HSBC

Investment Monthly

Focus on quality as policy tightening stays on course

September 2022

Key takeaways

- Although US headline CPI may have peaked, core inflation remains sticky in the US and elsewhere meaning that policy tightening is likely to stay on course. We now expect Europe to go into a recession in Q4 with more headwinds ahead. Our search for quality and resilient earnings outlook leads us to overweight on US equities and underweight Eurozone equities, and we prefer investment grade bonds with short-to-medium maturities.
- The heatwaves in China and Europe have intensified the energy supply issue and the US Inflation Reduction Act presents huge opportunities in the energy space (e.g. clean energy). High oil and gas prices are also positive for Energy which we remain overweight.
- We upgrade US Consumer Staples on high food prices, and downgrade US Healthcare due to financing pressure on biotech, and Materials on high input costs. Mexico benefits from trading with the US while waning semiconductor demand weighs on Taiwanese equities.

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	▶	Uncertainty around the path of inflation, central bank policy and earnings remains high supporting a neutral stance.
Government bonds	▼	Although yields have backed up, we see better opportunities for returns elsewhere.
Investment grade (IG) corporate bonds	▲	Amid uncertainty around growth and profits, we prefer investment grade over high yield and see attractive opportunities in short-to-medium dated IG following the back-up in yields.
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.

PUBLIC

IM31AUG2022

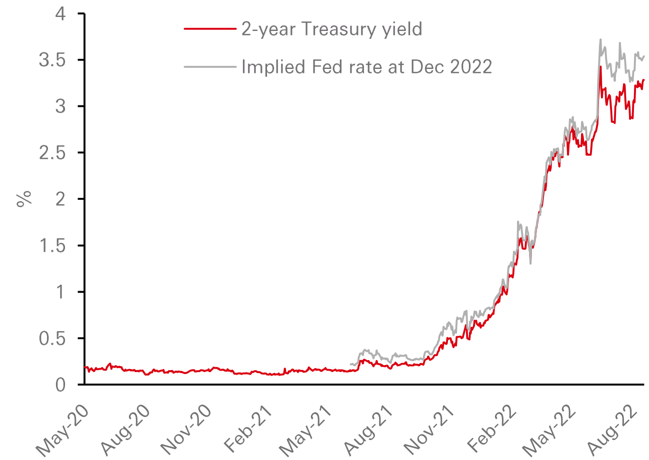
Talking points

Each month, we discuss 3 key issues facing investors

1. Will central banks slow down their rate hikes?

- Despite a lower US headline CPI in July (i.e. 8.5%), core CPI remained sticky (including rent, food and services). We think it's too early to price in a more dovish Fed which affirmed at the Jackson Hole Economic Symposium that it will stay on its path. Short-dated bond yields are close to their recent highs while the equity markets will increasingly focus on the earnings outlook. The USD strength is likely to persist.
- In Europe, inflation reached a new record of 8.9% in July and may hit double digits in Q4. Record-high inflation, the cost of living crisis and the impact of potential rationing of gas and energy support our view that the region (including the UK) will go into a recession in Q4 2022 and early 2023. Nevertheless, policy tightening will continue to bring inflation in check. We expect a 0.5% hike by the ECB in September to achieve a total of 1% rate rises by the end of the year.
- **We stay focused on quality companies with strong margin power and dividend payouts, particularly in the US** which has more quality stocks than Europe. We remain overweight on US equities and underweight on Eurozone equities. For bonds, we prefer investment grade with short to medium maturities.

Chart 1: Bond yields are close to recent highs, meaning that bond markets are giving up on a quick Fed pivot

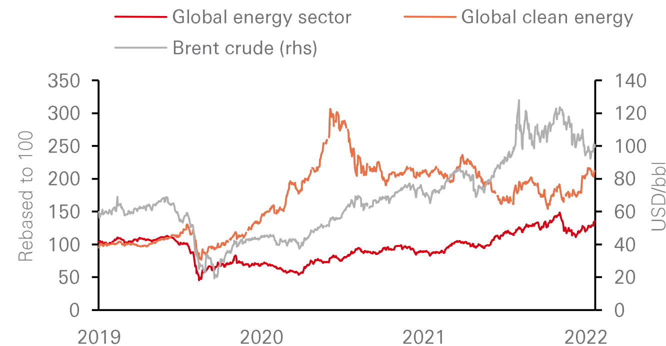


Source: Bloomberg, HSBC Global Private Banking as at 22 August 2022. Past performance is not a reliable indicator of future performance.

2. Does the outlook for Energy remain strong?

- The ongoing heat waves in China and Europe have renewed concerns over energy supply. Some areas in China will see power supply limitations but the seasonal tension should subside rather quickly. In Europe, heat and drought are affecting hydroelectric and nuclear generation. Cuts in Russian gas supply will also worsen the energy crisis, keeping energy prices high.
- Meanwhile, the US Senate has passed the Inflation Reduction Act which aims to double the amount of new, clean electricity-generating capacity by 2024 via massive investments. Clean energy will benefit.
- High oil and gas prices should also support energy stocks, even with oil prices off their highs. **We remain overweight on Energy**.

Chart 2: Energy stocks benefit from a resilient earnings outlook while clean energy receives structural support

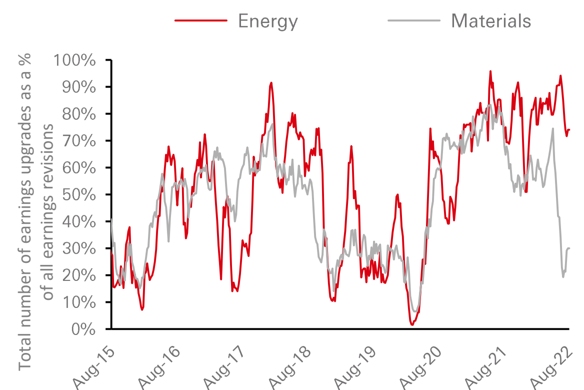


Source: Bloomberg, HSBC Global Private Banking as at 22 August 2022. Past performance is not a reliable indicator of future performance.

3. What else may benefit or suffer from the current environment?

- High food prices and strong earnings are key drivers for **our upgrade on US Consumer Staples to overweight**. While we keep European Healthcare overweight due to its heavy exposure to relatively resilient pharma stocks, we downgrade US Healthcare to neutral as biotechnology faces financing challenges.
- High energy costs are a problem for Materials, especially chemicals, which may see margin pressure from high input costs. We downgrade Materials to neutral in most regions. For Asia, we downgrade the sector to underweight due to the slower construction activities related to the depressed property market outlook in mainland China.
- Geographically, Mexico benefits from the strong trade links with the resilient US market and a structural reorientation of supply chains (e.g. industrial and consumer goods). **We therefore move EM LatAm to overweight.** The cross-strait tensions and waning global semiconductor demand warrant our downgrade on Taiwanese stocks to underweight.

Chart 3: Earnings momentum in the materials sector is weak on higher input costs



Source: Refinitiv Datastream, HSBC Global Private Banking as at 26 August 2022.

PUBLIC

Asset Class Views

Our latest house view on various asset classes

Asset class	6-month view	Comment
Global equities		
Global	▶	Uncertainty around the path of inflation, central bank policy and earnings remains high supporting a neutral stance.
United States	▲	We like the diversity and quality character of US stocks compared to Europe. Growth will slow but remains resilient due to a tight labour market. We prefer companies with strong market positions and healthy balance sheets.
United Kingdom	▶	Attractively valued but economic growth is challenged. High cost of living weighs on consumption. But the UK market is relatively cheap and has high exposure to the strong energy sector. Taken together, this supports a neutral view.
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	▶	Slower global demand and the continuation of some global supply chain disruptions support our neutral view on Japanese stocks.
Emerging Markets (EM)	▶	Concerns over Fed tightening, global growth slowdown and geopolitical tensions linger. EM LatAm benefits from Mexico's attractive valuations and growth prospects.
EM EMEA	▼	The region is impacted by a refugee crisis while high energy prices may dampen growth.
EM LatAm	▲↑	Mexican equities benefit from attractive valuations and the strong trade links with the resilient US economy, which contribute positively to the region.
Asian ex Japan equities		
Asia ex-Japan	▲	Fundamentals remain strong with a resilient ROE (return on equity) suggesting that some companies are still relatively profitable. We prefer Hong Kong domestic stocks and Thailand market due to their positive reopening outlook while current valuations have not fully reflected the benefits.
Mainland China	▶	Despite a potential recovery in H2 supported by policy and liquidity stimulus, property sector weakness, softening global economic outlook and COVID-related restrictions remain headwinds.
India	▶	India is struggling with inflation driven by soaring energy and food prices. India's growth in the coming months could slow and may lead to a reduction in inflationary pressures. At this juncture, valuations are not attractive.
Hong Kong	▲	Hong Kong's continued border reopening and economic normalisation will support a domestic consumption-led recovery. Growing business activity will benefit especially financial services.
Singapore	▶	Rising inflation warrants continued monetary tightening. Singapore faces headwind from a slowing global economy. We remain neutral on the back of growing inflation pressure and slowing growth. Valuations are not compelling.
South Korea	▶	Growth is set to slow this year with declining exports while the recovery in private consumption will only partly offset external weakness.
Taiwan	▼↓	We downgrade Taiwanese equities on the cross-strait tensions and waning global demand for semiconductors, which dominate the local equity market.
Government bonds		
Developed markets (DM)	▼	Although yields have backed up, we see better opportunities for returns elsewhere.
United States	▶	After the big sell-off in H1, most of the Fed rate hikes we expect are now priced in, but upside for investors is limited.
United Kingdom	▶	With inflation at the highest level in 40 years, 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	▼	As inflation remains relatively low, the Bank of Japan is expected to maintain its ultra loose monetary policy with very low yields on offer and a weak Yen
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)	▲	Amid uncertainty around growth and profits, we prefer investment grade over high yield and see attractive opportunities in short-to-medium dated investment grade following the back-up in yields.
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)	▲	The recent cheapening of Eurozone credit represents an opportunity for buy-and-hold investors, while GBP credit has proven to be relatively resilient. We emphasise however a preference for short-to-medium dated quality issuers.
Asia investment grade (IG)	▲	Asia credit offers attractive carry opportunities and stays relatively resilient to the energy supply shock. We prefer quality issuers in Indonesian hard currency bonds, Chinese SOEs, Chinese banks, etc.
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)	▶	European high yield remains vulnerable to the developments of the Ukraine war and its impact on energy provisioning. Spreads underperform on recession concerns.
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.

PUBLIC

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 hurting consumer sentiment. Margins remain under pressure from same factors plus labour shortages. Luxury goods segment remains resilient. Automakers are still suffering from supply and production issues but offer attractive valuations.
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 housing market and demand for mortgages. We downgrade Asia Financials on net interest margin squeeze, weak economic activity and risk due to COVID outbreaks in China.
Industrials	▼	▶	▼	▼	The outlook is improving as order books expand and supply issues have eased somewhat, but have not yet disappeared. Input costs remain a key concern but 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 select large-cap IT are attractive following recent pull-backs. We remain positive on its superior growth prospects as digitalisation, electrification and automation drive long-term, above-average growth for the next decade. We prefer large-cap companies with strong cash-generative businesses and market positions. That said, IT stock prices are highly sensitive to rates, and volatility may continue.
Communication Services	▲	▲	▲	▶	The media & entertainment industry remains challenged, while the telecoms industry benefits from steady cash flows and growth from increased data usage as more activity shifts online and business digitises. Investments in telecoms infrastructure hardware remain buoyant.
Materials	▶↓	▶↓	▶↓	▼↓	Commodity prices seem to indicate softer demand particularly from China in H2. We have become cautious with mining stocks. Higher energy and oil/gas feedstock prices could weigh on chemicals and construction materials. The sector trades at the lowest valuation relative to others, but growth prospects may be peaking.
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 ecommerce which is unlikely to change. Elsewhere office space has been reduced as employers promote hybrid models including some 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. We upgrade the sector in the US given the favourable pricing environment and growth outlook.
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.
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. We downgrade US Healthcare with its greater exposure to the biotech and services sectors compared to Europe (due to economic weakness, we like to stay in defensive sectors such as healthcare in Europe). Pharma stocks remain more resilient but the medicine pricing pressure via the US Inflation Reduction Act may be a headwind.
Utilities	▼	▼	▶	▶	Renewable stocks are again attracting attention after stock prices and valuation pulled back significantly from overly optimistic levels. That said, the US Inflation Reduction Act provides support for clean energy investment. More broadly for utilities, caution is still required as companies may not be able to pass on rising energy prices which may impact margins negatively.

PUBLIC

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.

© Copyright 2022. The Hongkong and Shanghai Banking Corporation Limited, ALL RIGHTS RESERVED.

No part of this document or video may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior written permission of The Hongkong and Shanghai Banking Corporation Limited.

PUBLIC