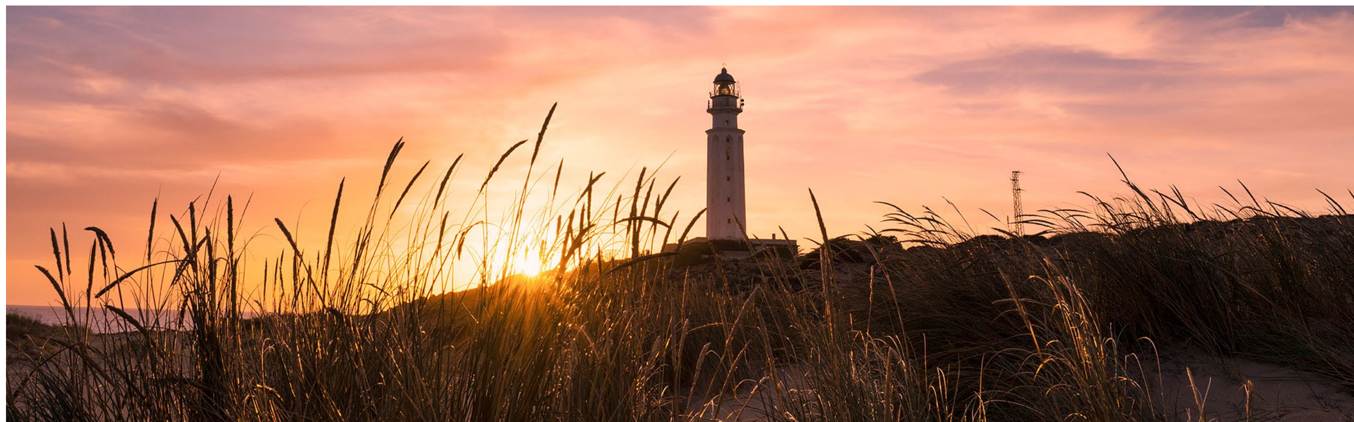
GIC Monthly View Summary May 2024

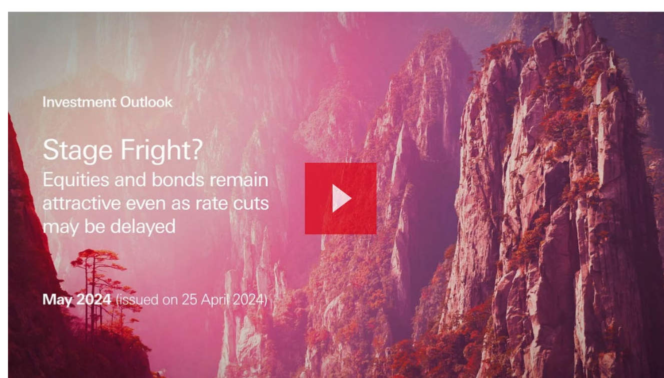
25 April 2024



Stage Fright? Equities and bonds remain attractive even as rate cuts may be delayed

- Following a higher-than-expected US CPI figure and comments from Fed Chair Powell, markets have pushed out the timing of the much-anticipated rate cuts.
- While rate cuts could indeed be delayed, we think the market move has gone too far. As a result, we find safe haven and investment grade bond yields attractive and continue to lock them in.
- For equities, the risk of high-for-longer rates and inflation is mirrored by broadening earnings and global economic growth. This is supportive of our equity overweight and our strategy of broadening our geographical and sector exposure.
- Further help should come from the earnings season, as analysts' US earnings expectations are too low for Q1, and we expect positive surprises. As for the inflation concern, we note that a 3.5% inflation level has historically been almost ideal for stock performance.
- The US dollar has been driven higher by the possibility of the ECB and Bank of England cutting before the Fed. As rate differentials remain the principal driver of currency markets, we maintain our bullish USD view, which should drive EUR and GBP lower still.

Watch a summary of our latest views



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

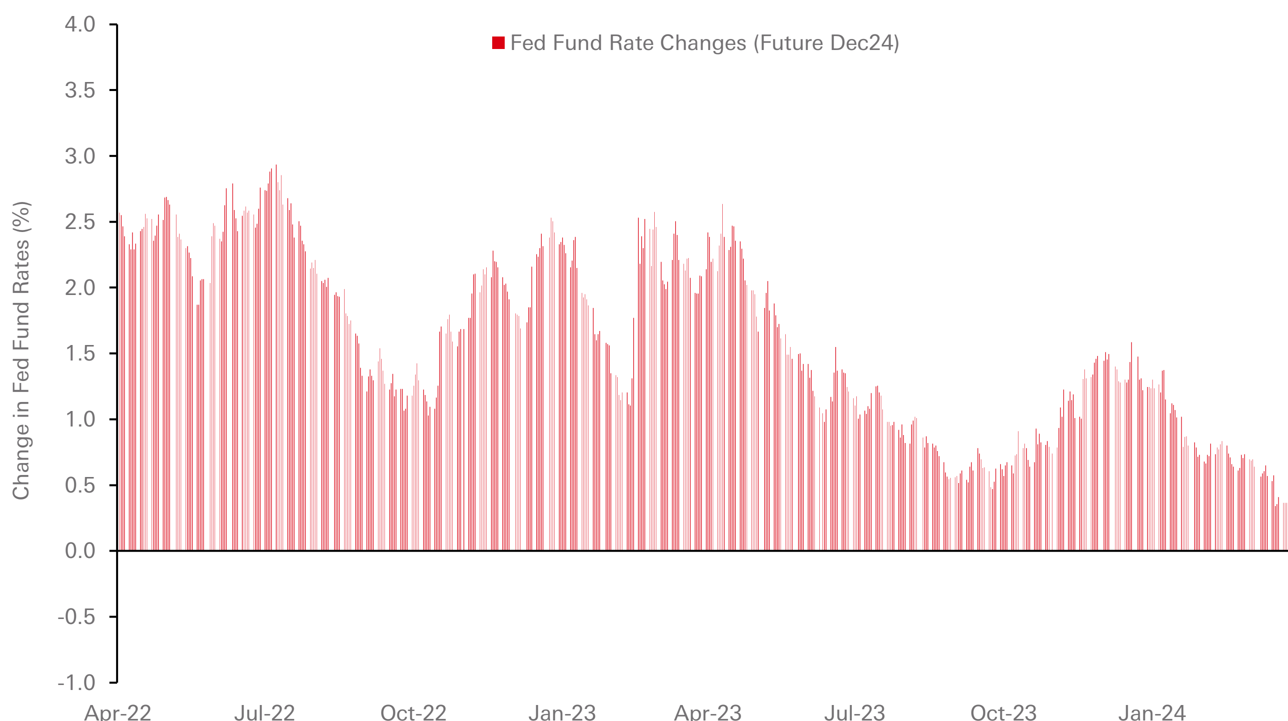
Priority #1 Extending bond duration ahead of policy easing

- Our view has been that the Fed will cut several times this year, starting with 25bps in June, but the risk of rate cut delay has grown materially. That said, the markets' moves seem to have gone too far. Last year, they expected 3 rate cuts by 2024, then almost 7, and now less than 2 by December.
- The Fed usually cuts before (or soon after) inflation reaches its peak. But if the market is right and the Fed waits till September to cut rates, this would be 27 months after the peak in CPI, something that has never happened before.
- Real yields also remain too high, and as they come down, this should support performance. We continue to lock in these yields ahead of the first Fed rate cut. As we approach the first rate cut, bonds should get better support.
- Credit spread valuations have become stretched lately, but our expectations of DM government bond yields to move lower over time support our overweight stance on Global IG.

Our focus:

- The current yield levels on safe haven bonds and investment grade are attractive and we continue to put cash to work to lock in those levels.
- We take the recent global bond selloff as an opportunity to further deploy cash at the belly of the IG credit curve and at the medium-to-long end of DM Sovereign debt.
- We are overweight on some DM government bonds (namely the US, UK, Australian and New Zealand) and are comfortable with 7-10 year maturities and remain selective on EM credit..

Investors anticipate less Fed easing this year



Source: Bloomberg, HSBC Global Private Banking as at 25 April 2024. Past performance is not a reliable indicator of future performance.

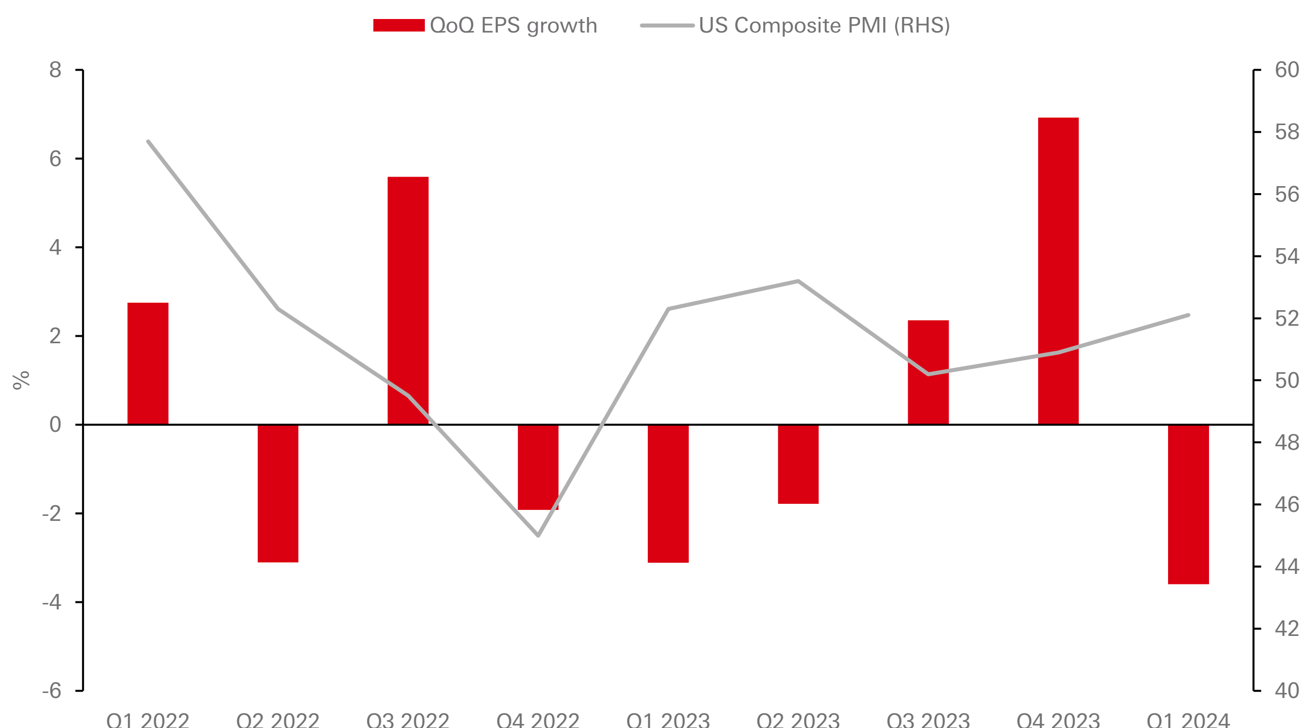
Priority #2 〉 Broadening US equity exposure to benefit from soft landing

- The US economy has continued to surprise to the upside and remains resilient. The support is both cyclical (improved business confidence and resilient consumer fundamentals) and structural (re-onshoring and the strong US position in technology).
- The risk of high-for-longer rates and inflation is mirrored by broadening earnings and economic growth, so we think equities will do well if bond market pressure gets less intense. We also expect positive surprises from the earnings season and believe analysts' US earnings expectations are too low for Q1. As for the inflation concern, a 3.5% inflation level has historically been almost ideal for stock performance.
- Technology, communications services, and consumer discretionary are forecasted to see the fastest growth in earnings in 1Q24 as per HSBC Global Research as at April 2024. Earnings expectations remain well above historical averages for 2024 as a whole though (+10.7%) and 2025 (+13.8%).

Our focus:

- We see attractive opportunities in Generative AI and Robots as well as Aerospace.
- The Inflation Reduction and CHIPS & Science Acts support our North American Re-Industrialisation and Healthcare Innovation themes.
- We pivot our style preference for the US to cyclical and believe the US economic resilience should support US consumer names and financials.

Earnings expectations are low, given the solid US PMI



Source: Bloomberg, HSBC Global Private Banking as at 23 April 2024. Past performance is not a reliable indicator of future performance.

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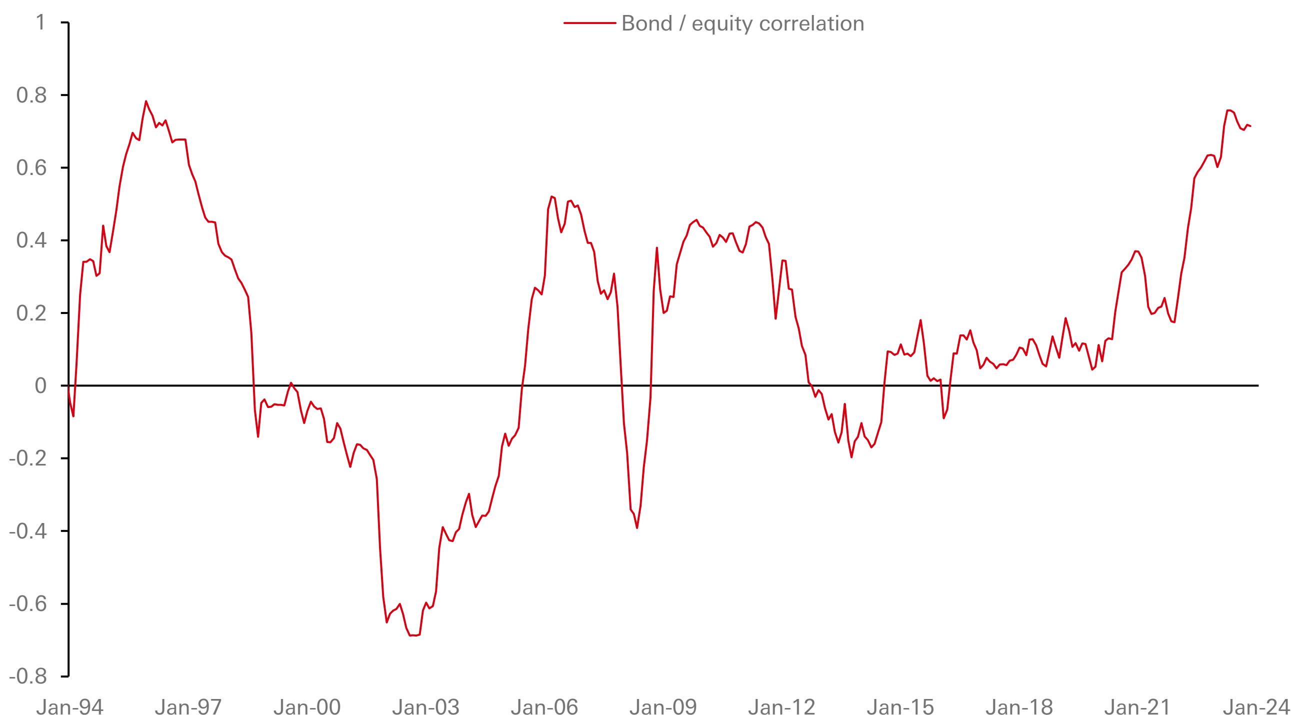
Priority #3 ❯ Hedging tail risks via alternatives, multi-asset and volatility strategies

- Volatility is bound to remain in our complex world, where markets pay much attention to central banks, which are very data-dependent.
- Volatility provides opportunities in multi-asset portfolios, especially as fundamentals and valuations show big differences between countries, sectors, companies and different rate markets.
- Well-managed multi-asset strategies, including alternatives, allow investors to broaden the opportunity set while also achieving appropriate diversification.

Our focus:

- A strategic allocation to private markets as a core holding should add protection to portfolios via risk diversification.
- Multi-asset strategies can dampen volatility thanks to diversification.
- As correlations between equities and bonds remain higher than usual, this diversification should be across asset classes, countries and sectors and avoid excessive single-name concentration.
- Lastly, volatility strategies can take a directional view on volatility, exploit spikes in volatility or generate income to stabilise portfolios' total returns.

Diversification through alternatives is even more key than usual due to the high equity / bond correlation



Source: Bloomberg, HSBC Global Private Banking as at 24 April 2024. Past performance is not a reliable indicator of future performance.

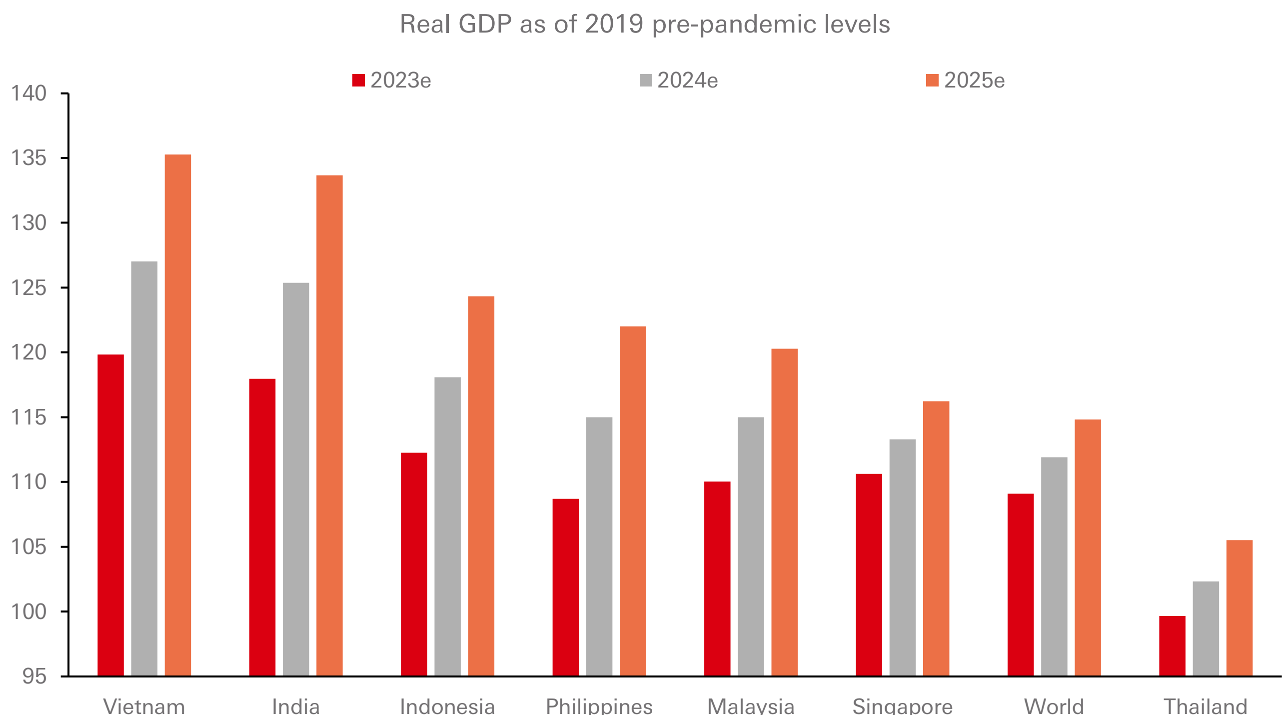
Priority #4 〉 Diversifying the Asian equity exposure

- Asia remains an important engine of global growth, but as it may take time for stimulus measures to result in increased Chinese growth, we do not foresee a sustained upside for Chinese equities in the short term.
- In both China and India, industrial production has improved, leading to improved performance in the industrial sector. Indian industrials are benefiting from a multi-year investment in capex cycle, positive tailwinds from global push to diversify industrial supply chains, as well as government incentives to boost manufacturing and industrial spending. Amid the Chinese government's ongoing policy push for high-end manufacturing sectors, we upgrade the Asian industrial sector from neutral to mildly overweight.
- We manage the volatility of our Asia exposure by actively diversifying within the region and find very supportive fundamentals and attractive valuations.

Our focus:

- India's stock and bond markets should benefit from the country's strong cyclical momentum and structural growth.
- We expect increased investment flows into Indonesia, and South Korea is well placed to benefit from the digital transformation.
- Japan can benefit from improving corporate governance and the growth in AI, digitalisation and automation.

India and ASEAN economies are expected to grow strongly versus pre-pandemic trends



Note: 2023 GDP growth number for World is based on HSBC estimate and actual numbers reported by other economies; rebased to 100 for 2019.
Source: HSBC Global Research forecasts, HSBC Global Private Banking as at 24 April 2024.

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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 cancelled. Investors may face uncertainties over when and how much they can receive such payments.
- Contingent convertible or bail-in debentures - Contingent convertible and bail-in debentures are hybrid debt-equity instruments that may be written off or converted to common stock on the occurrence of a trigger event. Contingent convertible debentures refer to debentures that contain a clause requiring them to be written off or converted to common stock on the occurrence of a trigger event. These debentures generally absorb losses while the issuer remains a going concern (i.e. in advance of the point of non-viability). "Bail-in" generally refers to (a) contractual mechanisms (i.e. contractual bail-in) under which debentures contain a clause requiring them to be written off or converted to common stock on the occurrence of a trigger event, or (b) statutory mechanisms (i.e. statutory bail-in) whereby a national resolution authority writes down or converts debentures under specified conditions to common stock. Bail-in debentures generally absorb losses at the point of non-viability. These features can introduce notable risks to investors who may lose all their invested principal.

Contingent convertible securities (CoCos) or bail-in debentures are highly complex, high risk hybrid capital instruments with unusual loss-absorbency features written into their contractual terms.

Investors should note that their capital is at risk and they may lose some or all of their capital.

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

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

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

Risk disclosure on Dim Sum Bonds
Although sovereign bonds may be guaranteed by the China Central Government, investors should note that unless otherwise specified, other renminbi bonds will not be guaranteed by the China Central Government.

Renminbi bonds are settled in renminbi, changes in exchange rates may have an adverse effect on the value of that investment. You may not get back the same amount of Hong Kong Dollars upon maturity of the bond.

There may not be active secondary market available even if a renminbi bond is listed. Therefore, you need to face a certain degree of liquidity risk.

Renminbi is subject to foreign exchange control. Renminbi is not freely convertible in Hong Kong. Should the China Central Government tighten the control, the liquidity of renminbi or even renminbi bonds in Hong Kong will be affected and you may be exposed to higher liquidity risks. Investors should be prepared that you may need to hold a renminbi bond until maturity.

Alternative Investments

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

Private Equity

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

Risk disclosure on Emerging Markets

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

Risk disclosure on FX Margin

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

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

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

Currency risk – where product relates to other currencies

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

Chinese Yuan ("CNY") risks

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

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

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

Illiquid markets/products

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

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

In broad terms "ESG and sustainable investing" products include investment approaches or instruments which consider environmental, social, governance ('ESG') and/or other sustainability factors to varying degrees. Certain instruments we classify as sustainable may be in the process of changing to deliver sustainability outcomes. There is no guarantee that ESG and sustainable investing products will produce returns similar to those which don't consider these factors. ESG and Sustainable investing products may diverge from traditional market benchmarks. In addition, there is no standard definition of, or measurement criteria for, ESG and sustainable investing or the impact of ESG and sustainable investing products. ESG and Sustainable investing and related impact measurement criteria are (a) highly subjective and (b) may vary significantly across and within sectors. HSBC may rely on measurement criteria devised and reported by third party providers or issuers. HSBC does not always conduct its own specific due diligence in relation to measurement criteria. There is no guarantee: (a) that the nature of the ESG / sustainability impact or measurement criteria of an investment will be aligned with any particular investor's sustainability goals; or (b) that the stated level or target level of ESG /sustainability impact will be achieved. ESG and Sustainable investing is an evolving area and new regulations are being developed which will affect how investments can be categorised or labelled. An investment which is considered to fulfil sustainable criteria today may not meet those criteria at some point in the future.

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