Video Transcript

HSBC Think Wealth CIO Exchange

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Willem Sels

Thank you Xavier for sitting down with me for this CIO exchange. And every market conversation these days seems to be starting with AI. So let's not break that rule.

Now AI is leading to a lot of excitement, but also to many questions about the impact on growth, on labour markets, inflation and therefore Fed policy. But what we've seen so far is that it's actually boosting activity through that construction of data centres and around the ecosystem.

So, is that just delaying the impact on labour markets and inflation, or we will still see it?

Xavier Baraton

Well, if I start with a conclusion: we see in our H2 outlook a net positive growth globally, but neutral on inflation and rates. Positive growth, yet with highly uneven impact across geographies and segments.

Inflation, not too worried, as I said, headline CPI is high, but core CPI is 2.5% by and large, and even the latest marks are more encouraging.

Jobs is more complex because it's bifurcated. It's K-shaped, very dependent on dissemination of AI and the emergence of agents. Probably not the job apocalypse, if we refer to academic work, or technological revolutions of the past. But potentially with some implications: disruption and dispersion on consumption.

US demand is robust, but we see income growth and saving rates as relatively weak at the moment. So again, inflation, rates-neutral, growth net positive but relatively modest, and more complexity. net positive but modesta in more complexity.

So, what does that mean for the bond market? Presumably quite constructive, actually, if you are not overly worried about inflation, yet you have that change in perception around AI, the complexity, which will probably mean a good market environment for an active bond manager.

Unless of course people continue to worry more and more about that supply issue. Let's try to decipher it, because it's a complex backdrop obviously for bond investors, as we have the inflationary threats looming in the background – energy but also El Niño, geopolitics and supply chain disruption, making the central banks vigilant.

Investors are pricing a few rate hikes, when in fact we know that, in the medium-term, second half of 2027, we expect central banks to cut rates.

So we see better value in the short-to-medium-term maturities. We continue to see a lot of volatility affecting the long end: bond vigilantes, supply-side pressure. And again inflationary threats hovering in the background.

So this means, nonetheless, as you implied it's an interesting environment for carry, simply said, as long as you diversify also into quality credit, securitised credit, quality emerging market debt, not just relying on government bonds.

And also understanding that if rates play a diversification role, again they are not the sole diversification opportunity. And it should be complemented with other options such as hedge funds, private assets, real assets, in order to make your portfolios as robust as can be in this fairly volatile environment

Willem Sels

You mentioned emerging markets there. This environment of stable or even lower interest rates when looking into 2027, seems a positive environment for emerging markets.

Yet you have that dichotomy within the market: some of them being supported by those high commodity prices because they're exporters, and others by the electronics, the AI demand, and so on.

Those two trends, to me, seem durable and lasting. Is that how you start your emerging market analysis and strategy?

Xavier Baraton

Yes, totally. Emerging markets are no longer the sort of one block of the past, really, and it's simply an addition of their individualised stories. So in local debt, the opportunities are maybe more measured now, as we've seen a lot of performance and the real yields versus the US have now reduced significantly.

We are ourselves, more selective in our allocations. Across emerging market equities we are way more confident.

So it's a selective positive tilt, quite clearly, because we still see opportunities from the valuation standpoint with significant gaps – 30% gaps from a multiple standpoint – vis-a-vis developed markets.

The strong performance we've seen so far, the mid-double digit, has been largely fuelled by earnings expectations reset as opposed to multiple expansion. So it's still attractive.

And we continue to see the dissemination of the AI investment and capex ramp-up disseminating from Taiwan and Korea, which are obvious beneficiaries, into a broader set of countries across Asia.

So we are positive on emerging markets, with an Asia tilt. And in addition to expected returns and other benefits, they offer diversification too.

Willem Sels

You mentioned a few themes already that we talked about, and our clients like to think along those lines because it gives a direction to portfolios.

And one that we've been highlighting, obviously, is the need for cheap and plentiful electricity, if you want to be in the AI trade. And on top of that, of course, geopolitics and chokepoints, adding to that need for energy independence, which becomes a national security item.

So that leads to a lot of investment in electricity, electricity grids, and electricity generation, benefiting industrials and infrastructure as an asset class and financials.

What are some of the trends that you like?

Xavier Baraton

It's definitely music to my ears. And probably two themes worth highlighting.

First one is definitely in relation to electrification: energy, utilities, renewables, obviously, but also grid development, smarter grids, batteries.

The second theme is about the circular economy. So it's more about the independence: reducing the dependency on external supply, both on energy as well as supply more broadly.

We're particularly interested in companies that can reduce their imports, that manage their waste, and can reduce their consumption of energy, and can localise it as well.

And maybe not a theme, but again, repeating the high-conviction, all these themes intersect around emerging countries and the new development of geopolitics, which is a feature of markets and no longer a bug.

Willem Sels

Thank you for all of those interesting ideas,and a real pleasure to sit down with you on the set together.

Xavier Baraton

Likewise. Thanks very much Willem.