

# Investment Monthly

## Market optimism on prospect of rate cuts and profit growth

June 2024



### Key takeaways

- ◆ April's improved US inflation data and a less hawkish Fed tone suggest that a Fed rate cut is likely in September. While the ECB should be on track to cut rates in June, we have shifted our expectation for the BoE to start in August. As the bond yield peak is likely behind us, we continue to lock in current yields from quality bonds, such as Treasuries and investment grade bonds.
- ◆ While strong earnings growth continues to add momentum in the US and technology, we have been broadening our geographical and sector exposure thanks to global cyclical and rate tailwinds. Amid mixed economic data, ongoing geopolitical conflicts and the upcoming US election, it's important to stay diversified or leverage multi-asset strategies to manage market volatility.
- ◆ The new supportive government measures have caused the recent tactical rally in the mainland Chinese and Hong Kong equity markets. However, we think it will need more support and time to resolve the issues in the property market and we therefore remain neutral in these markets. We continue to diversify in Asia, favouring India, South Korea and Japan. Following a surprise rate hike in Indonesia, we have shifted our allocation towards Malaysia based on improving global trade and IT activity.



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Asset class	6-month view	Comment
Global equities	▲	Global cyclical and rate tailwinds provide a favourable backdrop for global equities. We continue to broaden our geographical and sector exposure and look beyond the US and technology to capture more broad-based upside.
Government bonds	▶	We believe DM sovereign bond yield peak is behind us and rate cuts should come soon in the West, so we prefer US Treasuries and UK gilts up to 10 years to lock in current yield levels. Japanese government bonds remain unattractive.
Investment grade (IG) corporate bonds	▲	Global investment grade continues to be our largest overweight exposure across our bond allocation and its absolute yields remain attractive, despite tight credit spreads.
High yield (HY) corporate bonds	▶	Global high yield continues to outperform but tight credit spreads are insufficient for rising default risks amid the high interest rate environment. We prefer investment grade to high yield bonds.
Gold	▶	Uncertainty has driven gold to high levels but demand is likely to be capped at the current price.

▲ "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. What did inflation data in the US and UK mean to the bond markets?

- ◆ With April's improved US core inflation (0.3% m-o-m and 3.6% y-o-y) and a less hawkish Fed tone, we think a Fed rate cut is now likely in September. While the ECB should be on track to cut rates in June, we have moved the first rate cut by the Bank of England to August due to its strong April inflation data, wage growth and improving economic momentum. Global bond markets have recently rebounded as markets are more confident that the bond yield peak is behind us.
- ◆ As bond yields are currently near decade-high levels, we continue to lock them in. We don't think the high debt levels in the US are a key risk because 1) the prospect of rate cuts will lead people back to bonds; and 2) the Fed will slow the process of quantitative tightening. Lower interest rates will cause bond prices to rise, further boosting the total returns.
- ◆ We continue to favour quality bonds, particularly US Treasuries and UK gilts (up to 10 years), investment grade credit (5-7 years), and Indian local currency bonds for diversification and yield enhancement. Short-dated bonds are more preferable to cash for short-term investment needs as cash returns will fall when interest rates decline.

## 2. Should we allocate our equity exposure to the US only?

- ◆ Despite mixed economic data in the US, including some disappointments in consumer confidence and retail sales, the positive earnings season continues to boost momentum. The prospect of rate cuts and structural engines, such as investment in AI and infrastructure, re-onshoring of jobs and innovations in healthcare, have driven the US equity markets to new highs, following a correction in April.
- ◆ While we see plenty of opportunities in the US, we have been broadening our geographical and sector exposure thanks to global cyclical and rate tailwinds. For instance, the economic cycles of Europe, the UK and Japan seem to have bottomed. We continue to diversify into Asia to benefit from its strong fundamentals and domestic drivers. Apart from technology and consumer discretionary across regions, we also favour financials and healthcare in the US and Europe, US and Asian communications, as well as US and Asian industrials. Some Asian utility companies also offer attractive dividends.
- ◆ As ongoing geopolitical conflicts and the upcoming US election remain downside risks, it's important for investors to stay diversified or leverage multi-asset strategies to manage short-term market volatility.

## 3. Should we add exposure to mainland Chinese and Hong Kong stocks?

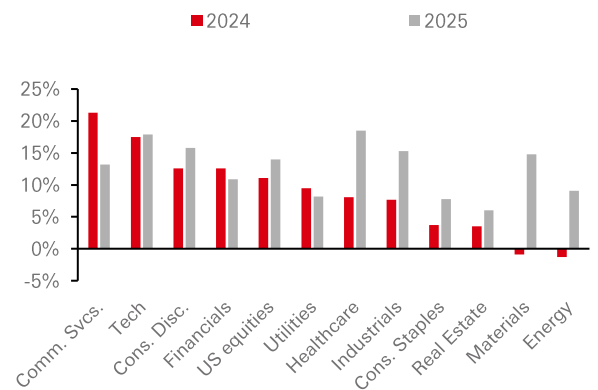
- ◆ Following the five measures from the CSRC to boost Hong Kong's international financial centre status and pro-growth policy guidance from China's Politburo meeting in April, the Ministry of Finance has also announced the issuance of RMB1 trillion in ultra-long special central government bonds to boost infrastructure spending. Recently, the Chinese authorities have also announced a new property rescue package, which includes the removal of the floor lending rate on mortgages, raising hopes for further easing measures in the coming months.
- ◆ These supportive measures have spurred the recent tactical rally of the mainland Chinese and Hong Kong equity markets. As their effectiveness has yet to be seen, and economic growth and consumer confidence will take time to accelerate, we stay neutral on both markets and remain selective in services consumption, high-end manufacturing and quality SOEs paying high dividends in mainland China. In Hong Kong, we prefer quality developers, insurance, telecom and utility companies.
- ◆ In Asia, we see more diverse opportunities in India, South Korea and Japan. Despite a positive long-term structural outlook for Indonesia, we see short-term uncertainty on its rate outlook following a surprise rate hike, so have shifted our allocation towards Malaysia, which should benefit from improving global trade and IT optimism.

**Chart 1: The prospect of rate cuts has caused yields to peak and drives more investors to lock them in**



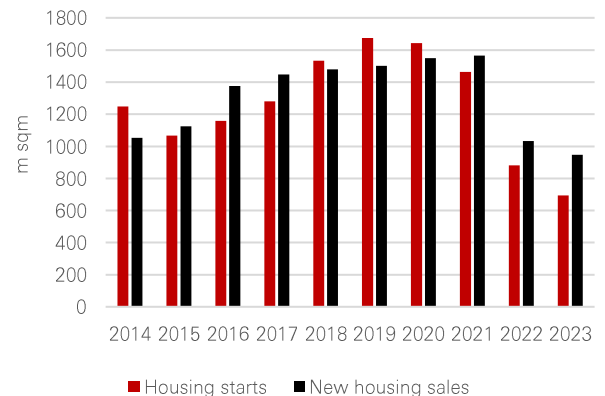
Source: Bloomberg, HSBC Global Private Banking and Wealth as at 21 May 2024. Past performance is not a reliable indicator for future performance.

**Chart 2: Earnings growth expectations in the US remain strong**



Source: LSEG, HSBC Global Private Banking and Wealth as at 17 May 2024. Past performance is not a reliable indicator of future performance.

**Chart 3: China housing starts fell faster than new housing sales since 2019, but inventory remains an issue**



Source: NBS, HSBC Global Private Banking and Wealth as at 18 May 2024.

# Asset Class Views

Our latest house view on various asset classes

Asset class	6-month view	Comment
<b>Global equities</b>		
Global	▲	Global cyclical and rate tailwinds provide a favourable backdrop for global equities. We continue to broaden our geographical and sector exposure and look beyond the US and technology to capture more broad-based upside.
United States	▲	Rising US soft-landing expectations, solid earnings growth, potential rate cuts and secular trends bode well for US equities, and benefit a broad range of sectors including IT, communications, consumer discretionary, industrials and healthcare.
United Kingdom	▶	While we are more positive on the global economic cycle and believe that the economic cycle of the UK economy has bottomed out, local sentiment remains mixed.
Europe ex-UK	▶	The economic cycle appears to have bottomed out and we focus on global leaders with strong balance sheets and strong innovation. Global demand for European products remains healthy. Valuations are also attractive.
Japan	▲	A more sustainable reflationary trend, corporate governance reforms and the AI boom support our bullish view on Japanese equities.
Emerging Markets (EM)	▶	We expect more emerging markets to cut rates following some of the Latin American countries. Corporate earnings growth is expected to rebound sharply for EM Asian markets in 2024.
EM EMEA	▼	The region is impacted by high energy prices and global interest rates, as well as geopolitical uncertainty.
EM LatAm	▶	While Brazil's earnings and price momentum are falling, Mexico is well supported by the US re-industrialisation.
<b>Asia ex Japan equities</b>		
Asia ex-Japan	▲	We continue to diversify in Asia to unlock its structural growth opportunities, favouring India and South Korea. Following a surprise rate hike in Indonesia, we've moved towards Malaysia on improving global trade and IT optimism.
Mainland China	▶	We focus on high quality stocks in service consumption and high-end manufacturing amid mixed economic data. The property rescue package and special treasury bond issuance should give support to growth.
India	▲	Strong economic fundamentals and fiscal prudence support our bullish view on Indian equities. We prefer Indian banks, consumer discretionary and industrials. We expect renewed reforms after the election to boost market sentiment again.
Hong Kong	▶	As the headwinds for the commercial real estate sector linger, we stay selective in undervalued quality stocks in the insurance, telecom and utility sectors for their growth resilience and the benefits from expected Fed interest rate cuts.
Singapore	▶	A rebound in industrial production and travel-related services suggest stronger GDP growth this year.
South Korea	▲	With more guidelines for the "Corporate Value-up Program" and robust exports supported by the broadening recovery in both tech and non-tech products, we remain positive on South Korean equities.
Taiwan	▶	We prefer the semiconductor and tech hardware sectors as the increasing AI and tech-related demand continues to support the equity market. Geopolitical uncertainties remain a key risk.
<b>Government bonds</b>		
Developed markets (DM)	▶	We believe the DM sovereign bond yield peak is behind us and rate cuts should come soon in the West, so we prefer US Treasuries and UK gilts up to 10 years to lock in current yield levels. Japanese government bonds remain unattractive.
United States	▲	Amid our expectations of gradual Fed rate cuts, we believe Treasury yields are at the top of the trading range and will decline over the coming months. We focus on locking in attractive bond yields ahead of rate cuts later this year.
United Kingdom	▲	We continue to favour UK gilts, seeing the policy rate fall to 3.75% by 2025, which is more dovish than market expectations.
Eurozone	▶	We expect the ECB to cut rates in June and maintain a neutral stance as absolute yield levels are lower than in the US.
Japan	▼	As we expect inflation to pick up, we believe the BoJ is on track to further hike interest rates in Q3. The 10-year Japanese government bond yield rose amid market speculation of policy normalisation but remain unattractive in our view.
Emerging Markets (Local currency)	▼	The stronger USD puts pressure on several EM currencies. While we remain underweight on EM local currency bonds, we continue to favour Indian local currency bonds due to the country's robust structural and cyclical growth outlook.
Emerging Markets (Hard currency)	▶	We prefer developed market investment grade on a relative basis. However, we still find opportunities in selected quality issuers in emerging markets, where the yields remain appealing.
<b>Corporate bonds</b>		
Global investment grade (IG)	▲	Global investment grade continues to be our largest overweight exposure across our bond allocation and its absolute yields remain attractive, despite tight credit spreads.
USD investment grade (IG)	▲	USD investment grade credit offers attractive spreads with the deepest liquidity. We are not worried about the impact of delinquencies on financial institutions, especially large banks, which remain well capitalised and adequately provisioned.
EUR and GBP investment grade (IG)	▲	With the prospect of rate cuts and improved forecasts for the growth/inflation mix, we lock in attractive yields in European high-quality bonds.
Asia investment grade (IG)	▲	As we expect Asian central banks to cut rates in H2, we focus on capturing attractive income from Asian financials, Indian local currency bonds, Indonesian quasi-sovereign bonds, Macau gaming and Chinese IT, media and telecom.
Global high-yield (HY)	▶	Global high yield continues to outperform but tight credit spreads are insufficient for rising default risks amid the high interest rate environment. We prefer investment grade to high yield bonds.
USD high-yield (HY)	▶	Although defaults remain low and refinancing risk is manageable, risk premia are too low in our view, so we continue to prefer investment grade on a relative basis.
EUR and GBP high-yield (HY)	▶	European high yield issuers often have lower leverage than in the US, but economic growth is lower, hurting cash flows. Our neutral stance reflects our preference for quality, even though growth may have bottomed at the end of last year.
Asia high-yield (HY)	▶	Despite recent supportive measures from the Chinese authorities, we remain cautious on China's property risks and prefer quality issuers for better risk-adjusted returns in the region.
<b>Commodities</b>		
Gold	▶	Uncertainty has driven gold to high levels but demand is likely to be capped at the current price.
Oil	▶	While geopolitics provide support for oil, spare capacity limits the upside. We expect oil prices to trade sideways.

## Sector Views

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

Sector	Global	US	Europe	Asia	Comment
<b>Consumer Discretionary</b>	▲	▲	▲	▲	Consumers have adapted to the higher interest rate environment helped by easing inflation and higher wages. The outlook for hospitality and tourism looks particularly constructive although luxury goods sales growth is more muted. Unseasonal weather is again disrupting seasonal buying patterns. Autos remain in turmoil as consumers are switching to hybrid vehicles rather than EVs due to the poor EV charging infrastructure. Home appliance demand remains subdued pending a recovery in home sales.
<b>Financials</b>	▲	▲	▲	▶	An improving economic and corporate outlook, combined with solid fundamentals and low valuations, should support the sector and, in particular, capital markets which have had a good start to the year with a pick-up in trading volumes, M&A activity, IPOs and bond issuance. Interest rates look set to decline only slowly, with a modest impact on earnings in 2024. Regional banks with significant exposure to the real estate sector are experiencing some challenges.
<b>Industrials</b>	▲	▲	▶	▲	Industrials continue to see steady improvements in demand as the economic pick-up spreads to Asia and Europe albeit slowly. US industrials continue to see robust domestic demand from re-shoring/near-shoring initiatives fuelled by the US's Inflation Reduction Act (IRA) and CHIPS Act. Company guidance is cautiously optimistic, with aerospace, defence and automation remaining potential bright spots.
<b>Information Technology</b>	▲	▲	▲	▲	Big tech stocks have seen some pull-back as the rally broadens. AI will be the key driver for the sector as the technology becomes increasingly embedded leading to product and service capability enhancements, productivity gains and competitive differentiation. The next wave of AI development should benefit digital infrastructure companies focused on cloud, data centres, software and cooling technologies.
<b>Communications Services</b>	▶	▲	▼	▲	US communications continue to deliver stellar earnings growth with the strongest sector growth forecast for this year as fundamentals and attractive prices continue to attract investors. In Asia, the stabilising regulatory environment and low valuations offer an attractive risk-return profile. In contrast, Europe's telecom services sector has little room for optimism.
<b>Materials</b>	▶	▶	▶	▶	Copper prices remain the bright spot in the commodity markets on rising renewables, electrical and digital infrastructure demand, plus some strategic inventory building in China. Iron ore, steel and EV battery materials remain lacklustre. Chemical stocks remain range-bound.
<b>Real Estate</b>	▼	▼	▶	▼	The outlook for commercial real estate is mixed with retail and office segments still looking unattractive, while warehousing is seeing improved demand and prices after a sustained period of weakness. The housing sector in some markets is showing tentative signs of improving sentiment in anticipation of lower interest rates. Chinese real estate remains problematic. Easing inflation and interest rates may lift sentiment and activity.
<b>Consumer Staples</b>	▶	▶	▶	▲	The cost margins of consumer staples appear secure as cost pressures have somewhat eased. The sector should benefit from strong seasonal demand with solid results going forward despite tough YoY comparables. The sector trades in line with historical valuations. We focus on quality stocks with strong brands and more resilient pricing power.
<b>Energy</b>	▶	▶	▲	▶	Low valuations, strong cashflow and high dividends appear to be insufficient to change sentiment towards the sector as energy prices remain range-bound. On a seasonally adjusted basis, supplies appear plentiful and inventories adequate, helped by the relatively mild winter in Europe. In 2024, energy prices may not benefit from geopolitical uncertainties as they have over the last two years.
<b>Healthcare</b>	▲	▲	▲	▼	New product launches, a less hostile pricing environment and the ebbing wave of major product patent expirations should help lift the sector after a period of under-performance. Healthcare sales growth should start to benefit from easier comparables and new pharma products should lift sentiment and expectations. In Asia, valuations remain elevated, trading well above historical levels.
<b>Utilities</b>	▶	▼	▶	▲	The outlook for European and US renewable energy projects continues to improve as governments have started to adopt more realistic pricing for new project auctions following a period of unprecedented cost increases. Interest rate cuts could provide a tailwind and improve sentiment further. Utilities may benefit as interest rates fall and investors look to high dividend paying stocks.

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