Investment Monthly

Position defensively as focus turns to slowing growth

October 2022

Key takeaways

- The pace of rate hikes should continue unless rents and wages show signs of easing. Central banks see slower growth as a pre-condition to beat inflation. Stay diversified with allocation to high quality bonds, and quality companies with strong margin power, manageable debt loads and dividend payouts to weather short-term market volatility.
- Earnings will be back in focus with further downside but more realistic expectations. The relative resilience of the US economy supports our bullish view on US equities and the USD. We prefer floating-rate notes, short-dated fixed rate bonds, and investment grade over high yield as growth slows, and have turned more defensive by upgrading US Utilities.
- The UK's significant new tax cuts and energy bills cap should provide some support. But rising inflation and interest rates are hurting consumers and are the main reasons for our recession view. We remain neutral on the UK's large exporters, which benefit from a weak GBP, but look for quality in equities and bonds, preferring investment grade ratings.

Willem Sels
Global Chief Investment Officer,
HSBC Global Private Banking and Wealth

Lucia Ku
Head of Wealth Insights
HSBC Wealth and Personal Banking

Asset class	6-month view	Comment
Global equities	▶	We expect earnings growth to decline but stay positive. With price/earnings ratios already down a lot, there is some support around the current levels. We focus on quality companies across sectors and geographies.
Government bonds	▼	Although yields have backed up, we see better opportunities for returns elsewhere.
Investment grade (IG) corporate bonds	▲	Global investment grade bonds should be more resilient than high yield as risk appetite is challenged and offer a good carry over developed market sovereign bond yields. We focus on short-to-medium maturities.
High yield (HY) corporate bonds	▶	We favour investment grade over high yield due to concerns over spread widening amid slowing growth.
Gold	▶	Despite high inflation and market volatility, we don't foresee much upside due to rising rates and a strong USD.

▲ "Overweight" implies a positive tilt towards the asset class, within the context of a well-diversified, typically multi-asset portfolio.
▼ "Underweight" implies a negative tilt towards the asset class, within the context of a well-diversified, typically multi-asset portfolio.
▶ "Neutral" implies neither a particularly negative nor a positive tilt towards the asset class, within the context of a well-diversified, typically multi-asset portfolio.
Icons: ↑ View on this asset class has been upgraded; ↓ View on this asset class has been downgraded.

Talking points

Each month, we discuss 3 key issues facing investors

1. How far will central banks hike?

- Rents and wages keep core inflation sticky in many markets. The former tends to lag house prices by 6-9 months while the tight labour market is creating strong demand for services. Unless they show some signs of easing, the pace of rate hikes will continue.
- We now expect the Fed to peak the federal funds rate at 4.75%, and the Bank of England to take the policy rate to 4.25% by Feb 2023, while the ECB is likely to hike deposit rates to 3% (with a 0.75% hike in their next meeting). Central banks see slower growth as a pre-condition to beat inflation.
- Against the backdrop of growth slowdown and higher rates, it's important to stay diversified **with allocation to high quality bonds, and quality companies** with strong margin power and dividend payouts to weather short-term market volatility.

2. What are the market implications of rate hikes?

- Equity market valuations face less downward pressure as price / earnings ratios have already fallen. Earnings will be back in focus with further downside but the good news is that expectations have already dropped. The resilience of the US economy supports **our overweight on US equities and our view on USD strength against EUR and GBP.** While the US mid-term elections may be a wild card, there are bigger risk events in the UK and Europe.
- For bonds, **floating-rate notes** could be an alternative to obtain yield pick-up amid an uncertain rate outlook. We also favour **short-dated fixed rate bonds** to limit the sensitivity to interest rate movements, and **prefer investment grade over high yield as growth slows**.
- We downgrade Consumer Discretionary in the US and globally to underweight on disposable income squeeze, Communications to neutral due to lower online advertising revenues, and Asian Technology to underweight on slowdown in global demand and supply chain pressures in semiconductors and smartphones. We upgrade US Utilities to neutral to increase our defensive exposure.

3. What is the impact of the UK's fiscal plans?

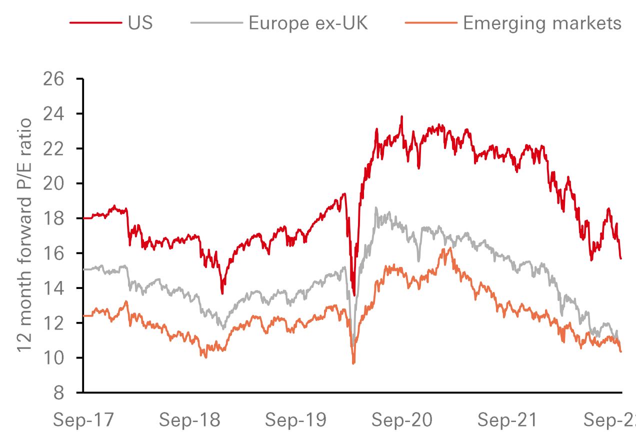
- The UK's "mini-budget" has stirred the markets with a bigger scope than thought, including significant tax cuts to boost demand (e.g. reduction in the basic income tax rate). As the government deficit will widen substantially, bond yields (i.e. the government's borrowing costs) spiked, causing the Bank of England to intervene by buying bonds.
- We believe the fiscal loosening should provide some help to households and companies but inflation may rise further, leading to a growing pressure on more rate hikes. Due to the fiscal package, we now expect a milder recession in the UK in Q4 through early 2023.
- With more aggressive tightening and a weaker GBP, **we remain over-weight on investment grade with a short-to-medium duration** but a neutral view on gilts, high yield and UK equities. Constant demand for energy supports our bullish view on European Energy. In USD portfolios, hedging GBP exposure on equity or bond positions is sensible.

Chart 1: Our current GDP growth forecasts

	Q3 '22	Q4 '22	Q1 '23	Q2 '23	2023 FY)
US	1.3%	1.0%	0.2%	0.2%	0.4%
UK	0.1%	-0.8%	-0.6%	0.1%	-0.2%
Eurozone	0.0%	-0.3%	-0.4%	0.0%	-0.2%
China (YoY)	3.9%	4.9%	4.6%	6.4%	5.2%

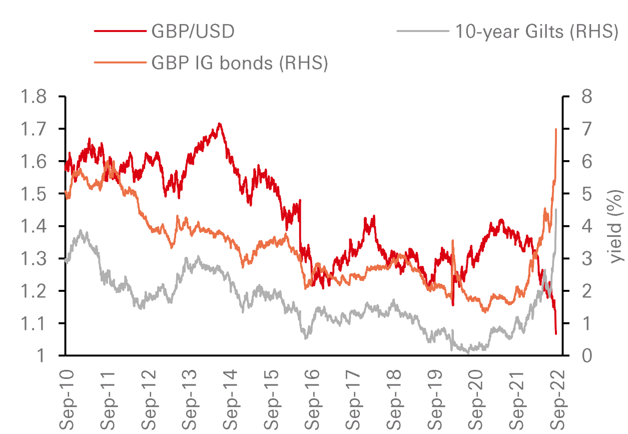
Source: HSBC Global Research, HSBC Global Private Banking as at 27 September, 2022. Forecasts are subject to change.

Chart 2: Equity market valuation multiples have dropped materially



Source: Bloomberg, HSBC Global Private Banking as at 27 September 2022. Past performance is not a reliable indicator of future performance.

Chart 3: GBP has plummeted to new lows while bond yields have spiked



Source: HSBC Global Private Banking as at 27 September 2022. Past performance is not a reliable indicator of future performance.

Asset Class Views

Our latest house view on various asset classes

Asset class	6-month view	Comment
Global equities		
Global	▶	We expect earnings growth to decline but stay positive. With price/earnings ratios already down a lot, there is some support around the current levels. We focus on quality companies across sectors and geographies.
United States	▲	Growth is slowing but remains resilient due to a tight labour market. The strong market positions and the quality character of US stocks support our overweight view but they remain volatile as we get through the mid-term elections.
United Kingdom	▶	Despite government intervention to cap energy prices, high inflation and cost of living continue to weigh on economic growth. But relatively cheap valuations and high exposure to the strong energy sector warrant our neutral stance.
Eurozone	▼	High energy costs, the Ukraine war and the impact of gas supply cuts remain key challenges. The situation may worsen towards winter as the cost of living squeeze intensifies with rising inflation. A recession is expected by Q4.
Japan	▶	The weak JPY gives companies an advantage but its outlook has become uncertain amid slower global demand and continuation of some global supply chain disruptions. JPY intervention can add to the equity market volatility.
Emerging Markets (EM)	▶	Concerns over Fed tightening, global growth slowdown and geopolitical tensions linger. Asia is relatively less impacted by policy tightening while LatAm benefits from Mexico's attractive valuations and growth prospects.
EM EMEA	▼	The region is impacted by high energy prices, weak growth in Europe and rate outlook uncertainty.
EM LatAm	▲	The Mexican economy benefits from resilient exports to the US, and their rate hikes are far advanced.
Asian ex Japan equities		
Asia ex-Japan	▶↓	We have become more cautious about the Asian IT sector and moved Asian ex Japan equities to a neutral stance. We prefer Hong Kong and Thailand due to their positive reopening outlook and undemanding valuations.
Mainland China	▶	Despite a potential recovery in H2 supported by policy stimulus, we think COVID-related disruptions, the property market stress and slowing exports remain headwinds.
India	▶	We are neutral on Indian equities due to stretched valuations and inflation concerns, but see structural growth opportunities associated with India's digital economy, green transition and smart manufacturing.
Hong Kong	▲	The recent relaxation in COVID-related restrictions is a significant move to revive economic activities and consumption. Domestic retail landlords, financial services and airline sectors will stand to benefit.
Singapore	▶	We expect further monetary policy tightening in October to tackle high and sticky core inflation. The growing inflation pressures and slowing economic growth outlook warrant our neutral stance.
South Korea	▶	Growth is set to slow this year with declining exports. The economy is closely linked to the technology sector and soft demand for semiconductors should affect investment inflows.
Taiwan	▼	Geopolitical risks across the Taiwan strait combined with a deteriorating earnings outlook for the semiconductor sector, which dominates the Taiwanese equity index, warrant our underweight view on the local equity market.
Government bonds		
Developed markets (DM)	▼	Although yields have backed up, we see better opportunities for returns elsewhere.
United States	▶	Most of the Fed rate hikes and slowdown in growth are priced in, but upside for investors is limited.
United Kingdom	▶	With inflation at the highest level in 40 years, and high government borrowing, Gilt volatility may remain elevated.
Eurozone	▼	Rising energy, goods and services prices push inflation higher, forcing the ECB to continue raising rates and current absolute yield levels remain unattractive.
Japan	▼	The Bank of Japan is likely to keep its extremely accommodative policy stance until inflation reaches the target of 2%. The USD/JPY fell off the highs after intervention from the Ministry of Finance but JPY remains weak.
Emerging Markets (Local currency)	▶	Select opportunities exist but some EM countries are hiking rates, while EM currencies could weaken, hurting returns.
Emerging Markets (Hard currency)	▶	Amid higher Treasury volatility, we still find yield but remain selective.
Corporate bonds		
Global investment grade (IG)	▲	Global investment grade bonds should be more resilient than high yield as risk appetite is challenged and offer a good carry over developed market sovereign bond yields. We focus on short-to-medium maturities.
USD investment grade (IG)	▲	The flat yield curve does not provide sufficient returns to extend duration. A short-to-medium term is preferred.
EUR and GBP investment grade (IG)	▲	European and UK investment grade bonds offer decent yields due to the pick-up in yield spread. We prefer higher quality names and short-to-medium maturities amid the sluggish growth outlook.
Asia investment grade (IG)	▲	We see attractive carry opportunities in Asia credit which stays relatively resilient. We prefer quality issuers in Indonesian hard currency bonds, Chinese SOEs and Chinese banks.
Global high-yield (HY)	▶	We favour investment grade over high yield due to concerns over spread widening amid slowing growth.
US high-yield (HY)	▶	While US high-yield companies still enjoy solid credit fundamentals and low default rates, tightening financial conditions and faster Fed fund rate hikes create downside risks.
EUR and GBP high-yield (HY)	▶	With the risk of more aggressive tightening and both EUR and GBP more likely to weaken, we prefer higher quality investment grade credit and maintain a neutral stance on high yield.
Asia high-yield (HY)	▶	Although most Asian markets are seeing relatively less inflationary pressure compared to the developed markets, the Fed tightening, a strong USD and slowing global demand are the headwinds. We are neutral on Asia high yield.
Commodities		
Gold	▶	Despite high inflation and market volatility, we don't foresee much upside due to rising rates and a strong USD.
Oil	▶	High price levels reflect supply concerns but demand is starting to decline. We foresee volatile sideways trading.

Sector Views

Global and regional sector views based on a 6-month horizon

Sector	Global	US	Europe	Asia	Comment
Consumer Discretionary	▼↓	▼↓	▼	▶	Inflation remains a headwind for demand with rising financing and energy costs. Margins and labour remain under pressure. Luxury goods remain resilient but auto, household appliances and retail see a slowdown in new order. We downgrade the sector globally and in the US as rising interest rates and living costs weighing on customer demand.
Financials	▶	▶	▼	▶	High inflation has resulted in central banks raising interest rates which is positive for Financials. However, brokers and investment banks are affected by slower market activity. The slowing global economy may hurt demand for new mortgages and loans while insurance companies are facing significant event risks.
Industrials	▼	▶	▼	▼	The outlook is improving as order books expand and supply issues have eased. Input costs remain a key concern. We are constructive on segments that support expansion/upgrading in manufacturing facilities such as electric vehicle production or alternative energy generation and those businesses offering productivity.
Information Technology	▶	▶	▶	▼↓	Valuations of high-quality, large-cap IT are attractive, but rising interest rates and economic uncertainty hurt sentiment. We remain positive on the sector's long-term growth prospects driven by digitalisation, electrification and automation. We downgrade Asia IT on weakening outlook for semiconductors and smartphones, plus rising geopolitical risks.
Communications Services	▶↓	▶↓	▲	▶	The media & entertainment industry remains challenged while telecoms companies benefit from increased data usage as more activity shifts online and business digitises. We downgrade the sector globally and in the US on a deteriorating economic outlook, rising interest rates and lower capital spending.
Materials	▶	▶	▶	▼	Commodity prices remain soft on weaker demand due to the slowing global economy. We remain cautious on mining stocks despite low valuations. Higher energy and oil/gas feedstock prices continue to weigh on the chemicals and construction materials industries. The sector trades at the lowest valuation relative to others but growth prospects remain uncertain.
Real Estate	▶	▶	▼	▶	Private residential real estate has benefitted from supply-demand imbalances, but rising interest rates may soften demand. Retail real estate suffers from long-term structural changes caused by the rise in e-commerce which is unlikely to change. Elsewhere, office space is being reduced as employers promote hybrid models including work from home.
Consumer Staples	▲	▲	▲	▲	The sector contains many quality stocks with good dividend yields. However, valuations are somewhat elevated, so we prefer companies with strong brands and/or pricing power which allow them to protect margins and earnings as inflationary pressures mount.
Energy	▲	▲	▲	▲	As ongoing geopolitical uncertainties, low inventories and supply-demand imbalances persist and the northern hemisphere heads into winter, we expect energy prices to either stabilise at these elevated levels or push higher. Chronic under-investment is likely to support prices in the medium term despite the energy transition gaining momentum. Valuations remain attractive. Our overweight includes Renewable Energy as the transition continues to accelerate.
Healthcare	▶	▶	▲	▶	As the world's economy slows, higher beta and small/mid-cap stocks may find financing more challenging. Biotechnology may struggle in this environment while pharma stocks should be more resilient. The renewed efforts on medicine pricing in the US Inflation Reduction Act may be a headwind.
Utilities	▶↑	▶↑	▶	▶	Renewable stocks remain attractively valued especially outside of the US. We upgrade US Utilities given their defensive nature and stable earnings/cash flow although valuations remain somewhat elevated. The US Inflation Reduction Act provides support for clean energy investment.

Disclaimer

This document or video is prepared by The Hongkong and Shanghai Banking Corporation Limited ('HBAP'), 1 Queen's Road Central, Hong Kong. HBAP is incorporated in Hong Kong and is part of the HSBC Group. This document or video is distributed and/or made available by HSBC Bank Canada (including one or more of its subsidiaries HSBC Investment Funds (Canada) Inc. ("HIFC"), HSBC Private Investment Counsel (Canada) Inc. ("HPIC") and HSBC InvestDirect division of HSBC Securities (Canada) Inc. ("HIDC")), HSBC Bank (China) Company Limited, HSBC Continental Europe, HBAP, HSBC Bank (Singapore) Limited, HSBC Bank Middle East Limited (UAE), HSBC UK Bank Plc, HSBC Bank Malaysia Berhad (127776-V)/HSBC Amanah Malaysia Berhad (807705-X), HSBC Bank (Taiwan) Limited, HSBC Bank plc, Jersey Branch, HSBC Bank plc, Guernsey Branch, HSBC Bank plc in the Isle of Man, HSBC Continental Europe, Greece, The Hongkong and Shanghai Banking Corporation Limited, India (HSBC India), HSBC Bank (Vietnam) Limited, PT Bank HSBC Indonesia (HBID), HSBC Bank (Uruguay) S.A. (HSBC Uruguay is authorised and oversought by Banco Central del Uruguay), HBAP Sri Lanka Branch, The Hongkong and Shanghai Banking Corporation Limited – Philippine Branch and HSBC Savings Bank (Philippines), Inc., and HSBC FinTech Services (Shanghai) Company Limited (collectively, the "Distributors") to their respective clients. This document or video is for general circulation and information purposes only.

The contents of this document or video may not be reproduced or further distributed to any person or entity, whether in whole or in part, for any purpose. This document or video must not be distributed in any jurisdiction where its distribution is unlawful. All non-authorised reproduction or use of this document or video will be the responsibility of the user and may lead to legal proceedings. The material contained in this document or video is for general information purposes only and does not constitute investment research or advice or a recommendation to buy or sell investments. Some of the statements contained in this document or video may be considered forward looking statements which provide current expectations or forecasts of future events. Such forward looking statements are not guarantees of future performance or events and involve risks and uncertainties. Actual results may differ materially from those described in such forward-looking statements as a result of various factors. HBAP and the Distributors do not undertake any obligation to update the forward-looking statements contained herein, or to update the reasons why actual results could differ from those projected in the forward-looking statements. This document or video has no contractual value and is not by any means intended as a solicitation, nor a recommendation for the purchase or sale of any financial instrument in any jurisdiction in which such an offer is not lawful. The views and opinions expressed are based on the HSBC Global Investment Committee at the time of preparation, and are subject to change at any time. These views may not necessarily indicate HSBC Asset Management's current portfolios' composition. Individual portfolios managed by HSBC Asset Management primarily reflect individual clients' objectives, risk preferences, time horizon, and market liquidity.

The value of investments and the income from them can go down as well as up and investors may not get back the amount originally invested. Past performance contained in this document or video is not a reliable indicator of future performance whilst any forecasts, projections and simulations contained herein should not be relied upon as an indication of future results. Where overseas investments are held the rate of currency exchange may cause the value of such investments to go down as well as up. Investments in emerging markets are by their nature higher risk and potentially more volatile than those inherent in some established markets. Economies in emerging markets generally are heavily dependent upon international trade and, accordingly, have been and may continue to be affected adversely by trade barriers, exchange controls, managed adjustments in relative currency values and other protectionist measures imposed or negotiated by the countries with which they trade. These economies also have been and may continue to be affected adversely by economic conditions in the countries in which they trade. Investments are subject to market risks, read all investment related documents carefully.

This document or video provides a high level overview of the recent economic environment and has been prepared for information purposes only. The views presented are those of HBAP and are based on HBAP's global views and may not necessarily align with the distributors' local views. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of its dissemination. It is not intended to provide and should not be relied on for accounting, legal or tax advice. Before you make any investment decision, you may wish to consult a financial adviser. In the event that you choose not to seek advice from a financial adviser, you should carefully consider whether the investment product is suitable for you. You are advised to obtain appropriate professional advice where necessary.

We accept no responsibility for the accuracy and/or completeness of any third party information obtained from sources we believe to be reliable but which have not been independently verified.

Important Information about HSBC Global Asset Management (Canada) Limited ("AMCA")
HSBC Asset Management is a group of companies, including AMCA, that are engaged in investment advisory and fund management activities, which are ultimately owned by HSBC Holdings plc. AMCA is a wholly owned subsidiary of, but separate entity from, HSBC Bank Canada.

Important Information about HSBC Investment Funds (Canada) Inc. ("HIFC")
HIFC is the principal distributor of the HSBC Mutual Funds and offers the HSBC Mutual Funds and/or the HSBC Pooled Funds through the HSBC World Selection® Portfolio service. HIFC is a subsidiary of AMCA, and indirect subsidiary of HSBC Bank Canada, and provides its products and services in all provinces of Canada except Prince Edward Island. Mutual fund investments are subject to risks. Please read the Fund Facts before investing.

®World Selection is a registered trademark of HSBC Group Management Services Limited.

Important Information about HSBC Private Investment Counsel (Canada) Inc. ("HPIC")
HPIC is a direct subsidiary of HSBC Bank Canada and provides services in all provinces of Canada except Prince Edward Island. The Private Investment Counsel service is a discretionary portfolio management service offered by HPIC. Under this discretionary service, assets of participating clients will be invested by HPIC or its delegated portfolio manager, AMCA, in securities, including but not limited to, stocks, bonds, mutual funds, pooled funds and derivatives. The value of an investment in or purchased as part of the Private Investment Counsel service may change frequently and past performance may not be repeated.

Important Information about HSBC InvestDirect ("HIDC")
HIDC is a division of HSBC Securities (Canada) Inc., a direct subsidiary of, but separate entity from, HSBC Bank Canada. HIDC is an order execution only service. HIDC will not conduct suitability assessments of client account holdings or of the orders submitted by clients or from anyone authorized to trade on the client's behalf. Clients have the sole responsibility for their investment decisions and securities transactions.

The following statement is only applicable to HSBC Bank (Taiwan) Limited with regard to how the publication is distributed to its customers: HSBC Bank (Taiwan) Limited ("the Bank") shall fulfill the fiduciary duty act as a reasonable person once in exercising offering/conducting ordinary care in offering trust services/ business. However, the Bank disclaims any guarantee on the management or operation performance of the trust business.

THE CONTENTS OF THIS DOCUMENT OR VIDEO HAVE NOT BEEN REVIEWED BY ANY REGULATORY AUTHORITY IN HONG KONG OR ANY OTHER JURISDICTION.

YOU ARE ADVISED TO EXERCISE CAUTION IN RELATION TO THE INVESTMENT AND THIS DOCUMENT OR VIDEO. IF YOU ARE IN DOUBT ABOUT ANY OF THE CONTENTS OF THIS DOCUMENT OR VIDEO, YOU SHOULD OBTAIN INDEPENDENT PROFESSIONAL ADVICE.