Special Coverage

Fear In The Markets:
The Smart Investor's Response

Xian Chan
Global Head of Wealth Insights
HSBC Wealth and Personal Banking

Key takeaways

Strategically, we are still Overweight[1] on equities and the selloff has now created a more attractive entry point for investors who can stomach short-term volatility.

Tactically, we are now more cautious over the next 3 months:

- We are downgrading global equities from Overweight to Neutral, on the expectation that corporate earnings will deteriorate significantly in the short-term, particularly in developed markets.

Global Equities

- We prefer higher quality bonds, and we are upgrading investment grade corporate bonds from Underweight to Neutral.

Corporate Bonds

[1] ▲ "Overweight" implies that, within the context of a well-diversified, typically multi-asset portfolio, and relative to relevant internal or external benchmarks, HSBC Global Asset Management has (or would have) a positive tilt towards the asset class.

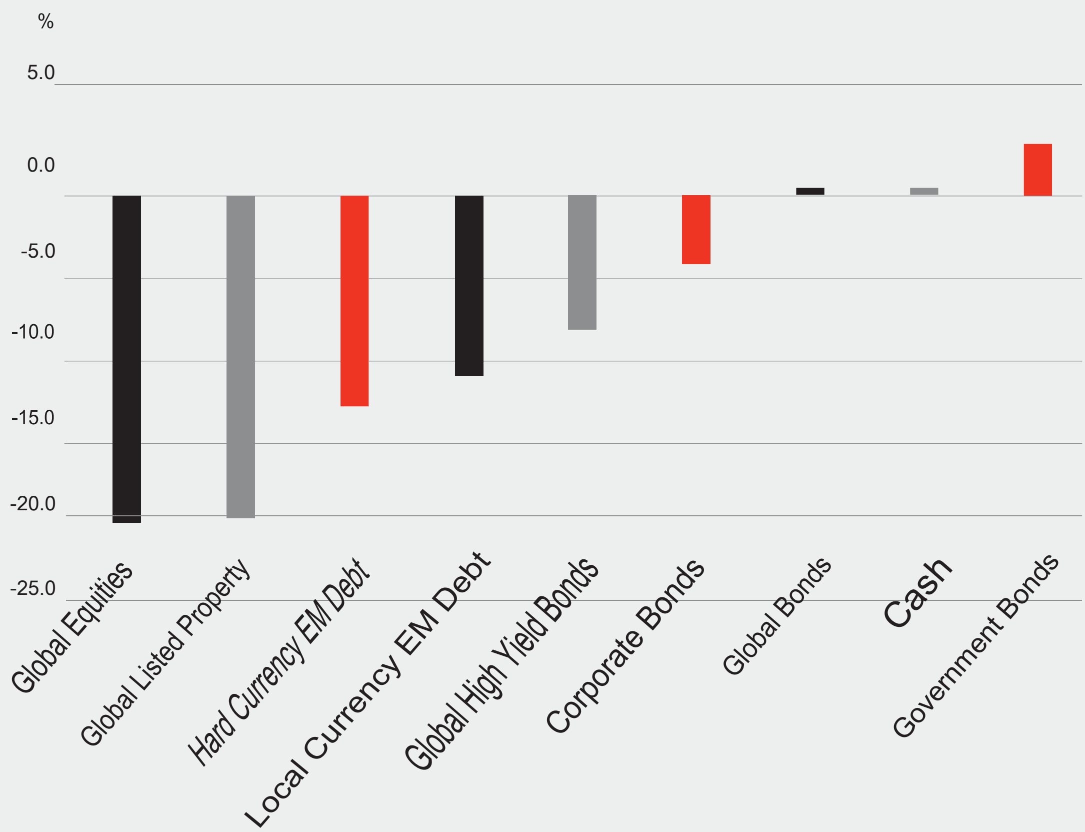
▼ "Underweight" implies that, within the context of a well-diversified, typically multi-asset portfolio, and relative to relevant internal or external benchmarks, HSBC Global Asset Management has (or would have) a negative tilt towards the asset class.

▶ "Neutral" implies that, within the context of a well-diversified, typically multi-asset portfolio, and relative to relevant internal or external benchmarks, HSBC Global Asset Management has (or would have) neither a particularly negative nor a positive tilt towards the asset class.

Investors come in many shapes and sizes, but right now they all have one thing in common: fear. The global stock market is down about 20% for the year now. The question of whether US stocks can sustain their bull run has been answered with a resounding “no”. While few would have predicted that a global pandemic would trigger the selloff, the US is now formally in bear-market territory, having fallen over 20% from its peak in February.

The selloff has been widespread across most markets globally, with even traditionally “defensive” sectors like healthcare or utilities falling victim. The selloff has been non-discerning across different industry sectors. On the flipside, any government bond that’s considered even remotely safe has been in high demand, and bond yields are now even lower than before. Witness the proverbial “flight to safety”.

Year-to-Date Performance till 13 March 2020



Source: Refinitive datastream, as of 13 Mar 2020.
Past performance is not an indication of future returns. The value of units may go down as well as up.

Note: the chart shows total returns of asset classes in USD dollar (USD). Asset class performance is represented by different Indices - Global Equities: MSCI ACWI Net Total Return Index; Global Listed Property: FTSE EPRA Nareit Developed Index; Global High Yield Corporate Bonds: Bloomberg Barclays Global High Yield Corporate Total Return Index; Global Investment Grade Corporate Bonds: Bloomberg Barclays Global Aggregate Corporate Total Return Index; Emerging Market Local Currency Government Bonds: Bloomberg Barclays Emerging Market Local Currency Government Total Return Index.;Global Government Bonds: Bloomberg Barclays Global Aggregate Treasuries Total Return Index.

Financial markets are delicately balanced

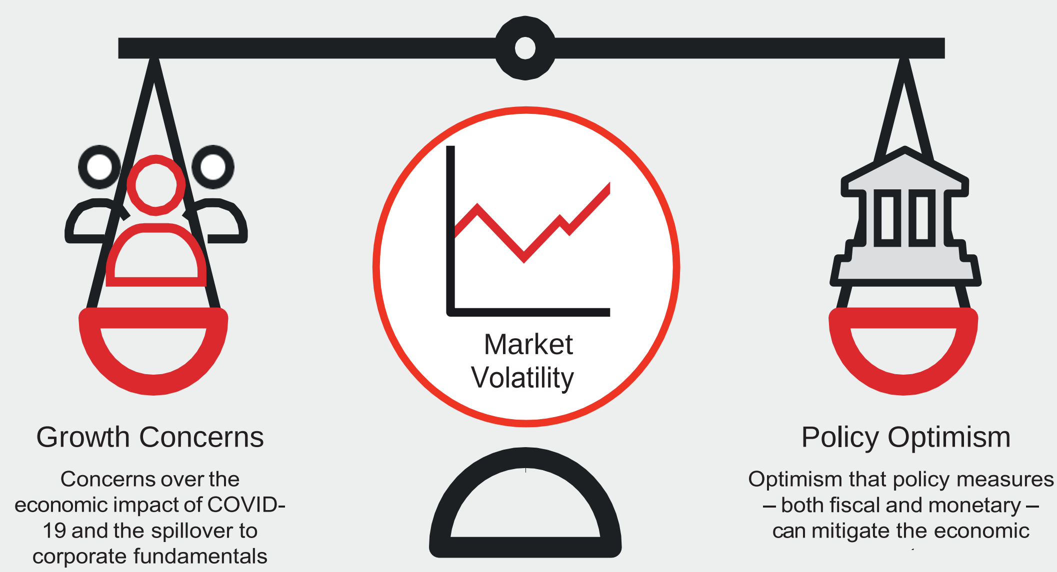
Which way will they tip?

Imagine our current volatility as a weighing scale. On one side are investors, fearful for the global economy and wondering how much worse the virus will get.

On the other side, we have the measures taken by authorities around the world. These include control and limitation measures to limit viral spread, monetary stimulus to lower the cost of corporate debt and fiscal stimulus to support vulnerable consumers through this challenging period. The authorities have not held back so far, with the US Federal Reserve cutting interest rates to zero and the European Central Bank increasing quantitative easing. Attention is now focussed on how much fiscal stimulus governments will inject.

Investors eagerly process each new bit of information. When the implications of a new development are unclear (as in the case of coronavirus), they may well feel that the only safe option is to sell now and figure it all out later. We should therefore expect markets to be choppy and volatile in the short term, as further news breaks about the virus and its economic and financial implications.

Growth Concerns Versus Optimism For Policy Stimulus



Source: HSBC Global Asset Management. March 2020 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 forecasts, projection or target.

Four themes to guide investors over the coming months

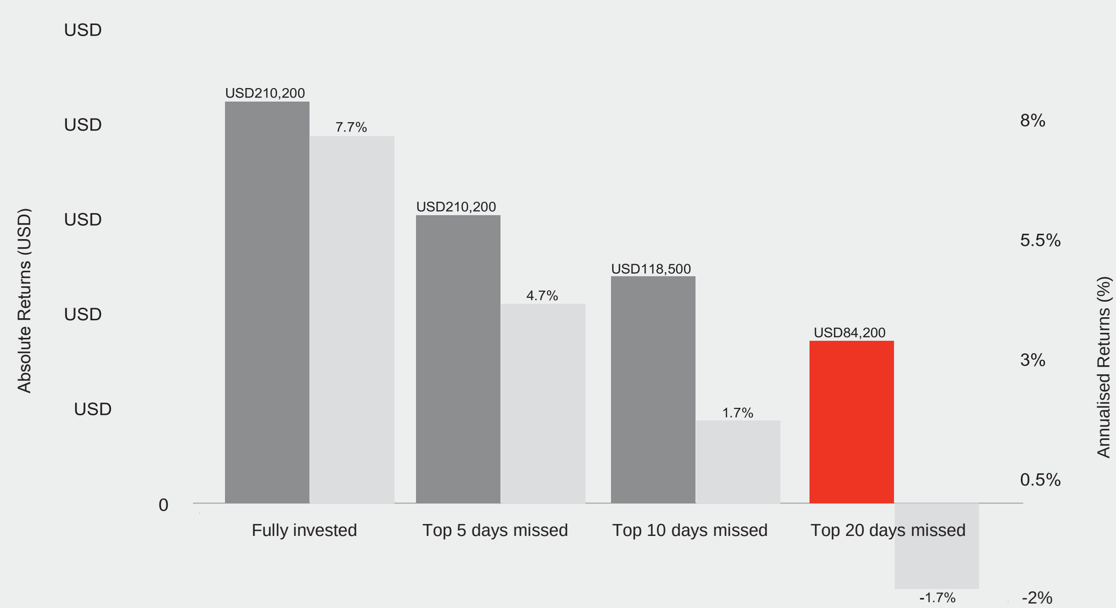
1 Take a breath and don't panic

One of the worst things an investor can do right now is sell all, or even a substantial chunk, of their equities – especially if they've already suffered significant losses.

In volatile times, market movements tend to be larger than normal – up as well as down. So, if you've cashed out, you risk missing out on large gains upwards. In fact, missing even one day of major gains can be damaging. According to data from 2004 to 2014[2], portfolios that missed out on the top 20 performing days during this period would have been significantly harmed.

Whereas "timing the market" is notoriously difficult, the right strategy is, in fact, to focus on "time in the market".

Why Market Timing Could Cost Returns



Source: Bloomberg, MSCI Daily Total Return Gross World Index (GDDUWI index)

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[2]The period 2004 to 2014 was selected because it includes the Global Financial Crisis and European Debt Crisis, along with other volatile periods.

2 Prepare for volatility over the coming months

We expect the economic outlook to remain uncertain, with see-sawing markets and persistent volatility, and have therefore made several short-term changes to our investment views (covering the next 3 months).

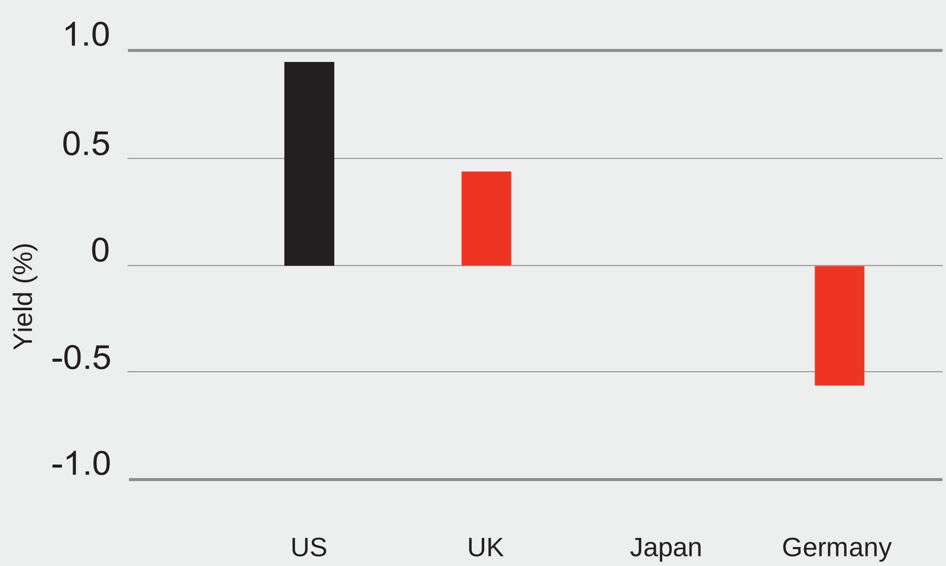
We are **downgrading global equities from Overweight to Neutral**, on the expectation that corporate earnings will deteriorate significantly in the short-term, particularly in developed markets. We still think equities are an attractive investment over the long term but caution is warranted for now. We stress this is a modest reduction and NOT a call to sell everything.

We are **upgrading investment grade corporate bonds from Underweight to Neutral.** With yields on government bonds now even lower, the excess yield available on investment grade corporate bonds looks more attractive. Corporate bonds are also more reasonably priced, and reflect some of the risks of a global recession, as well as deterioration in corporate earnings.

Although we're **maintaining our Underweight position on core government bonds**, we acknowledge that they still have a place in a diversified portfolio. While these assets have performed well during volatile times, with their yields at an unprecedented low we do have concerns about their ability to rally much further (and offer the same diversification benefits). Nonetheless, they should continue to hold up well in the current volatility.

It's vital that you take steps now to optimise your portfolio, while ensuring the right level of exposure for your risk tolerance. That means including high quality bonds, even though valuations on core government bonds are particularly expensive right now. These allocations should be looked on as a form of portfolio insurance, particularly for the short-term.

10 Year Government Bond Yields: Low and Unattractive



Source: Refinitive datastream, as of 13 Mar 2020.
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3 Look for “smart diversifiers”

Since traditional safe-haven assets like core government bonds are so expensive, there’s nowhere cheap or easy to hide. We’ve already mentioned investment grade corporate bonds as an alternative, but it must be stressed that since these bonds are issued by companies and not governments, they do have a higher correlation with the stock market.

Because of this, investors should consider additional ways of diversifying. **Alternative investment strategies**, which aim to deliver absolute returns uncorrelated to market conditions, should be considered if available.

Gold is another asset that traditionally performs well during volatility, although prices are currently very high, making it hard to be bullish. But gold is still a useful store of value in times like these and we expect prices to be supported by even lower interest rates and continued short-term volatility.

If neither of these approaches is readily available, a more traditional **multi-asset portfolio approach**, where investment decisions are made by full-time professionals against your risk target or budget, would be a smart option amid the current uncertainty.

4 Consider opportunities for the long term

With uncertainty comes opportunity. This matters to long-term investors because **cheaper entry points to global equity markets now exist.** This means that long-term prospective returns on equities are now higher than they were before, **making them more attractive for investors with a longer-term time horizon.** Remember that it’s extremely difficult to time the market and call the absolute bottom so it’s worth considering the opportunities.

Within equities, we think that **Emerging Market (EM) equities, particularly in Asia are especially attractive from a long-term perspective**. Emerging Markets have more scope for policy action than, say, the Eurozone and Japan, and indeed we’ve already seen authorities in China and other Asian markets take aggressive fiscal and monetary action to support the economy. Lower energy prices should also help EM markets that are “non- petro” economies.

Because Asia was forced to confront the coronavirus a few months before the rest of the world, the continent is arguably closer to returning to some semblance of normal life. This can only be positive Asian economies and, correspondingly, for EM and Asian investments.

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