

Q2 / 2025

HSBC Perspectives

Shaping your investment portfolio



HSBC

Opening up a world of opportunity

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Rising AI adoption broadens the opportunity set in an uncertain world

The start of 2025 has brought the acceleration of major changes in the global landscape. DeepSeek's breakthrough artificial intelligence (AI) model is not only challenging the established dominance of the US but also drawing everyone's attention to the potential for mass AI adoption. We now see AI as the key to unlocking opportunities across markets and sectors.

Meanwhile, tariffs and frictions are shaking up trade and raising inflation concerns, and international relations and policies are becoming less predictable. However, these unfavourable forces are occurring when the global economy is in good health, interest rates are falling in most developed markets, and many corporates are cash-rich. Economists are projecting a respectable GDP growth rate of around 3% for the global economy and 2.3% for the US. While that should offer strong protection against potential surprises, we think diversification is as important as ever in the current environment.

What does this mean for investors?

The underperformance of US equities year-to-date underlines the need for a broader opportunity set. There are two main reasons for this: first, the run-up in equity valuations driven by the Magnificent 7 stocks is pushing investors to look for other options. Second, accelerating AI adoption will create a rush to invest in software and automation across all industries. Governments, too, recognise the need to invest in electrification and infrastructure to grow strategically important industries to stay competitive and ensure security in all of its aspects, including defence and cybersecurity, as well as access to electricity and resources.

This trend is happening around the world. So, while the US remains fundamentally resilient, US exceptionalism is waning, and we're broadening geographically into Asia, where we continue to favour India, Singapore and Japan, as their domestic drivers remain intact. During Q1 2025, we also added China and the UAE to our preferred list. The story of DeepSeek and the enthusiasm over technological innovation has put previously unloved Chinese tech stocks back in the spotlight. Government support is a shared driver for both China and the UAE, leading to more investment in technology-related capex, and the UAE is further supported by its strong structural drivers and the boom in its housing and tourism sectors.

Naturally, technology is a direct beneficiary, but the power of technological innovation, intertwined with supporting policies and structural tailwinds, points to opportunities elsewhere too, across IT, Communications, Financials, Industrials and Healthcare. Outside of the Magnificent 7 stocks in the US, we expect earnings growth momentum in the Forgotten 493 companies in the S&P 500 to be increasingly compelling, and adopt a similar strategy in Asia and Europe to capture broadening earnings growth.

A need to diversify through multi-asset strategies and non-traditional assets

We think geographical and sector diversification can best be delivered through multi-asset portfolios as we aim to exploit both structural and tactical opportunities amid rising uncertainty. As the Fed is expected to cut rates further in the second half of 2025, US Treasuries and quality bonds offer attractive returns at their current yield levels. While we lengthened bond durations in Q1 to lock in attractive yields for longer, we're also leveraging flexible duration strategies to capture any opportunity that arises. In fact, the market dynamics we see in today's fast-moving world have prompted us to look for an even higher level of diversification by adding renewables, infrastructure and gold as and when appropriate.

We hope these insights, together with our four investment themes for Q2, will guide your investment journey in the months ahead.



Willem Sels

Global Chief Investment Officer,
HSBC Global Private Banking and Wealth

Key data to watch

Global economic growth is in healthy shape. Lower inflation expectations in developed markets allow most central banks to continue cutting rates.

	GDP		Inflation	
	2025f	2026f	2025f	2026f
World	2.7	2.6	3.4	2.9
US	2.2	1.8	3.0	2.7
Eurozone	0.9	1.3	2.3	2.0
UK	0.9	1.5	3.4	2.6
Japan	1.3	0.9	2.6	1.9
Mainland China	4.5	4.4	0.6	0.9
India	6.5	6.5	4.4	4.6

Source: HSBC Global Research as at 7 March 2025. Estimates and forecasts are subject to change. India inflation forecasts are fiscal year.

The Magnificent 7 and the US have lost their leadership as investors broaden sector and geographical exposure.



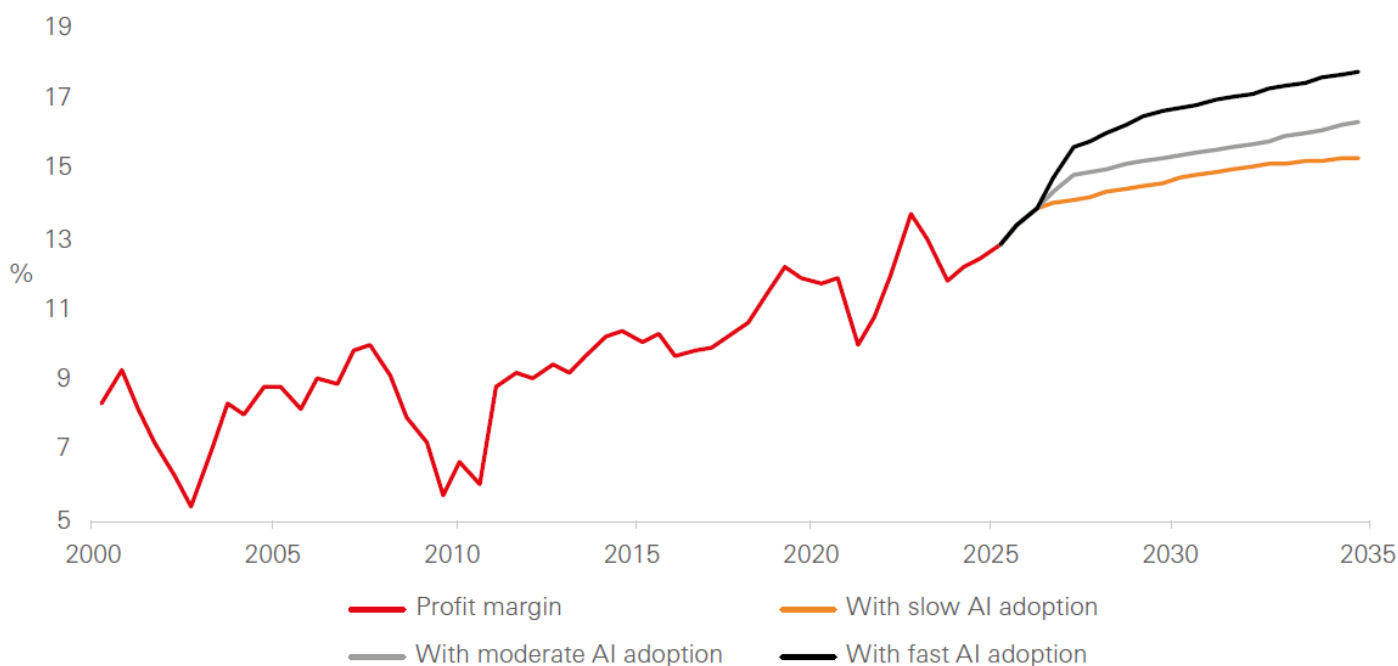
Source: Bloomberg, HSBC Global Private Banking and Wealth as at 10 March 2025. Past performance is not a reliable indicator of future performance.

While Chinese equity valuations remain cheap, we expect further upside due to technological innovation and a more favourable policy environment for the private sector.



Source: Bloomberg, HSBC Global Private Banking and Wealth as at 10 March 2025. Past performance is not a reliable indicator of future performance.

Opening up AI with cost-effective models accelerates adoption, resulting in a productivity boost and earnings growth not only in technology but across various sectors.



Source: Bloomberg, HSBC Global Private Banking and Wealth as at 10 March 2025. Past performance is not a reliable indicator of future performance.

Four investment themes to help shape your portfolio

1 Look beyond the US to capture regional equity drivers

US economic resilience and steady earnings growth continue to provide a positive backdrop for US equities. However, markets have high expectations for Trump's administration, and investors may be disappointed if policies don't materialise as expected. Policy uncertainty and stretched valuations have pushed investors to look for other options to broaden and diversify exposure. While we're neutral about US equities, our optimism is less pronounced than previously.

We've increased our exposure in Asia. Despite US tariff risks, many markets in the region boast strong domestic drivers that put them in a competitive position. For instance, Japan is supported by mildly positive inflation and an improved earnings outlook. India's strong structural trends and government stimulus, as well as Singapore's attractive valuations and dividend yield, also bode well for equities. In China, rapid technological progress is set to create huge opportunities across industries and sectors.

Elsewhere, we see opportunities in the UAE due to its positive structural growth, improved cyclical momentum and booming housing market. The market is also relatively insulated from most external headwinds. Geographical diversification into these markets helps balance risks and opportunities.

- ◆ We downgrade US and global equities to neutral, and continue to broaden our geographical footprint in markets such as the UAE.
- ◆ Within Asia, we have a stronger preference for China over India, although both are in favour. We're also positive on Singapore and Japan.





2 Broaden sector opportunities driven by AI adoption and policy priorities

AI and innovation are accelerating at full speed globally thanks to DeepSeek's breakthrough, lifting market sentiment outside of the US and beyond the technology sector. Earnings growth is broadening from the AI enablers to AI adopters and from tech to non-tech. In the US, Magnificent 7 stocks are losing some of their appeal, while any businesses able to leverage the power of AI to develop new business models and enhance productivity could emerge as winners. Pro-growth policies, including tax cuts and deregulation, are also catalysts for sectors such as industrials and financials.

In Asia, the adoption of AI and supportive government policies in China and elsewhere are urging companies and governments to invest to keep up. Spending on software and automation should increase further, and data centres are on the rise. The resulting demand for energy and infrastructure should benefit Industrials.

Europe is facing many challenges, but we nevertheless see opportunities in Industrials due to increased defence and infrastructure spending. Financials benefit from increased M&A activity, a rebound in capital markets activity and still low valuations.

- ◆ **In the US, we look for sector diversification in the Forgotten 493 stocks across Technology, Communications, Financials, Industrials and Healthcare.**
- ◆ **We're more selective in Europe, favouring Technology, Industrials, Financials and Healthcare. In Asia, we see opportunities in Technology, Communications, and Industrials.**

3 Employ multi-asset and active bond strategies to navigate uncertainty

While we're fascinated by the AI-driven opportunities, inflation, geopolitical tensions and policy surprises remain key risks for Q2.

Multi-asset strategies can kill two birds with one stone. Exposure to different sectors and markets allows investors to capture growth opportunities more cost-efficiently than tapping into them individually. And at the same time, professional managers can react to changing market conditions more proactively. Another advantage is their ability to access new and emerging opportunities in the private markets, which are inaccessible to retail investors. The diverse mix of investment instruments provides effective checks and balances.

Bonds play a key role in a diversified portfolio in both good and bad times for their diversification benefits and income generation. We still favour quality bonds for their better risk-adjusted returns, and the current elevated bond yields can provide an attractive income stream to stabilise portfolios.

While we see value in locking in current yields through longer maturities, we believe a flexible approach to duration can allow investors to capitalise on tactical opportunities as they emerge.

- ◆ **Multi-asset strategies offer diversification across regions and asset classes, seizing growth opportunities while mitigating downside and duration risks.**
- ◆ **We look to quality bonds, such as UK gilts and investment grade corporate bonds, for an attractive income stream, with a duration preference for 7-10 years.**

4 Embrace unconventional assets to enhance diversification

A traditional equity/bond allocation doesn't seem sufficient in today's complex world. Unconventional assets can help individual investors bring diversification to the next level.

Although fossil fuels may return to favour under the new US administration, the global focus on energy security and independence means renewables will remain a key part of the energy mix. Rising AI adoption also leads to huge demand for sustainable energy globally. So, we believe the energy transition is unlikely to reverse, and the goal of reaching net zero emissions by 2050 still requires substantial investment.

Power and electricity are only becoming more important as our economies become more data-driven and AI adoption gathers pace. Digital infrastructure is a top priority for governments and corporates, particularly in cloud computing, data centres, networking equipment and semiconductors. The USD500bn US Stargate project on AI infrastructure is an example.

Lastly, we think gold has its role to play as a safe-haven asset and a hedge against the unexpected.

- ◆ **Sustainability remains a driving force for many governments and companies. We see attractive investment opportunities, especially where sustainability drivers intersect with energy security and independence.**
- ◆ **Infrastructure offers relatively stable cash flows and dividends, and gold remains appealing to both individual investors and central banks for diversification.**



Regional market outlook

Where should you invest your money?

United States



After a long period of outperformance, US economic growth has become a bit more mixed but is still relatively resilient. Most consumers are doing well, but some inflation pressures (e.g. egg prices) are causing more prudent spending. Businesses, however, are spending rapidly on AI, software and innovation to stay ahead. Meanwhile, the government is stimulating investment in data centres and electricity, and it's also planning tax cuts. These positives should more than offset the negative impact of tariffs. Inflation may remain sticky, but real rates are high, allowing the Fed to cut a few more times this year.

The Eurozone and UK



The Eurozone's domestic growth remains weak compared to the US and inflation is in check, allowing the central bank to continue its rate cuts. Geopolitics creates two-way risk. A prolonged cease-fire in the Middle East and Ukraine could help sentiment, while US tariffs will likely remain a challenge. More fiscal spending (led by defence and infrastructure) could lift activity.

The UK hopes to get a trade deal with the US but domestic consumption is capped by sticky inflation. Government expenditure has driven recent growth but fiscal constraints may halt this tailwind. We think the central bank will cut rates more than markets expect.

EM EMEA and EM Latin America



EM EMEA is negatively affected by the slow growth in the EU. While a cease-fire between Russia and Ukraine could help the region, the fraught relations with Russia and the remaining uncertainty may continue to weigh on confidence in the region.

Latin America is facing a few issues. Mexico is in the eye of the tariff storm with the US, with the outlook depending on whether further negotiations are successful. In Brazil, concern over fiscal excess has led bond yields and funding costs to jump. In both cases, the uncertainty is putting a dampener on business and investor confidence.





Asia (ex-Japan)

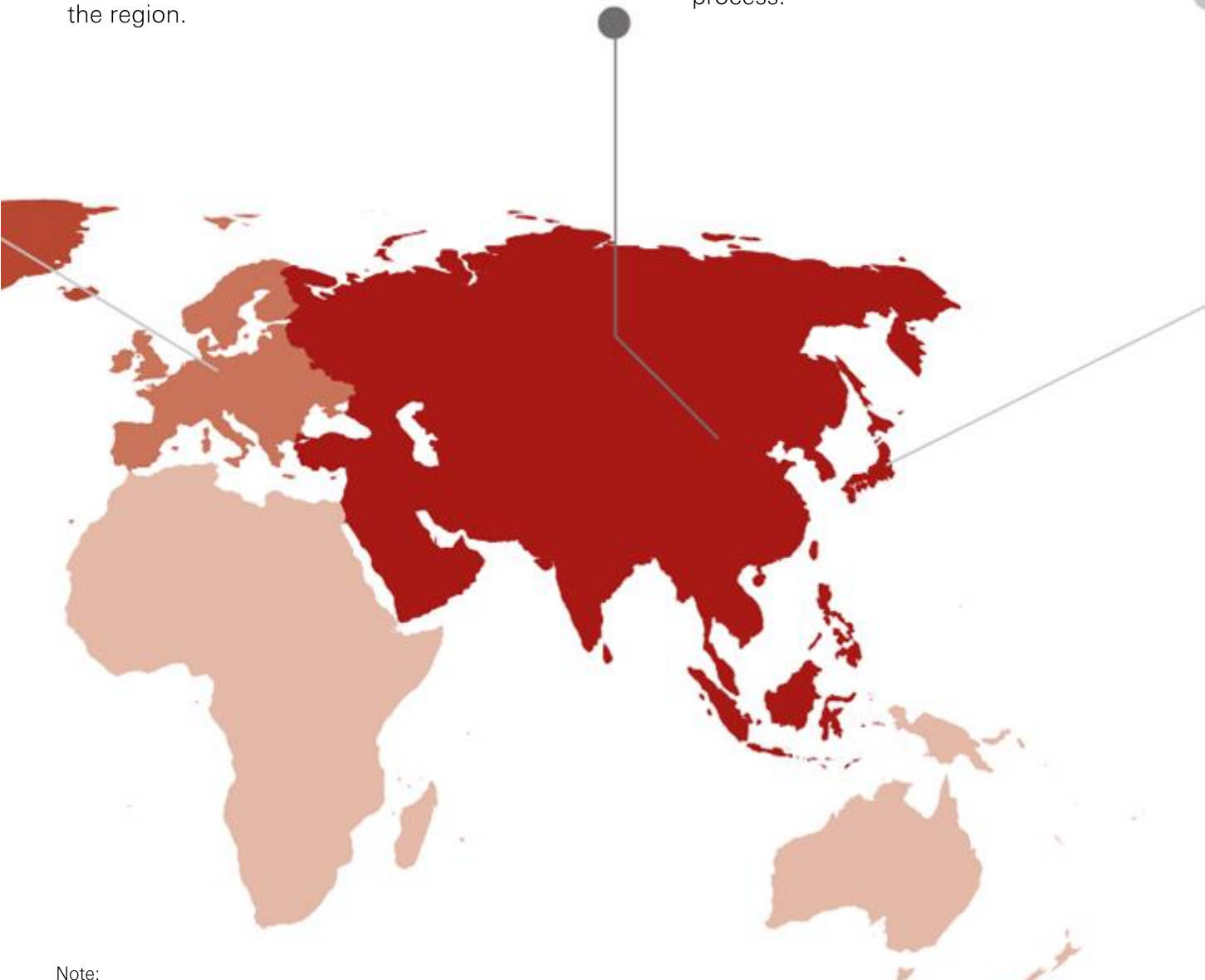
China has been in the spotlight thanks to its rapid technological progress, which was illustrated by DeepSeek but comprises a long list of technological achievements. The government's policy pivot towards a friendlier stance on the private sector also helps lift sentiment. As deflationary forces continue, markets await news of further stimulus for the consumer before economic growth and earnings can accelerate.

India has seen a cyclical slowdown, but while it may take some time to rebound, the structural forces remain very supportive. As for ASEAN, the open economies are exposed to US tariffs, but the supply chain diversification continues to benefit the region. Domestic demand remains resilient in the region.



Japan

Economic growth has been exceeding expectations, lifted by Japan's exit from deflation in recent years. Workers are demanding higher wages, which is increasing their purchasing power and economic activity. Companies are benefitting from better pricing power and are returning some of their profits to shareholders through higher dividends and share buybacks. The rising inflation is causing the Bank of Japan to increase rates, but we think this will remain a relatively gradual process.



Note:

The above comments reflect a 6-month view (relatively short-term) on asset classes for a tactical asset allocation. For a full listing of HSBC's house view on asset classes and sectors, please refer to our Investment Monthly issued at the beginning of each month.

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