Asia may outperform in 2022, so consider leverage for greater flexibility

The financial markets in 2021 were extreme. The Covid-19 vaccination programme went smoothly in the US and Europe, leading governments to ease anti-pandemic restrictions. These helped recoveries in the economy and in consumption, and sent US and EU equities higher. On the other hand, although the Chinese and HK governments successfully contained the epidemic, the tightening regulations by the Chinese authorities triggered market panic. Coupled with the financial crisis in Chinese property developers, the Chinese and HK stock indices lagged behind other major markets, and the Hang Seng Index and the Hang Seng China Enterprises Index were the worst performers over the whole year.

Asia may be a bright spot in 2022

2022 is the third year after the outbreak of Covid-19. HSBC believes the global economy has already moved from the robust recovery stage to the mid-cycle stage. As countries already begin to trim their stimulus measures, we expect growth of the global economy to moderate from 5.7% in 2021 to 4.1% in 2022. Although the pace of equity returns may slow in tandem with the economy, HSBC expects corporate profits to grow steadily. In addition, companies may benefit given the low possibility of large-scale lockdowns, as US and European countries adopt a strategy of living with the virus. So we are still overweight on riskier assets such as US, Europe and Asia equities.

Among the regions, HSBC expects Asia to be the bright spot in the coming year. Although many investors are worried that harsh regulations by the Chinese authorities and the funding crisis in property developers may drag down risky assets, we see indications showing the authorities may relax some of the regulations. For instance, the Central Economic Work Conference in December indicated that the central government will proactively launch policy to keep the economy stable and allow capital growth in an orderly and sustainable manner.

The Chinese government aims for steady economic growth. Meanwhile, in some Asian countries such as South Korea, Singapore and Malaysia, 80% of the population has been vaccinated, which may help local consumption and economic normalisation. The rebound in developed countries such as the US and Europe may also support Asian exports. Given the background, HSBC expects Asia (ex-Japan) GDP to grow by 5.3% in 2022, higher than 3.8% in US and Europe.

While the outlook is bright in Asia, Asian stock valuations are very attractive as well. Take the MSCI Asia (ex-Japan) stock market as an example. Bloomberg shows that its P/E ratio is 16.3X, which is far below the 21.2X and 25.8X in MSCI AC World Index and S&P Index. The gap with the S&P Index is the largest in the last 20 years, reflecting the attractiveness of Asian equities. If investors are aware that Asia is emerging from the epidemic, asset prices may outperform others in 2022.

The financial sector may benefit from rate hikes, while consumer- and ESG-related sectors may also outperform

Since mid-2021, inflation has been a hot topic in the market. HSBC expects inflation to stay high in the first half of 2022 due to solid raw material prices and supply chain issues. High inflation may raise concerns that the major central banks could start tightening monetary policy soon or even raise interest rates. HSBC estimates that, given inflationary pressures and the improving job market, the Federal Reserve may raise interest rates by 25 points in March, June and September.

Some investors are worried that the rate hikes may trigger market turmoil, but the historical data suggests that a sharp sell-off in global and US equities is unlikely in the early stages of a rate hike cycle. In fact, even if the Fed raises interest rates three times in 2022, the Federal Fund rate will still be at a low level which may only have limited impact on companies' fund cost and profitability.

There is no doubt that uncertainty over the rate hike path may result in market fluctuations, but the expectation of rate hikes may raise speculation that banks' income from net interest margins may jump. The regulator has eased restrictions on dividend and share repurchase, and with the positive global economic outlook and the increase in M&A activity, HSBC expects financial stocks to outperform.

Investors should particularly pay attention to consumer-related stocks. Job markets in the US and Europe have improved from the pandemic, as the US jobless rate fell to 4.2% in November, slightly higher than the 3.5% before the outbreak of Covid-19. The average hourly wage has already surpassed the pre-pandemic high in mid-2021 and has kept going up, so the strategy of coexisting with the virus, the better job market and rising salaries may benefit the consumer and retail sectors. HSBC therefore prefers consumer-related stocks, such as consumer discretionary.

At COP26 in November, many countries made commitments on carbon emissions and clean energy. For example, President Biden promised to halve greenhouse gas emissions by 2030 and planned to achieve zero emissions by 2050; China also agreed to reach carbon neutrality in around 2060. In order to move toward emission reduction goals, we expect more investments in clean energy, electric vehicle equipment, and green infrastructure in the coming years. In fact, the earlier Chinese 14th Five-Year Plan drew up a blueprint for sustainable development in various fields such as renewable energy, electric vehicles and innovative technologies. The US House of Representatives also passed a $1.75 trillion social expenditure and climate bill earlier, so HSBC expects that in future, power generation, infrastructure, transportation and manufacturing may accelerate their transformation along with decarbonisation. Green industries may be one of the winners in the future, and ESG products may become more popular in the market.

Make good use of leverage for asset allocation

In summary, although HSBC estimates the global economy to be at the mid-cycle stage and that growth may moderate, corporate profits are likely to keep growing with a better job market and higher vaccination rate. These may support more risky assets such as US and Asian equities, including financial and consumer-related stocks. ESG-related stocks may also outperform.

Even though HSBC is positive on the market outlook, investors should understand and adjust the proportion of stocks and bonds in their portfolios based on their own risk profiles. Traditionally, if investors are more willing to bear potential risks for higher returns, they can increase the proportion of risky assets such as stocks and high-yield bonds, and reduce investment-grade bonds, and vice versa.

In addition, investors can consider leverage as a tool in asset allocation. Take investment-grade bond funds as an example. Although the interest rate return is not as good as that of high-yield bond funds, investors can multiply the investment principal by leverage, and the overall return may be comparable to that of directly buying high-yield bond funds with the same principal. At the same time, since the price of investment-grade bonds is relatively stable, and the scale of related assets and fiscal quality are relatively good, the downside risk may be lower.

However, investors should acknowledge that leveraged investment carries certain risks. If the overall market sentiment reverses and triggers a sharp fall in fund prices, investors may suffer huge losses due to leverage. In addition, any rise in interest rates or reduction in a fund's dividend may affect interest rate income and even cause losses.

In conclusion, after investors understand the risks they can bear, they should analyse and discuss different types of investment products and tools in detail with their Relationship Managers or Investment Consultants. In addition to stocks and bonds, they can also consider using leverage for asset allocation to balance returns and risks.

Source: HSBC, Bloomberg, data as of 20 December 2021.

HSBC Wealth Solutions

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