GIC Monthly View Summary November 2023

19 October 2023

Using the yield spike to ensure portfolios have enough duration

- Stronger than expected US economic data and concern about high bond supply have pushed up bond yields, especially for longer maturities.
- As a result, the yield curve is now much less inverted for US Treasuries, and it is even upward sloping for investment grade bonds.
- This removes a big obstacle for those investors who have been torn between the desire to lock in yields for longer, but were not willing to give up yield by extending duration.
- We extend our duration preference for DM government bonds to 'medium-to-long' and maintain a 'medium' duration in investment grade – well above the typical exposure of many investors.
- We think rate exposure is much more generously priced than credit risk, and therefore continue focus on quality bonds.
- As the Middle East conflict has shocked the world and events continue to unfold, volatility may remain with us. In this context, we manage portfolio volatility through our existing overweight positions in bonds and hedge funds. We also remain bullish on the US dollar, focus on quality stocks and overweight energy.
- The US earnings season has started and we think consensus expectations are on the conservative side. We maintain our overweight on US stocks, given resilient growth. Our three High Conviction themes are complementary and give broad exposure.

Watch a summary of our latest views

Click on the image to hear from our
Global Chief Investment Officer, Willem Sels

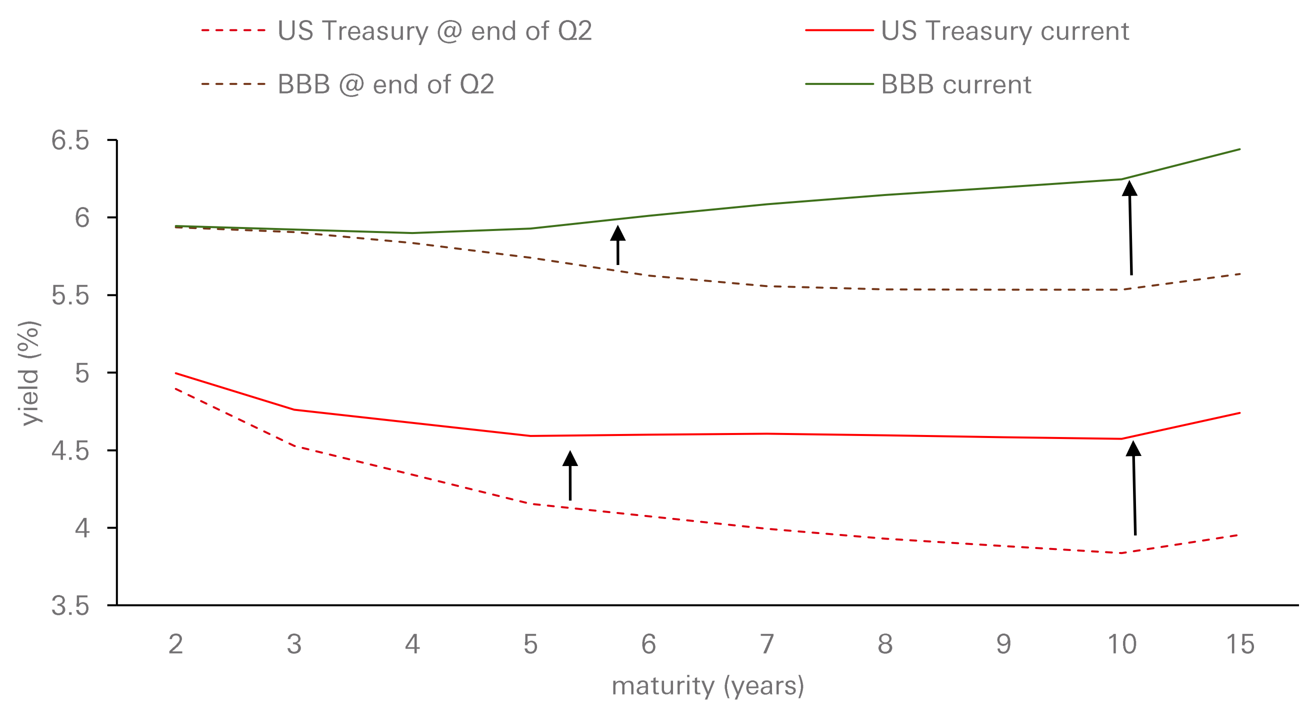
Priority #1 › Use the spike in term premia to ensure portfolios have enough duration exposure

- The likely end of the policy rate hikes had already convinced many investors that they needed to 'lock in' yields, but they hesitated to do this for too long, because the yield curve was so downward sloping. This should now no longer be an obstacle, following the disinversion of the Treasury curve, and the upward sloping nature of the investment grade curve. We also saw bond yields being pushed up, especially for longer maturities, as US data surprised on the upside and the ongoing concerns around high bond supply.
- But the current real yield level looks unsustainable in our view—if it was maintained here, it would further tighten financial conditions and slow the economy, in turn supporting Treasuries.

Our focus:

- We extend the duration of our Treasury, Eurozone, Australian and Canadian government bond holdings. But more generally, across government and investment grade bonds, we want to make sure that portfolios have sufficient duration – many investors are still short versus benchmark.
- We think rate exposure is much more generously priced than credit risk and, therefore, we continue to focus on quality bonds.

The Treasury yield curve is now much less inverted, and the IG yield curve is now upward-sloping



Source: Bloomberg, HSBC Global Private Banking as at 13 October 2023.

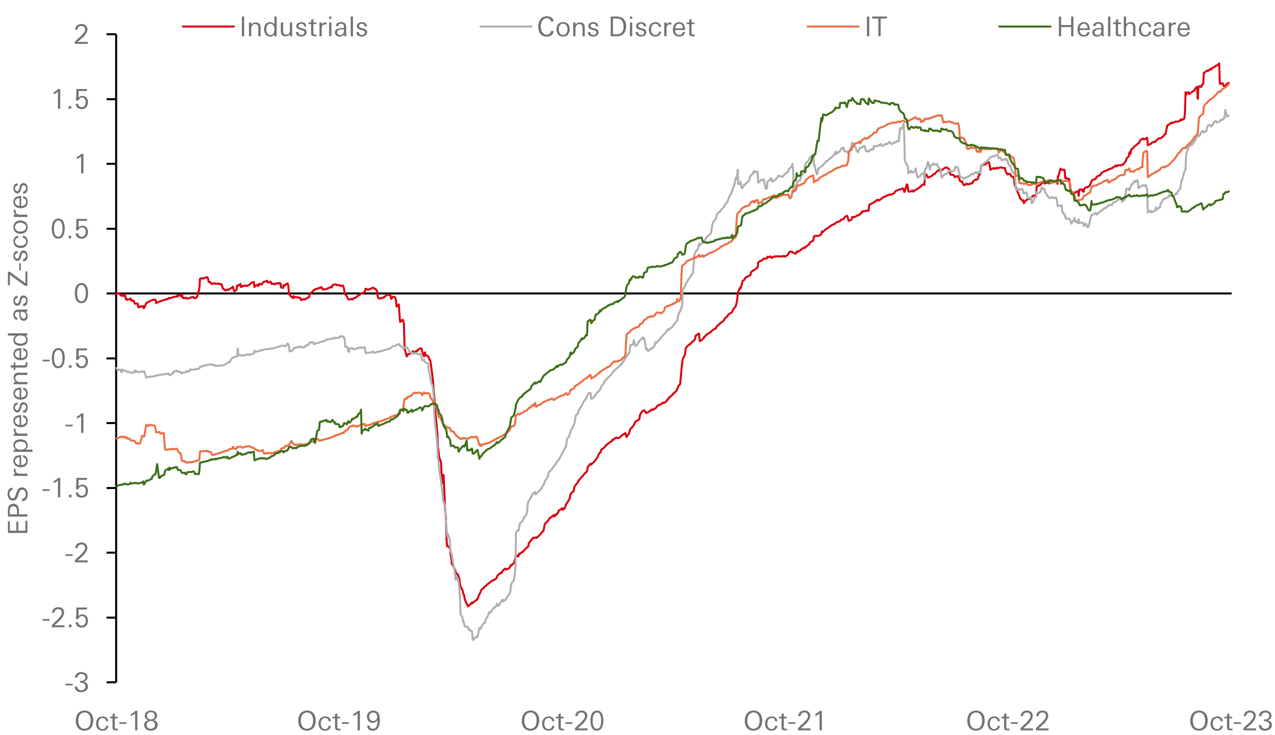
Priority #2 〉 Overweight in US stocks, using a broad exposure including our three High Conviction Themes

- The US cycle is better supported than most of the world, as resilient US labour markets, sharper inflation drops and the stimulus from Biden administration continue to benefit the US economy. On top of that, the Fed has probably finished its rate hikes. We thus continue to be overweight in high quality bonds and hedge funds, and prefer US stocks and USD over other equity markets and currencies.
- As rate volatility remains high, we want to balance our style exposure between value and growth.
- The US earnings season has started, and we think consensus expectations are on the conservative side. We maintain our overweight on US stocks, given resilient growth.

Our focus:

- Our following US themes provide the much-needed diversification: while ‘American Resilience’ (including many consumer discretionary companies) has a growth-style bias, our ‘North American Re-Industrialisation’ theme (overweight on industrials) has a value-style tilt, and ‘Innovation and Opportunities in Healthcare’ has a low volatility and quality style tilt.

Earnings drift is positive for our preferred sectors



Source: Bloomberg, HSBC Global Private Banking as at 13 October 2023.

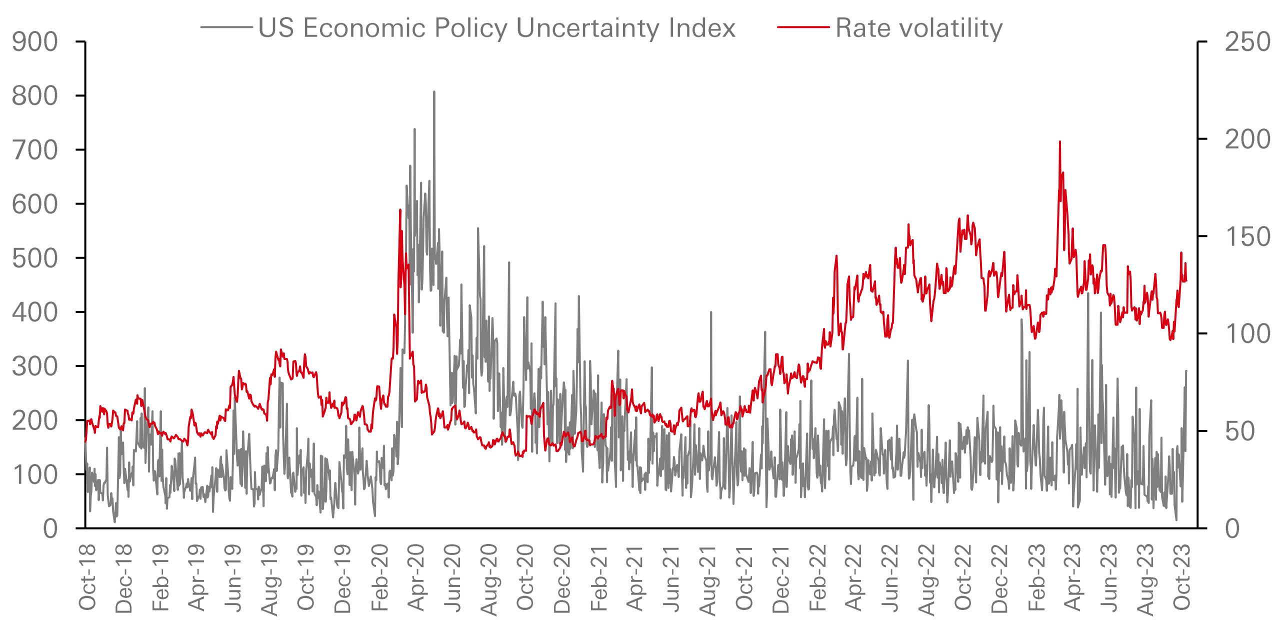
Priority #3 ❯ Hedge funds to diversify further

- As discussed in our Q4 Investment Outlook, we think markets will spend most of the time in the 'soft landing' scenario. However, the Middle East conflict has impacted the global risk appetite and added volatility. The world is in shock, and our thoughts are with the many casualties. Events continue to evolve, and we do not think it is wise to speculate; instead, we try to manage portfolio volatility.
- The impact of the added volatility on the market has remained mild, thanks to the US economic resilience, though events continue to unfold and volatility should remain high. Initially, there was a bid for safe havens such as USD, US Treasuries and gold, and oil has moved higher. But as other variables such as US CPI and Fed statements have generally pulled in the other direction, markets have not shown a continued drift so far.
- Uncertainty is high, and data are volatile on both the inflation and growth front. Hence, markets can change their minds day to day on whether activity and inflation are too hot or too cold.

Our focus:

- These short-term gyrations are impossible for most investors to manage this quickly, but hedge funds can play short term moves through bond, currency and equity sector and style moves.
- The geopolitical uncertainty further increases the need for diversification and some hedge funds, including CTAs, can take views on gold and oil.

Economic policy uncertainty is high, and data and rates are volatile, providing opportunities for hedge funds



Source: Bloomberg, HSBC Global Private Banking as at 12 October 2023. Past performance is not a reliable indicator of future performance.

Risks of investment in fixed income
There are several key issues that one should consider before making an investment into fixed income. The risk specific to this type of investment may include, but are not limited to:

Credit risk
Investor is subject to the credit risk of the issuer. Investor is also subject to the credit risk of the government and/or the appointed trustee for debts that are guaranteed by the government.

Risks associated with high yield fixed income instruments
High yield fixed income instruments are typically rated below investment grade or are unrated and as such are often subject to a higher risk of issuer default. The net asset value of a high-yield bond fund may decline or be negatively affected if there is a default of any of the high yield bonds that it invests in or if interest rates change. The special features and risks of high-yield bond funds may also include the following:

- Capital growth risk - some high-yield bond funds may have fees and/ or dividends paid out of capital. As a result, the capital that the fund has available for investment in the future and capital growth may be reduced; and
- Dividend distributions - some high-yield bond funds may not distribute dividends, but instead reinvest the dividends into the fund or alternatively, the investment manager may have discretion on whether or not to make any distribution out of income and/ or capital of the fund. Also, a high distribution yield does not imply a positive or high return on the total investment.
- Vulnerability to economic cycles - during economic downturns such instruments may typically fall more in value than investment grade bonds as (i) investors become more risk averse and (ii) default risk rises.

Risks associated with subordinated debentures, perpetual debentures, and contingent convertible or bail-in debentures

- Subordinated debentures - subordinated debentures will bear higher risks than holders of senior debentures of the issuer due to a lower priority of claim in the event of the issuer's liquidation.
- Perpetual debentures - perpetual debentures often are callable, do not have maturity dates and are subordinated. Investors may incur reinvestment and subordination risks. Investors may lose all their invested principal in certain circumstances. Interest payments may be variable, deferred or cancelled. Investors may face uncertainties over when and how much they can receive such payments.
- Contingent convertible or bail-in debentures - Contingent convertible and bail-in debentures are hybrid debt-equity instruments that may be written off or converted to common stock on the occurrence of a trigger event. Contingent convertible debentures refer to debentures that contain a clause requiring them to be written off or converted to common stock on the occurrence of a trigger event. These debentures generally absorb losses while the issuer remains a going concern (i.e. in advance of the point of non-viability). "Bail-in" generally refers to (a) contractual mechanisms (i.e. contractual bail-in) under which debentures contain a clause requiring them to be written off or converted to common stock on the occurrence of a trigger event, or (b) statutory mechanisms (i.e. statutory bail-in) whereby a national resolution authority writes down or converts debentures under specified conditions to common stock. Bail-in debentures generally absorb losses at the point of non-viability. These features can introduce notable risks to investors who may lose all their invested principal.

Contingent convertible securities (CoCos) or bail-in debentures are highly complex, high risk hybrid capital instruments with unusual loss-absorbency features written into their contractual terms.
Investors should note that their capital is at risk and they may lose some or all of their capital.

Changes in legislation and/or regulation
Changes in legislation and/or regulation could affect the performance, prices and mark-to-market valuation on the investment.

Nationalisation risk
The uncertainty as to the coupons and principal will be paid on schedule and/or that the risk on the ranking of the bond seniority would be compromised following nationalization.

Reinvestment risk
A decline in interest rate would affect investors as coupons received and any return of principal may be reinvested at a lower rate. Changes in interest rate, volatility, credit spread, rating agencies actions, liquidity and market conditions may have a negative effect on the prices, mark-to-market valuations and your overall investment.

Risk disclosure on Dim Sum Bonds
Although sovereign bonds may be guaranteed by the China Central Government, investors should note that unless otherwise specified, other renminbi bonds will not be guaranteed by the China Central Government.
Renminbi bonds are settled in renminbi, changes in exchange rates may have an adverse effect on the value of that investment. You may not get back the same amount of Hong Kong Dollars upon maturity of the bond.
There may not be active secondary market available even if a renminbi bond is listed. Therefore, you need to face a certain degree of liquidity risk.
Renminbi is subject to foreign exchange control. Renminbi is not freely convertible in Hong Kong. Should the China Central Government tighten the control, the liquidity of renminbi or even renminbi bonds in Hong Kong will be affected and you may be exposed to higher liquidity risks. Investors should be prepared that you may need to hold a renminbi bond until maturity.

Alternative Investments
Hedge Fund - Please note Hedge Funds often engage in leveraging and other speculative investment practices that may increase the risk of investment loss. They can also be highly illiquid, are not required to provide periodic pricing or valuation information to investors, and may involve complex tax structures and delays in distributing important information. Alternative investments are often not subject to the same regulatory requirements as, say, mutual funds, and often charge high fees that may potentially offset trading profits when they occur.

Private Equity - Please note Private Equity is generally illiquid, involving long term investments that do not display the liquid or transparency characteristics often found in other investments (e.g. Listed securities). It can take time for money to be invested (cash drag) and for investments to produce returns after initial losses.

Risk disclosure on Emerging Markets
Investment in emerging markets may involve certain, additional risks which may not be typically associated with investing in more established economies and/or securities markets. Such risks include (a) the risk of nationalization or expropriation of assets; (b) economic and political uncertainty; (c) less liquidity in so far of securities markets; (d) fluctuations in currency exchange rate; (e) higher rates of inflation; (f) less oversight by a regulator of local securities market; (g) longer settlement periods in so far as securities transactions and (h) less stringent laws in so far the duties of company officers and protection of Investors.

Risk disclosures

Risk disclosure on FX Margin

The price fluctuation of FX could be substantial under certain market conditions and/or occurrence of certain events, news or developments and this could pose significant risk to the Customer.

Leveraged FX trading carry a high degree of risk and the Customer may suffer losses exceeding their initial margin funds. Market conditions may make it impossible to square/close-out FX contracts/options. Customers could face substantial margin calls and therefore liquidity problems if the relevant price of the currency goes against them.

The leverage of a product can work against you and losses can exceed those of a direct investment. If the market value of a portfolio falls by a certain amount, this could result in a situation where the value of collateral no longer covers all outstanding loan amounts. This means that investors might have to respond promptly to margin calls. If a portfolio's return is lower than its financing cost then leverage would reduce a portfolio's overall performance and even generate a negative return

Currency risk – where product relates to other currencies

When an investment is denominated in a currency other than your local or reporting currency, changes in exchange rates may have a negative effect on your investment.

Chinese Yuan ("CNY") risks

There is a liquidity risk associated with CNY products, especially if such investments do not have an active secondary market and their prices have large bid/offer spreads.

CNY is currently not freely convertible and conversion of CNY through banks in Hong Kong and Singapore is subject to certain restrictions. CNY products are denominated and settled in CNY deliverable in Hong Kong and Singapore, which represents a market which is different from that of CNY deliverable in Mainland China.

There is a possibility of not receiving the full amount in CNY upon settlement, if the Bank is not able to obtain sufficient amount of CNY in a timely manner due to the exchange controls and restrictions applicable to the currency.

Illiquid markets/products

In the case of investments for which there is no recognized market, it may be difficult for investors to sell their investments or to obtain reliable information about their value or the extent of the risk to which they are exposed.

Environmental, Social and Governance ("ESG") Customer Disclosure

In broad terms "sustainable investments" include investment approaches or instruments which consider environmental, social, governance and/or other sustainability factors to varying degrees. Certain instruments we classify as sustainable may be in the process of changing to deliver improved sustainability outcomes.

There is no guarantee that sustainable investments will produce returns similar to those which don't consider these factors. Sustainable investments may diverge from traditional market benchmarks.

In addition, there is no standard definition of, or measurement criteria for, sustainable investments or the impact of sustainable investments. Sustainable investment and sustainability impact measurement criteria are (a) highly subjective and (b) may vary significantly across and within sectors.

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Sustainable investing is an evolving area and new regulatory frameworks are being developed which will affect how sustainable investments can be categorised or labelled. An investment which is considered to fulfil sustainable criteria today may not meet those criteria at some point in the future.

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