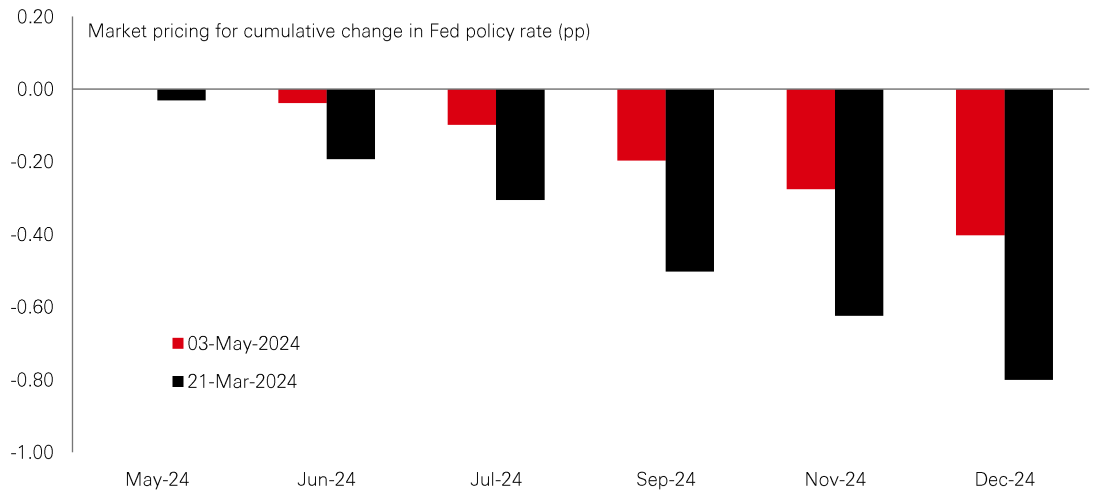
Investment Weekly

6 May 2024

Chart of the week – Fed on summer holidays



Recent US data have thrown the Fed's plans to enact a policy pivot off course. The primary problem is sticky inflation; the Fed's preferred price gauge jumped 3.7% q/q annualised in Q1, up from around 2% in the second half of last year. Q1 GDP came in below expectations but masked still-strong consumer spending, while some keenly watched surveys have softened. Meanwhile, labour data point to a gradual cooling of demand, but the picture varies across indicators.

Broadly resilient growth and labour data have allowed the Fed to focus on inflation. **The upshot is that the Fed has backed away from any near-term rate cuts** – something Chair Powell confirmed in his press conference last week.

Ultimately, we expect core inflation to return to a downward trend in H2 2024 – **disinflation is just delayed**. That's particularly the case when housing-related components begin to reflect the muted rent increases that have been underway for well over a year. But the Fed will need to see a few months of better inflation data to feel confident that it can start to ease policy, which effectively means taking the summer off and returning to the issue in September.

This year started with seven rate cuts being priced for 2024. Moving to zero may not be a big problem for risk assets if GDP and profits growth hold up. But the longer interest rates are frozen at restrictive levels, the more likely they are to bite the economy and cause some financial instability. That may create problems further down the road, even challenging the widely-held assumption of investors for a 'soft' or 'no landing'.

Earnings Outlook →

Exploring the profit growth challenge for tech giants

Putting Cash to Work →

Why there are opportunity costs to holding cash

Asian Bonds →

The story of Asian bond resiliency amid Fed repricing

Market Spotlight

Emerging trends in ESG

The growing influence of ESG (Environmental, Social and Governance) in portfolio management has made it a mainstream political topic. In a year when half the world's population will be voting in national elections, key ESG issues will be under scrutiny.

One area to watch is that while new reporting frameworks have helped to tackle issues like 'greenwashing', there are still divergent views that need to be aligned on ESG regulations across the US, Europe and Asia. Another key development is the shift from 'tell me', to 'show me' when it comes to disclosure on ESG claims. And as part of this drive to improve transparency, there are moves to enhance data quality and ensure ethical use of AI.

Elsewhere, there is growing attention on supporting Asia and EM countries to decarbonise. And efforts are also being made to ensure workers in carbon-intensive industries in both DMs and EMs don't suffer unduly in the low-carbon transition. Finally, a trend to keep an eye on is the continuing popularity of investing in biodiversity and nature, as evidenced by a four-fold growth in assets under management in European funds in this area.

Source: HSBC Asset Management. Macrobond, Bloomberg. Data as at 11.00am UK time 03 May 2024.

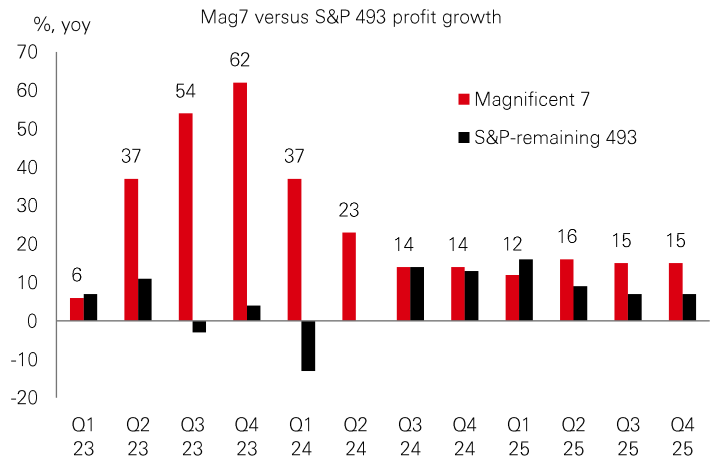
Lens on...

Magnificent earnings – a hard act to repeat?

The Q1 earnings season is past the midpoint, and so far, results have been encouraging. Broadly speaking, the Magnificent Seven (Mag7) have delivered versus expectations, even if idiosyncratic issues are driving a wedge between individual stock performance.

But while earnings have been impressive, there are risks. Currently, the Mag7 12-month forward price-earnings ratio (PE) is 30x versus 18x for the rest of the S&P. It shows how much investors are willing to pay-up for breathtaking profit growth. But with the market cap of the Mag7 having grown eight-fold over the past decade to over USD13 trillion (larger than MSCI Europe at USD11 trillion), their sheer size will make maintaining strong profits growth harder. And it sets the market up for a material correction if earnings disappoint.

On a sequential basis, EPS growth is expected to broaden out over coming quarters, lessening the dependence on a small group of companies. The question then becomes if the remaining 493 can deliver the goods?



Putting cash to work in fixed income

In the current environment of high interest rates, it's tempting to lock up money in cash accounts. But there are potential opportunity costs of doing so. The first point to make is **fixed-income assets have scope for capital gains**, unlike cash. And high-quality government and corporate bonds are inherently less volatile than most equity asset classes, making them less risky.

Also, quants have crunched the numbers and calculated that just a 50bp dip in US Treasury yields would produce a 12-month total return of around 6% on 2-year Treasuries, rising to 13% on a 30-year bond. But the risks are asymmetric. Even if yields rise by 50bp (associated with falling bond prices), you would still make a positive return on 2, 5, and 10-year bonds. This is because high coupons more than offset the capital loss.

Further progress on disinflation has the potential to push yields lower, as this provides central banks with the confidence to cut rates. A downside economic shock could push yields down even more. These scenarios are consistent with a period of outsized returns for bondholders.

Estimated 12m Total Return under different US Treasury yield changes

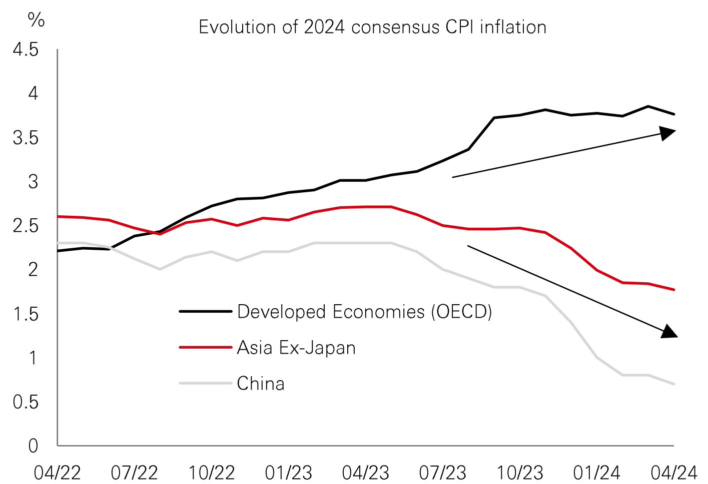
	Increase			Decrease		
	300bps	100bps	50bps	-50bps	-100bps	-300bps
2yr	-0.4%	3.1%	4.0%	5.8%	6.7%	10.6%
5yr	-7.2%	0.5%	2.5%	6.8%	9.0%	18.5%
10yr	-15.5%	-3.1%	0.5%	8.1%	12.3%	30.6%
20yr	-22.6%	-6.5%	-1.2%	11.2%	18.1%	51.4%
30yr	-24.9%	-8.9%	-2.6%	12.8%	22.0%	67.8%

Asian bonds shine

April was a tough month for Western government bond markets as investors priced out 2024 Fed rate cuts, with the US 10-year yield rising by around 50bp. The US dollar also rose. But Asian local currency bonds managed to weather the storm, seeing fairly limited drawdowns. We think this is reflective of the region's solid macro fundamentals and decent valuations.

Unlike the US, inflation across Asia is well under control, making real bond yields attractive. For those economies close to policy targets, potential rate cuts later this year – aided by a potential Fed pivot – could lower nominal yields and create capital gains.

Putting cash to work in Asian bonds as part of global asset allocations also comes with diversification benefits. Markets in China, India, and Indonesia tend to reflect more domestic macro and policy cycles and local supply-demand conditions. This means they have lower correlations with global bonds. Supply and demand conditions in the India bond market are especially favourable at the moment, given fiscal consolidation and rising inflows ahead of increasing weightings in the GBI-EM bond index this summer.



Past performance does not predict future returns. The level of yield is not guaranteed and may rise or fall in the future.

Source: HSBC Asset Management. Macrobond, Bloomberg. Data as at 11.00am UK time 03 May 2024.

Key Events and Data Releases

Last week

Date	Country	Indicator	Data as of	Actual	Prior
Tue. 30 April	JP	Industrial Production (mom)	Mar (P)	3.8%	-0.6%
	CN	Official Manufacturing PMI	Apr	50.4	50.8
	EZ	Eurozone GDP (q-o-q)	Q1 (P)	0.3%	-0.1%
	US	Employment Cost Index (q-o-q)	Q1	1.2%	0.9%
	MX	GDP (q-o-q)	Q1 (P)	0.2%	0.1%
Wed. 1 May	US	ISM Manufacturing Index	Apr	49.2	50.3
	US	FOMC Interest Rate Decision	May	5.50%	5.50%
Thu. 2 May	IN	HSBC manufacturing PMI	Apr	58.8	59.1
	BR	S&P Global Manufacturing PMI	Apr	55.9	53.6
Fri. 3 May	US	Change in Non-Farm Payrolls	Apr	-	303k
	US	ISM Services Index	Apr	-	51.4

P – Preliminary, Q – Quarter **CN – China, EZ – Eurozone, IN – India, MX – Mexico, JP – Japan, BR – Brazil**

The week ahead

Date	Country	Indicator	Data as of	Survey	Prior
Mon. 6 May	US	Q1 Earnings	Q1		
	CN	Caixin Services PMI	Apr	52.5	52.7
	IN	HSBC Services PMI	Apr (F)	61.7	61.7 (P)
	US	Senior Loan Officer Bank Lending Survey	Q1		
Tue. 7 May	GE	Factory Orders (mom)	Mar	0.4%	0.2%
Wed. 8 May	GE	Industrial Production (mom)	Mar	-1.0%	2.1%
	BR	Banco de Brazil Interest Rate Decision	May	10.50%	10.75%
Thu. 9 May	UK	BoE Interest Rate Decision	May	5.25%	5.25%
	MX	Banco de Mexico Interest Rate Decision	May	11.00%	11.00%
	MX	CPI (y-o-y)	Apr	-	4.4%
	CN	Trade Balance (USD bn)	Apr	81.4	58.6
Fri. 10 May	IN	Industrial Production (y-o-y)	Mar		5.7%
	US	University of Michigan Consumer Confidence Index	May (P)	77.0	77.2

P – Preliminary, Q – Quarter **CN – China, IN – India, MX – Mexico, BR – Brazil, GE – Germany**

Source: HSBC Asset Management. Data as at 11.00am UK time 03 May 2024.

Market review

US Treasuries rallied after Fed Chair Powell said, "it's unlikely that the next policy move will be a hike", and the FOMC acknowledged there has been a "lack of progress" in achieving the 2% inflation target. Global equity markets were mixed. In the US, the rate-sensitive Russell 2000 fared better than the S&P 500 and Nasdaq as investors digested mixed Q1 earnings. The Euro Stoxx 50 index weakened despite signs of recovery in the eurozone. The Nikkei 225 index posted modest gains, with the yen rebounding against the US dollar following reports of Ministry of Finance intervention. In EM, the Shanghai Composite rallied on rising optimism of further supportive policy measures following the latest Politburo meeting. India's Sensex index also performed well. Both oil and gold were weaker last week, as was copper, which fell amid continued concerns about weak physical demand in China.

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