Reality Check

Quarterly Outlook

April 2019

HSBC

Reality Check

Overview

- Global equity markets have performed strongly in Q1 2019 after a weak end to 2018
  - The rebound has been quite rapid, as central banks moved away from their tightening bias and market perceptions of recession risk abate
- However, global growth has dropped slightly below trend and we do not expect a return to 2017's synchronised global boom
  - "Cyclical divergence" between robust US and softer rest-of-the-world, persists
- Global inflation pressures remain largely contained
  - The eurozone and Japan are still battling with core inflation well below target
  - US bucks the trend, with measures of core inflation around the Fed's target and rising wage growth
- Slower growth and muted near-term inflation pressures have led to a marked shift towards more dovish monetary policy across many economies
  - The US Federal Reserve (Fed) has backed away from further rate hikes this year and intends to stop reducing its holdings of Treasuries by the end of September 2019
  - European Central Bank (ECB) announced further targeted lending operations (TLTROs) at its March meeting, following poor economic data, and expects to leave policy rates unchanged until at least next year
- Downside risks (e.g. trade tensions) remain. Markets continue to ignore the risk of an inflation pickup
- Given this macro backdrop, it is important to be diversified, to be willing to be adaptive to any changes in the environment. We think it is time for a "reality check" in 2019

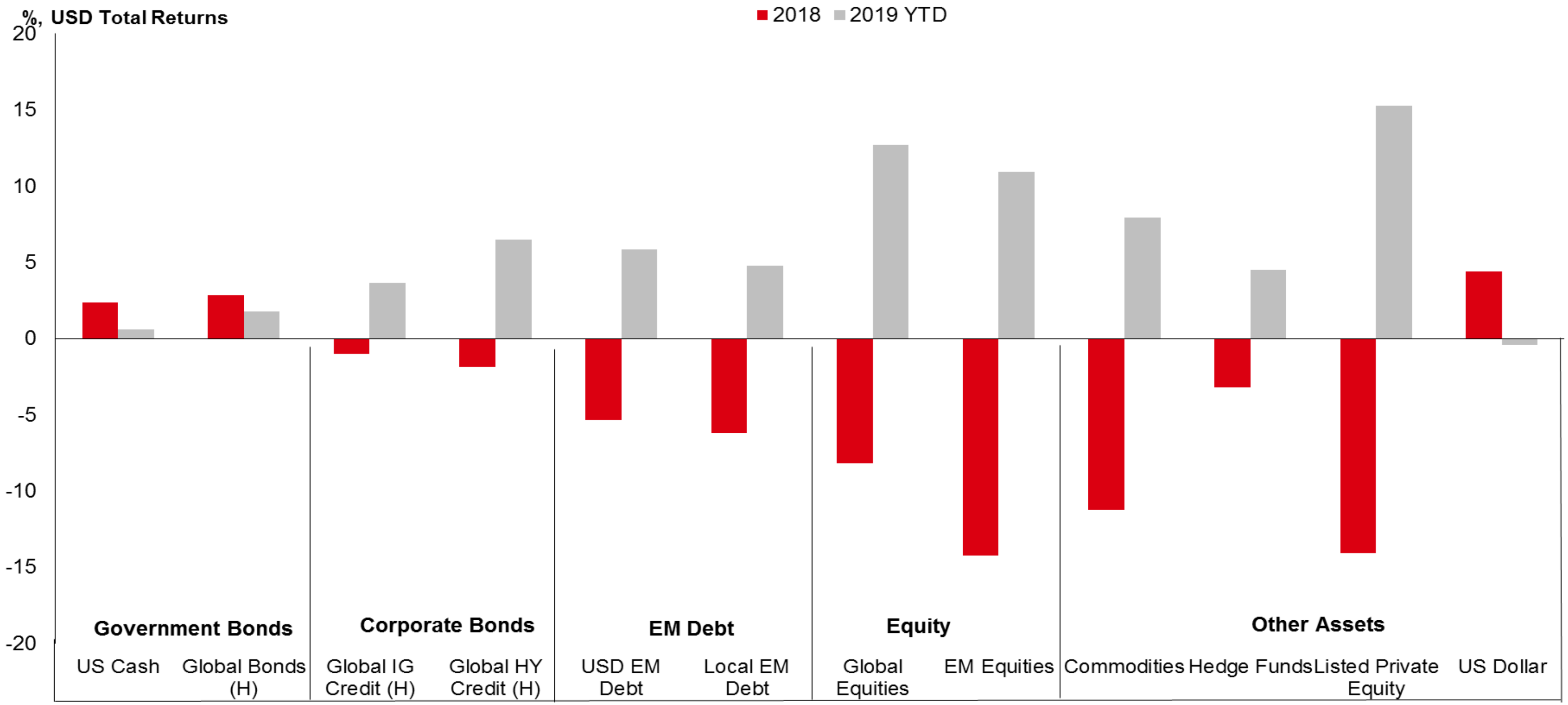
Past performance is no guarantee of future returns.

Source: HSBC Global Asset Management, March 2019***. Any views expressed were held at the time of preparation and are subject to change without notice.***
Global growth trend is 3% while our current global Nowcast is around 2.1% in the first two month of this year. Please note that these numbers are based on market exchange rates and not based on Purchasing Power Parity (PPP). While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Global Asset Management (UK) Limited accepts no liability for any failure to meet such forecast, projection or target.

Market performance

Asset class performance in 2018 and 2019 year-to-date

- Most risk assets have recovered this year
- Global equities are now positive, in total return terms, when compared to 2018



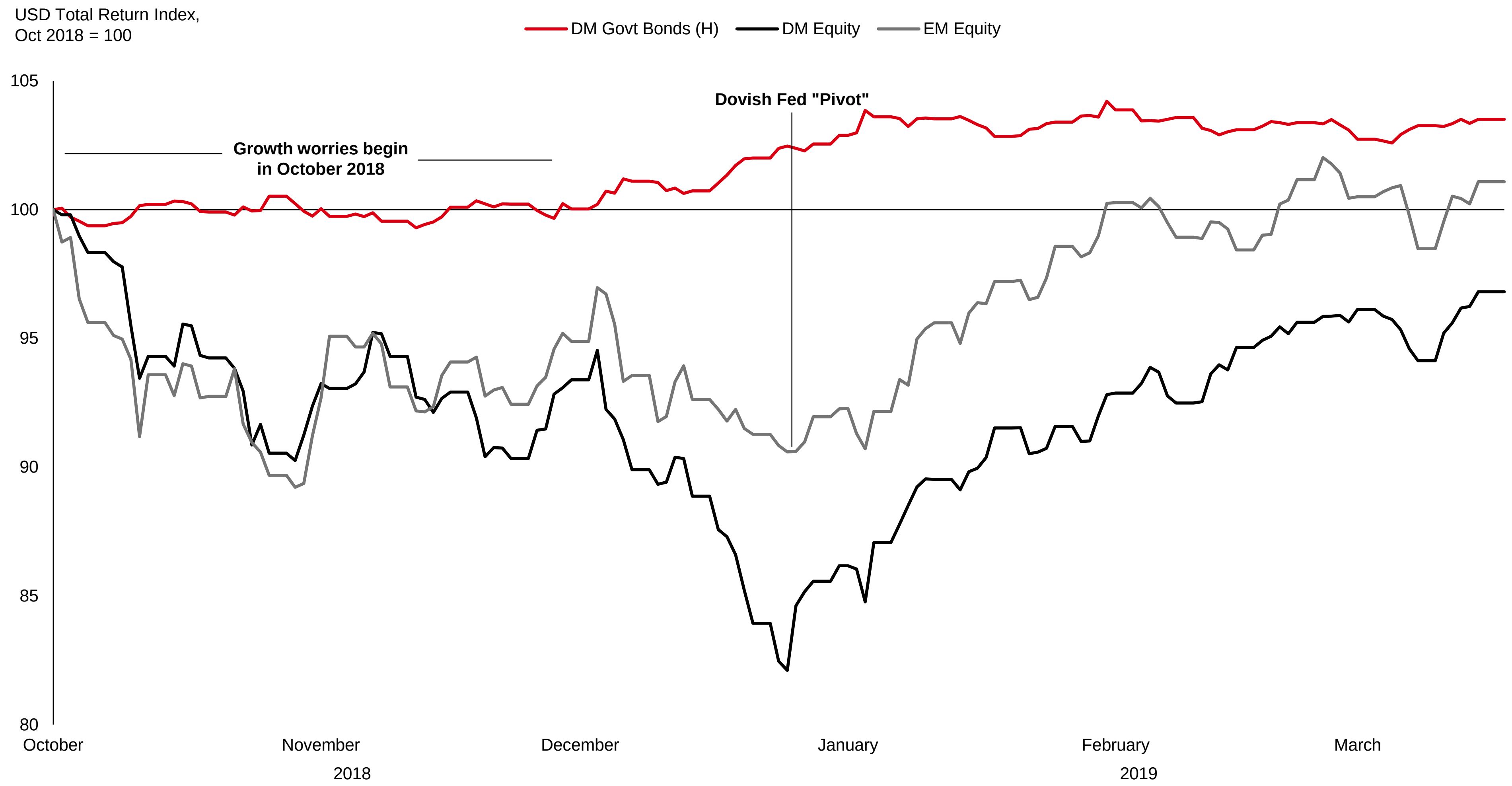
Past performance is no guarantee of future returns.

Source: Bloomberg, HSBC Global Asset Management, ***as at 21st March 2019***. All asset class returns shown as USD total returns (unhedged) unless stated. (H) - Refers to currency-hedged USD total returns. Any views expressed were held at the time of preparation and are subject to change without notice. **Government bonds:** Barclay 3m USD LIBOR Cash index (US Cash), Bloomberg Barclays US Treasury Total Return Unhedged USD (US Treasuries), Bloomberg Barclays Global Aggregate Treasuries Total Return Index Hedged USD (Global Bonds (H)), Bloomberg Barclays Global Inflation-Linked Total Return Index Hedged USD (Global ILBs (H); **Corporate Bonds:** Bloomberg Barclays Global Aggregate Corporate Total Return Index Hedged USD (Global IG Credit (H)), Bloomberg Barclays Global High Yield Corporate Total Return Index Hedged USD (Global HY Credit (H)); **EM Debt:** J.P. Morgan EMBI Plus Composite (USD EM Debt), J.P. Morgan GBI-EM Global Diversified Composite Unhedged USD (Local EM Debt); **Equity:** MSCI Daily TR Gross US USD (US Equities), MSCI Daily TR Gross World USD (Global Equities), MSCI Daily TR Gross EM USD (EM Equities); **Other Assets:** Bloomberg Commodity Index Total Return (Commodities), Credit Suisse Hedge Fund Index (Hedge Funds), Listed Private Equity Index USD TR (Listed Private Equity), Dollar Index (USD).

Market journey

Key market movements and events since Q4 2018

- Risk appetite gained traction after US Fed Chair Powell first hinted at a more dovish stance at the very beginning of the year



Past performance is no guarantee of future returns.

Source: Bloomberg, HSBC Global Asset Management March 2019**.** All asset class returns shown a***re*** USD total returns (unhedged) unless stated. (H) - Refers to currency-hedged USD total returns.
Any views expressed were held at the time of preparation and are subject to change without notice.

Market perceptions of growth and inflation

A recovery in growth perception terms, but market assumes disinflation

- Market perceptions of growth have continued to recover from last year's sell-off on the back of continued outperformance from risk assets
- While market-implied growth is showing positive momentum, inflation expectations have not done much
- This means that it does not take much for a surprise in the inflation data to cause a big change in inflation expectations

Growth assets have improved over the last month

Market pricing neglects inflation risks

Past performance is no guarantee of future returns.

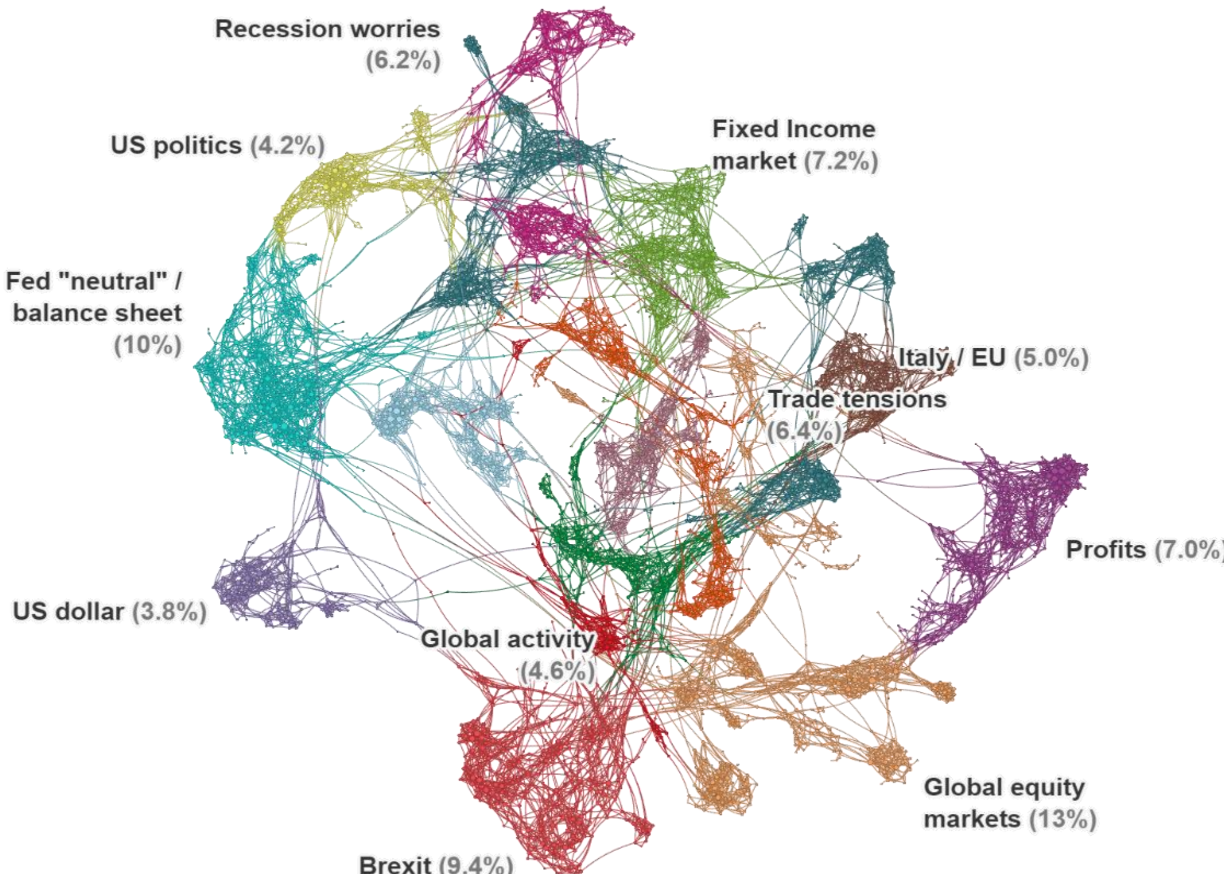
Source: Bloomberg, HSBC Global Asset Management, March 2019.

**These indicators are the market performance of an equal volatility long-short portfolio of (1) growth asset classes against defensive asset classes (implied growth index), and (2) inflation-hedged asset classes against inflation-vulnerable asset classes (implied inflation index)*

What is the market discounting?

Key market narratives over the last 3 months

- One approach we use to understand what the market is discounting is to monitor market narratives
- Using “Natural Language Processing” and Machine Learning tools to analyse over 20,000 financial news articles, we identify the following key market narratives that are “top of mind”;
  - Fed “dovish” stance has been front-of-mind together with Brexit news. Both themes have dominated the financial media
  - Trade tensions continue to influence stories about China
  - Recession worries (a top of mind theme last December) have fallen significantly

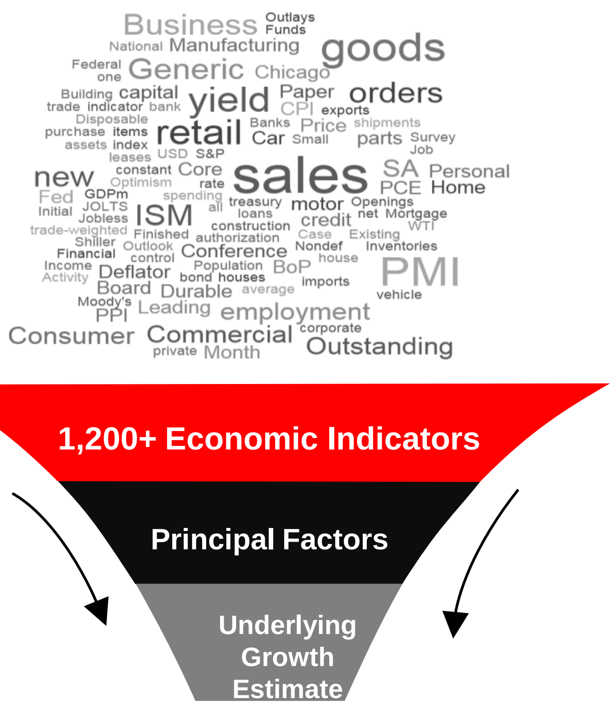


Source: HSBC Global Asset Management and Quid, March 2019. For illustrative purposes only.

The Global Nowcast

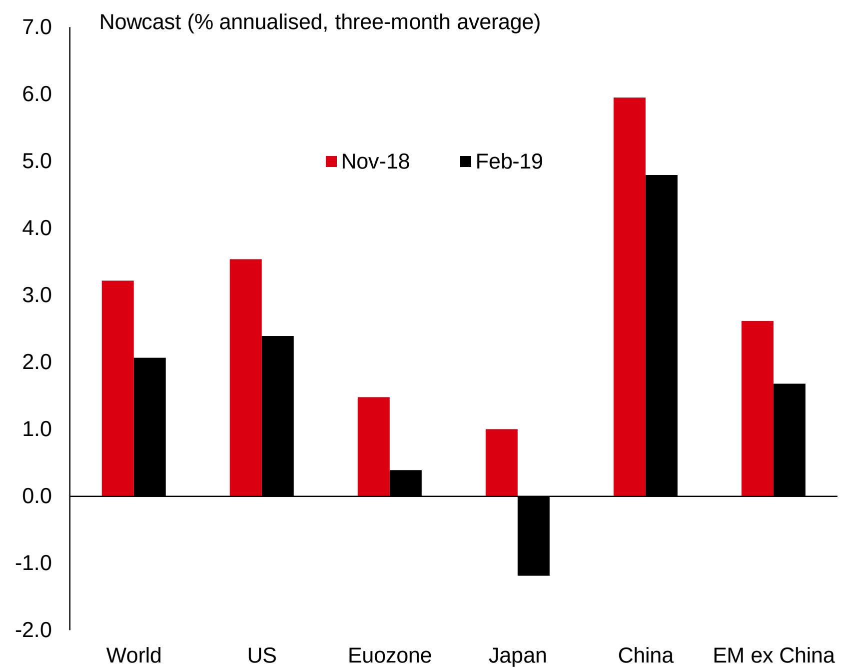
Using big data to track economic growth in real time

- Our global Nowcast dropped to a little over 2% annualised in the three months to February, down from above 3% as recently as November and over 4% in early 2018. We still see this as a cyclical moderation rather than the start of a deeper downturn
- Some of this cyclical weakness has been driven by temporary factors that could now begin to reverse since the policy environment has become more supportive and dovish.



Nowcasting the Business Cycle

Nowcast evolution – we remain in a global cyclical slowdown



Past performance is no guarantee of future returns.

Source: HSBC Global Asset Management, as at March 2019, and subject to change. For illustrative purposes only.

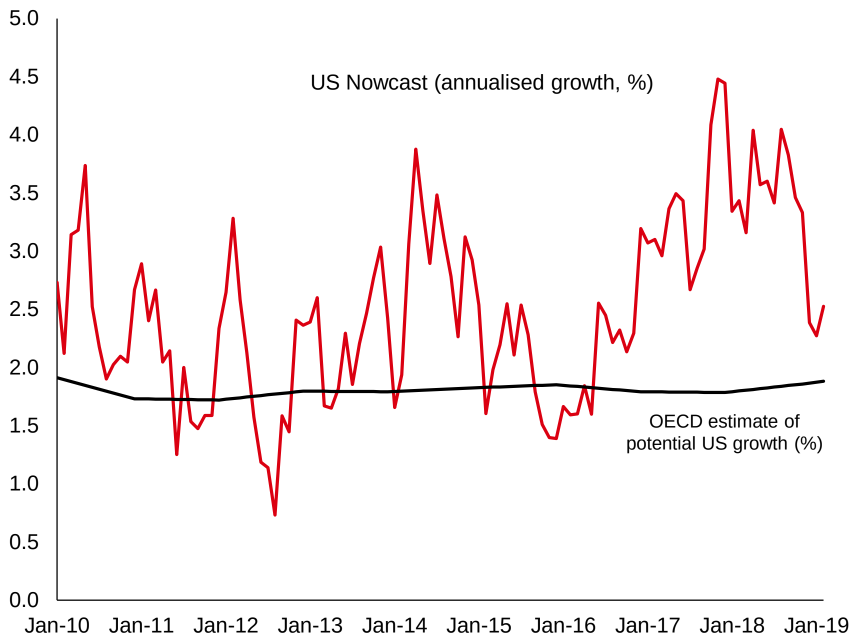
Nowcast is a systematic approach to measuring where we are in the economic cycle in "real-time". It is not a forecast. Our algorithm builds a measure of growth based on more than 1,000 key macro-economic variables.

US: Economy likely to slow further during 2019

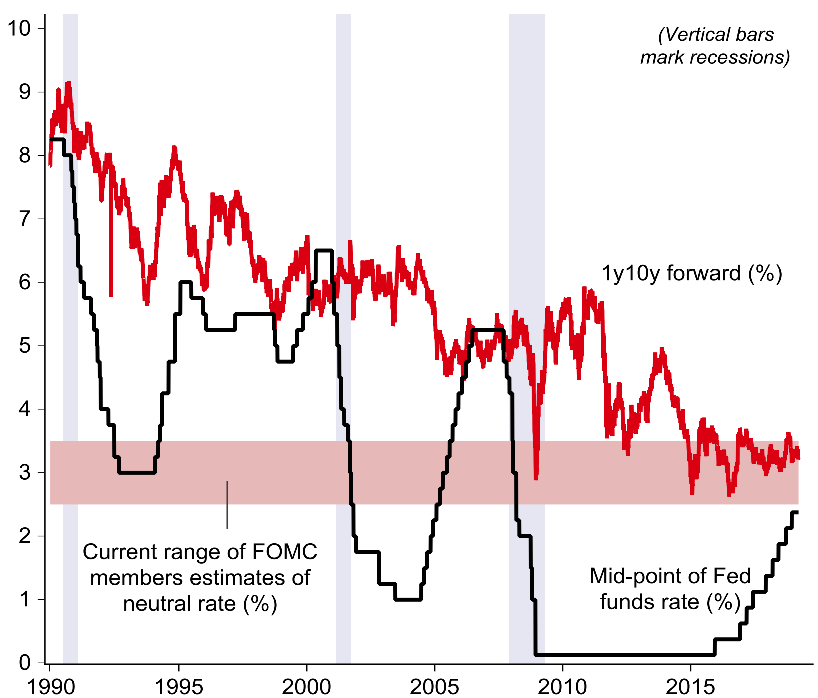
Monetary policy still accommodative

- The US economy has slowed, with growth in Q4 2018 of 2.6% qoq annualised, down from over 4% in Q2. However, Q4 growth was still comfortably above widely-accepted estimates of US trend growth (the Federal Reserve and the OECD both put trend marginally below 2%)
- Although Q1 data have been mixed, our US Nowcast edged up to 2.5% annualised growth in February from 2.3-2.4% in the prior two months However, this pace of growth is unlikely to persist in 2019, given 2018s fiscal stimulus fades and past interest rate rises bite
- Our base case is that US growth returns to trend during the course of 2019
- At its March meeting, the Fed signalled no rate hikes in 2019 and one 25bp possible hike in 2020

Nowcast growth still above trend



Policy rate still below Fed's neutral rate of between 2.5%-3%



Past performance is no guarantee of future returns.

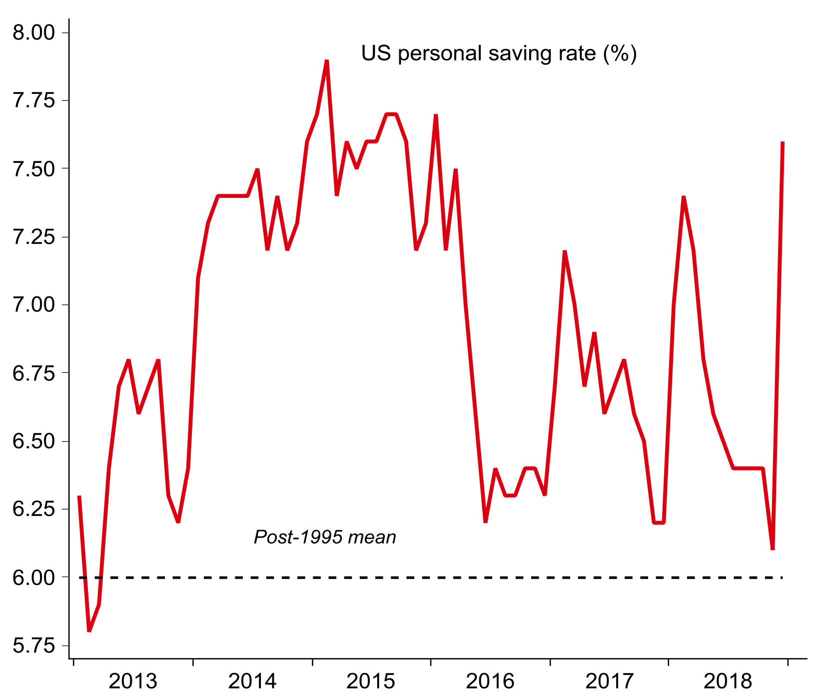
Source: HSBC Global Asset Management, Macrobond, March 2019.

US: Consumer concerns overdone

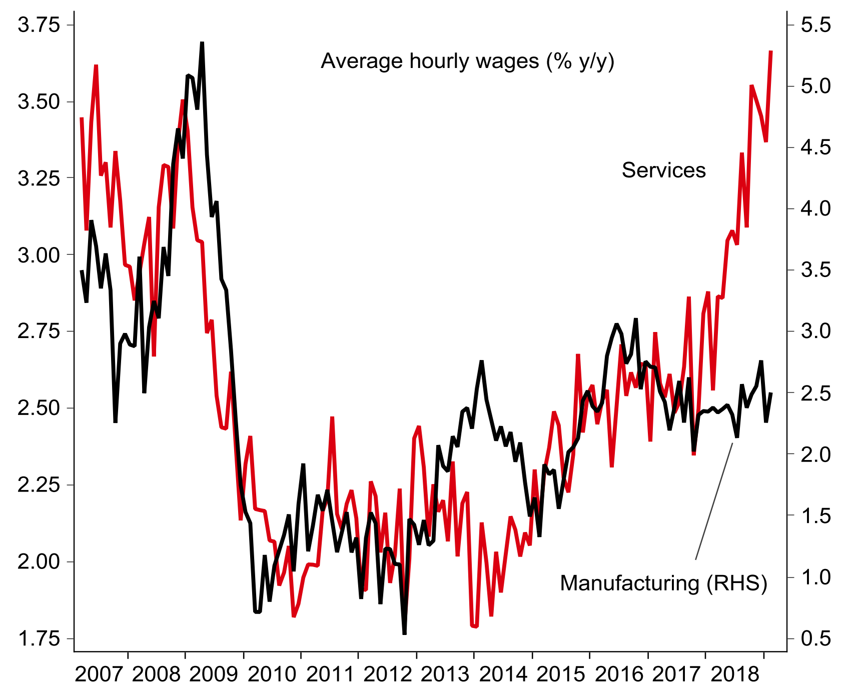
Fundamentals remain solid

- The fall in retail sales/consumer spending at the end of 2018 questioned the outlook for the US consumer
- We continue to believe the US consumer is in a good position with a range of factors supporting spending:
  - Income growth is strong - the fall in spending at the end of 2018 was matched by a rise in the saving ratio, which could easily unwind
  - The benefits of the fall in the oil price are still feeding through
  - Equity markets have recovered from their December sell-off, boosting household wealth
- Wage growth has recovered, especially in the service sector

Saving rate spike



Wage growth has recovered



Past performance is no guarantee of future returns.

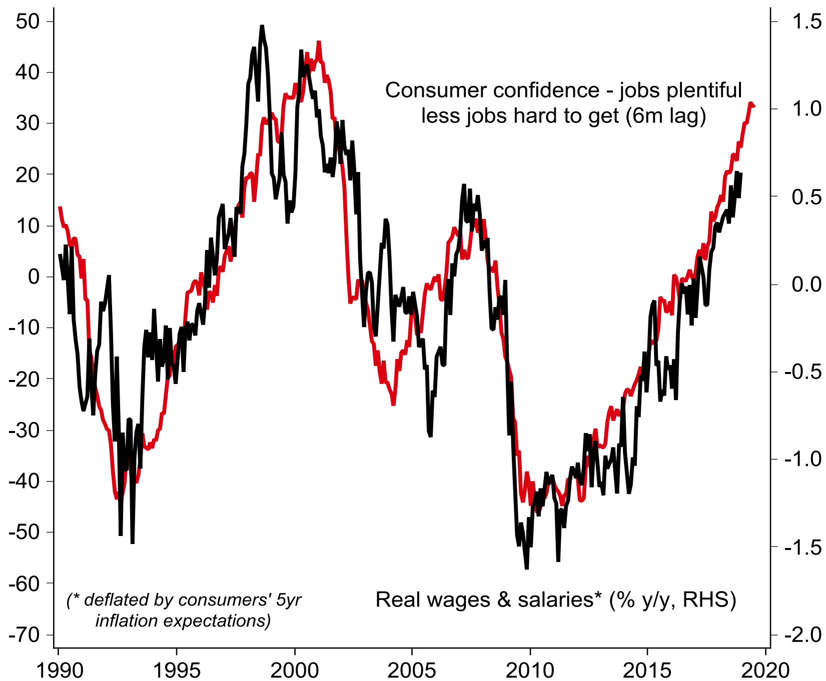
Source: HSBC Global Asset Management, Macrobond, March 2019.

US: Inflation & trade risks

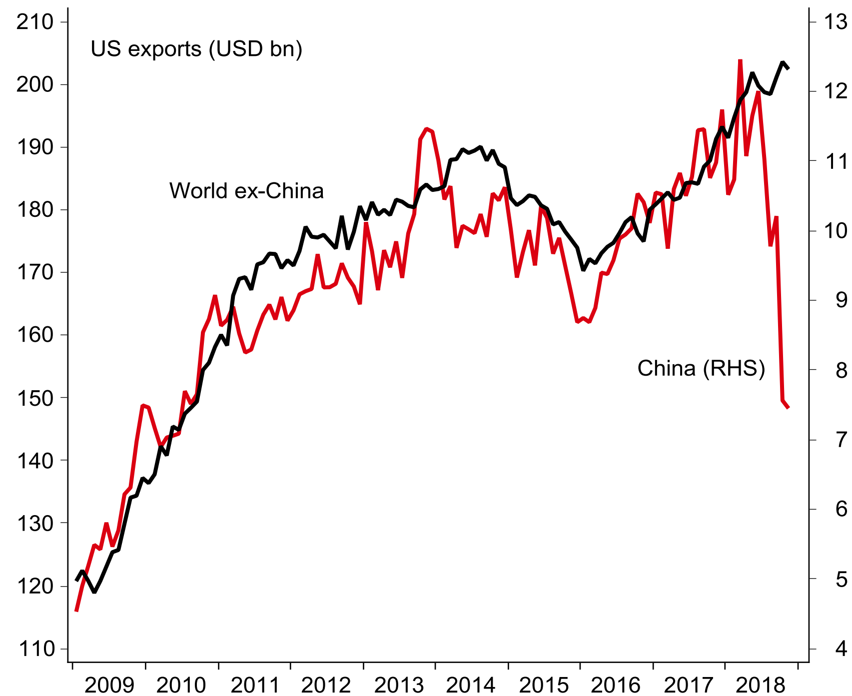
Key vulnerabilities

- Tight labour market is consistent with further increases in wage growth – could lead core inflation to pick up late in the year
- Intensification of trade dispute with China could hurt global economy – potential headwind to US growth, pulling it below trend

Future inflation pressures?



Trade tensions biting



Past performance is no guarantee of future returns.

Source: HSBC Global Asset Management, Macrobond, March 2019.

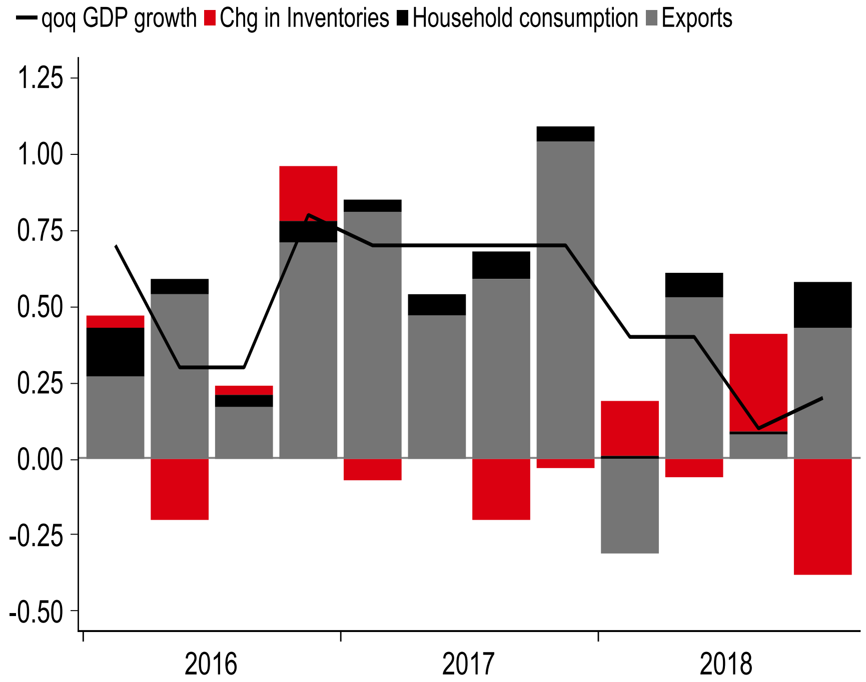
Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Global Asset Management accepts no liability for any failure to meet such forecast, projection or target.

Eurozone: not as bad as it seems?

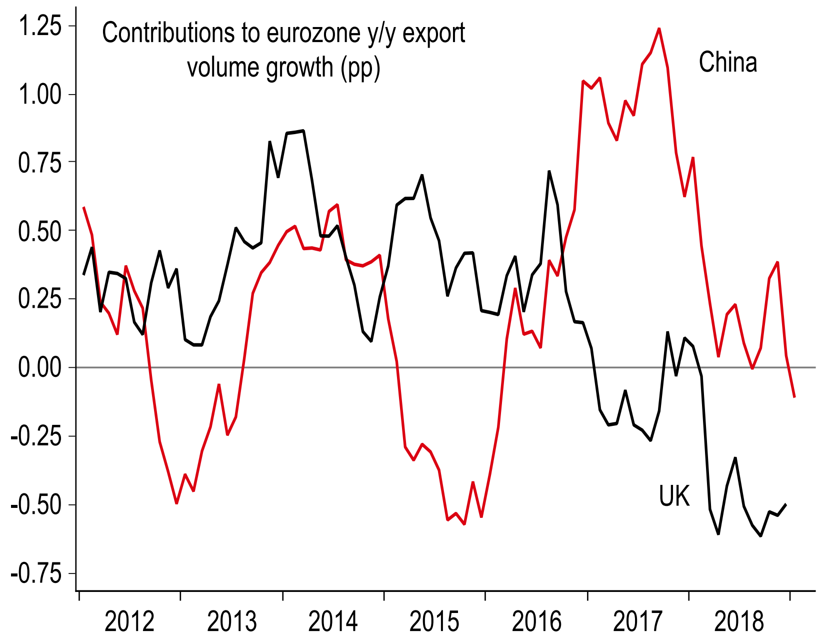
Q4 saw a rebound in export growth, and big drag from inventories

- Expenditure breakdown of eurozone Q4 GDP reveals some positive takeaways
  - Rebound in export growth**,** as drag from China slowdown ended
  - Large drag from inventories, which likely reflects hangover from auto-industry disruption over summer - carmakers shifting stocks
  - Strongest contribution from government sector since Q1 2016

GDP contributions



Contributions to export growth by country



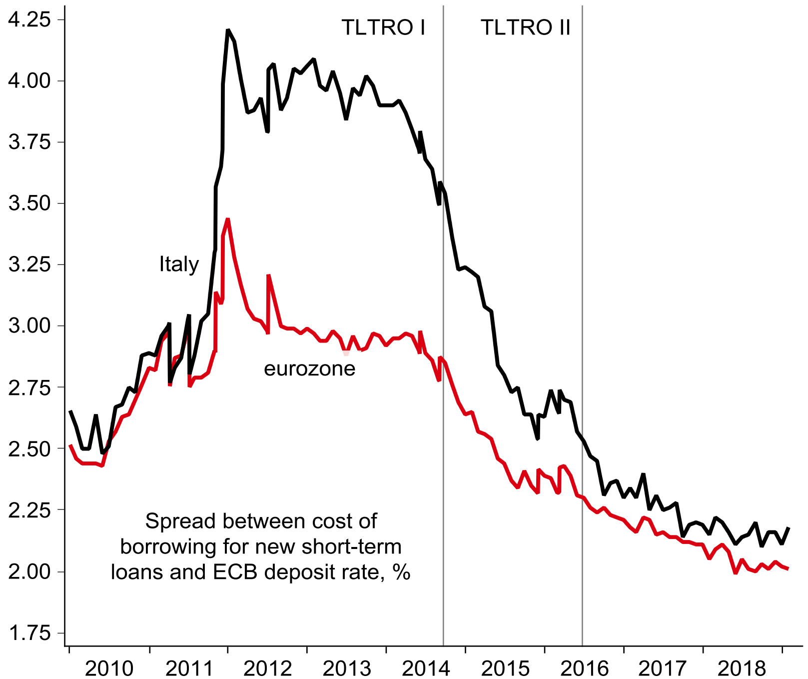
Source: HSBC Global Asset Management, Macrobond, March 2019.

Eurozone: TLTROs[1] to the rescue?

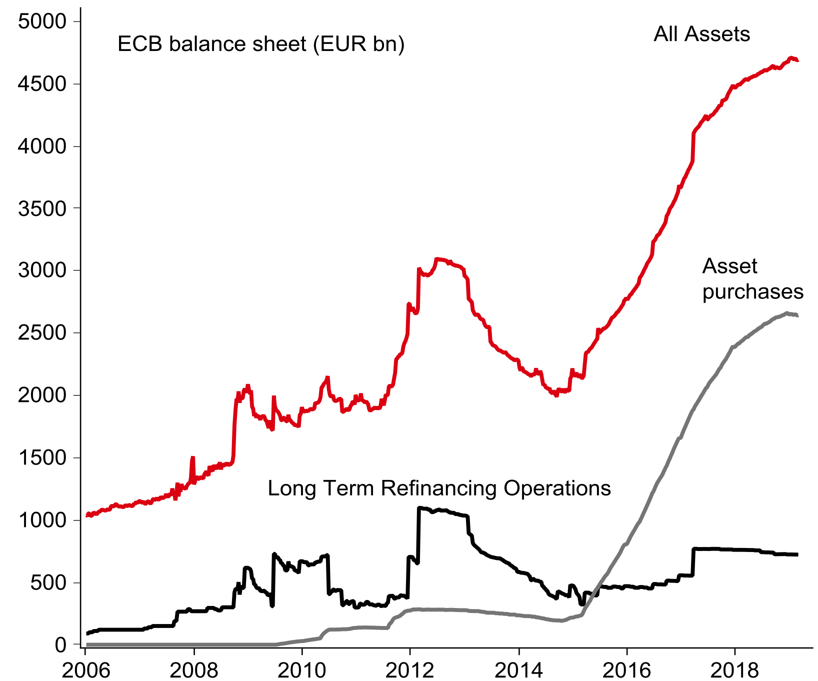
A significantly weaker growth and inflation outlook forced the ECB to act

- As expected, the ECB cut its growth and forecasts at its March meeting. Weaker outlook pushed it to implement policy changes
  - Current forward guidance is for rates *to be* on hold this year until at least next year**,** and TLTRO III to run between September 2019 - March 2021
- New targeted lending operations (TLTROs) programme is important to prevent a tightening in lending conditions, especially in Italy (largest take up of TLTRO II funds)

Struggling Italy has been a big beneficiary of TLTROs



LTROs are about 15% of the ECB balance sheet



Source: HSBC Global Asset Management, ECB, Macrobond, March 2019. [1] Targeted Longer-Term Refinancing Operations created by the European Central Bank.

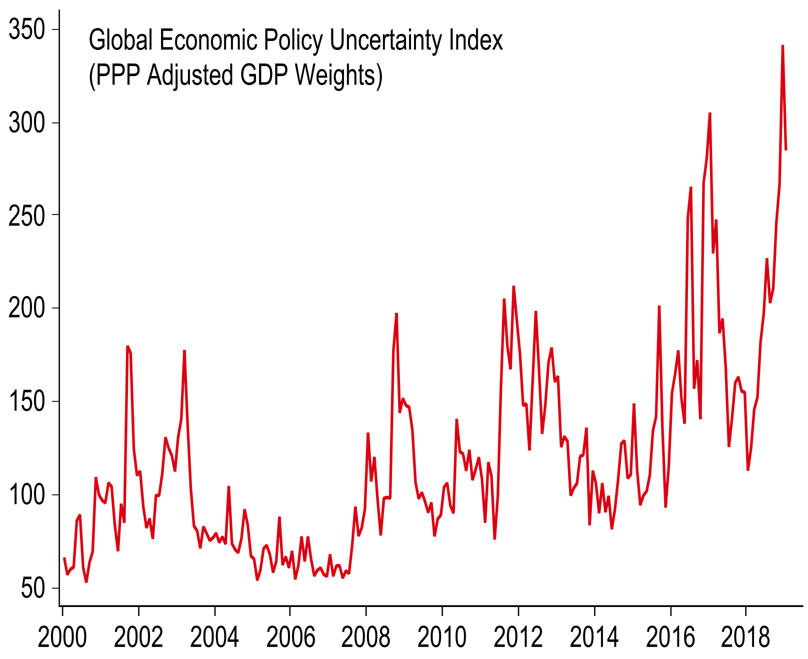
Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Global Asset Management (UK) Limited accepts no liability for any failure to meet such forecast, projection or target.

Eurozone: the perils of uncertainty

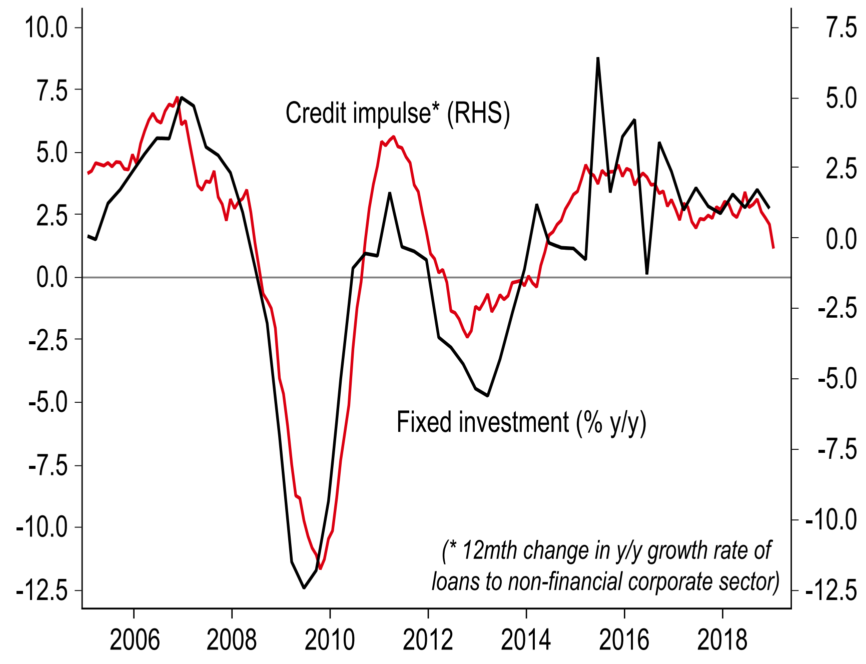
An uncertain future is weighing on decision making

- Global uncertainty is elevated, with many risk factors centred in Europe
  - Potential for a “no-deal” Brexit, rising “populist” movements, risk of auto tariffs, and fragile Italian fiscal dynamics
- This is weighing on firm’s confidence to invest and hire, and consumers’ willingness to spend
- Latest ECB bank lending survey notes softer demand for loans, reflected in softer credit growth

Global uncertainty is elevated



A softer picture for credit growth



Source: HSBC Global Asset Management, ECB, Macrobond, March 2019.

Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Global Asset Management (UK) Limited accepts no liability for any failure to meet such forecast, projection or target.

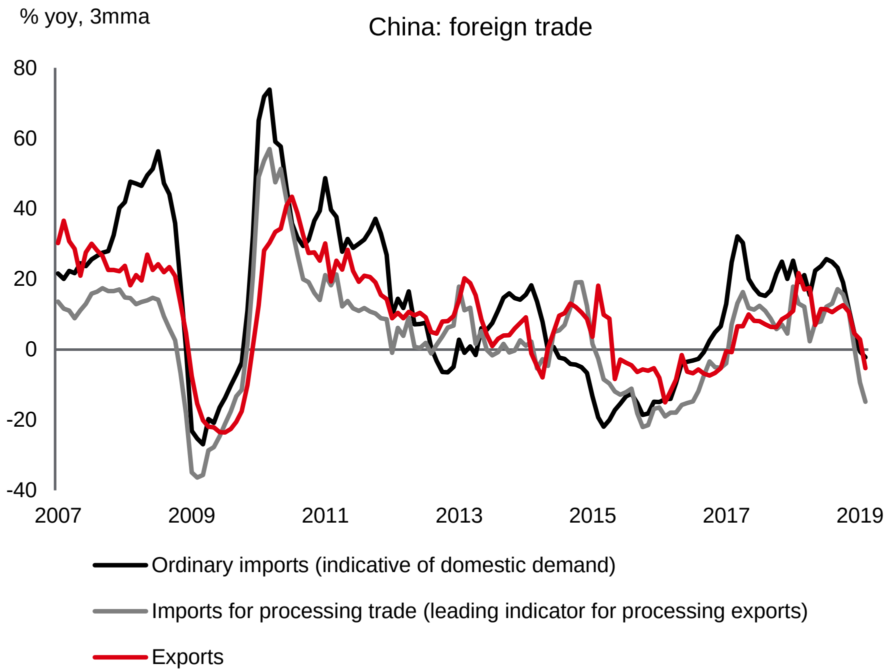
Asia: China's trade data has softened

Weaker global manufacturing remains a key risk

- Expectations have risen for a trade deal to be reached in the near future, but the uncertainty remains over the structural issues and enforcement mechanism, and whether existing tariffs will be rolled back
- China's exports to the US slowed sharply since November 2018, while imports from the US also plunged since last September
  - Import contraction narrowed in February as China resumed purchasing agriculture and energy products from the US.
  - US-China trade relations are a key swing factor, but weaker global manufacturing remains a key risk to the near-term trade outlook

China's imports and exports to the US have softened

Recent trade data hints at softer Chinese domestic demand



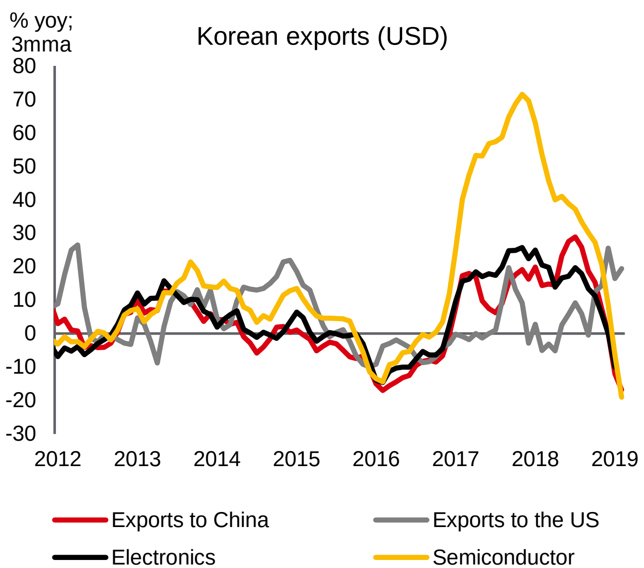
Source: Bloomberg, CEIC, HSBC Global Asset Management, March 2019.

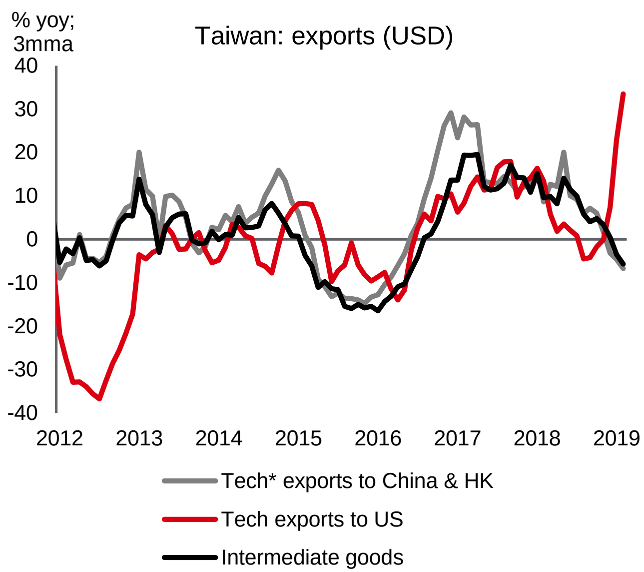
Asia: US-China trade tensions – not all bad

Some Asian countries have benefited from trade and investment diversion

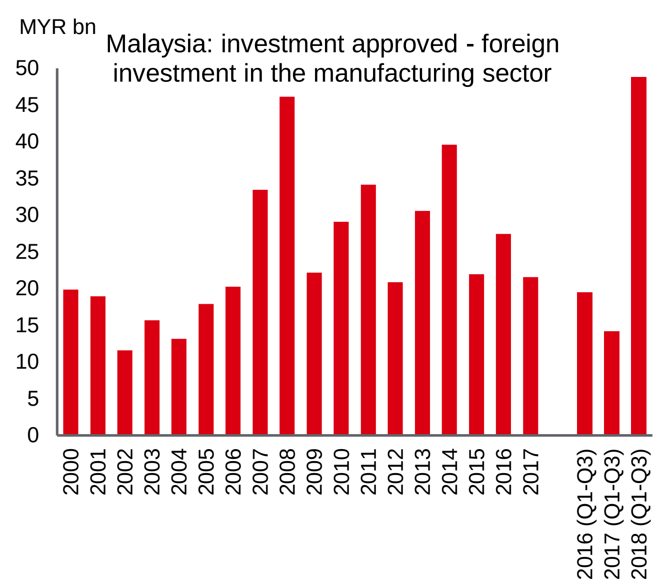
- Headwinds from Fed policy tightening, China's growth slowdown and US-China trade tensions have eased, but risks remain; as slowing global growth continue to weigh on EM Asia's trade and growth outlook
- US-China trade tensions have accelerated shifts in corporate strategy and long-term planning of supply-chain reconfiguration.
  - Multinational/ Chinese/US companies have shifted production to existing facilities and sourcing of procurement from suppliers outside China
- In the near term, Asian countries could lose from a US-China trade deal that leads to a shift in China's imports towards the US, although the impact will depend on the list, and the size, of products China plans to purchase

Korean and Taiwanese exports to the US have held up since Q4 2018 as shipments to China slowed





Prospects of FDI inflows to Malaysia improved



Note: * tech products include electronic products, information & communication products and optical precision instruments, etc.

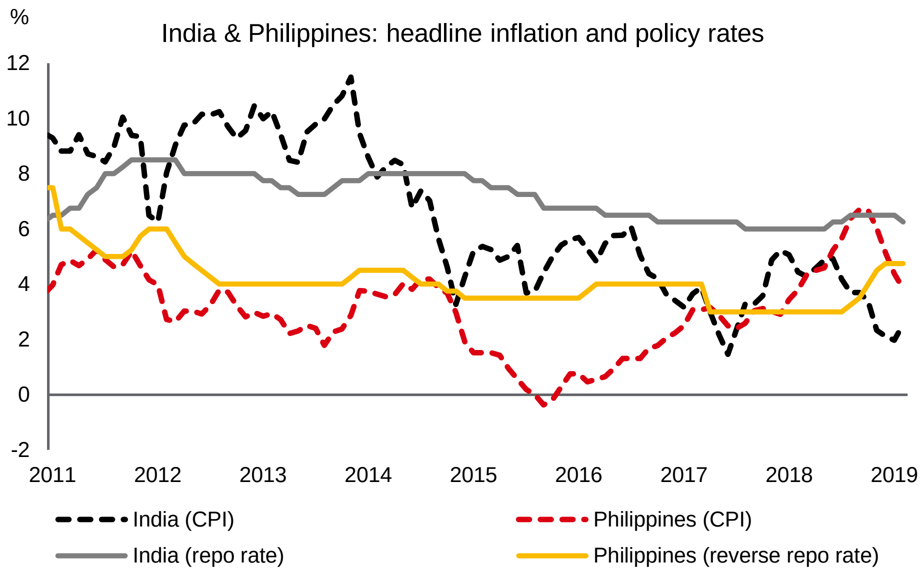
Source: Bloomberg, CEIC, HSBC Global Asset Management, March 2019.

Asia: turn in monetary policy stance in India and Philippines

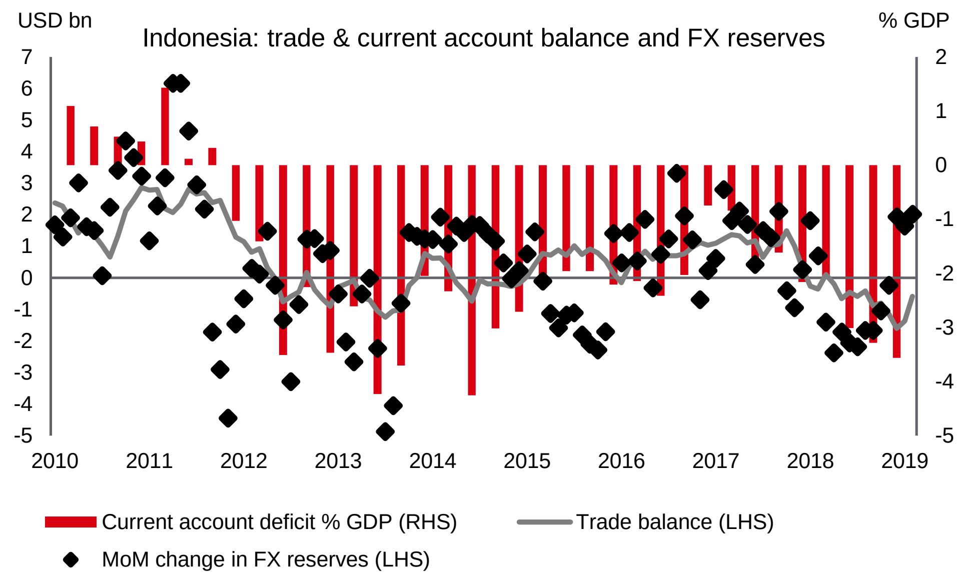
Fed policy remains a key part of Bank Indonesia's reaction function

- Easing inflation and a pro-growth policy shift under a new Governor of both the Philippines and Indian central banks has strengthened the case for monetary easing.
  - We think another policy rate cut is likely in Q2 in India following a 25bp cut in February, given benign inflation.
  - We expect cuts to the reserve requirement ratio in Philippines
- Macroeconomic and financial stability remain Bank Indonesia's policy priority, focusing on containing the current account deficit and maintaining the attractiveness of domestic financial assets.
  - Easing external financing pressures amid more data-dependent and cautious Fed policy, opens room for relaxing macro-prudential regulations to lift liquidity and credit growth

Easing inflation has opened room for monetary policy easing in India and Philippines



Indonesia: no signs of a narrowing trend in the trade deficit



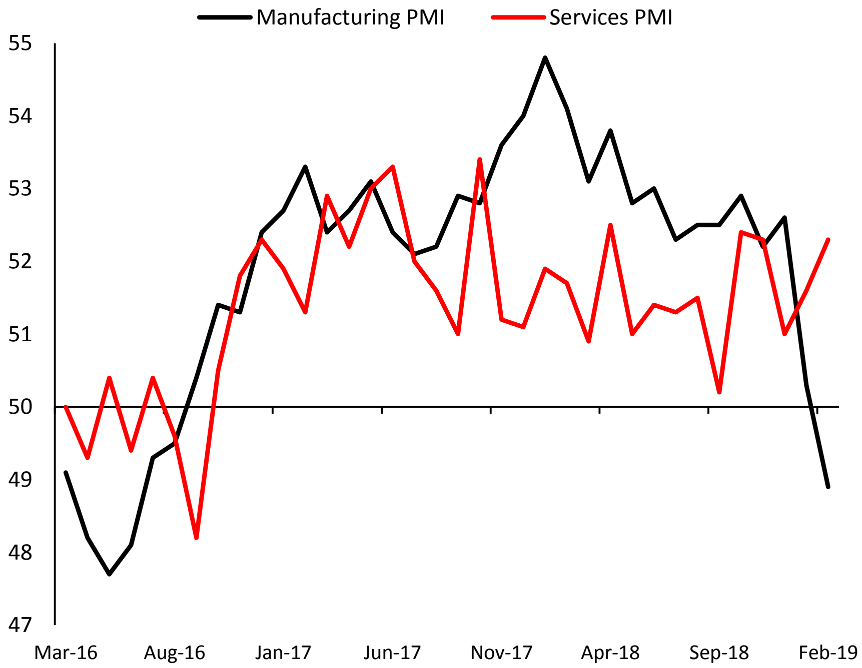
Source: Bloomberg, CEIC, HSBC Global Asset Management, March 2019.

Asia: Japan manufacturers hit hard by weak global trade

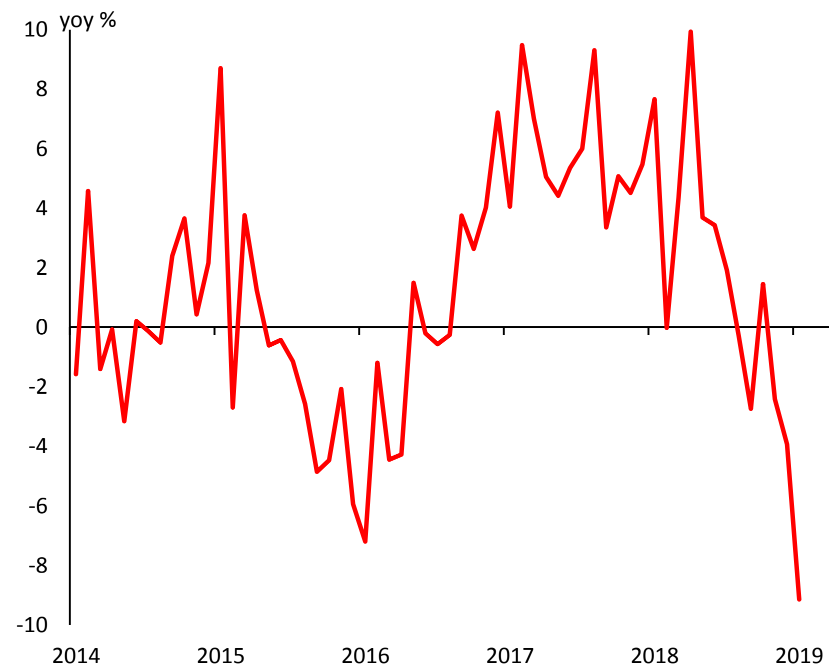
Some resilience in domestically-oriented services

- Soft global trade is a major issue for Japanese manufacturers given their exposure to China
  - The conclusion of the section 232 investigation in the US could prolong external downward pressures
- Services have fared better since the end of last year, supported by the overall increase in employment
  - Stagnating wages could dampen the outlook for services

Sharp slowdown in Japan manufacturing, not in services



Japan exports of goods (in volume terms)



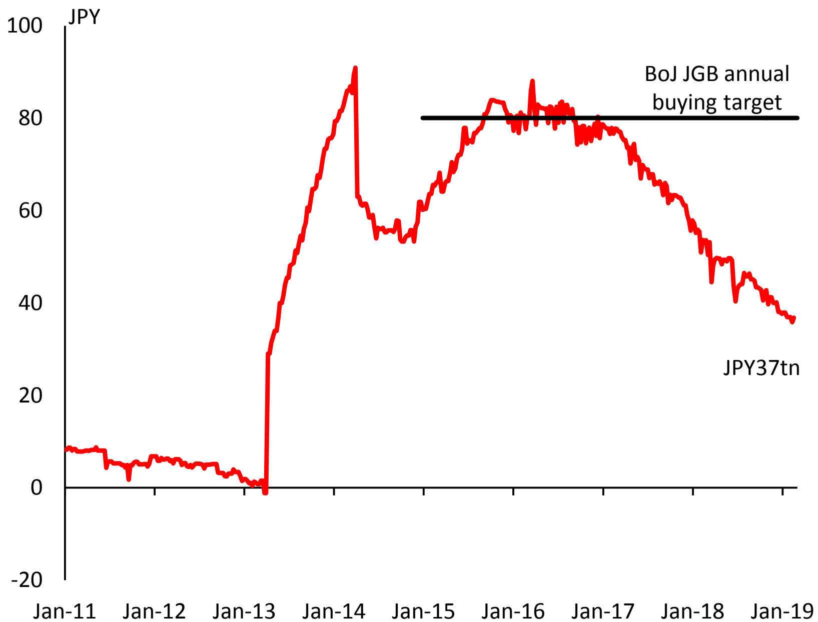
Source: HSBC Global Asset Management, Bloomberg, Datastream, March 2019.

Asia: Japan policy options still limited for the BoJ

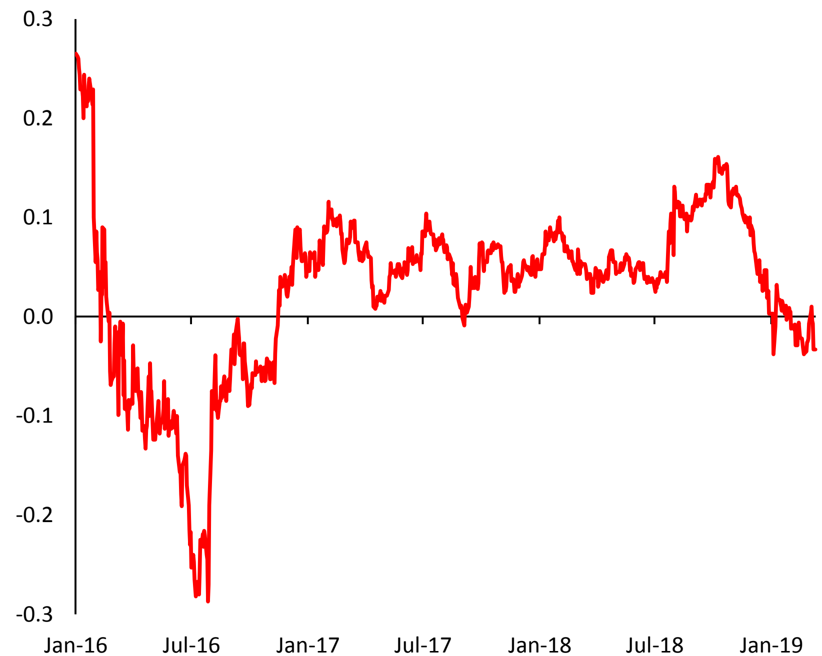
Reality v. market perception

- Actual BoJ JGB buying brought down to JPY37 trillion (indicative target still at JPY80 trillion)
  - Despite lower volumes of JGB buying, 10-year yields returned to negative levels at the beginning of the year
- Changing the JGB buying target is difficult in terms of forward guidance as it would be perceived as hawkish
  - Other options, like the Yield Curve Control parameters, are also constrained

The BoJ buys less and less JGBs



10-year JGB back to negative levels



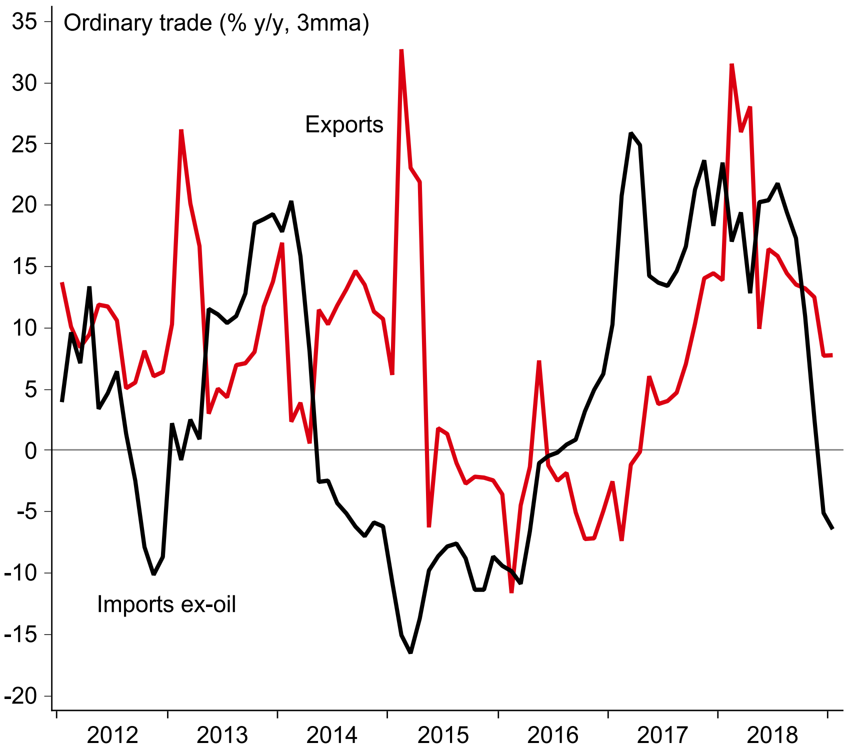
Source: HSBC Global Asset Management, Bloomberg, Datastream, March 2019.

China: Signs of a Domestic Slowdown

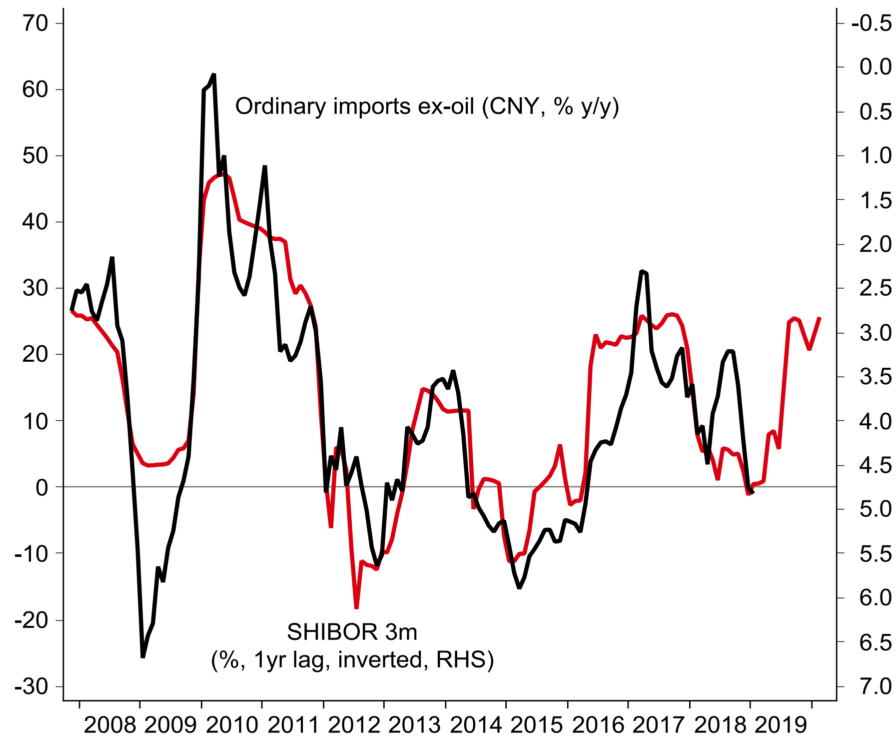
Trade war less important?

- Chinese ordinary imports excluding oil are contracting in a y/y basis and have slowed more sharply than exports
  - Weak ordinary imports points to domestic weakness as the main driver of the slowdown
- This is consistent with the impact of past policy tightening feeding through

Ordinary imports contracting



Processing imports & exports falling

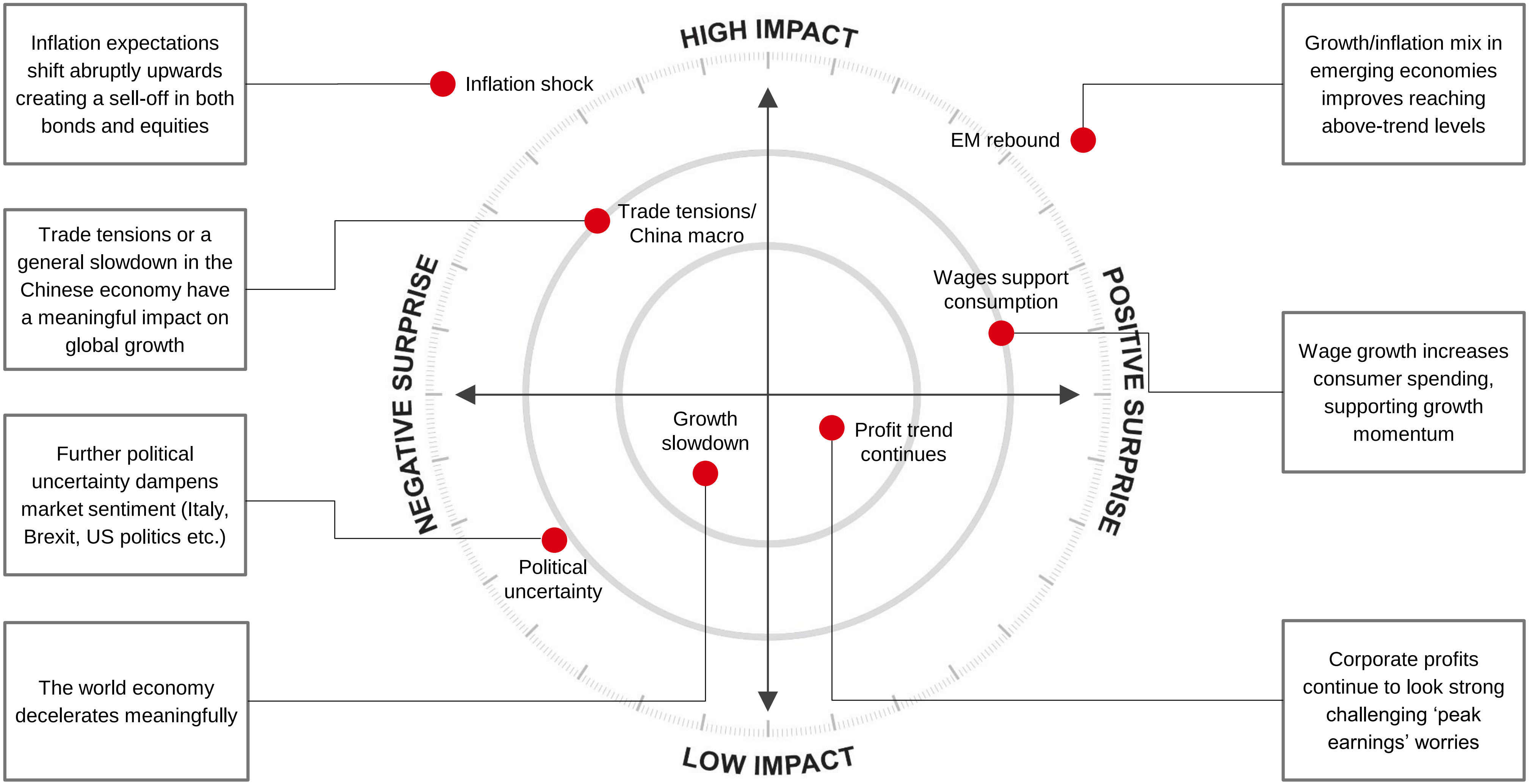


Source: HSBC Global Asset Management, Macrobond, March 2019.

Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Global Asset Management (UK) Limited accepts no liability for any failure to meet such forecast, projection or target.

Risk compass

Key risks to monitor

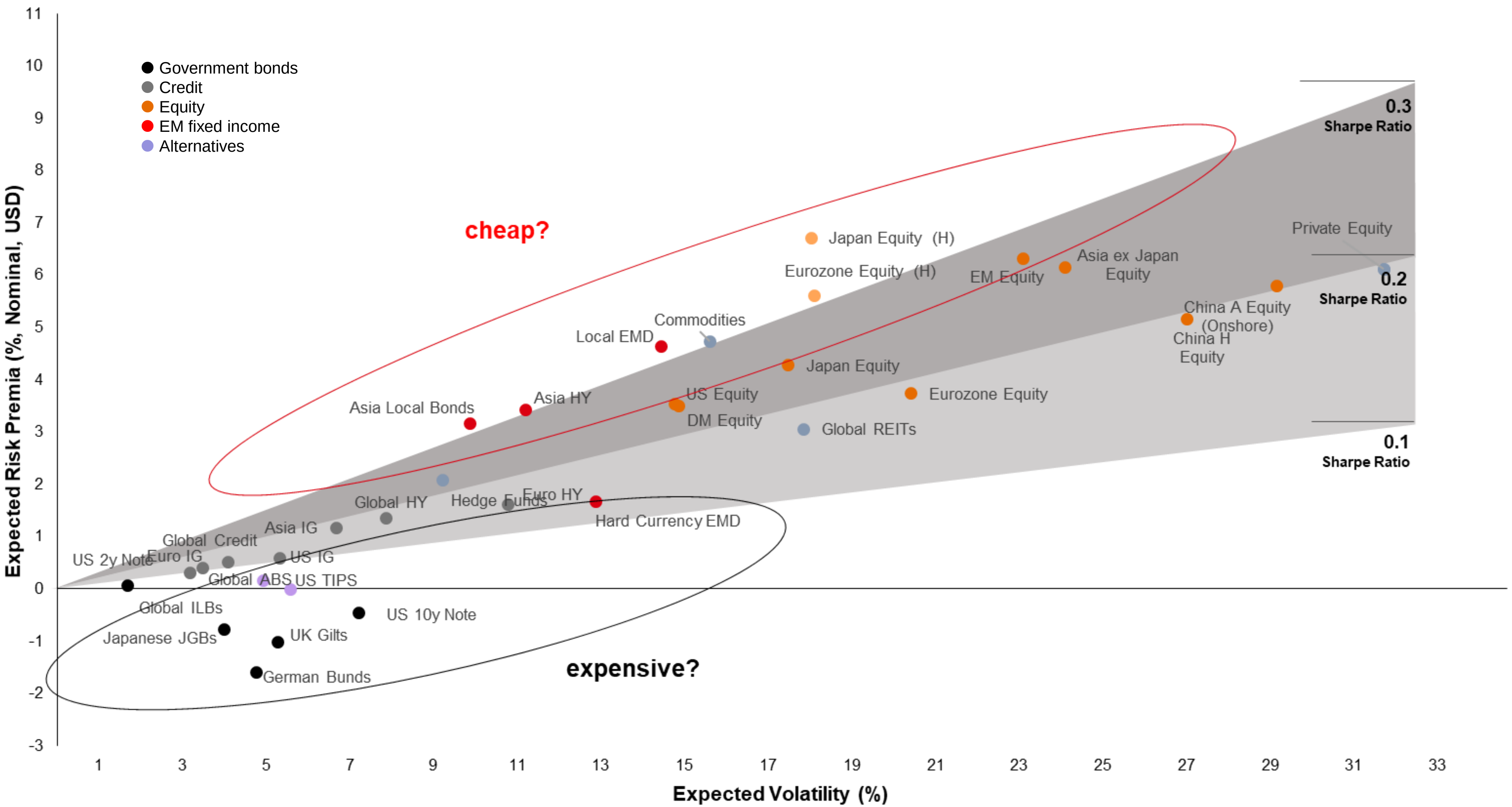


Source: HSBC Global Asset Management, March 2019. For illustrative purposes only. Any views expressed were held at the time of preparation and are subject to change without notice.

The pecking order of asset classes

Today's implied market odds

◆ Chart shows the updated pecking order of asset classes (as at end February 2019)



*Global Fixed Income assets are shown hedged to USD. Local EM debt, Equity and Alternative assets are shown unhedged

Source: Bloomberg, HSBC Global Asset Management, as at end February 2019. For illustrative purposes only. Any views expressed were held at the time of preparation and are subject to change without notice. While any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Global Asset Management (UK) Limited accepts no liability for any failure to meet such forecast, projection or target.

Multi-asset house views

Asset Class		View	Comments
Aggregates	Global DM bonds	▼	Low prospective returns and the scope for an upside surprise in the inflation picture (versus market expectations) changes the risk properties of bonds. We are UW
	Global Credit	↔	Corporate and macro fundamentals still look good but prospective returns have compressed. The credit risk premium still looks reasonable, but current pricing penalises duration exposure (bond risk premium is negative). We are Neutral, with a cautious outlook
	Global Equities	▲	Despite some compression in the equity risk premium during 2019, equities still look attractive versus today's opportunity set. The mix of OK growth, no recession, and dovish policy favours global equities and emerging markets
	EM asset classes	▲	EM asset classes benefit from a combination of attractive valuations, a dovish Fed, and residual growth/recession worries after a tough 2018. We stay OW
Bonds	US	▼	Recession and rate cuts are priced in. Inflation risks are neglected. Valuations (in the belly and long end) are not as attractive as they were last year. Stay UW
	Europe	▼	We continue to measure a very negative risk premium in European bonds. Investors are having to pay a high price for safety
	Local currency EM bonds	▲	Most EM bonds offer us high prospective returns and a margin-of-safety: high real interest rates, positive bond premia, and attractively priced currencies
Credits	DM Credit	↔	Credit spreads have compressed and duration risk remains a drag on prospective returns. IG credits look expensive. We prefer to take growth risk through equities
	Asia Credit	▲	Valuations look neutral overall but prospective risk-adjusted returns look attractive in some segments. We like Asia HY
	Hard Currency EM bonds	↔	Hard currency EM debt is beginning to look a little expensive (mainly because of long US duration). Other parts of the opportunity set look preferable
Equities	Developed Markets	▲	Growth perceptions have recovered from 2018's sell-off. But stretched valuations in DM fixed income forces us out of global bonds and into equities. A combination of OK growth and dovish policy creates a benign backdrop for global equities
	Emerging Markets	▲	We find attractive valuations in EM equity and currency markets combined with improving market sentiment and macro-economic momentum
	Asia (inc Japan)	▲	Pan-Asia equity offers us high risk-adjusted returns, and reasonable earnings growth in an environment where risks are well-known
Other	US dollar	↔	In our opinion, there are "two dollar" exchange rates. Dollar versus majors is likely to be range-bound. Dollar versus EM is at a valuation extreme
	Commodities	↔	Economically-sensitive commodities could benefit from our relatively benign macro outlook, but we prefer to deploy active risk in other asset classes
	Index-linked bonds	▲	Inflation is an under-priced, but high impact risk. We prefer global linkers to nominals - but we are very wary of over-extending duration

Source: HSBC Global Asset Management, as at March 2019. Any views expressed were held at the time of preparation and are subject to change without notice.

Important Information for Customers:

WARNING: THE CONTENTS OF THIS DOCUMENT 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. IF YOU ARE IN DOUBT ABOUT ANY OF THE CONTENTS OF THIS DOCUMENT, YOU SHOULD OBTAIN INDEPENDENT PROFESSIONAL ADVICE.

This document has been issued by The Hongkong and Shanghai Banking Corporation Limited (the "Bank") in the conduct of its regulated business in Hong Kong and may be distributed in other jurisdictions where its distribution is lawful. It is not intended for anyone other than the recipient. The contents of this document may not be reproduced or further distributed to any person or entity, whether in whole or in part, for any purpose. This document must not be distributed to the United States, Canada or Australia or to any other jurisdiction where its distribution is unlawful. All non-authorised reproduction or use of this document will be the responsibility of the user and may lead to legal proceedings.

This document has no contractual value and is not and should not be construed as an offer or the solicitation of an offer or a recommendation for the purchase or sale of any investment or subscribe for, or to participate in, any services. The Bank is not recommending or soliciting any action based on it.

The information stated and/or opinion(s) expressed in this document are provided by HSBC Global Asset Management Limited. We do not undertake any obligation to issue any further publications to you or update the contents of this document and such contents are subject to changes at any time without notice. They are expressed solely as general market information and/or commentary for general information purposes only and do not constitute investment advice or recommendation to buy or sell investments or guarantee of returns. The Bank has not been involved in the preparation of such information and opinion. The Bank makes no guarantee, representation or warranty and accepts no responsibility for the accuracy and/or completeness of the information and/or opinions contained in this document, including any third party information obtained from sources it believes to be reliable but which has not been independently verified. In no event will the Bank or HSBC Group be liable for any damages, losses or liabilities including without limitation, direct or indirect, special, incidental, consequential damages, losses or liabilities, in connection with your use of this document or your reliance on or use or inability to use the information contained in this document.

In case you have individual portfolios managed by HSBC Global Asset Management Limited, the views expressed in this document may not necessarily indicate current portfolios' composition. Individual portfolios managed by HSBC Global Asset Management Limited primarily reflect individual clients' objectives, risk preferences, time horizon, and market liquidity.

The information contained within this document has not been reviewed in the light of your personal circumstances. Please note that this information is neither intended to aid in decision making for legal, financial or other consulting questions, nor should it be the basis of any investment or other decisions. You should carefully consider whether any investment views and investment products are appropriate in view of your investment experience, objectives, financial resources and relevant circumstances. The investment decision is yours but you should not invest in any product unless the intermediary who sells it to you has explained to you that the product is suitable for you having regard to your financial situation, investment experience and investment objectives. The relevant product offering documents should be read for further details.

Some of the statements contained in this document 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. Such statements do not represent any one investment and are used for illustration purpose only. Customers are reminded that there can be no assurance that economic conditions described herein will remain in the future. Actual results may differ materially from those described in such forward-looking statements as a result of various factors. We can give no assurance that those expectations reflected in those forward-looking statements will prove to have been correct or come to fruition, and you are cautioned not to place undue reliance on such statements. We do not undertake any obligation to update the forward-looking statements contained herein, whether as a result of new information, future events or otherwise, or to update the reasons why actual results could differ from those projected in the forward-looking statements.

Investment involves risk. It is important to note that the capital value of investments and the income from them may go down as well as up and may become valueless and investors may not get back the amount originally invested. Past performance contained in this document 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. Past performance information may be out of date. For up-to-date information, please contact your Relationship Manager.

Investment in any market may be extremely volatile and subject to sudden fluctuations of varying magnitude due to a wide range of direct and indirect influences. Such characteristics can lead to considerable losses being incurred by those exposed to such markets. If an investment is withdrawn or terminated early, it may not return the full amount invested. In addition to the normal risks associated with investing, international investments may involve risk of capital loss from unfavourable fluctuations in currency values, from differences in generally accepted accounting principles or from economic or political instability in certain jurisdictions. Narrowly focused investments and smaller companies typically exhibit higher volatility. There is no guarantee of positive trading performance. 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. Mutual fund investments are subject to market risks. You should read all scheme related documents carefully.

Issued by The Hongkong and Shanghai Banking Corporation Limited

Expiry: 1 July 2019