic conditions in the countries in which they trade. Investments are subject to market risks, read all investment related documents carefully.

This document or video provides a high-level overview of the recent economic environment and has been prepared for information purposes only. The views presented are those of HBAP and are based on HBAP's global views and may not necessarily align with the Distributors' local views. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of its dissemination. It is not intended to provide and should not be relied on for accounting, legal or tax advice. Before you make any investment decision, you may wish to consult an independent financial adviser. In the event that you choose not to seek advice from a financial adviser, you should carefully consider whether the investment product is suitable for you. You are advised to obtain appropriate professional advice where necessary.

The accuracy and/or completeness of any third-party information obtained from sources which we believe to be reliable might have not been independently verified, hence Customer must seek from several sources prior to making investment decision.

The following statement is only applicable to HSBC Mexico, S.A. Multiple Banking Institution HSBC Financial Group with regard to how the publication is distributed to its customers: This publication is distributed by Wealth Insights of HSBC México, and its objective is for informational purposes only and should not be interpreted as an offer or invitation to buy or sell any security related to financial instruments, investments or other financial product. This communication is not intended to contain an exhaustive description of the considerations that may be important in making a decision to make any change and/or modification to any product, and what is contained or reflected in this report does not constitute, and is not intended to constitute, nor should it be construed as advice, investment advice or a recommendation, offer or solicitation to buy or sell any service, product, security, merchandise, currency or any other asset.

Receiving parties should not consider this document as a substitute for their own judgment. The past performance of the securities or financial instruments mentioned herein is not necessarily indicative of future results. All information, as well as prices indicated, are subject to change without prior notice; Wealth Insights of HSBC Mexico is not obliged to update or keep it current or to give any notification in the event that the information presented here undergoes any update or change. The securities and investment products described herein may not be suitable for sale in all jurisdictions or may not be suitable for some categories of investors.

The information contained in this communication is derived from a variety of sources deemed reliable; however, its accuracy or completeness cannot be guaranteed. HSBC México will not be responsible for any loss or damage of any kind that may arise from transmission errors, inaccuracies, omissions, changes in market factors or conditions, or any other circumstance beyond the control of HSBC. Different HSBC legal entities may carry out distribution of Wealth Insights internationally in accordance with local regulatory requirements.

Important Information about the Hongkong and Shanghai Banking Corporation Limited, India ("HSBC India")

HSBC India is a branch of The Hongkong and Shanghai Banking Corporation Limited. HSBC India is a distributor of mutual funds and referrer of investment products from third party entities registered and regulated in India. HSBC India does not distribute investment products to those persons who are either the citizens or residents of United States of America (USA), Canada, Australia or New Zealand or any other jurisdiction where such distribution would be contrary to law or regulation.

The following statement is only applicable to HSBC Bank (Taiwan) Limited with regard to how the publication is distributed to its customers: HSBC Bank (Taiwan) Limited ("the Bank") shall fulfill the fiduciary duty act as a reasonable person once in exercising offering/conducting ordinary care in offering trust services/ business. However, the Bank disclaims any guarantee on the management or operation performance of the trust business.

The following statement is only applicable to PT Bank HSBC Indonesia ("HBID"): PT Bank HSBC Indonesia ("HBID") is licensed and supervised by Indonesia Financial Services Authority ("OJK"). Customer must understand that historical performance does not guarantee future performance. Investment product that are offered in HBID is third party products, HBID is a selling agent for third party product such as Mutual Fund and Bonds. HBID and HSBC Group (HSBC Holdings Plc and its subsidiaries and associates company or any of its branches) does not guarantee the underlying investment, principal or return on customer investment. Investment in Mutual Funds and Bonds is not covered by the deposit insurance program of the Indonesian Deposit Insurance Corporation (LPS).

Important information on ESG and sustainable investing

In broad terms "ESG and sustainable investing" products include investment approaches or instruments which consider environmental, social, governance and/or other sustainability factors to varying degrees. Certain instruments we classify as sustainable may be in the process of changing to deliver sustainability outcomes. There is no guarantee that ESG and Sustainable investing products will produce returns similar to those which don't consider these factors. ESG and Sustainable investing products may diverge from traditional market benchmarks. In addition, there is no standard definition of, or measurement criteria for, ESG and Sustainable investing or the impact of ESG and Sustainable investing products. ESG and Sustainable investing and related impact measurement criteria are (a) highly subjective and (b) may vary significantly across and within sectors.

HSBC may rely on measurement criteria devised and reported by third party providers or issuers. HSBC does not always conduct its own specific due diligence in relation to measurement criteria. There is no guarantee: (a) that the nature of the ESG / sustainability impact or measurement criteria of an investment will be aligned with any particular investor's sustainability goals; or (b) that the stated level or target level of ESG / sustainability impact will be achieved. ESG and Sustainable investing is an evolving area and new regulations are being developed which will affect how investments can be categorised or labelled. An investment which is considered to fulfil sustainable criteria today may not meet those criteria at some point in the future.

THE CONTENTS OF THIS DOCUMENT OR VIDEO HAVE NOT BEEN REVIEWED BY ANY REGULATORY AUTHORITY IN HONG KONG OR ANY OTHER JURISDICTION.

YOU ARE ADVISED TO EXERCISE CAUTION IN RELATION TO THE INVESTMENT AND THIS DOCUMENT OR VIDEO. IF YOU ARE IN DOUBT ABOUT ANY OF THE CONTENTS OF THIS DOCUMENT OR VIDEO, YOU SHOULD OBTAIN INDEPENDENT PROFESSIONAL ADVICE.

© Copyright 2024. The Hongkong and Shanghai Banking Corporation Limited, ALL RIGHTS RESERVED.

No part of this document or video may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior written permission of The Hongkong and Shanghai Banking Corporation Limited.