Think Wealth Client Connect - Rethinking the role of bonds

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Sai:
Welcome to HSBC Think Wealth Client Connect. Today I'm pleased to be joined by Raymond Sagayam. Raymond is Managing Partner of the Pictet Group and Co-CEO of Pictet Asset Management. Raymond brings over 25 years of experience in global markets with a deep expertise in fixed income. He is the perfect partner for us today to unpack the latest market outlook.

Sai:
We'll discuss some of the key questions on investors' minds, including AI-related concentration in equities and the role of fixed income in investment portfolios. Raymond, thank you again for joining us.

Raymond:
Thank you Sai. Thank you, HSBC, for having me.

Sai:
Raymond, we've heard a lot today about AI. Clearly, there's opportunities in AI, but there're also risks, especially around concentration. How do you think investors should approach this?

Raymond:
The big hyperscalers, the mega caps in the US comprise 70% of that earnings delivery in the context of AI in the US. And that is enormous. But it also is incredibly concentrated.

There is life beyond the hyperscalers. And here I think about the big names in South Korea, Taiwan and Japan. One of the ways in which we encourage investors to continue to benefit from the strong impetus in the AI value chain is to look for diversification geographically. Look for other names in other countries, but also other sectors as well.

Another dimension is what's happening on the debt side.

We've seen treasuries continue to test new highs in terms of yields and of course being correlated with higher yields in the Eurozone, in France and in the UK. This level of indebtedness is going to make things very complicated from an asset allocation perspective.

Sai:
You have, however, argued that bonds may no longer offer the type of portfolio protection that investors once expected. It would be great to hear more of your views on that topic.

Raymond:
Bonds are still relevant, but it depends on what regime we're facing.

Gone are the days where we could rely, in a singular fashion, on US Treasuries to be a safe haven and as a diversifier in broader bond and equity portfolios.

We also need to make a distinction between corporate bonds and sovereign bonds. For many years post the global financial crisis, it was sovereign bonds which were perceived as the risk-free asset.

But now, with such an indebted picture, would you rather own a sovereign which is indebted. And is constantly refinancing at higher yields, or a blue-chip corporate in the same or a different jurisdiction? That's a question which investors are now going to have to start asking themselves. And it's a question which was relevant actually, if we are in an inflation regime, perhaps the one that we're facing right now, unsurprisingly, gold is a better hedge. US TIPS (US Treasury Inflation-Protected Securities) and let's not forget Chinese government bonds, the second largest bond market in the world.

Finally, if we're looking at a geopolitical environment with geopolitical shocks and crises, Swiss government bonds remain relevant. Japanese government bonds tend to have their sway as well.

Here, we think emerging market debt offers compelling valuation from yields and potential currency appreciation, particularly in local currency debt.

At the same time, they're not experiencing the same fiscal largesse and fiscal issues as the West. So I would also add that alongside in an investment programme which is ultimately seeking diversification away from concentration risk.

So in answer to your question, today, bonds are the right assets, but just for the wrong problem.

Sai:
Thank you. Raymond. Are there any other asset classes you think we've not yet talked about?

Raymond:
Yes. There's one which features quite strongly and comes to mind, which is liquid alternatives.

So this goes beyond private, which as I mentioned earlier remains extremely relevant. Here I'm talking about liquid hedge fund strategies, either multi-strategy or single strategies. Why important? Dispersion is extremely high. You're getting rewarded to select stocks and credit on the long and short side.

In a market which is becoming increasingly highly valued, these strategies are starting to deliver and they're delivering consistently.

I believe that ability to generate repeatable alpha will persist for years and not just months. That is something which investors should be looking at very closely.

Sai:
Thank you, Raymond. That's a useful reminder of the benefits of alternatives, especially liquid alts in our portfolio. If we just step back, what do you think investors should be most cautious about in today's environment?

Raymond: The risk that the conflict in the Middle East is far from over, and the upward pressure that can have on the energy complex, once again, on an already elevated inflation backdrop, particularly in the US, is something we must pay close attention to.

So I think watching closely the energy complex, US yields and those clearing levels, the velocity of US

yield moves. But also Western European debt in the eurozone. I think are areas to keep a very close eye on. Right now they haven't reached a tipping point. But if the velocity starts to accelerate, that can affect sentiment. Ultimately sentiment is what will change the entire equation.

Sai:
Raymond, thank you.

Sai:
It's been a pleasure to have you with us on HSBC Think Wealth. Thank you.

Raymond:
Thank you, Sai. And thank you very much for having me on the show.