

Investment Outlook

Q1 2023

Looking for the Silver Lining



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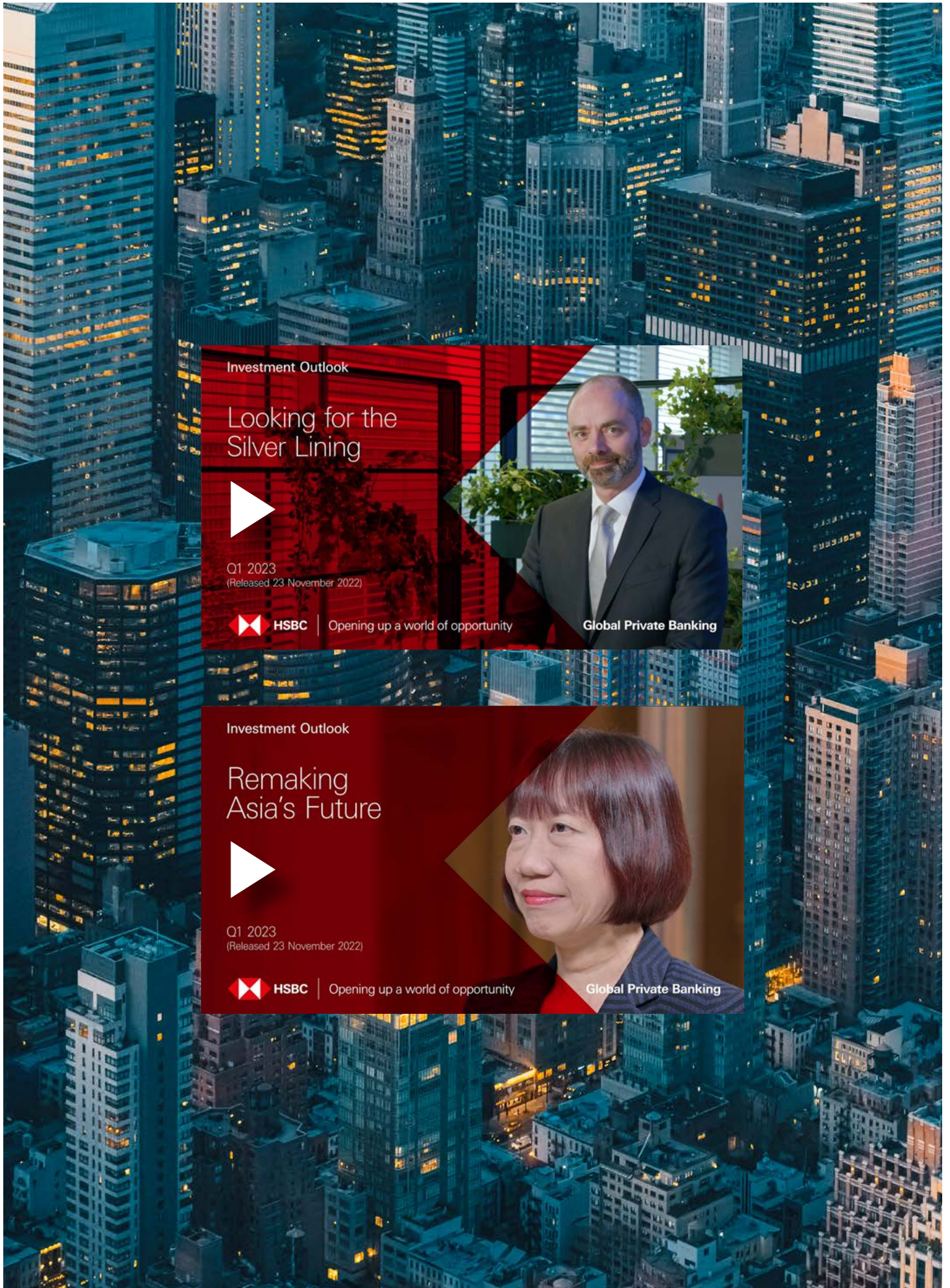
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Welcome

Dear client

As we look into 2023, the headwinds from slowing growth and higher rates that have been plaguing investors will remain key market drivers. But while the cyclical outlook remains a major challenge, we are starting to see a silver lining on the rate front.

Let's look at the bad news first. Global economic momentum continues to slow, with the Eurozone and UK in recession, US growth well below normal, and China's 2023 recovery likely to be shallow. This cyclical headwind largely determines how we feel about stocks. We expect consensus earnings growth to slow further, so we are underweight on global equities, with a defensive sector bias and a focus on quality stocks with strong market positions. Geographically, the relative resilience of the US leads us to prefer US stocks over European stocks. In Asia, we have upgraded Chinese stocks because policy measures are easing COVID and housing related risks. Asia's reopening is supportive of economic activity but the tech cycle is slow.

On the rate front, markets have tried several times to anticipate peak rates, but so far fallen back each time. The lower-than-expected US inflation print for October, however, signals that we are getting closer to peak rates, even if we're not quite there yet. Commodity price inflation, transportation costs and supply chain issues are all easing. Rents are still rising but should plateau in coming months, as they tend to follow house prices, which have been falling.

As the Fed approaches peak rates, USD's impressive bull run should come to a halt. We therefore adopt a neutral view on the greenback. And with bond markets already pricing a 5% Fed funds rate for Q1 2023, we feel comfortable

with the yield level of short-to-medium dated and highly rated bonds, which we overweight. Adjusted for their relative risk levels, bonds have sold off more than equities this year, making them look cheap. We also like bonds for diversification purposes, because their correlation with equities typically drops in times of slowing economic growth. We further diversify portfolios through our overweight in hedge funds, which benefit from high volatility, the diverging fundamentals of different countries, and the rising income hedge funds receive on their cash balances.

While our confidence in short-to-medium dated bonds, our upgrade of Chinese stocks and downgrade of USD are signs that we see a silver lining, we will keep monitoring important milestones that could make us add more risk. When the peak in core inflation and Fed rates is eventually confirmed, we may well increase our rate exposure through increased duration and add back to our tech exposure. Good news on the rate front may help stocks too, but before we see a sustained equity rally, the cyclical outlook first needs to stabilise. That will have to wait, as rate hikes have a lagged effect on economic growth. But once the cycle is more stable, we could get more positive on stocks and lower rated credit. Stronger global risk appetite would eventually also lead us to take a bearish view on USD.

Those are potential reasons for future optimism, but for now, we remain cautious and see four priorities for investors. First, we rebalance portfolios towards high rated bonds. Secondly, we build recession resistant portfolios by focusing on quality stocks and partial inflation hedges. Third, we enhance the diversification from bonds by adding

hedge funds and a core allocation to private assets and real estate. And finally, we position in structural trends, noting that many companies that are well placed for such trends now often trade at cheap valuations.

One case in point is sustainability. Some governments have allowed more oil and gas drilling to secure energy supplies, but this does not put into question the long term investment case for climate mitigation and adaptation solutions. In fact, the same governments have also invested in renewable energy and nuclear, while households and businesses have invested in solar and increased insulation, and are making production processes more efficient to save on high energy bills. So the short-term cost incentive is adding to the long-term sustainability driver, compressing the green premium and advancing new green solutions and technologies.

At the end of a difficult year, investors face an important balancing act. On the one hand, there is great uncertainty around geopolitics and the timing of the turn in the rate, inflation and growth cycles. On the other hand, almost all assets have repriced since the start of 2022. The good news is that even quality assets are now much cheaper and investors can build resilient portfolios with respectable expected returns, and wait for better fundamentals to take riskier positions.



Willem Sels,
Global Chief Investment Officer
23 November 2022

Our Portfolio Strategy

The global economic slowdown will remain a key headwind for stocks for some time and we are mildly underweight in global equities. An overweight in high-rated bonds can provide diversification, and bond yields already price in a lot of tightening. As the growth cycle lags the rate cycle, we much rather take rate risk than cyclical risk. We are also overweight in hedge funds to diversify and mitigate uncertainties. We look for the silver lining and explore what could eventually make us more bullish. And we continue to highlight structural opportunities at attractive valuations, related to sustainability, technology and in Asia.

1. The way we see the world

The global economic slowdown will remain a major driver for markets. The Eurozone and the UK are going through a recession, and although the US is more resilient, growth is below normal there too, and we may see one or two negative quarters of US growth in 2023. China's growth rate could bottom as supportive monetary policy should start to pay some benefits. Recent policy measures reduce

Fixed income: overweight

Focus on high quality borrowers
Keep overall duration below benchmark

Equities: mildly underweight

Prefer US over Eurozone and UK
Prefer EM Asia and Latin America over EM Europe
Maintain a defensive sector tilt, with a focus on quality and income

Alternatives: overweight

Overweight in hedge funds
Keep core allocations to private markets and real estate

downside tail risks for housing markets and ease COVID-related bottle necks, but economic activity is unlikely to accelerate sharply.

While low rates in the past decade were designed to boost growth and avoid deflation, the interplay between rates, growth and inflation now works the other way around. Sticky inflation is bound to

keep rates high for longer, which should continue to slow growth, with a lag. Housing markets are already seeing the effect of higher rates, with prices, sales and construction activity levels down in developed markets (DM). Consumers have seen their mortgage payments rise (sometimes double or triple) and the cost of petrol, food, clothing and utility bills shoot up. For the vast majority, wages have not kept up with inflation, forcing them to reduce spending on discretionary items in particular. Governments have come to the rescue, but as their cost of borrowing has shot up, their ability to act is limited: the most dramatic recent illustration was the UK, where the government was forced by markets to abandon spending plans and raise taxes instead (ending many economists' belief in Modern Monetary Theory in the process).

Slower economic growth should gradually lead inflation to come down, and the October US CPI figure triggered hopes in this direction. The good news is that oil, natural gas and transportation costs are down already, and the shortage of semiconductors is easing. This is contributing to lower goods price

inflation, which we think will continue to ease, and may surprise to the downside. On the other hand, though, there are plenty of sticky inflation items, related to rents (which lag house prices) and services, propped up by a still strong labour market. So while inflation should come down in 2023, it is unlikely to get anywhere near the typical 2% central bank targets. That means that central banks are not yet done with their rate hikes, and many will want to keep their rates in restrictive territory to ensure the inflation dragon is really slain. In the case of the US Federal Reserve, we think rates will go to 5% in Q1 and then stay around that level through 2023 and 2024.

In summary, we expect a fundamental market backdrop of slowing global growth, while rates continue to rise for now, and plateau later (China is a notable exception, as its growth is slow but finding a bottom, and Chinese rates are relatively stable).

But a big issue for investors is that there are huge uncertainties around this outlook. The many components entering into CPI create a confusing picture and make accurate forecasts

difficult. In addition, the lag with which all the rates hikes we've seen around the world will affect inflation and growth, is highly uncertain, creating the risk of policy error (too little or too much tightening). Political topics are key too: China's COVID policy is closely watched by markets, the outlook of the Russia-Ukraine war is unpredictable but has big implications, and the policy gridlock in the US congress could lead to challenges around the debt ceiling. We're also seeing a rise in insolvencies of some smaller and weaker corporates as a result of higher rates, higher input and labour costs though not a credit crisis (due to the careful management of leverage by households and corporates in recent years). Finally, the hawkish tone of the ECB, coupled with the new Italian government, may test investors' nerves in the Eurozone's periphery.

Amid this uncertainty, luckily, there are some structural trends that remain in place and give investors some long term direction. Some commentators are wondering whether the Russia-Ukraine war, which has caused some governments to drill for more oil and gas to secure energy supplies, puts into

question the sustainability revolution. We don't think this is the case: households and companies have reacted to the war by installing more solar panels, insulating their houses better and trying to reduce energy consumption, while governments have also invested in renewable energy and nuclear. COP27 and COP15 have illustrated that climate change and biodiversity are impacting each other, and addressing the cause of either also tends to help address the other challenge. Much more needs to be done urgently, and the effort needs to be sustained, if we want a chance to hit the 1.5C target. We think the structural support for sustainability themes is enhanced by the short term need to save on costly energy, fertilisers, packaging, transport etc. Among other structural trends, we think the much debated de-globalisation and US-China strategic competition leads to supply chain diversification, re-onshoring and nearshoring, benefiting Mexico, our Total Security and ASEAN Tigers themes. We discuss the long term trends more in our chapter on High Conviction (HiCo) Themes.

2. Our current positioning

Our portfolio strategy adapts to the serious cyclical challenges but recognises the run-up in bond yields to date. We're much happier to take some interest rate risk than cyclical risk, and are therefore mildly underweight in equities, focusing on quality, income and a defensive sector positioning. In bonds, we think short-to-medium maturities are the place to be, as they incorporate almost all of the rate hikes we expect to see, while extending duration would increase volatility without giving investors much more yield (as yield curves are flat or inverted). Clearly, the economic downturn also directs us to high credit ratings, and we favour investment grade borrowers in DM and EM. Rising rates hurt both equities and bonds in 2022, but with many rate hikes priced in, and the focus of market focus increasingly turning to the economic cycle, we think bonds and equities will become less correlated, with high quality bonds becoming a better diversifier than they were in 2022. We add further diversification through our hedge funds (HF) overweight, and believe HF continue to benefit from a great opportunity set amid high volatility, rotation between sectors and markets, and geographical differences in monetary policy and growth momentum. We also note that many hedge fund strategies that use futures and OTC derivatives, complemented with cash related instruments, see their return potential lifted by higher cash rates.

How does our world view affect our investment priorities?

Four key priorities for investors	Related focus areas
Rebalancing positions towards bonds ahead of peaking interest rates	Overweight on IG bonds in DM and EM, with 2-5 year maturities HiCo themes in Short-to-Medium Dated Quality credit, and DM financials
Building recession resistant portfolios	Quality stocks and bonds Focus on income, partial inflation hedges and HiCo themes on American Resilience, Asia's Reopening Winners and Durable Dividends
Risk diversification to mitigate market volatility and geopolitical uncertainty	Diversification through our hedge funds overweight and core allocation to alternatives
Positioning in structural growth trends supported by tailwinds	Energy Transition and Independence, ASEAN Tigers, Asia's Green Transformation Financing Biodiversity Action Total Security and Smart Mobility

As our table shows, we believe there are four priorities for investors.

- ◆ First, we rebalance portfolios towards bonds, focusing on investment grade in developed and emerging markets. Our related High Conviction themes are in Short-to Medium Dated Quality Credit, DM Financial bonds at the top end of the capital structure, and Asian Quality Credit.
- ◆ Secondly, we try to make portfolios more resistant to recession risk (which is in part triggered by sticky inflation), by focusing on quality stocks and bonds, companies providing dividend income or those whose revenues are boosted by inflation (energy, staples, infrastructure). Our HiCo themes of American Resilience, Durable Dividends and Hedging Against Inflation can help achieve this.

- ◆ Thirdly, amid all the uncertainty and the risk scenarios we have discussed, we emphasize diversification. The low rate environment of the past decade was sometimes referred to as TINA (There Is No Alternative to equities), and until recently, our capital market assumptions used to consider cash and high rated bonds the least attractive assets from a risk/return perspective. The rise in yields has corrected that, and the new environment is now sometimes referred to as TARA (There Are Reasonable Alternatives to equities; including bonds, some cash, and alternative assets). So we diversify with high rated bonds and hedge funds, and believe other alternatives such as private assets and real estate are key parts of well-diversified portfolios too. By using spikes in



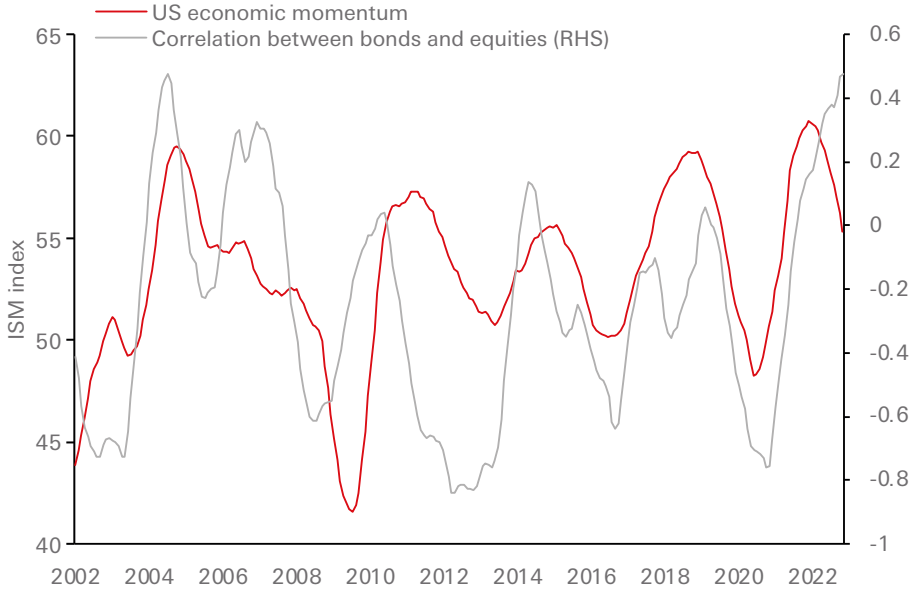
volatility to generate income or partial downside protection, investors can take positions with limited directional risk.

- ◆ Lastly, our HiCo themes tap into structural trends, which can sometimes be crowded out by the noise coming from the rate and growth debate, but which remain in place. We continue to hit the green button with themes under our 'Investing for a Sustainable Future'

trend. Asia's short term dynamics have been held back by the delayed recovery in China, but Beijing's recent pivot towards optimisation of COVID policy and property easing measures are giving us some more confidence. We have moved our focus towards Southeast Asia, and towards the beneficiaries of supply chain reorientation and the reopening post-COVID. We have consciously been reducing

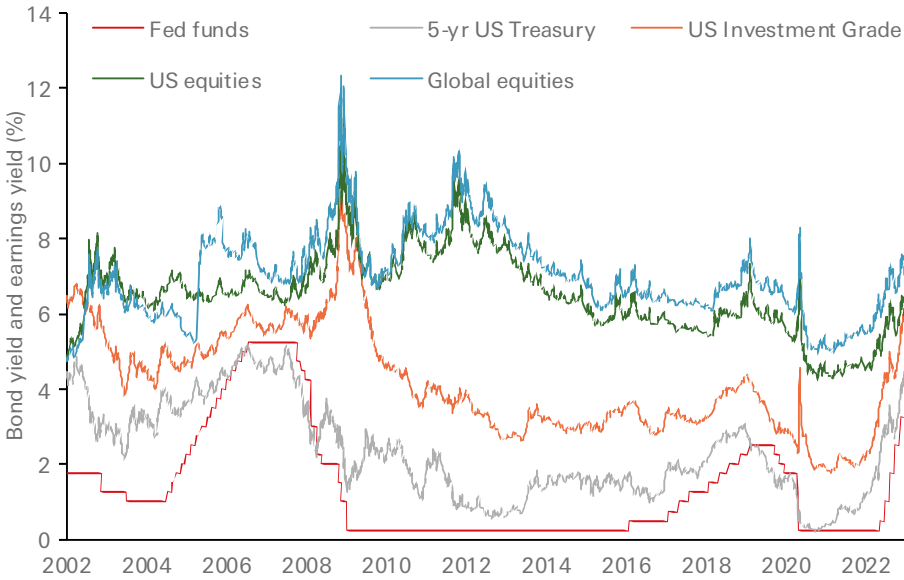
the number of themes under the 'Digital Transformation' umbrella, as rising rates hurt growth stocks, and some companies in this area are hit by semiconductor shortages, waning demand for consumer electronics and lower ad revenues. We retain our themes related to Smart Mobility and Total Security as they have the strongest short term support in our view.

Historically, equities and bonds become less correlated when the economic cycle slows.



Source: Bloomberg, HSBC Global Private Banking as at 22 November 2022. Past performance is not a reliable indicator of future performance.

The fall in valuations has pushed up bond yields and equities' earnings yield, but the move in bonds is more significant.



Source: Bloomberg, HSBC Global Private Banking as at 22 November 2022. Past performance is not a reliable indicator of future performance. Note: equities' earnings yield is the inverse of the Price / Earnings ratio.

3. What could make us more constructive?

We've outlined our core views and the uncertainties around that view, which were mainly focused on the downside risks. But what could make us more positive? We're currently still facing the worst possible combination of slowing growth, high inflation and rising rates. But almost all assets have become much cheaper than they were in early 2022, and if markets become more confident that some of the fundamentals are stabilising, and risks are appropriately priced, markets could bottom and even recover later in 2023.

Our table shows a possible path towards a more constructive environment. We think we're more likely to see better rate sentiment before we see better news on the growth front. Markets will try to assess when the Fed can be confident that inflation is well on its way down, because that will allow it to slow hikes and eventually pause. It's impossible to know for sure, but this milestone

could happen in Q1 or early Q2, and would create a more constructive bond environment and allow us to increase our duration exposure. FX markets would be affected too: we moved USD to a neutral view after the lower-than-expected October CPI figure, which will make it harder for markets to keep forecasting ever higher rates, and should halt the widening in interest rate differentials between USD and other currencies. In equities, more stable – or even lower – bond yields would mean more support for growth stocks, and this could lead us to add back more high conviction themes under the 'Digital Transformation' trend. We note though that we would still continue to stick to quality stocks and bonds until the cycle starts to bottom.

From a cyclical perspective, we foresee a possible bottoming of global economic data around Q2 or Q3, but little upward economic momentum from there. On the earnings side, we think consensus forecasts need to come down further, but once analysts forecast zero earnings

growth or a small earnings recession, and earnings momentum stabilises, this could be the signal for markets that enough pessimism is priced in. This would be a key milestone allowing us to add back to equities and take a less defensive sector stance. Local factors matter too: while recent policy measures have made us more positive on China, we would want to see an easing of the energy crisis and the Russia-Ukraine war before upgrading Europe. In the UK, increased trust in government policies helps, but it is hard to see a sharp and sustained market rebound amid a prolonged recession. In stage 3, improved risk appetite would reduce the safe haven appeal of USD, leading to more support for cyclical currencies and those with a more attractive yield.

For now, we maintain our cautious portfolio composition, but we think it is useful to continue to watch key milestones as we are hopeful that some markets will see a rebound sometime in 2023, and investors need to be nimble.

How could our views change when rates peak or growth bottoms?

Current position

- ◆ Underweight equities – building recession resistant portfolios
- ◆ Overweight bonds but with a focus on short-to-medium maturities and quality borrowers
- ◆ We moved USD to neutral

Milestone 1: What could we change after rates have peaked?

- ◆ Extend duration of bond holdings
- ◆ Less challenging environment for tech and other growth stocks
- ◆ Stick to quality stocks and bonds

Milestone 2: What could we change when economic growth and earnings stabilise?

- ◆ Add to equity exposure and become less defensive
- ◆ Selectively add to credit risk
- ◆ Geographical preferences depend on improvement in key local challenges
- ◆ USD to decline

Are Diversified Portfolios Still a Better Option than Cash?

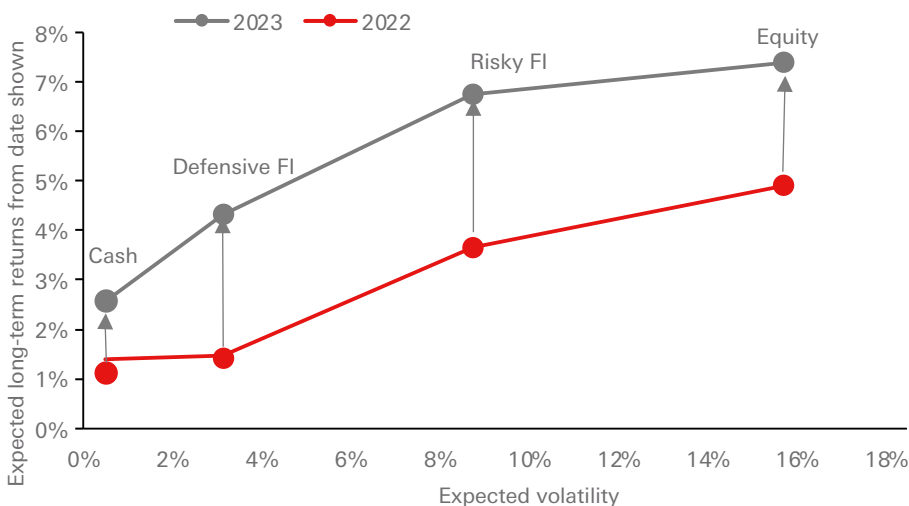
Perhaps disheartened by the 2022 market sell-off and enticed by rising interest rates, some investors wonder whether making substantial allocations to cash is becoming a viable strategy. We recognise that cash is now less unattractive than it used to be, and we have tactically upgraded it to neutral. But our strategic allocation to cash remains low, and we see three reasons to remain diversified across asset classes.

First, whilst cash rates have indeed increased, so have risk premia across global markets. Second, regardless of whether the Fed gets inflation under control, history shows that most asset classes should outperform cash in both scenarios, which strengthens the case for diversification. Finally, following a historical repricing episode, we believe that fixed income is now offering positive excess returns over cash rates, and this is reflected in our strategic asset allocation for 2023.

Remaining invested and diversified across the asset class is a useful investment principle that helps instil discipline and avoid pitfalls of market timing. Evidence shows that embracing market volatility is a rewarding strategy for investor with a long-term horizon. Due to the absence of prolonged, deep selloffs in the 15 years following the Global Financial Crisis (GFC), this principle may have felt particularly easy to follow. In addition, cash rates were effectively zero over most of the period. With nothing to be gained from holding cash and plenty to be lost to inflation, astute investors embraced market risk by investing in a mix of bonds, stocks, and alternatives, whilst limiting their cash allocations during this period.

But 2022 has been painful for both stock and bond investors. Following a rapid adjustment of the Fed's monetary policy stance, cash rates are now sitting at 4%, levels not seen since 2007. Perhaps disheartened by the recent sell-off and enticed by higher interest rates, some investors wonder whether cash has become a more attractive proposition than it used to be. We sympathise with this view, mainly on the basis that the regime of financial repression is probably behind us, and we may again see a regime where cash returns begin to outpace inflation again (in the US,

While cash rates have moved up, long term return expectations for bonds in particular have moved up much more sharply.



Source: HSBC Global Asset Management, HSBC Private Banking, 22 November 2022. Defensive FI: Government Bonds, Corporate Credit, Securitised Credit and Inflation-linked Bonds. Risky FI: High Yield and Emerging Market Debt. Equities: Developed and Emerging equities. All expected returns are shown in USD.

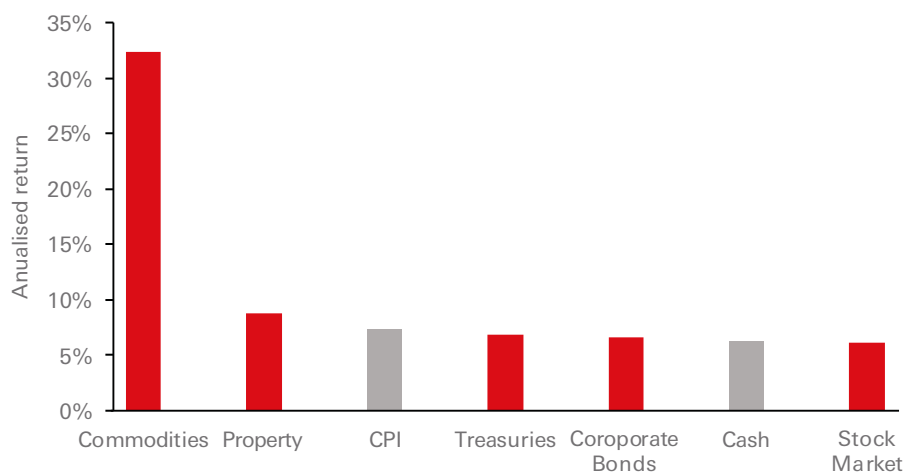
we think inflation could fall below the Fed policy rate in H2 2023). With that in mind, we have recently upgraded our view on cash to neutral.

But one needs to compare the outlook for cash against all other asset classes as viable alternatives when allocating assets. In spite of their recent increase, the market consensus is that cash rates are not going to remain at these levels for a long period of time. Our expectation is that the Fed will cut rates from 2025, and that the cash rate will average 2.58% over the next 10 years in

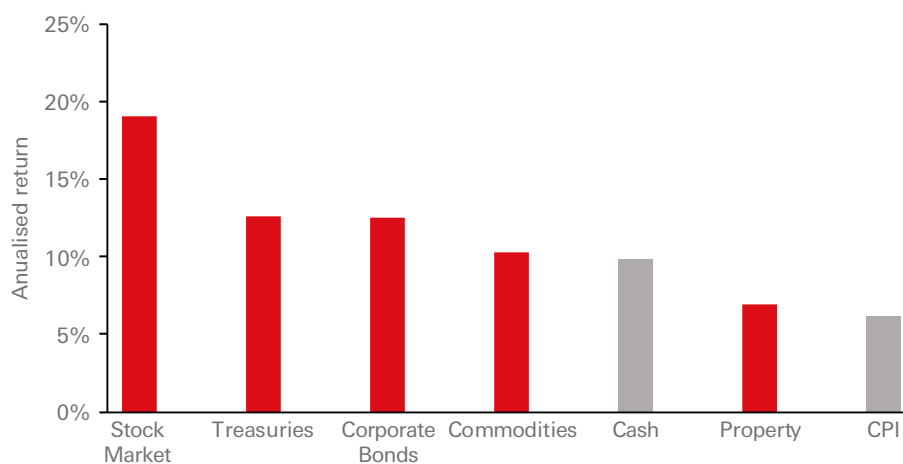
USD, 0.81% in the Eurozone, 1.70% in the UK and 3.09% in China. At the same time, our estimate of the expected equity risk premium has increased from 4.12% to 4.91% over the last twelve months. As seen in chart below, fixed income risk premia are particularly elevated relative to history, and our long term return forecasts have moved up considerably, especially for defensive fixed income. Whilst we agree cash is no longer unattractive, we must emphasize that positive real returns on cash are far from guaranteed. To get some idea

of potential asset class performance in the forthcoming period outside of our core scenario, we have to venture away from the post-GFC experience of near-zero interest rates and base our scenarios on periods with high cash rates: the 1970s, when cash rates were high and inflation kept escalating, and the 1980s, when cash rates were equally elevated, but inflation was brought under control. Evaluating both scenarios can give us some insight on what we may reasonably expect, regardless of whether the Fed gets inflation under control in coming years.

Scenario 1: High cash rates and spiralling inflation (1970s)



Scenario 2: High cash rate and declining inflation (1980s)



Source: HSBC Private Banking, Bloomberg, Yale University, Dartmouth college, 22 November 2022 . Returns are shown in USD between 31 Dec 1969 and 31 Dec 1989.

The first inference to be made from these scenarios is that most asset classes tend to outperform cash even when cash rates are elevated, reinforcing the case for remaining invested in a diversified portfolio. Equities are particularly sensitive to inflation dynamics – they may struggle to do better than cash if inflation remains problematic (1970s), but they should deliver superior returns if monetary policymakers regain control (1980s). Broad commodities remain a relevant hedge against particularly severe inflationary episodes. And perhaps most interestingly, fixed income outperforms cash in both reflationary and disinflationary scenarios.

In our Strategic Asset Allocation update for 2023, we are marginally increasing our allocation to fixed income. We are putting a particular emphasis on inflation linked bonds, as their real yields have returned to levels not seen in more than a decade. Tactically, we increased our cash allocation to neutral this year. But at its neutral weight, cash still represents the smallest percentage allocation in our diversified multi-asset portfolio, and we continue to advocate broad diversification across the investable asset classes as a time-tested strategy for the long run.

Remaking Asia's Future

Against a challenging macro backdrop of global downturn, Asian economies continue to stand out as a relative safe haven with resilient domestic fundamentals to weather the recession risks. We believe Asian economies can maintain their relative outperformance against the global peers with silver linings of accelerating economic reopening and more growth supportive policy initiatives. China's recent pivot towards gradual relaxation of the Zero COVID policy and more comprehensive policy support for the property sector are notable drivers to support its gradual growth recovery in 2023. We expect GDP growth in Asia ex-Japan to accelerate to 4.5% in 2023 from 3.9% in 2022, which is still respectable compared with many developed economies which should see close to zero growth in 2023. We believe a recovery in China's consumption and investment amid its gradual reopening would boost the overall growth outlook for the region, given China is the single largest trading partner of 16 major Asian economies.

Our Top Trend of **Remaking Asia's Future** looks for the most attractive structural and tactical opportunities in the region.

Our four high conviction themes

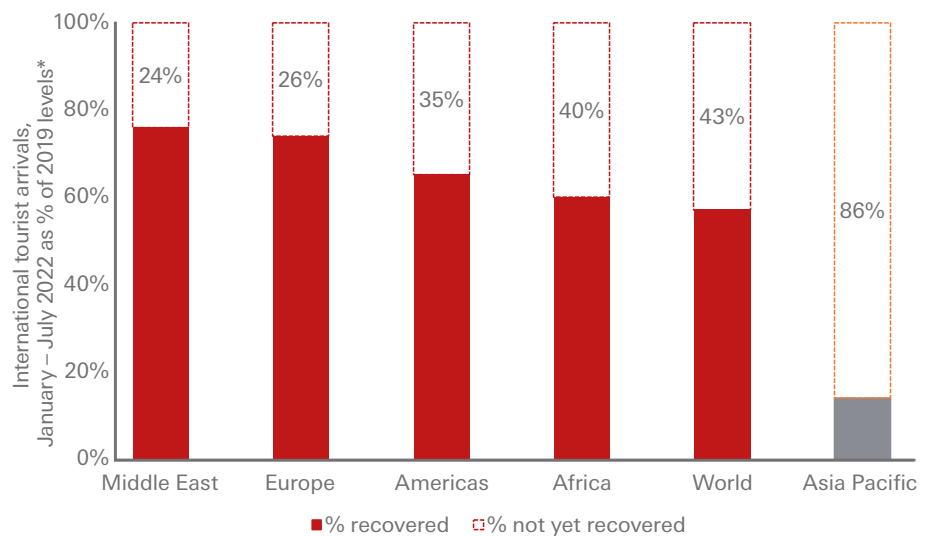
1. Asia's Reopening Winners
2. ASEAN Tigers
3. Asia's Green Transformation
4. Asian Quality Credit

Our new High Conviction Theme of **Asia's Reopening Winners** focuses on beneficiaries of the widening reopening trend across the region. The 20 new measures announced by China's National Health Commission to cut quarantine time, optimise pandemic

control measures and stop excessive local containment restrictions marked an important milestone in the gradual relaxation of the Zero COVID policy. We expect China will likely announce more meaningful reopening measures after the State Council leadership reshuffle at the National People's Congress in March 2023 when booster vaccinations are ramped up more broadly across the nation in the coming months.

We expect North Asian economies, including Mainland China, Hong Kong, Taiwan, South Korea and Japan, should feel the largest positive impact of reopening in 2023 given their border

Asia has the largest potential upside in reopening



Source: UNWTO, HSBC Global Private Banking, 22 November 2022.

reopening and relaxation of COVID restrictions have lagged behind the rest of the world. Southeast Asia should continue to benefit from the strong momentum of overseas travellers' inflow and tourism boom. In Thailand, tourist arrivals have climbed to only half of pre-COVID levels. We expect the reopening-driven recovery to continue in Southeast Asia and tourism stands to benefit from the boom.

According to World Travel & Tourism Council estimates, Asia Pacific is expected to revert to pre-pandemic levels in terms of contribution of travel and tourism to GDP in 2023. The recovery of tourism in Asia was still half way through 2021, according to UNWTO, and we expect this recovery

trend to continue. Asia's travel and tourism sectors are forecast to grow at an annualised rate of 8.5% over the coming decade, double the pace of 4% growth for the regional economy. Riding on the reopening tailwinds, we favour quality industry leaders in the travel, airlines, hospitality, food and beverages, Macau gaming and mass consumption sectors in Asia.

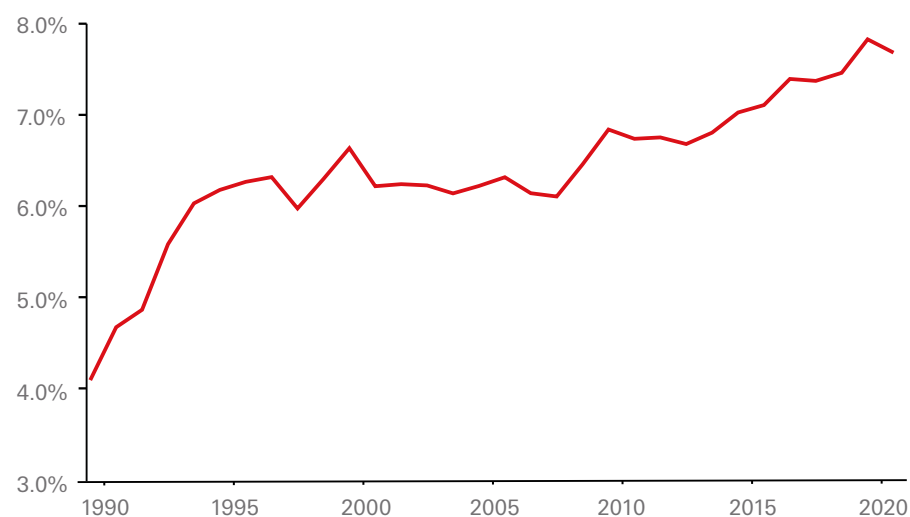
The ASEAN economies are showing silver linings of resilience with a strong consumer spending outlook amid continued economic reopening. We launch a new theme on **ASEAN Tigers**, capturing growth opportunities in consumption companies, infrastructure, ASEAN banks and Singaporean REITs. ASEAN is now a more economically

integrated region through the Regional Comprehensive Economic Partnership, which is the world's largest free trade bloc. We believe ASEAN economies can also benefit from the reconfiguration and regionalisation of Asia's supply chains. And selected ASEAN markets, such as Indonesia, can gain from high commodity prices, proving to be defensive to the inflation shock.

ASEAN stock markets have recorded one of the strongest earnings growth in 2022, outperforming global and regional peers, and we expect this trend to continue going into 2023. Indonesia and Thailand have some of the most solid economic momentum within Southeast Asia, thanks to strong consumer demand. Valuations remain attractive

ASEAN has played an increasingly important role in the global trade

ASEAN's global share of exports, %



Source: UNCTAD Stat, HSBC Global Private Banking, 22 November 2022.

relative to history and other regional markets. Over the past decade, ASEAN economies have undergone a healthy reset as they have deleveraged and continued to invest in infrastructure. As a result, ASEAN companies have developed resilient fundamental strengths and stronger balance sheets to withstand headwinds from the strong dollar and high US rates.

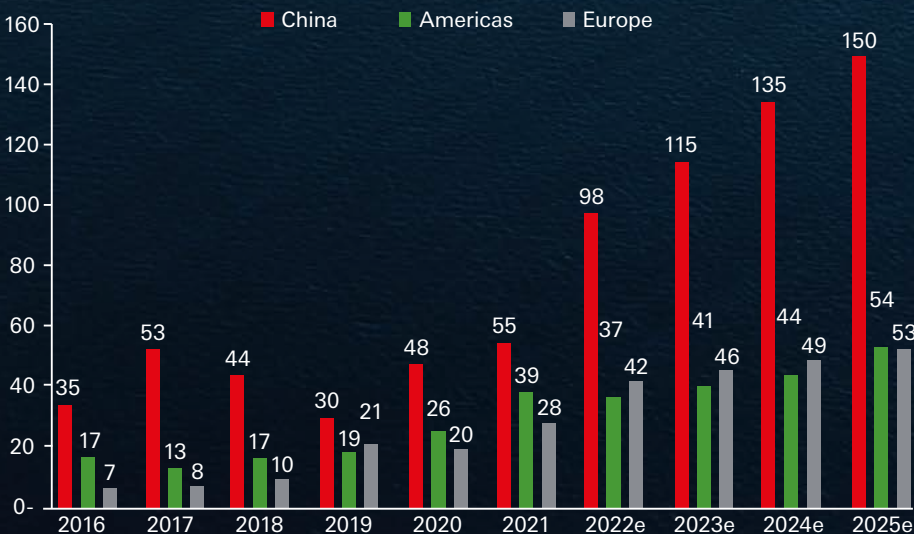
Among the structural growth opportunities, our High Conviction Theme of Asia's Green Transformation stays focused on opportunities from the energy transition and independence, green infrastructure development and

innovation of new energy vehicles technologies in the region. We favour renewable energy equipment makers of solar, wind and green hydrogen, smart grid manufacturers and leaders in the Electric Vehicles (EV) supply chains. The World Bank estimates China needs to invest up to USD17trn for energy transition, green infrastructure and technologies to meet its carbon neutrality goals by 2060. China is growing into a global powerhouse in EV, and one out of three new cars sold in China is now electric. Pure EV plays, some conventional Original Equipment Manufacturers (OEMs) and battery companies can

benefit from the net zero transition. We expect China's annual solar installed capacity to reach 115GW by 2023 and increase at a 15% CAGR to 150GW in 2025.

In India, investments of around USD300bn will be needed to complete the 500GW of renewable energy capacity target by 2030. Southeast Asian countries are also rushing to issue green bonds to finance eco-friendly projects. In ASEAN and East Asia, the amount of sustainable bonds outstanding accounted for about 18% of world's total, trailing only Europe as the second-largest market, according to Asian Development Bank.

China should witness the strongest solar demand growth in the world over the next few years.



Source: SolarPower Europe, BNEF, HSBC estimates, HSBC Global Research, HSBC Global Private Banking, 22 November 2022.

Positioning for moderating inflation and peaking of the US interest rate cycle, we remain bullish on the theme on Asian Quality Credit, especially amid the substantial yield pick-up across the Asian credit markets in 2022. However, this theme stays focused on high quality corporate bonds in Asia, including high grade Hong Kong corporate bonds, Chinese TMT

bonds and Indonesian hard currency bonds. With Hong Kong's accelerating reopening to the outside world, we favour investment grade bonds in the retail and property space. We continue to see attractive carry opportunities in Indonesia's quasi-sovereign investment grade bonds, thanks to the country's improving fiscal position in a strong commodity cycle. We prefer short-to-medium duration Asian investment grade bonds which are expected to see lower price volatility relative to longer-dated credit amid rate volatility.

Asian IG credit spreads are attractive versus US IG bonds



Source: Bloomberg, HSBC Global Private Banking, 22 November 2022. Past performance is not a reliable indicator of future performance.

Opportunities Amid High Rates and Slowing Growth

The set of themes under our second trend balance the attraction of improved valuations in equities and bonds against the current deterioration of the cyclical momentum and the high level of uncertainty. They also act as a counter-weight to many of our other themes, which typically have a growth-style bias and follow longer-term trends. We recognise there is some overlap between the themes we discuss below, but by combining some of the ideas, all focused on quality and/or cyclical defensiveness, investors can find tangible ways to help compose a defensive portfolio with reasonable return potential.

Our six high conviction themes

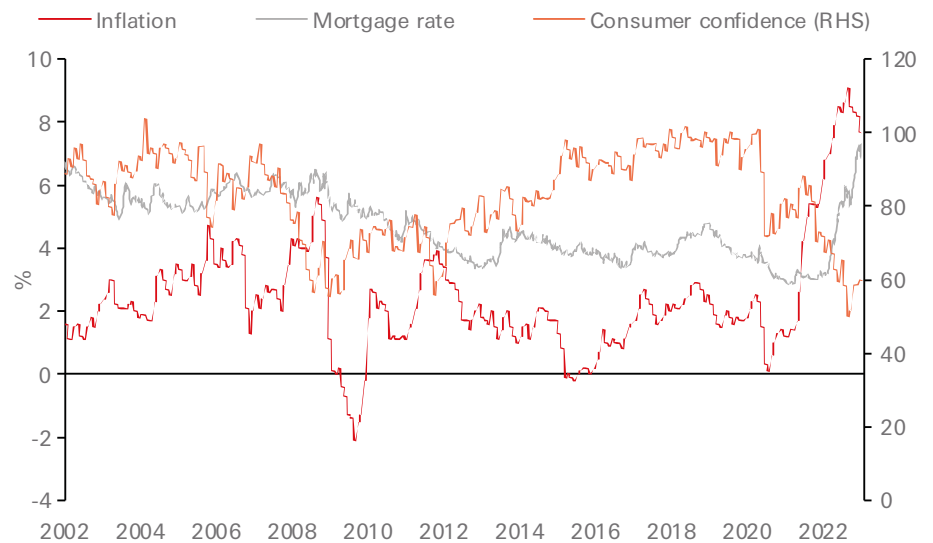
1. American Resilience
2. Durable Dividends
3. Recession Survivors
4. Hedging Against Inflation
5. Short-to-Medium Dated Quality Credit
6. DM Financials – Moving Up the Capital Structure

American Resilience: The US economy is growing at below-normal speed, but it still remains more resilient than other economies. Key to this is the fact that it is an energy exporter, so we see opportunities in oil and gas. Many US households managed to save during the pandemic and unemployment remains very low. So while we have been shifting out of discretionary consumer goods and services, we see support for consumer

staples, as consumers trade down to lower cost goods, but keep spending.

Durable Dividends: Dividends can substantially add to total returns, especially when the potential for sustained upside in equity markets is limited. Of course, as the cycle slows, it is important to select companies that have sufficiently strong cash flows to pay out constant or growing dividends. But dividend expectations have been

Consumers have seen their mortgage payments and inflation jump, and this is weighing heavily on their confidence.



Source: Bloomberg, HSBC Global Private Banking as at 22 November 2022

recovering, in part because banks (typically among the high dividend payers) are getting a lift from rising rates. From a style perspective, dividend stocks tend to be value oriented, which can help balance portfolios that are heavy on growth stocks. They also tend to have a quality bias and often qualify as 'low volatility' stocks, which should help as we expect market volatility to remain higher than usual.

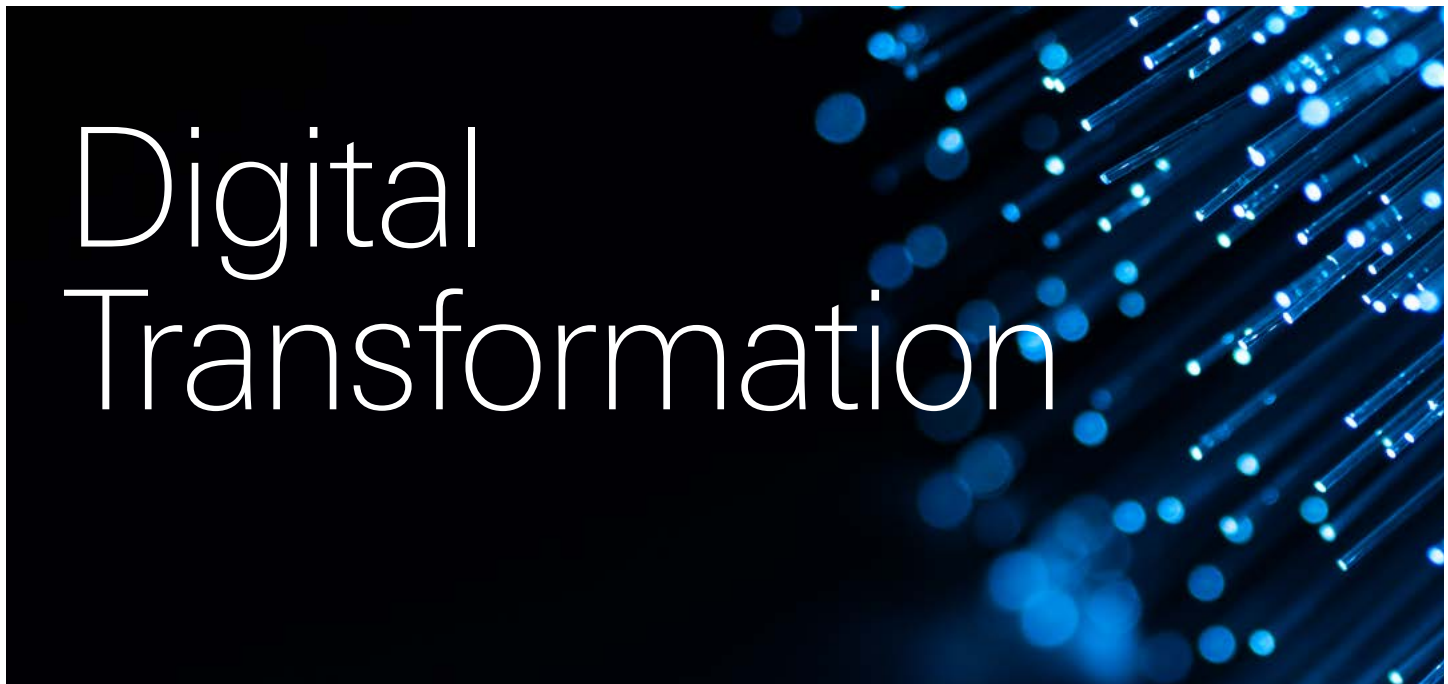
Recession Survivors: The UK is in recession and we expect the Eurozone to enter a recession soon. So we are underweight on the region in our equity portfolios and look for companies that can weather a recession. Such companies will have a quality bias, i.e. strong market positions and resilient earnings, as well as manageable leverage. In addition, the companies we look for tend to be in defensive sectors, such as energy, consumer staples and healthcare.

Hedging Against Inflation: In financial markets, no inflation hedge is perfect, but we find three avenues attractive. Firstly, the energy sector should continue to generate substantial cash flows, even after the fall of energy prices. And in the event that prices were to spike again and cause CPI to rebound, the sector would outperform. Second, we like consumer staples stocks with strong market positions as food and goods inflation is often passed on to the consumer, lifting revenues for those companies. And lastly, we look at infrastructure, as many of them benefit from a link (often set by the regulator) between their input costs and the prices they charge, which protects their profits. We have removed real estate from this high conviction theme, as higher borrowing costs may continue to weigh on real estate values, but real estate continues to be a key component in a well-diversified core portfolio.

Short-to-Medium Dated Quality Credit: our large overweight of short-to-medium dated and high-rated bonds in our core portfolio is also reflected in our high conviction themes. We continue to focus on investment grade, because we think high yield spreads are somewhat too tight and sensitive to the growth slowdown. And we prefer short-to-medium maturities as credit yield curves are very flat and hence, it does not pay to try to get a higher yield by extending duration. Investors who worry that policy rates could go even higher than what is currently priced in can add floating rate notes.

DM Financials – Moving up the Capital Structure: Banks have strengthened their capital and liquidity ratios in response to stringent regulatory requirements under the Basel III accord. That said, Tier 1 capital can be sensitive to the local economy and sovereign spreads, especially in Europe, where the economy is weakening. In that context, we are moving up the capital structure, to Tier 2 and Senior unsecured bonds. We find yields attractive in this area, compared to both sovereign and non-financial bond yields.





Amid slowing global growth, trade tensions and high inflation, governments, corporates and consumers have shifted priorities in an attempt to limit the impact of those disruptive forces by focusing on things like alternative sources of energy and supply chains' reconfiguration. Where does this leave the global wave of digital transformation?

Our two high conviction themes

- 1. Smart Mobility
- 2. Total Security

We think it actually provides renewed impetus to digitisation. The diversification, shortening and automation of supply chains that companies are seeking often involves much more digitisation. And the efficiency drives to tackle inflation often lead to manually intensive processes being substituted for digital alternatives. Digital technologies are transforming society both by substituting existing technologies or processes or devices, and also by opening up new avenues of doing things.

Smart Mobility

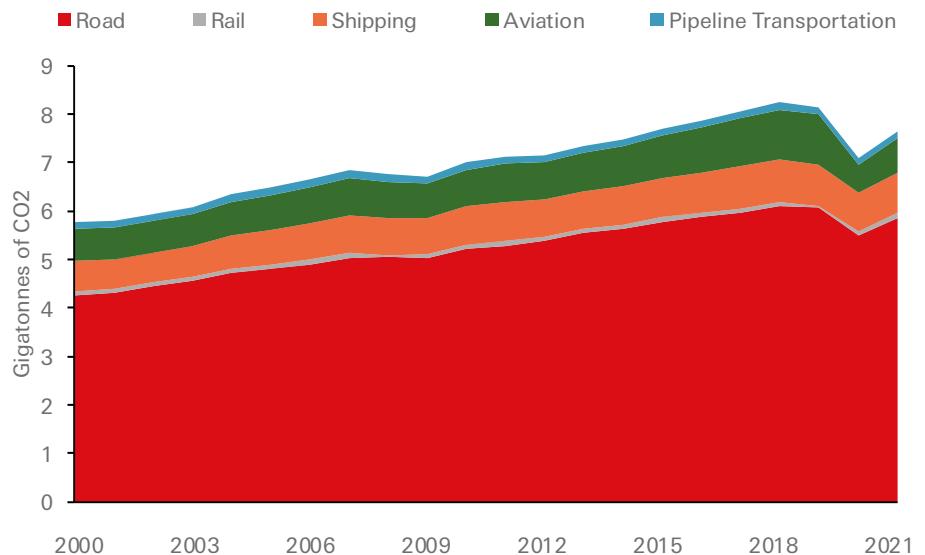
Rarely do several separate strands of technology converge in the ways we are seeing in the transportation sector and these technologies will transform many aspects of the way people travel both locally and over long distances. Smart mobility has multiple benefits as it increases access; provides alternatives; improves the experience and expands options. Our investment theme focuses on two key areas:

- 1) The integration of smart technologies into the infrastructure and the modes of transport that facilitate the movement of people and goods.
- 2) The beneficiaries of limiting the use of fossil fuels in transportation.

Let's look at a practical example of each to illustrate how this is already happening in the real world.

Over the last two decades, leisure and business travel has been transformed at almost every step by automation and digitisation. A new wave of innovations is being unleashed as 5G networks and

Global CO2 emissions from transport by sub-sector in the Net Zero Scenario, 2000-2021



Source: International Energy Agency, HSBC Global Private Banking as at 22 November 2022



low-earth orbit satellites are connecting existing infrastructure users, devices and transportation. Fully integrated transportation systems are becoming a reality. Anybody with a smart phone can purchase a ticket on an airline, train or bus for many of the world's transport networks before they even arrive in the country. Smart technologies allow you to see passenger loading when selecting a seat; choose less busy routes or times when driving; be informed of delays or congestion in real time; view locations using streaming. Simple enhancements give the traveller more choices and allow them to be in greater control of their own destiny, literally!

Let's look at the second aspect of our Smart Mobility theme, the beneficiaries of the transition away from use of fossil fuels to power transportation. According to the IEA, in 2021 transportation accounted for 37% of global CO2 emissions from end use sectors, equivalent to 7.7 gigatons of carbon. The Paris Agreement, the COP26 and the IPCC climate study give an even greater sense of urgency to the adoption of zero-emission technologies. Electricity, hydrogen, biofuels and ammonia are potential zero-emission or green fuels that should help reduce emissions. Governments in several countries have mandated a ban on the sale of new

vehicles powered by petrol or diesel engines from 2030 or 2035 which will accelerate the adoption of electric vehicles.

The opportunity for investors lies with the associated new technologies replacing those reliant on fossil fuels. Based on currently available technology, lithium batteries offer the best alternative source of power for everything from gadgets and sensors to vehicles. Commercial vehicles and trains could benefit from the advancements in hydrogen fuel cell technology although its adoption is still some way behind lithium batteries.

Therefore, travel is set to become a more pleasant and environmentally friendly experience.

Total Security

To many people, the world today seems a less safe place than at the turn of the century which is strange given all the advances in commerce, science, technology, communication and life expectancy until recently. There is increased awareness of vulnerabilities at national, corporate, and personal level and increased demand for security. Governments are not solely responsible for security, as popular culture frames it "everybody has skin in the game". We examine potential developments and

beneficiaries in this broad topic in our Total Security investment theme.

The digital transformation has many benefits, but it also leads to a new security threat, namely, cybercrime. Governments and companies are investing heavily to protect digital infrastructure, software and confidential data in an attempt to deter physical and digital attacks. The technology industry is responding to these multiple threats by developing software that detects spyware and computer viruses, unlocks ransomware and creates firewalls to block hacking. A service industry has evolved to provide advice to potential targets.

In recent years, wider security risks to physical assets and their supply lines have reappeared with many goods including food, water and energy. Governments and companies are trying to mitigate the effects by increasing inventories, diversifying sources and supply chains, investing in alternative energy and developing more local capabilities.

As the world's population continues to expand and resources become ever more constrained this will drive growth in demand for security product and services, although sentiment and growth may ebb and flow with perceived risks and threats.

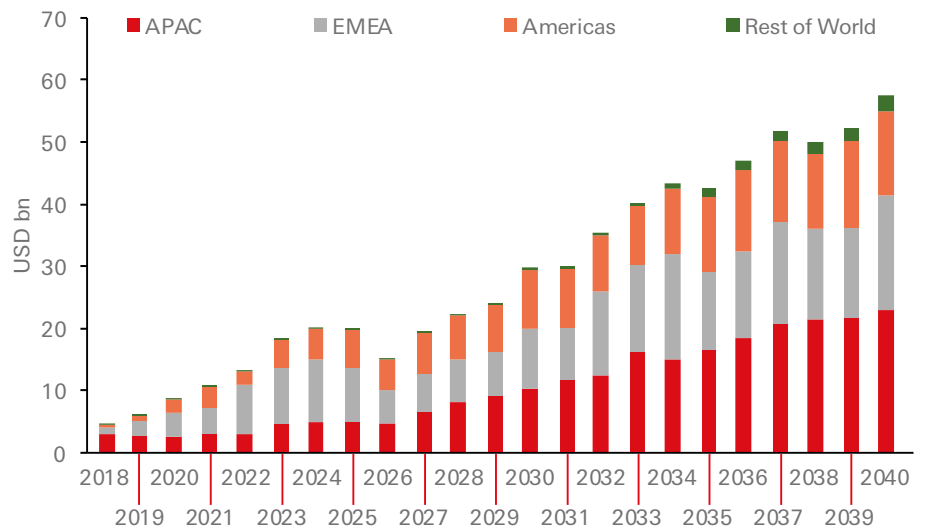
Investing for a Sustainable Future

The 27th Conference of the Parties of the United Nations Framework Convention on Climate Change (or COP 27 for short) had a raised urgency compared to other years and the acceptance and activity on sustainability issues is markedly higher than it has ever been. There is a broad spectrum of crises facing life on earth, the majority of which are a result of human activity and it is now widely accepted that we need to move quickly to limit the impact of our historic mistakes. The good news is that we have everything we need to get to where we need to be in terms of sustainability: we have the understanding, the technology, the capital and increasingly the desire. As a result, for investors, the opportunity set is getting deeper and broader every day and we have identified 4 themes within the sustainability trend that we believe represent excellent opportunities going forward.

Our four high conviction themes

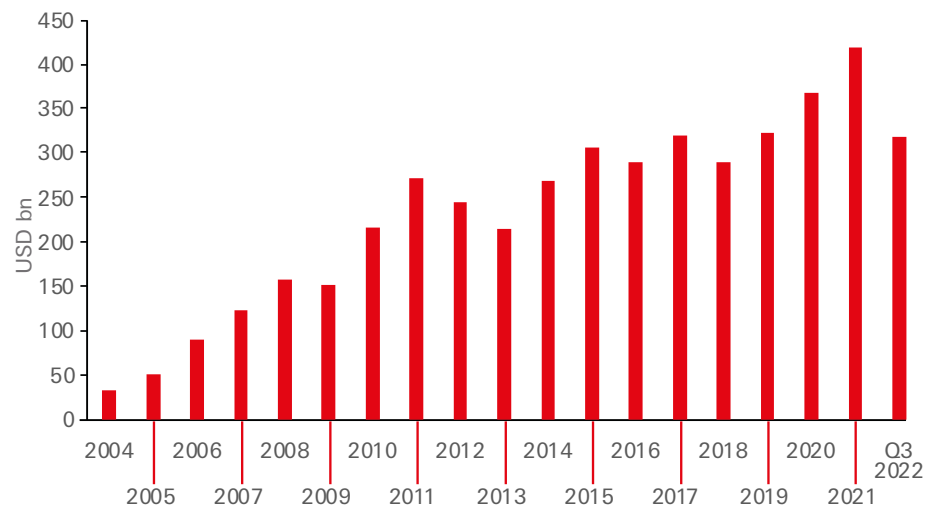
1. Energy Transition and Independence
2. Financing Biodiversity Action
3. Sourcing Income in a Sustainable Way
4. The Rise of S in ESG

Projected annual investment in energy storage



Source: Bloomberg Finance L.P. HSBC Global Private Banking, 22 November 2022.

Annual Renewable Energy Capacity Pipeline



Source: Bloomberg New Energy Finance (BNEF), HSBC Global Research, HSBC Global Private Banking as at 22 November 2022

Energy Transition and Independence

The energy transition from high carbon fossil fuels to a lower carbon mix of fossil fuels and renewables has been well underway for many years with solar, wind and other renewable sources such as hydro gaining a bigger share of the energy mix. Still, the transition is in a relatively early stage with plenty of opportunities left. Grids, cables and substations for example need to be updated to accommodate these renewable energy formats and the growing trend for residential renewable energy generation also needs support and a framework to operate effectively within. Likewise, battery technology and its wider infrastructure needs to be considered alongside these new considerations. The cost of storage is falling and global energy storage installations are expected to grow exponentially from 33GWh in 2020 to 1055GWh in 2030 according to Bloomberg.

The War in Ukraine has added momentum to the energy transition trend and highlighted the dangers and cost of being overly reliant on others for domestic energy supplies. Europe, and Germany in particular, have suffered from rapidly rising energy prices and threats of blackouts. This gave governments globally a new reason to support and accelerate their sustainable energy plans as a sustainable future is also a domestically generated future. Germany for example, saw demand for residential solar panels surge following the onset of the conflict with sales in the first 6 months of 2022 equivalent to the total number for 2021. Overall, the trend of renewable energy expansion is ongoing.

Financing Biodiversity Action

Biodiversity is rapidly moving up the agenda and seeing many initiatives to try and reverse some of the damage that we have caused to our natural environment. The recent win by Luiz Inácio Lula da Silva in the Brazilian presidential race is a good example. This win was at least to some extent a result of his stance on the protection of the Amazon which was in marked contrast to his opponent and incumbent, Jair Bolsonaro. It was a clear message from the people of Brazil, echoed by those concerned with sustainability around the world that preservation and regeneration of our planet's biodiversity are now a top priority. At the local level we are seeing a growing appetite for rewilding, refilling clear areas of land with the natural wild flora, native grasses, trees and flowers which we have learned carries benefits to our natural ecosystem far beyond what is immediately apparent. The biodiversity of our planet has been greatly reduced in the last 150 years and we are only now realising the roles that many plants and animals play in protecting our environment and keeping it in balance. Policy and social demand is now building behind this theme, boosting the potential of businesses active in this area.

Sourcing Income in a Sustainable Way

With markets undergoing a significant de-rating in 2022, investors are looking for more stable investments that have an income component to their returns. Through our theme of Sourcing Income in a Sustainable Way, we have identified companies which have a stable foundation at the business level and

can deliver attractive dividends but also do so in a sustainable way. This way investors can get the benefits of an attractive investment approach aligned to the current investment environment while also supporting a sustainable future.

The Rise of S in ESG

The social impact of a company's role in the broader society is becoming an ever more important consideration for investors. The pandemic was a key trigger that brought the social side of corporate behaviours (good and bad) to the forefront of the headlines. Workers who had been considered disposable were reclassified as essential and as a result their bargaining power has gained ground. Inflation has now added to employee motivations and created a further drive within worker bodies for better pay and conditions. Train strikes have been ongoing in the UK for example, as the unions there look for a larger portion of profits to go to the workers. In the US, calls for higher minimum wage levels and resulting unionisation discussions have been dampened by some major retailers raising their pay and benefits beyond the level legally required but this may not last. What this means for investors is that some companies will be better positioned than others to navigate the mounting pressures from these issues. Companies that perform well in areas such as diversity and inclusion, and strive to achieve equality as well as equity, will have the draw of talent, in turn resulting in better relations with regulatory bodies and clients, and in a stronger bottom line.

Equities

Global equities struggled in 2022 as markets repriced stocks for issues like COVID, the impact of the Russia-Ukraine war, high inflation, global tightening of monetary policy, tighter corporate margins, and slower earnings growth. As we enter 2023, we do so with some trepidation. The repricing we've seen makes valuations now look attractive, but until earnings growth is downgraded sufficiently to reflect the new reality, the risk premium is unlikely to compress much, and volatility should remain in place.

Overweight

Markets: US, Mexico, Brazil, Switzerland, Mainland China, Indonesia, Thailand and Hong Kong

Sectors: Consumer Staples and Energy (including renewables)

Underweight

Markets: UK, Germany, Spain, Italy, South Africa, Turkey, South Korea and Taiwan

Sectors: Industrials and Consumer Discretionary

Global style bias

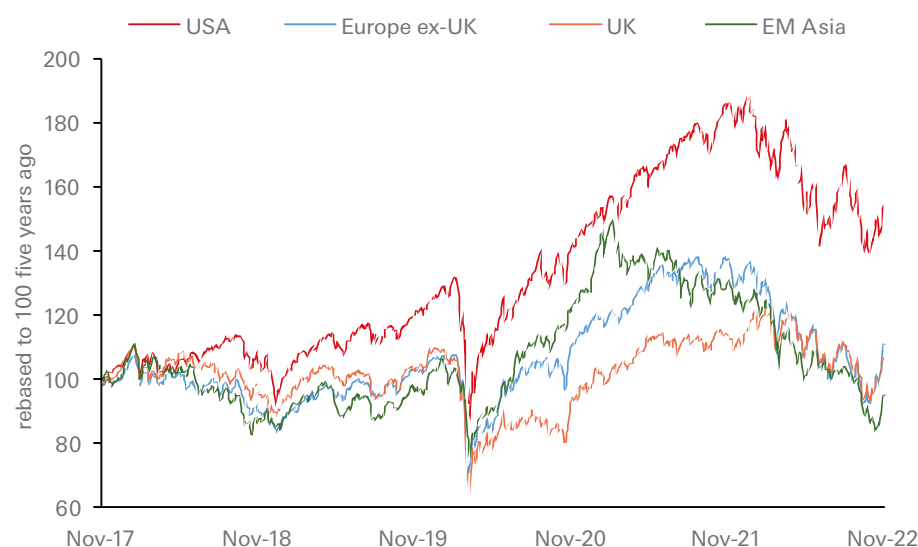
Quality and Income

Asia's growth should gradually pickup, in part because of recent policy announcements in China that reduce tail risk and signal an increased focus on balancing COVID control with growth. Meanwhile, Europe and the UK seem destined to be in recession. In the US, the healthy balance sheets put together in 2021 could prevent the economy from toppling over into outright recession but slower growth seems inevitable. We maintain a defensive sector positioning, starting with an overweight in consumer staples as rising food prices may keep margins wider than anticipated. We

also like the energy sector, as supply constraints should keep inventories tight and prices high; renewable energy generation benefits from people's desire to save on costly oil and gas, as well as the continued structural trend.

In terms of style, we focus on quality companies with resilient earnings. Companies that maintain high levels of cash should be able to maintain dividend policies, providing attractive total return opportunities for income investors. And with bond yields still remaining high and volatile, we maintain our balance between value and growth stocks.

Daily bond yield moves have been much larger than usual, providing hedge funds with many opportunities.



Source: Bloomberg, HSBC Global Private Banking as at 22 November 2022. Past performance is not a reliable indicator of future performance.

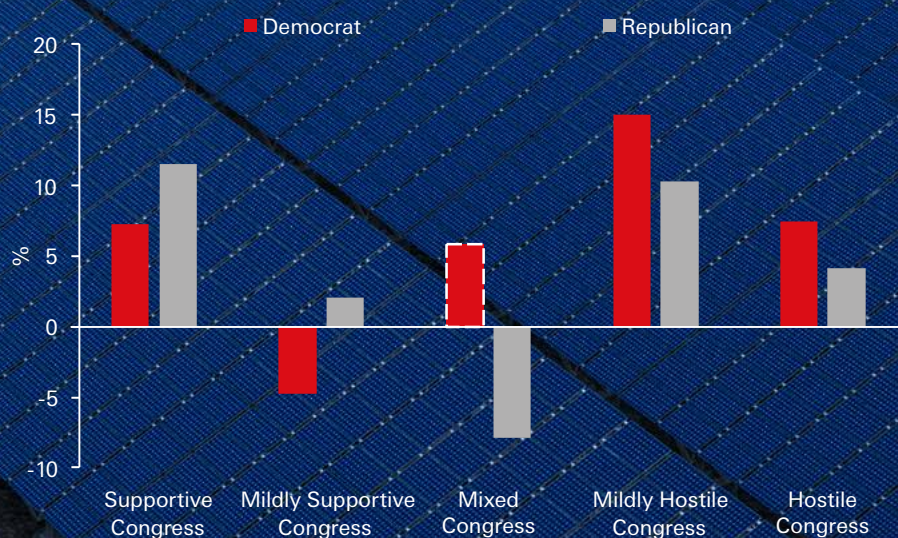
Europe on the brink

In Europe, recession seems all but a certainty as food and energy prices remain stubbornly high and the war continues to create fiscal drag in the region. Equities in Europe are also being weighed down by weak domestic demand. Global trade flows, which have often helped lift European equity markets, are set to slow further in the face of this global slowdown. Europe has been hit

hard by the Chinese zero tolerance policy against the COVID pandemic. Because of the cyclical challenges, we're even more defensive in Europe than in other regions, with an overweight in healthcare and an underweight in financials. As in other regions, tight supplies and good profitability has allowed us to also keep our overweight position on the European energy companies. Valuations look compelling but given the outlook for the region's

economic performance, further earnings downgrades seem probable and we think we will need to wait for an easing of the energy crisis before the valuation gap with the US can compress. The UK market continues to do better than the state of the local economy would suggest, thanks to the presence of many global companies, but the deep cost of living crisis and fiscal tightening should nevertheless weigh on performance in our view.

A split congress has historically been relatively constructive for US stocks, under a Democratic president.



Source: HSBC Global Asset Management, HSBC Global Private Banking as at 22 November 2022.
Past performance is not a reliable indicator of future performance.

Mildly overweight on EM Asia

Asian equity markets have seen quite a disparity in terms of performance. Some Southeast Asian markets have outperformed as border reopening has boosted consumption and shifting supply chains have lifted production. In addition, food and energy producers in the region have benefited from the same global trends we have seen in other regions. Also, domestic demand has been more resilient and intraregional trade has kept markets buoyed and economies have reopened. Taiwan and South Korea however have been hit by the fading global demand for semiconductors and the global competition in technology. It is in China that we have made the big change, upgrading the market to a mild overweight after weak performance. Although we do not see a big pickup in economic growth, we believe the downside risk related to housing and COVID has been reduced by Beijing's recent policy pivot towards growth recovery. The market now expects more initiatives in coming months. Reduced risk coupled with attractive valuations have made the market more attractive, warranting the upgrade.

Maintaining our overweight in the Americas

Slower economic growth and contracting margins should weigh on US earnings growth in 2023. Equity investors also continue to struggle with the Fed's historically aggressive tightening of monetary policy and still very high inflation. High rates are particularly painful for technology, which is a large sector in the US.

Still, US equities remain our main overweight globally as we believe the US may avert outright recession. Many US companies refinanced their balance sheets and extended the duration of their bonds when rates were still low in 2021. This implies they do not have to refinance in the near term, and should be good for their cash levels and profitability. US stocks rallied going into the midterm elections and a split congress has traditionally been good for US stocks.

Many US consumers refinanced their mortgages too in 2021, and many of them have long maturities and fixed rates, which should now help cap their debt service costs for some time. This, combined with faster wage growth, has put consumer balance sheets in a fairly healthy

position. Therefore, while the higher inflation and rate structure will take a bite out of growth and demand in the US, we feel that both the corporate and consumer sectors remain liquid enough to survive the downturn. Nevertheless, the weakening cycle means that we maintain a defensive posture with overweight positions in consumer staples, energy and utilities.

In Latin America, equity markets have fared better than their other EM counterparts. Central banks in the region tightened monetary policy earlier than others, and are now more advanced, giving some like Brazil the possibility to start cutting rates in Q2 2023. As China's COVID measures are adjusted, providing further stimulus for the domestic economy, Latin America, especially Brazil and Chile, could benefit substantially from the improvement in trade flows. And in Mexico, the near shoring theme is providing a boost. As American companies move supply chain management closer to US borders, the economy has already begun to see an improvement due to this long-term theme.

China's valuations are particularly cheap compared to other markets, and reduced downside economic risk leads us to upgrade Chinese equities to mildly overweight.



Source: Bloomberg, HSBC Global Private Banking as at 22 November 2022. Past performance is not a reliable indicator of future performance.

Two milestones ahead

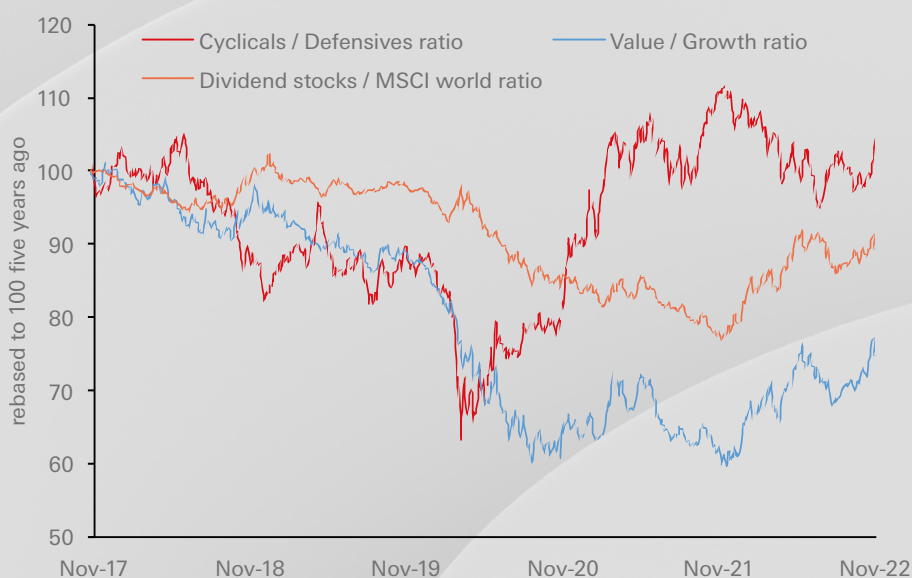
While we remain cautious on global equities for now, we could take more positive steps when two milestones are reached. Further evidence of rates peaking would benefit rate-sensitive stocks, including technology. But we would need to reach the second milestone – a stabilisation of growth and earnings

– before we would see more sustained and widespread support for stocks.

In the meantime, we focus on quality companies that produce solid cash flows and maintain low levels of net debt. We also continue to look for income, either through dividend payouts or stock re-purchase programs to enhance the potential

for improved total returns. We take a balanced view between growth and value. While we pay close attention to sector bets, this remains a stock-pickers' market, and close attention should be paid to resilience of underlying business models.

Higher rates have hurt growth stocks, while high dividend stocks have done well. Amid the slowdown, the recent pickup in cyclicals looks odd to us.



Source: Bloomberg, HSBC Global Private Banking as at 22 November 2022. Past performance is not a reliable indicator of future performance.

Fixed Income

Rate volatility remains elevated on the back of hawkish central banks' rhetoric and high inflation prints, which have been detrimental to bond market returns. The silver lining is that bond valuations price in most of the rate hikes we foresee and have gained in attractiveness relative to other asset classes, such as equities. As a consequence, we hold an overweight in fixed income, but we remain cautious and focus on quality corporate credit, mostly in investment grade (EM and DM) and at the "short-to-medium" part of the yield curve. The flat or even inverted yield curve shapes do not adequately compensate for taking additional duration exposure in our opinion. We expect DM sovereign bond yields to remain volatile in the short-term but to decline over 2023 as inflation and economic growth head south and corporate credit spreads continue to widen, especially for lower-rated issuers.

Overweight

Government bonds: UK Gilts

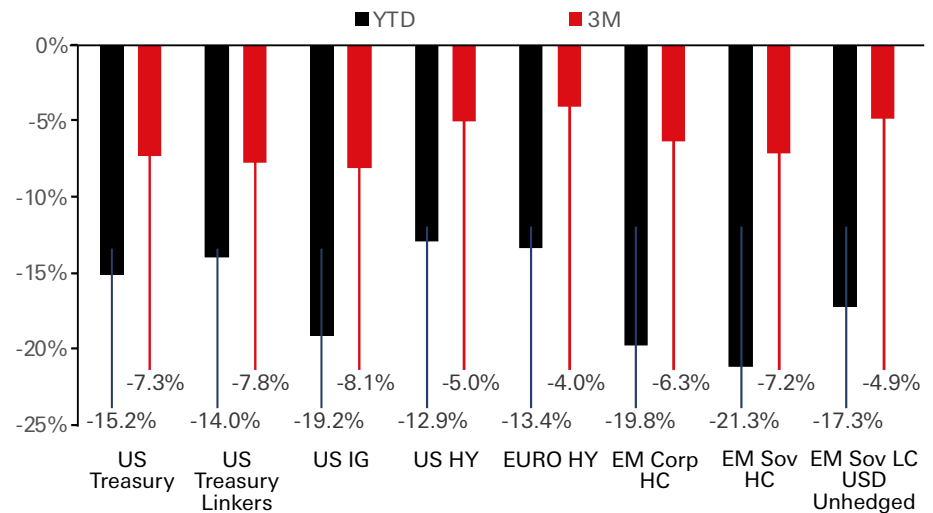
Credit and EM: US, European and UK IG; Australian and New Zealand corporate bonds; GCC and Mexican Hard Currency bonds; Brazilian HC corporate bonds; Mexican and Brazilian Local Currency bonds

Underweight

Government bonds: German and Japanese government bonds, European Periphery debt

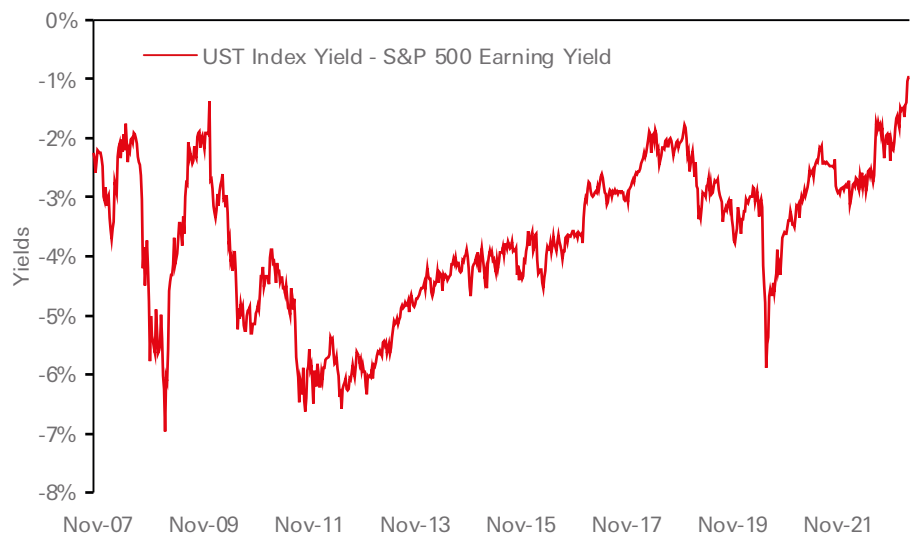
Credit and EM: Argentinian, Turkish and Ukrainian Hard Currency bonds; Turkish and Indian Local Currency bonds, Russian debt in Hard and Local currency

Rate volatility has been detrimental to bond returns



Source: HSBC Global Private Banking, JP Morgan, BOFAML indices as at 22 November 2022. Past performance is not a reliable indicator of the future performance

US Treasury valuations have improved relative to equities



Source: HSBC Global Private Banking, Bloomberg as at 22 November 2022. Past performance is not a reliable indicator of the future performance



Developed Markets: overweight with a focus on carry opportunities at the short-to-medium end of the corporate credit curve

Following the repricing for tighter monetary policies and the high level of DM real rates, which are almost back to pre-2008 levels, we believe it is right to hold a mild overweight for bonds and a modest underweight in equities. But the uncertainty around the global economy and central banks' inflation fight "at all costs", force us to be cautious in our bond allocation, especially when considering that the Federal Reserve has already hiked interest rates to a restrictive territory. Consequently, we reduced our long-held underweight position in DM government bonds, which represent the safest part of our bond allocation and serve as a diversifier to risk assets (i.e. their returns function generally counter-cyclically). Another supportive argument is the differential between US Treasuries and the S&P 500 earnings yield, which is at its tightest since 2007, making bond valuations more attractive on a relative basis. Finally, with a 5% Fed funds peak rate now priced in by markets, we also believe that a peak in DM bond yields rates is not too far away.

Some DM rates may have even seen their peak already: this might be the case in the UK, where the BoE met market expectations with an outsized 75bp hike to 3% in November, but struck a distinctly dovish tone. This supports our view that the end of tightening cycle is very close and Gilt yields may have

peaked in October, following the mini-budget announcement. We therefore upgraded our view on Gilts to a mild overweight in November, while keeping a full overweight on quality credit, short-dated IG bonds in GBP. They offer the widest credit spreads on average across DM IG markets.

Overall, our global bonds overweight consists of an overweight in global IG (i.e. USD, EUR, GBP), neutral Global HY and a small underweight in sovereign debt. We continue to focus on carry opportunities at the short-end of the corporate credit curves (2-5-year maturities), focusing on Global IG and high BB-rated companies, where the carry trade is the most attractive in our view when compared to relative risks.

At the sector level, we mostly concentrate on Energy and Financial companies, with a preference for the top-end of their capital structure (refer to our Theme on DM Financials: Moving Up the Capital Structure). In other sectors, we focus on companies with strong balance sheets, declining leverage and increasing cash flow generation and healthy bond maturity profiles.

Emerging Markets: focus on short-to-medium dated quality credit

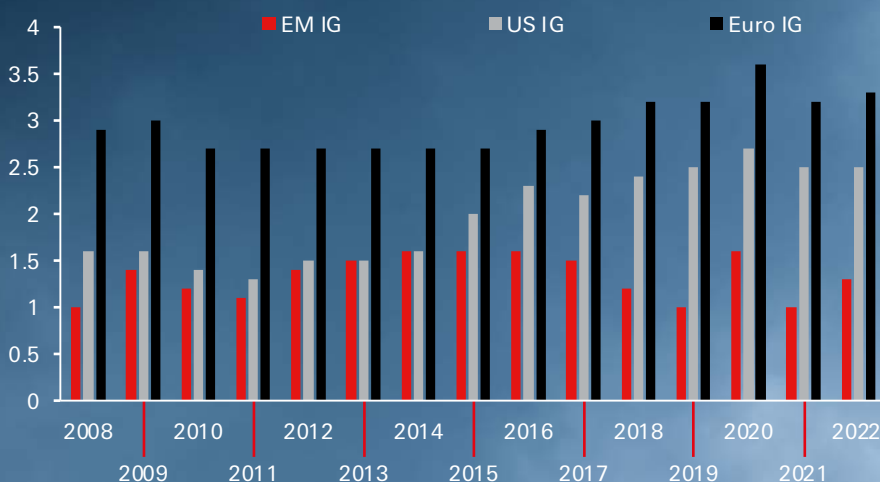
Emerging market bonds in hard currencies (HC) performed poorly this year, suffering from challenging global economic environment and rising rates coupled with idiosyncratic stories such as the Russia-Ukraine war and the

weak China property sector. As of the end of October, EM sovereign bonds had a negative return of 23.8% and EM corporate bonds delivered a negative return of 19.8%. EM local bonds were more resilient, declining by 9.5% on average, but including FX weakness, they provided quite similar negative return of 19.3% in USD terms.

A flight to quality also led to significant outflows from EM funds this year, which added pressure to EM bond prices as fund managers had to liquidate positions in illiquid markets in order to satisfy redemptions. All in all, EM credit underperformed US High Yield bonds, which delivered a negative return of 12.2% as of the end of October.

EM corporate fundamentals are at the strongest level in over 10 years

Net leverage IG companies



Source: HSBC Global Private Banking as at 22 November 2022; JP Morgan estimates as of Q2 2022

At the same time, emerging market economies are now much more resilient to global challenges and EM corporate fundamentals are at the strongest level in over 10 years. As of the end of Q2 2022, the average net leverage of Global EM was 1.3x (see graph). US IG companies had an average net leverage of 2.5x and European IG at 3.3x. Despite macro headwinds, EM companies' credit metrics should remain stable this year as most companies continued to see revenue and EBITDA growth and were able to pass on rising costs to customers.

The EM corporate default rate, excluding the troubled areas of Chinese property, Russian and Ukrainian issuers, also

remains limited at just 1.2% and is similar to DM markets where the default rate is 1.5% for US HY and 0.3% for European HY. Within EM, the default rate is unsurprisingly the highest in EM Europe at 21.7% and Asia at 12.8% while Middle East & Africa remains at 0.0% and Latin America is at a fairly contained 2.2%.

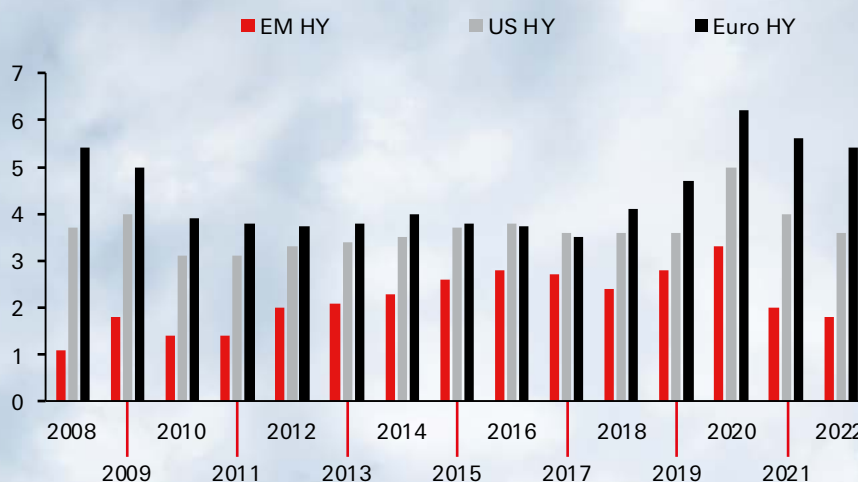
While macro risks remain elevated in the near term and volatility in risky assets might continue, we find that short-to-medium dated quality EM credit offers value due to solid credit quality and improved valuations. On average, EM corporate bonds provide a yield of 8.7% and have an investment grade rating of BBB. However, we remain selective

focusing on cash-rich companies with low refinancing risks and stress the importance of diversification.

On a regional basis we prefer Brazil, Mexico and the GCC which have demonstrated more economic resilience in the current global environment. We recently upgraded Brazil from neutral to a mild overweight stance based on an improved macroeconomic backdrop and reduced political uncertainty as the presidential elections are behind us. We remain neutral on EM LC markets as global risks remain elevated, pressuring EM countries' fiscal and current accounts. The only two local markets where we are mildly overweight are Brazil and Mexico.

EM corporate fundamentals are at the strongest level in over 10 years

Net leverage HY companies



Source: HSBC Global Private Banking as at 22 November 2022; JP Morgan estimates as of Q2 2022

Currencies and Commodities

USD strength has been a key dynamic of financial markets since the start of 2021, but the outlook is changing. The dollar benefited from the leadership of the Fed in setting the pace of monetary policy tightening and an attractive rate pickup compared to many other G10 currencies. But as we get closer to peak rate levels, we think those rate differentials are unlikely to widen further, and the gap may even narrow with some countries. As a result, the main tailwind for USD is fading fast. USD will still get some support however from weakening global economic growth, relative economic resilience in the US and mixed-to-weak risk appetite.

As a result, we recently downgraded USD to neutral; upgraded EUR and GBP to a neutral view; and JPY and SGD to a bullish view. In the commodities space, we remain neutral on Gold, Silver and Oil as we see muted momentum.

USD strength has been a very consistent story over the past two years and investors who have stuck with it have benefited from strong currency gains, with the USD index trading at 20 year highs in early November. While there were three main tailwinds (widening interest rate differentials, weakening global economic growth, weak risk appetite), at least one of them (rate differentials) is quickly falling away.

Bullish

JPY, SGD, BRL

Neutral

USD, EUR, GBP, CHF, AUD, NZD, CAD, EM FX (including RMB), Gold, Silver and Oil

Bearish

KRW

The October US CPI figure, which finally showed a decline in core inflation, is giving markets hope that we are approaching peak rates, and as a result, there is reduced upside risk to



the 5% peak rate level that markets currently price in. We think it is too early to become negative on USD however, as the Fed still needs to implement additional 100bps of rate hikes and the US economy is still relatively resilient amid a struggling global economy. Moreover, until risk appetite improves and equities see a more sustainable bounce, the safe haven characteristics of USD also provide it with some downside support.

The mirror image of our USD downgrade is an upgrade of EUR and GBP to a neutral view. Both currencies are cheap following the sharp USD rally. But both are also facing recessions, limiting the potential for upside. Of course, commodity prices play a key role here. European nations are commodity importers, and the recent rise in oil and gas prices has forced the European and UK central banks to tighten policy in the midst of an unprecedented cost of living crisis. Central banks are therefore left in a dilemma as the room for tightening further narrows: the BoE recently became more dovish due to weak growth prospects, while the ECB remains somewhat more hawkish and still does not forecast a recession. The uncertainty

around macroeconomic forecasts will continue to generate some FX volatility, which investors can exploit, while others may look at hedging unwanted USD exposure to lock in and protect gains made so far.

While EUR and GBP will probably move sideways, we believe JPY will manage to recover and we move to a bullish view. Of course, the pronounced weakness to date is one factor, in addition to the likelihood of further intervention. The yen is also helped by a strong reduction in investors' bearish positioning and some volatility in global risk appetite, and this should help compensate for the continued yield disadvantage.

The cyclical character of AUD means that it will likely struggle to capitalise on the fading USD momentum. AUD also faces domestic risks given the rapid tightening cycle compared to other major central banks. CHF could be supported by relatively robust local economic drivers but the yield differential with the US will continue to limit CHF's upward potential.

In EM Asia, low Chinese inflation translates into an attractive real yield, which supported RMB. We see upside risks if China's economy rebounds in 2023, but hold a neutral view on RMB

for now. We keep our prudent stance on KRW, however. KRW could continue to suffer from the weak technology cycle. We see further upside risks for SGD, due to strong economic fundamentals and the Monetary Authority of Singapore's tightening policy. Outside of Asia, we are constructive on BRL. The country shows robust economic drivers, and the currency offers one of the largest real rates among EM. In addition, political uncertainties largely reduced since elections have passed.

Despite the recent bounce in commodity prices, we do not expect Gold and Silver to outperform in the coming months. USD's recent strength has weighed on both metals, while higher rates and real bond yields create a competitive disadvantage for gold compared to cash and bonds. Oil prices have decreased since the beginning of June and although we do not expect them to decrease further, we do not expect a strong rebound either. Global supply has picked up given the increase in Russia's production, but demand is softer than before. The market seems adequately supplied for now, so we believe prices will trade sideways in the coming months.

USD momentum is stalling



Source: Bloomberg, HSBC Global Private Banking as at 22 November 2022. Past performance is not a reliable indicator of future performance.

Hedge Funds

We maintain our positive outlook for hedge funds because market conditions, which we forecast to persist well into the first half of 2023, are supportive for a number of strategies. In addition, higher cash rates provide a tailwind for certain strategies such as managed futures and equity market neutral. We have the strongest positive conviction on developed market discretionary macro, systematic market neutral and multi-PM strategies all of which have made money during 2022.

The environment remains supportive for developed market focused macro managers. Divergences in the timing, speed and magnitude of monetary tightening and potential recession across G10 economies should offer fertile opportunities in both directional and relative-value fixed income trades. In FX,

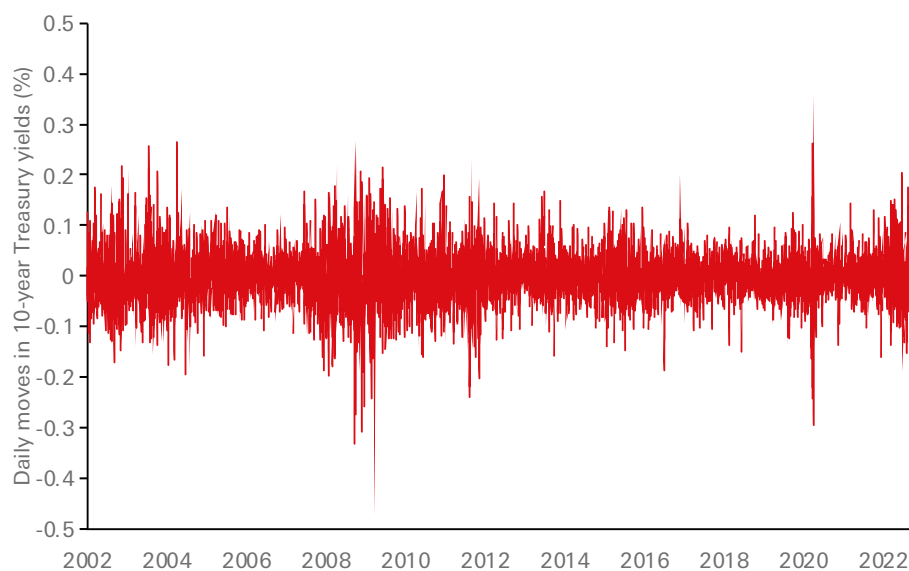
USD strength remains a key trend with the Fed further ahead in its hiking cycle than the rest of the world. Tactical shorts in equity markets are popular exposures as stocks come under pressure from both higher rates and recession fears. In contrast we maintain our neutral negative outlook for EM focused macro managers due to geopolitical and economic headwinds. Idiosyncratic opportunities do however exist in certain markets. But these bright spots are nonetheless challenged by the negative sentiment, elevated volatility and low levels of liquidity making trading difficult.

We remain neutral on Managed Futures strategies, neutral positive for Market Neutral Systematic and neutral negative for Equity Long-Bias Systematic. For managed futures while trend followers are not necessarily long volatility, they need 'something to happen' to make

profits, and the outsized price action this year continues to be beneficial. This is particularly true for managers who have shorter lookback windows and are more reactive. For other approaches, market neutral systematic in particular, we note that the current environment of elevated dispersion at a sector and single stock level along with heightened volatility provide a ripe opportunity as we continue to see outsized contributions from idiosyncratic stock selection.

We continue to maintain an outright positive outlook on multi-strategy and multi-PM managers. Many multi-PM managers have continued to deliver strong returns in this unpredictable and whipsaw market, which continues to validate our high conviction in the space. Risk management at multi-PM shops is notoriously sophisticated and involved, and its varied sources of uncorrelated

Daily bond yield moves were much larger than usual, providing hedge funds with many opportunities



Source: Bloomberg, HSBC Global Private Banking as at 22 November 2022. Past performance is not a reliable indicator of future performance.

return streams have worked well and helped create resilience in this uncertain market. In our view, the ability to attract and retain talent continues to be one of the most important differentiating factors of a successful multi-PM fund.

We maintain our neutral outlook on Equity long/short across US, Europe, Technology, and neutral positive outlook for Asia Equity long/short. Against the backdrop of rising rates, many equity long/short managers continue to run with reduced risk as they expect markets to remain volatile in the near term. Many have also reduced their index hedges, switching to more single name equity shorts as dispersion is expected to be higher in this environment. In summary, whilst there may be more asymmetry to the downside for equity markets during 1H 2023, this is an environment where equity long short managers can perform

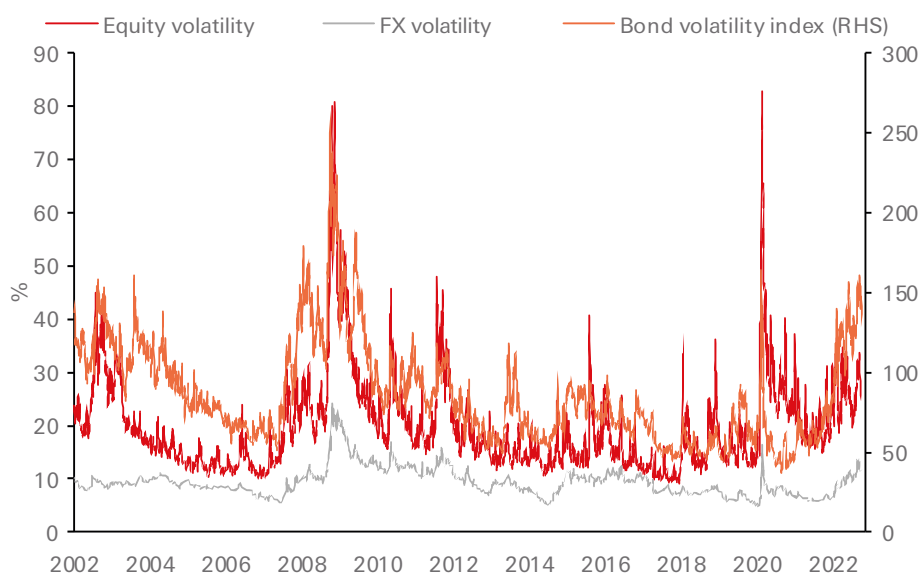
and become a natural replacement for longer-biased equity exposure, with increased alpha. Turning to Asia, while the earnings picture remains weak, significant de-risking over the past 9 months has meant that valuations are below fair value with a number of fundamentally strong companies trading cheaply.

We maintain our neutral rating on Event Driven strategies and favour managers who have broad expertise across sub-strategies and the ability to opportunistically allocate across all asset classes. As a result of the rapid tightening of monetary policy, we could be on the cusp of the next credit cycle, although credit issues should remain substantially less than in 2008. Still, this should represent a fertile opportunity set for managers that can redeploy capital dynamically across the capital structure

and geographies. In addition, there remains a robust level of activist campaigns increasingly focused around “sell the company” demands, strategy/operational improvement and corporate governance.

Within credit our view for Structured Credit remains neutral/positive, and our outlook for both Credit Distressed and Credit Long/short remains neutral. However, considerable improvements in spread, carry and dispersion continue to get our attention as we believe the next credit cycle may be nearing. Structured Credit appears to be the most attractive currently as loss adjusted yields have improved into the high single/low double digits.

Volatility has picked up across markets, but particularly in bonds



Source: Bloomberg, HSBC Global Private Banking as at 22 November 2022. Past performance is not a reliable indicator of future performance.

Private Markets

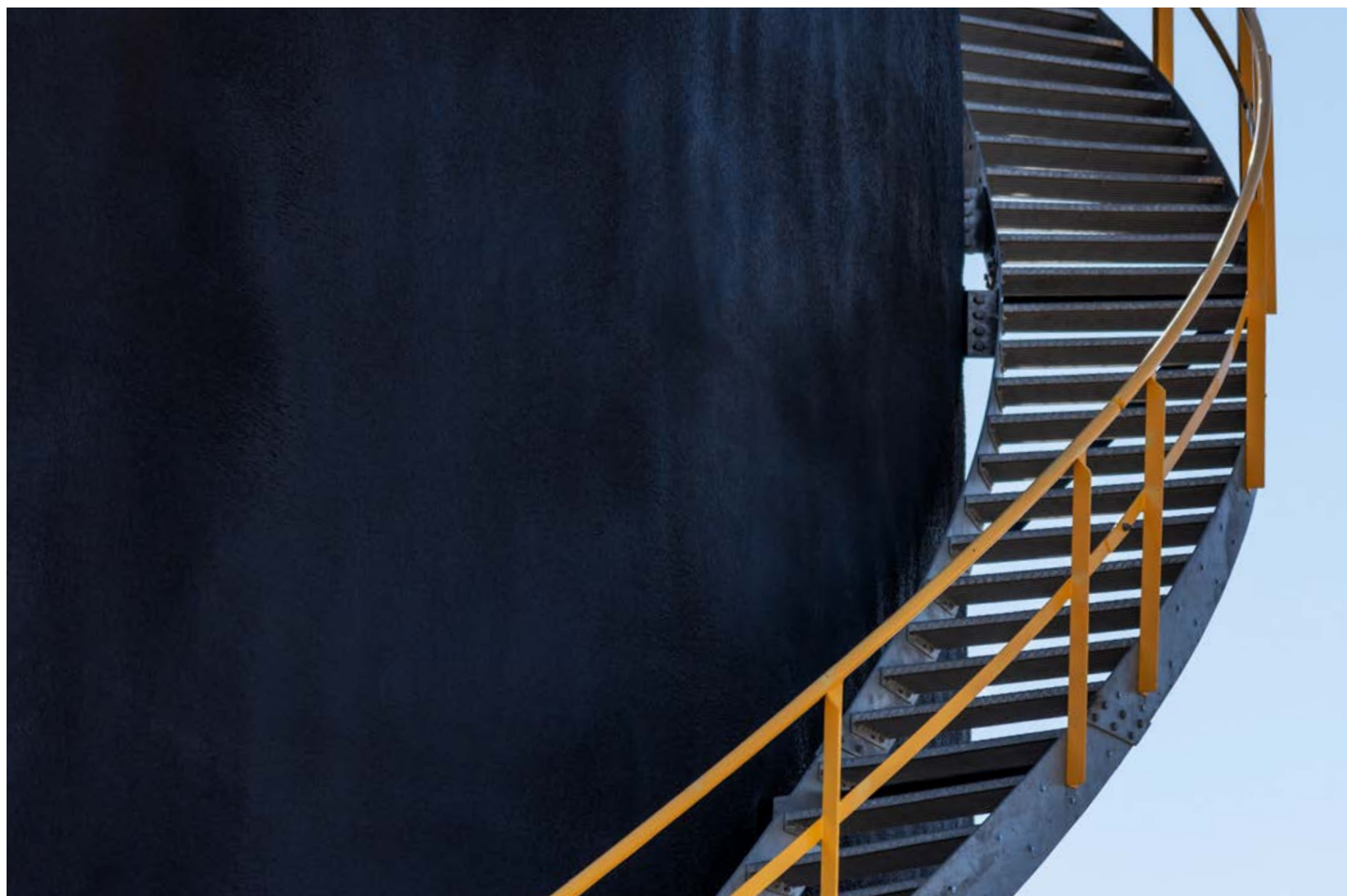
Amid sharp declines in public markets, Private Equity (PE) valuations have dropped and continue to soften, but less than public markets. Fundraising and exits have dropped too, but activity levels should still remain in line with historical averages. Despite the challenging environment, we believe PE provides opportunities to take advantage of targets, especially in sectors where public valuations have suffered the steepest declines (such as technology and healthcare). And we believe there are attractive deals in the secondary market to acquire high quality exposures at discounted levels.

As the macroeconomic picture worsens, most PE firms have been forced to re-examine and write down the value of their investments on the back of lower public valuations, higher costs of capital, and a deteriorating growth outlook. That said, in many cases, the valuation compression has been muted, partly explained by the lower correlation between public market equity valuations and private market valuations. Manager performance continues to vary considerably and the gap between top and bottom quartile funds is increasingly apparent.

While fundraising activity continued to decline, it remains in line with historical quarterly averages and we

have seen strong levels of fundraising in Q3 compared to last year. Despite the headwinds in the broader market, investor appetite for PE remains strong. We have seen an increase in value of \$166.1bn in Q3 compared with the same period last year of \$157.9bn. However, we are witnessing a lower number of PE fund closings (3,347 vs 1,6242) as Limited Partners (LPs) are focusing on re-ups, resulting in a thinning of the herd and leading to more “mega-funds”. Looking ahead, we think many LPs have already hit their allocation targets for the year and Q4 figures will be more subdued.

In the secondary market, overall transaction volumes in H1 2022



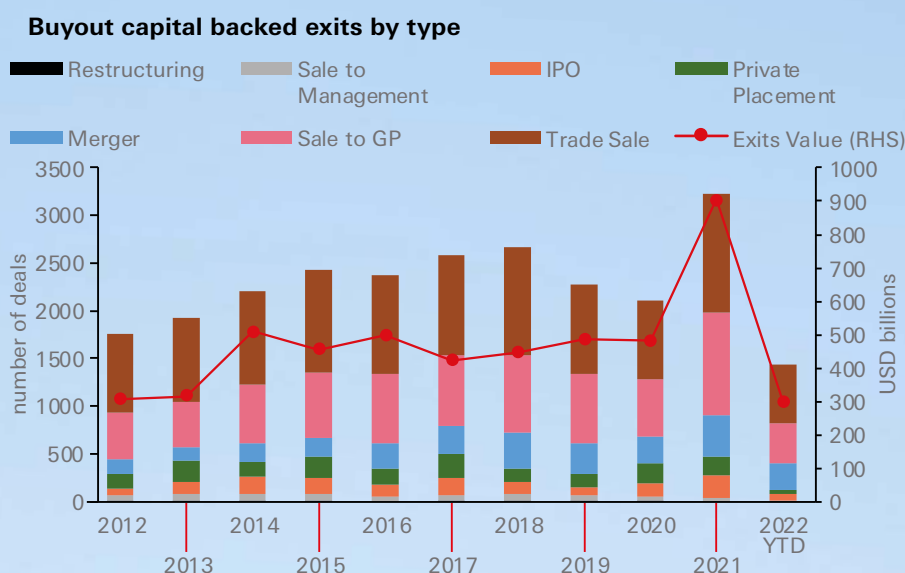
increased by 18% compared to H1 2021, reaching \$57bn of assets traded. In our opinion, this reflects the appeal of the secondary market as a source of liquidity for private equity asset owners and managers in uncertain market conditions. This presents a compelling opportunity for secondary buyers to acquire high quality exposures at attractive pricing levels, especially in sectors that have suffered the steepest declines (such as technology and healthcare).

In terms of exits, we are seeing General Partners (GPs) bidding their time for the right exit opportunities and PE firms holding on to their investments

rather than being forced sellers in an unattractive market environment, thus slowing the flow of exits year to date. When looking at Buyouts, IPOs as an exit path suffered the most notable decline. Last year, IPOs accounted for roughly 25% of exits, compared to 17% this year in value terms, and only 5% by deal number, as investors shy away from IPOs amid market volatility and issuers from the low valuations. Still, exit values should roughly be aligned with pre-pandemic levels.

Deployment has been slower so far this year as GPs are more disciplined and cautious given the macro environment and we expect due diligence timelines to

lengthen. GPs are not under pressure to deploy capital and competition around deals has been a bit lower than it has been for a couple of years. Despite the headwinds in the broader market, pockets of activity remain. Investor appetite for IT deals remains robust given the long-term trends in increased digitalisation and tech innovation that will drive attractive long-term growth opportunities in the sector. Many investors view the shift in valuations as a buying opportunity for assets that were previously perceived as being too expensive, and we expect PE firms to find attractive take-private targets.



Source: Preqin, HSBC Global Private Banking as at 22 November 2022.

Real Estate

Higher interest rates have pushed up property yields, causing values to decline and opening up a widening gap in price expectations between potential buyers and sellers. We anticipate further capital value declines. Property fundamentals are generally still healthy, though a weakening economy indicates rental growth should slow in the coming quarters.

Rising rates have triggered a widespread increase of property yields, hitting capital values. According to Green Street Advisers, values have fallen by 10-15% in the US and Europe in Q3 2022. Despite the rise in property yields, the spread with bond yields remains historically low, pointing further potential declines in property values. Falling values have opened up a widening gap in price expectations between potential buyers

and current owners. As a result, activity declined 21% YoY in Q3 in the US, 37% in Europe and 38% in Asia (source: Real Capital Analytics).

The sharpest corrections have been recorded in sectors that used to be the most sought after, where property yields were the lowest and which still have the strongest long-term outlook for rental growth and occupancy.

This is most apparent for the logistics and residential sectors as strong competition between investors for the best assets often implied record low yields and the use of leverage. Although values have now fallen sharply for the lowest yielding sectors, this mainly reflects a paring back of gains rather than a change of fortunes.

Just as investor demand has been curtailed, some open-ended property funds are dealing with a wave of redemption requests. To raise cash, they may need to sell assets, adding

supply at a time of falling demand, adding further to downward pressure on values although 'fire sales' can usually be avoided by managers deferring redemptions. Withdrawals are also a function of falls in bond and equity values in portfolios, which have rendered investors over-exposed to property and trigger a need for portfolio rebalancing.

Occupier market fundamentals are generally still in reasonable health but slowing economic growth weighs on leasing demand across all property types. Expansion plans and or costs can be reduced, putting downward pressure on rents and values. Unlike previous downturns, however, development activity does not pose a major risk as the profitability of developing has been sharply curtailed by high costs of materials, labour and debt.

The office sector has been most impacted by the pandemic due to the permanent shift towards hybrid working. Geographically, this shift has been greater in the US and Europe than in Asia-Pacific where a stronger cultural attachment to the office and higher density cities support office working. Whilst occupiers may have reduced their overall need for office space, there has been a notable shift towards leasing better quality space that supports corporate sustainability targets. Offices in secondary locations needing substantial capital expenditure due to environmental regulations are considered most at risk.

Retail property fundamentals have been recovering from the big COVID-pandemic hit. However, the cost of living crisis hurts retail spending. Moreover, many prime retail locations

in city centres are struggling with lower footfall from tourism (which remains well below pre-pandemic levels) and the reduced frequency of white collar workers going into the office.

E-commerce spending (as a share of all retail sales) has fallen back into line with its pre-pandemic trend in many economies. Still, logistics leasing remains above trend as, in addition to demand related to e-commerce spending, businesses invest in improving supply chain resilience after several years of disruption caused by the pandemic and geopolitical upheaval. Market rents are typically above in-place rents currently paid by tenants indicating substantial income growth for landlords even if market rental growth slows.

Residential property is amongst the more defensive sectors as economies

slow because people usually cut discretionary spending (such as eating out and holidays) before missing their monthly rent payments. In addition, higher interest rates have reduced the affordability of buying flats and houses, further sustaining demand from renters. Whilst there may be some signs, specifically in the US, of multifamily rents stabilising, demographic tailwinds continue to support other parts of the residential sector such as single-family and senior housing.

Direct property valuations rely on evidence of market transactions and, as a result, will take time to adjust to the current environment of higher interest rates, slowing economies and weaker investor demand. By contrast, publicly-listed real estate equities are marked to market and adjust quickly.

Disclaimer

Risks to our View

The key risk factors include adverse regulatory changes, health concerns, spectrum cost and allocation issues excess capital expenditure by telecom operators, trade tensions, evolution of 5G standards, uncertainties in pricing and demand for new products and services in 5G and related offerings.

Risk Disclosures

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 canceled. 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.

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.

Nationalization 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 significantly affect the prices and mark-to-market valuation.

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.

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 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.

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 recognised 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.

Disclosure concerning sustainable investments

“Sustainable investments” include investment approaches or instruments which consider environmental, social, governance and/or other sustainability factors (collectively, “sustainability”) to varying degrees. Certain instruments we include within this category may be in the process of changing to deliver 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 (“sustainability impact”). 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 regulations may come into effect which may affect how an investment is categorised or labelled. An investment which is considered to fulfil sustainable criteria today may not meet those criteria at some point in the future.

Greenwashing risk is defined as giving a false impression or misleading information of a product's climate and environmental friendly credentials and, whilst not considered a standalone risk, can manifest through sales outcomes, marketing materials, product design and external disclosures at product and firm level.

Alternative Investments

Investors in Hedge Funds and Private Equity should bear in mind that these products can be highly speculative and may not be suitable for all clients. Investors should ensure they understand the features of the products and fund strategies and the risks involved before deciding whether or not to invest in such products. Such investments are generally intended for experienced and financially sophisticated investors who are willing to bear the risks associated with such investments, which can include: loss of all or a substantial portion of the investment; increased risk of loss due to leveraging, short-selling, or other speculative investment practices; lack of liquidity in that there may be no secondary market for the fund and none expected to develop; volatility of returns; prohibitions and/or material restrictions on transferring interests in the fund; absence of information regarding valuations and pricing; delays in tax reporting; - key man and adviser risk; limited or no transparency to underlying investments; limited or no regulatory oversight and less regulation and higher fees than mutual funds.

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