HSBC Global Private Banking – September 2023

The less usual suspects
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Global risk appetite has been well supported so far this year because inflation has been falling and we've all been looking forward to the end of the interest rate hikes by the Federal Reserve.

But we have seen some volatility in equity markets recently driven by that spike in US Treasury yields.

So it's clear that interest rates are still in the driver's seat. So what is the outlook, Laurent, for interest rates and for US Treasury yields? Yeah, well Willem, as you mentioned, effectively the inflation is well on the path towards the central banks' targets, which is a good thing.

The Fed has probably already delivered its final rate hike. And I think we should be able to say that the Eurozone and the UK will effectively do that very soon.

Treasury volatility has mainly come from fears of higher issuance, due to a frontloading of funding. But this should not have any lasting effects in the market. Stronger-than-expected growth in the US has also contributed to higher yields, though I would think this should rather be positive for stocks, as it was positive for other risky assets such as high yield markets.

We got to a point now that we have actually increased our US Treasury exposure because we think yields are at attractive levels. We also remain overweight on investment grade with medium duration.

We think bonds issued by quality corporates in developed and emerging markets will outperform cash over the next six months. But we are neutral in global high yield because credit spreads are too tight relative to investment grade bonds and for the current stage of this economic cycle.

Thanks Laurent, your rate outlook is actually quite comforting for stocks, because much of the rally has been driven by tech and other interest rate sensitive stocks.

So we don't get out of tech, because there are some really interesting growth stories here. Given the high valuations, though, we want to balance value and growth styles.

So we cast a wider net and we look beyond the usual suspects and also like financials, health care, industrials and consumer discretionary.

The resilient US economy should allow the rally to broaden well beyond IT. So we keep our American Resilience theme, which focuses on the consumer, but we have added two additional US themes.

One focuses on the re-industrialisation of North America, and the other on US Healthcare. We continue to prefer the US over Europe because of that more resilient economy, and the likelihood that the Fed will start to cut rates in the spring.

That's probably not possible in Europe, where inflation is stickier. In Asia, we've had a diversified approach for some time. Indian and Indonesian stock markets have done well, thanks to strong cyclical momentum, the global supply chain diversification and portfolio inflows.

China's recovery, however, has disappointed and although very low inflation allows for more monetary and fiscal stimulus, the weak property sector remains an obstacle for any sharp rebound. So our Asian themes centre around Asia's Rising Tigers (including India and ASEAN countries), the net zero transition and Asian quality credit.

And across the region, we see a recovery in travel, and interest in consumer services, which is a much stronger area of demand than consumer goods.

Now, the four priorities for our portfolio strategy try to solve some of the issues we debate most often with our clients. Firstly, with cash rates near multi-year highs, we address the temptation to sit on cash.

At current levels, we think it is better to lock in bond yields of medium duration quality credit. You can't lock in cash yields, and when markets start to anticipate rate cuts, bonds will benefit whilst cash returns will fall.

Our second priority addresses the issue that those stocks that clients typically feel most enthusiastic about are also amongst the most expensive.

By thinking outside of the box, we broadened the opportunity set, looking for quality stocks across the US market. Our overweight in Mexico, Brazil, India and Indonesia, also diversify our exposure beyond the world's two largest economies.

And in the currency market, we have to look beyond the usual suspects too. But we see some upside for the Mexican Peso, the Brazilian Real and the Indian Rupee.

Thirdly, even though the US economy should remain resilient and we're at the end of the rate hikes, economic data will remain volatile. And that creates market volatility, but also opportunities.

So we use uncorrelated assets and volatility strategies, to tap into tactical and relative value opportunities and to diversify.

And last but not least, investors worry about climate change and threats to biodiversity.

As the public policy focus on these topics increases and innovation and investments accelerate, we think there are many opportunities for investors to participate in the truly transformative sustainability revolution.