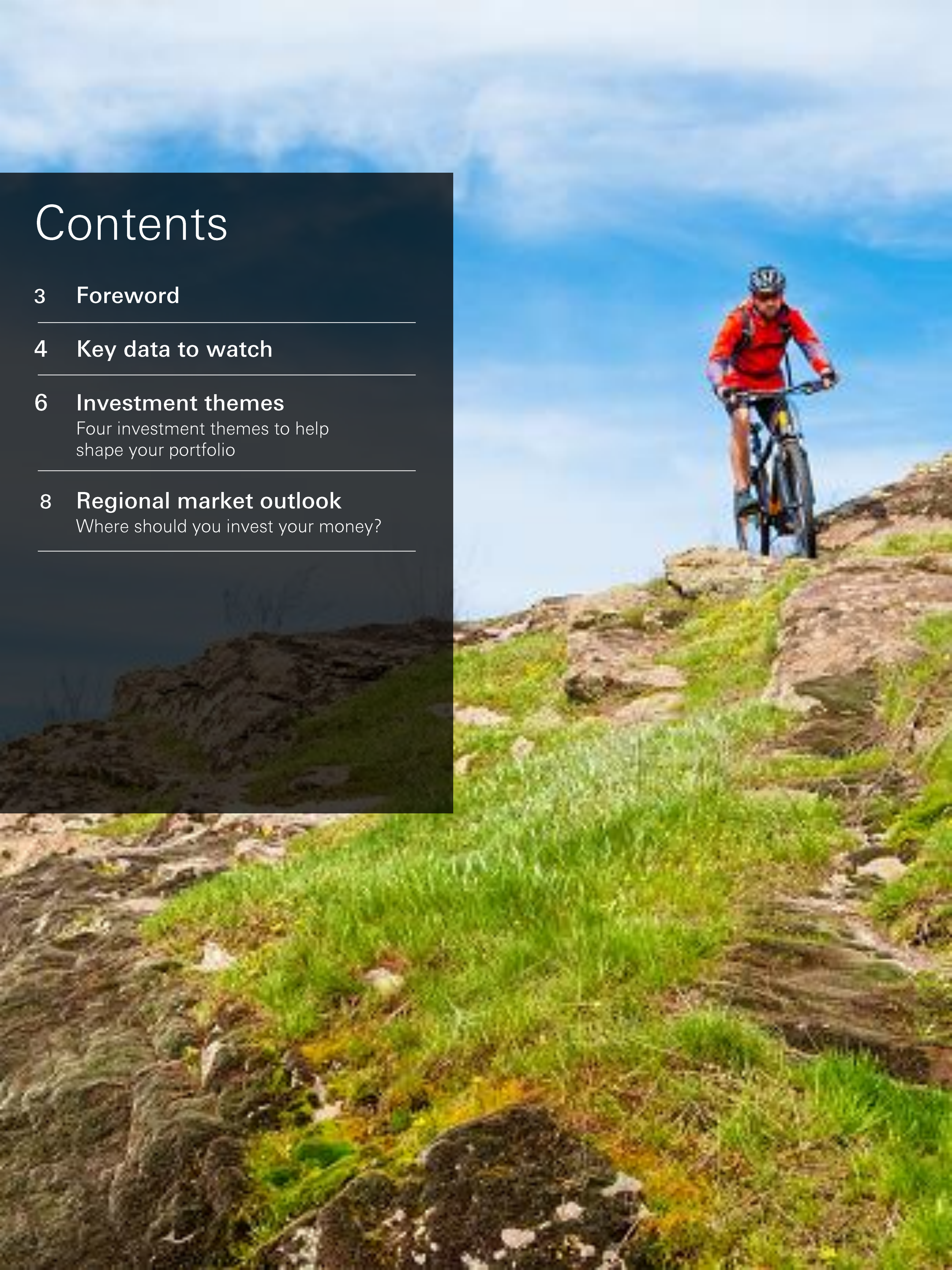
Q3 / 2024

HSBC Perspectives

Shaping your investment portfolio

HSBC | Opening up a world of opportunity



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Broadening global cyclical and rate tailwinds provide opportunities

Market expectations for Fed rate cuts have been on a roller-coaster ride, swinging from too enthusiastic in Q1 to quite conservative at the time of writing as inflation has proved stickier than expected. As rate cuts are just a matter of time, we lock in current attractive bond yields. In equities, we see a richer set of opportunities across geographies and sectors, driven by broadening global cyclical and rate tailwinds.

What does this mean for investors?

Looking ahead to the second half of the year, fundamentals remain constructive, supporting our recent move to a more risk-on stance and our upgrades of equities and sectors in a number of markets.

In the US, the higher probability of a soft landing and better-than-expected Q1 earnings give us confidence that equities have further upside. While US equities remain our biggest overweight position, current improvement in cyclical momentum in other countries should foster earnings growth as well, broadening it beyond the US.

Looking beyond the US and technology

Asia should benefit from the improving global outlook and strong domestic tailwinds, which should continue to uphold earnings momentum in India and South Korea. Continental Europe, the UK and Japan meanwhile are also gathering pace and rebounding from the bottom of their economic cycles.

Easing interest rate-related cost pressures are benefitting both corporates and households globally, stimulating more consumption and investment as well as boosting shareholder returns. Structural trends are another key catalyst. The wave of technology and AI-driven innovation promises to raise productivity across industries and boost equity performance beyond technology. We also see opportunities in non-cyclical areas in selected regions, such as healthcare in the US and Europe and utilities in Asia.

Moving cash into bonds to lock in yields now

Looking at the underlying causes of US inflation and how long rates have already been in restrictive territory compared with previous cycles, we maintain our view that the Fed will cut rates this year, most likely in September. However, the Bank of England and the ECB should begin moving sooner. As a result, we continue to focus on locking in current bond yields, with a preference for government bonds and USD-denominated investment grade credit, where we see attractive risk-adjusted returns.

While it makes sense to extend duration to lock in and enjoy high yields for longer, some investors could consider short-dated bonds for shorter-term investment needs.

Sustainability is shaping the way we live, do business and invest. The transition remains a priority for governments and corporates globally, with clean energy and biodiversity gathering most attention in terms of investment, government policies and global governance.

Managing risks without compromising on opportunities

In addition to the ongoing conflict in the Middle East, the upcoming US election will be on investors' radars in the second half of the year. Historically, markets tend to be volatile in the lead up to the vote and rebound after the result is known. Nevertheless, it's worth noting that the election outcome may have an impact on areas such as relative sector performance (e.g. energy and financials) and global trade.

This quarter, we've also included one feature article about future consumer trends, which tie in well with our investment themes.

In conclusion, we see the combination of global equity exposure and quality income from bonds as a good way to capture opportunities while managing risks. This can be achieved through a diversified portfolio or a multi-asset strategy with the help of professionals. We hope these insights will help you position your portfolios to achieve your investment goals.

Willem Sels
Global Chief Investment Officer,
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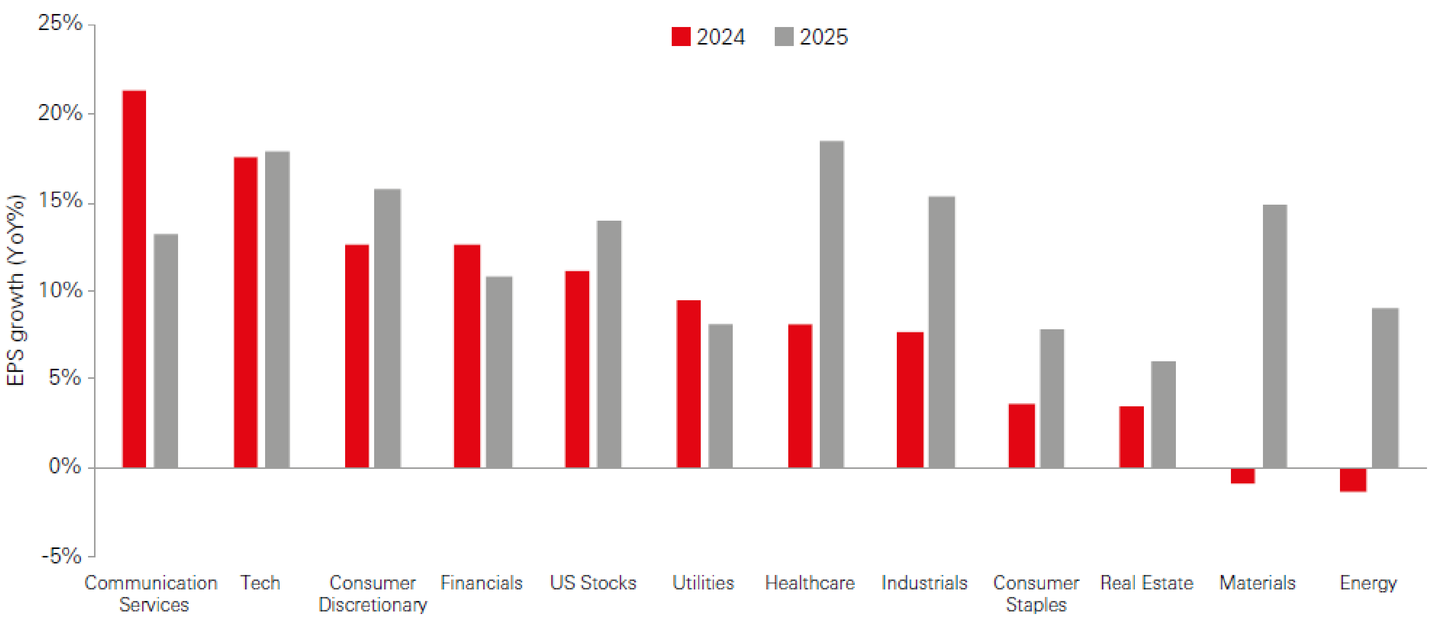
Key data to watch

Although the US is still the driving force behind global growth, the economic cycles of Europe, the UK and Japan appear to have bottomed out, while Asia remains a key growth engine

	GDP		Inflation	
	2023	2024f	2023	2024f
World	2.7	2.6	6.4	5.8
US	2.5	2.3	4.1	3.3
Eurozone	0.5	0.5	5.4	2.4
UK	0.1	0.4	7.3	2.3
Japan	1.9	0.6	3.3	2.3
Mainland China	5.2	4.9	0.2	0.7
India	7.7	6.3	5.4	4.5

Source: HSBC Global Research as at 17 May 2024. Estimates and forecasts are subject to change. India inflation forecasts are fiscal year.

Earnings growth expectations in the US remain strong



Source: LSEG, HSBC Global Private Banking and Wealth as at 17 March 2024. Past performance is not a reliable indicator of future performance.

Global calendar

Key events – second half of 2024			
Jul 18	European Central Bank (ECB) policy decision	**Nov 5**	The United States presidential election
Jul 31	Federal Open Market Committee (FOMC) policy decision	**Nov 7**	FOMC and BoE policy decisions
Aug 1	Bank of England (BoE) policy decision	**Nov 11-22**	UN Climate Change Conference (COP29)
Sep 12	ECB policy decision	**Nov 18-19**	G20 Summit
Sep 18	FOMC policy decision	**Dec 12**	ECB policy decision
Sep 19	BoE policy decision	**Dec 18**	FOMC policy decision
Sep 18-19	UN Sustainable Development Goals Summit 2024 (SDG)	**Dec 19**	BoE policy decision
Oct 17	ECB policy decision		

Four investment themes to help shape your portfolio

1. Look beyond the US to capture equity upside

We're increasingly positive on earnings as pressure from wage increases and interest rate-related costs eases, and are broadening our geographical exposure to widen the opportunity set in equity markets. The US economy remains the most resilient among developed markets, with strong Q1 earnings growth and a forecast of 11% for 2024. Prospects for the Eurozone, UK and Japan are also picking up as their economic cycles appear to have bottomed out.

Asia remains in good shape to deliver growth above the global average with its dynamic growth drivers. India is accelerating at full speed, supported by strong fundamentals and investment flows, while demand for artificial intelligence and memory chips are catalysts for South Korea. We also see signs of stabilisation in China's economy with decisive government support.

While opportunities abound, ongoing geopolitical risks and the unpredictable outcome of the US election are wild cards to watch out for. If past elections are any guide, markets tend to rally when the dust has settled. The prudent option is to remain invested in a well-diversified portfolio of quality assets across regions.

- **We continue to overweight global equities, diversifying into the US, Mexico, India, South Korea and Japan.**
- **A multi-asset strategy can help capture opportunities from different asset classes while managing downside risks.**

2. Unlock opportunities across sectors amid rate cuts and structural tailwinds

The broadening of cyclical momentum, fuelled by rate cut expectations and AI-led innovation should support earnings growth beyond technology. This is most evident in the US, where economic resilience and a strong labour market bode well for consumption while loan demand and a pick-up in mergers and acquisitions are positives for banks. The structural trends of US re-industrialisation and on-shoring/near-shoring of jobs are also helping to boost manufacturing activity in the industrials sector.

The cyclical tailwinds are also creating opportunities in Europe and Asia, where tech and consumer discretionary sectors can benefit from increased corporate and consumer spending. The high exposure of European consumer discretionary companies to the US is a bonus. Meanwhile, robust industrial production in India and China makes Asian industrials a bright spot for investors.

Some non-cyclical sectors are also faring well and shouldn't be missed. Innovation and product launches are raising sales expectations in healthcare, while utilities should gain traction from Asian investors looking for high dividends as interest rates fall.

- **We maintain a pro-cyclical stance in the US, favouring IT, communications, consumer discretionary, industrials, financials and healthcare.**
- **Our approach outside the US is more balanced. We prefer European IT, consumer discretionary, financials, energy and healthcare. In Asia, our overweight positions include IT, consumer discretionary and staples, communications, industrials and utilities.**

3. Lock in yields now to secure relative solid income streams

The risk of high-for-longer policy rates and inflation has caused bond market volatility. Although inflation has remained stickier than expected in the US in recent months, we maintain our view that the Fed will begin policy easing this year because: 1) the Personal Consumption Expenditure Price Index (the preferred Fed gauge) has made significant progress towards the Fed's target range; and 2) Fed policy has been in restrictive territory for much longer than in past cycles. And while we think the kick-off has now moved to September, this is still earlier than the markets expect.

With markets now pricing in a later start to Fed cuts, bond yields are close to multi-year highs. This provides a good opportunity to move cash into bonds and lock in attractive yields to earn a solid income stream. When rates are cut, there's a big opportunity cost for people who don't lock in bond yields now. Returns on bonds can be boosted further by price gains when the timing of rate cuts becomes clearer.

Although high yield has performed well and default risks aren't expected to accelerate, spreads remain tight, and we continue to focus on higher quality bonds for better risk-adjusted returns.

- **We overweight US Treasuries and UK gilts for a medium-to-long duration (7-10 years), while maintaining a medium duration preference (5-7 years) for investment grade bonds, preferably in US dollars. Indian local currency bonds remain attractive too.**
- **If investors prefer to invest for a shorter duration or have liquidity needs, putting money in some short-dated bonds is a better option than sitting on cash.**

4. Position for sustainable growth with clean energy and biodiversity

Energy and biodiversity remain top priorities on the sustainability agendas of governments and corporates. The focus of investment and government policies provides good hints of where the opportunities lie.

With a global shift towards lower-carbon energy production, 2023 was another record year for investment, including a 17%[1] y-o-y increase for the energy transition theme, most notably in areas such as electrified transport, hydrogen, carbon capture and energy storage, as well as USD673 billion invested in renewable energy. Policy tailwinds will surely add to the momentum and set the direction to follow. For example, China increased the national target for reducing energy intensity per unit of GDP to 2.5% (from 2% in 2023) at its National People's Congress this year.

In view of the severe impact on natural ecosystems over the past 50 years, biodiversity has become a focal point for investors and environmentalists. The expansion of human activities in fishing, farming and manufacturing continues to put pressure on ecosystems, which could result in an estimated loss in global GDP of USD2.7 trillion by 2030.[2] There are growing initiatives and investment efforts aimed at conserving and restoring biodiversity.

- **We see structural opportunities in sustainable energy, such as renewables, hydrogen, energy storage and carbon capture.**
- **Global agreements on biodiversity will have a meaningful impact in industries like food, pharmaceuticals and cosmetics.**

Sources: 1. Bloomberg New Energy Finance 2023; 2. World Bank: Economy faces huge losses if we fail to protect nature, World Economic Forum, July 2021.

Regional market outlook

Where should you invest your money?

United States

While high interest rates are starting to ease both the excessive strength in the labour market and inflation concerns, domestic growth remains strong. Innovation, driven in part by AI, is boosting investment and raising productivity. US tech firms are benefitting of course, but the benefits are spreading to other sectors as well. As a result of the resilient economic growth, earnings are well supported as cost pressures and interest payments start to ease. We maintain our overweight on US stocks and broaden our sector exposure, adopting a cyclical stance. As the Fed may cut slightly later than the central banks in Europe, we expect to see mild further USD strength.

Eurozone and UK

While economic growth remains much lower in Europe than in the US, Europe is nevertheless coming out of recession and seeing better growth. Easing energy cost pressures, a mild pick-up in global trade and a stabilisation of Chinese demand are all positive factors. As the Eurozone equity markets are now trading at a significant discount to US equities and the ECB may cut rates before the Fed, we moved from an underweight to a neutral position on Eurozone stocks in Q1. We maintain our neutral view on the UK as well, as it seems to have turned the corner. European stock markets have less exposure to the strong growth in tech than the US does, but we still see a broad scope of opportunities.

EM EMEA and EM Latin America

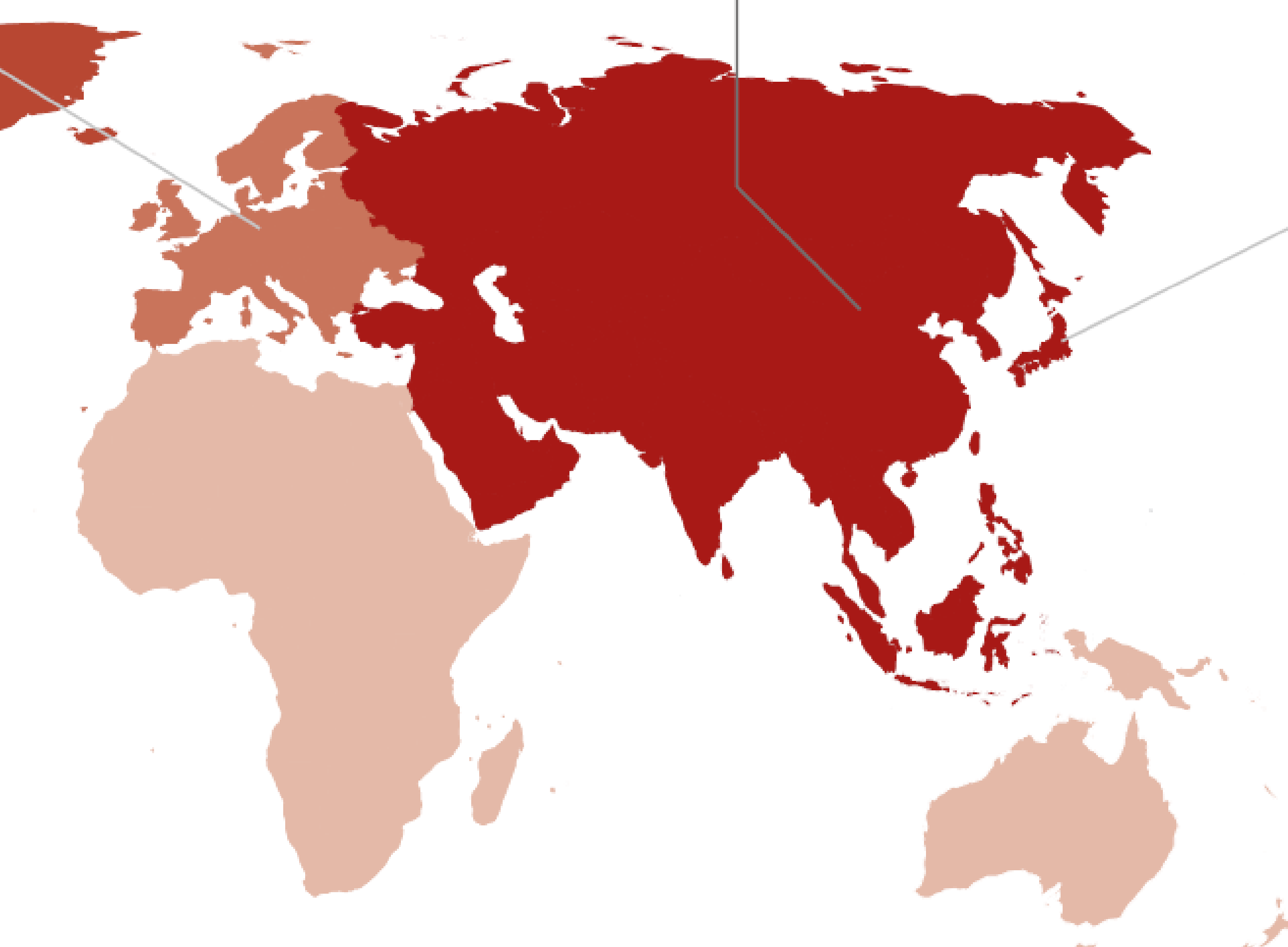
EM EMEA is benefitting from the prospect of global rate cuts and the stabilisation of the Eurozone economy. However, it remains vulnerable to geopolitical headlines due to its proximity to two devastating military conflicts. Latin America gains from near-shoring (or ‘friend-shoring’) activities as US companies bring their supply chains closer to home – a process which we expect to continue after the US election. The region’s outlook should benefit from any improvement in Chinese demand and is further supported by a rate cut cycle that is already in progress.

Asia (ex-Japan)

Asia's equity markets provide a rich set of diverse opportunities. India's economic growth remains impressive, while its attractive long-term potential could be boosted further by increased reforms after the election. China's economic growth has found a bottom thanks to monetary and fiscal support, and the recent rebound shows that investors are looking for selective opportunities. South Korea is enjoying the renewed pick-up in global tech demand. We like to tap into all of these opportunities and achieve a good level of diversification.

Japan

We maintain a positive view on Japanese stocks as their earnings are supported by the weak JPY and a mild pick-up in domestic economic growth. As the country has exited a long period of deflation, consumer and business confidence have picked up. And investors are enjoying a much sharper focus on shareholder value creation, which is boosting dividends and share buybacks. Currency volatility is high and can affect returns, though we believe that following the sharp fall, JPY should stabilise as rate cuts in the US and Europe could reduce the yield disadvantage of JPY.



Note:
The above comments reflects 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.

Glossary

Alternative investments: a broad term referring to investments other than traditional cash and bonds. These may include real estate, hedge funds, private equities and commodities investments, among other things. Some of these investments may offer diversification benefits within a portfolio.

Asset class: a group of securities that show similar characteristics, behave similarly in the marketplace and are subject to the same laws and regulations. The main asset classes are equities, fixed income and commodities.

Asset allocation: the allocation of funds held on behalf of an investor to various categories of assets such as equities, bonds and others, based on their investment objectives.

Company fundamentals: the intrinsic value of a company as analysed by looking at its revenue, expenses, assets, liabilities and other financial aspects.

Diversification: often referred to as "not putting all your eggs in one basket", diversification means investing in a variety of different markets, products and securities to spread the risk of loss.

Fiscal policy: the use of government spending and tax policies to influence macroeconomic conditions such as aggregate demand, employment, inflation and economic growth.

Investment strategy: the internal guidelines that a fund follows in investing the money received from its investors.

Inflation: the rise in the general price levels of goods and services in an economy over a period of time.

Monetary policy: the process by which the authorities of a country control the supply of money. This often involves targeting a rate of interest for the purpose of promoting economic growth and stability.

Quantitative easing (QE): also known as large-scale asset purchases. A monetary policy whereby a central bank buys government securities or other financial assets from the market to increase the money supply and encourage lending and investment.

Strategic asset allocation: a practice of maintaining a mix of asset classes which should meet an investor's risk and return objectives over a long-term horizon and is not intended to take advantage of short-term market opportunities.

Tactical asset allocation: an active management strategy that deviates from the long-term strategic asset allocation in order to capitalise on economic or market conditions that may offer near-term opportunities.

Tapering: the reduction of the interest rate at which a central bank accumulates new assets on its balance sheet under a policy of QE.

Volatility: a term for the fluctuation in the price of financial instruments over time.

Disclosure appendix

1. The article "Gamechangers: future consumers. How consumption trends are evolving" is dated as at 10 May 2024.
2. All market data included in this report are dated as at close 9 May 2024, unless a different date and/or a specific time of day is indicated in the report.
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