# Investment Monthly

## [Update] AI revolution – broadening exposure beyond the US and tech

March 2025

### Key takeaways

- We think the US equity YTD underperformance is not a reflection of worsening fundamentals but a sign of improved prospects beyond the US and tech. Thanks to AI-led innovation and pro-growth policies, earnings growth is broadening across Communications, Financials, Industrials and Healthcare outside of the Mag-7 stocks.
- The rapid AI development in China led by DeepSeek's breakthrough, and the supportive stance of the government towards private enterprises and tech innovation, warrant our recent upgrade of Chinese equities, and subsequently, Asia ex-Japan equities, to overweight. AI monetisation, cloud expansion and semiconductor growth are key catalysts for the tech sector.


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- In addition to an improved economic and political outlook for Germany and France, we upgrade Europe ex-UK equities to neutral on increased defence and infrastructural spending in Europe, which also benefits European Industrials. Attractive valuations and underestimates of the number of rate cuts by the Bank of England support our upgrade of UK gilts to overweight. In EMEA, the UAE looks attractive due to its strong financial sector growth, AI-driven infrastructure investments and growing activities outside of oil.

| Asset class | 6-month view | Comment |
|---|---|---|
| Global equities | ▲ | Despite ongoing geopolitical and tariff concerns, global equities are supported by diverse opportunities thanks to AI-innovation, easing interest rates and robust earnings growth. We broaden our exposure to capture growth across regions. |
| Government bonds | ▼ | The recent decline in DM rates supports our call for a longer duration. We have moved UK gilts to overweight but remain bearish on Japanese government bonds. |
| Investment grade (IG) corporate bonds | ▶ | Although credit spreads are relatively tight and we foresee reduced scope for price gains, we still favour global investment grade for diversification and income generation by locking in elevated yields. |
| High yield (HY) corporate bonds | ▶ | The rise in defaults may be mild as growth is resilient, but spreads remain tight. We remain selective in high yield bonds with a shorter duration preference for 3-5 years. |
| Gold | ▲ | Gold prices remain elevated amid trade tariff and geopolitical uncertainties, while ongoing buying from central banks to diversify their holdings is also supportive. |

▲ "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.

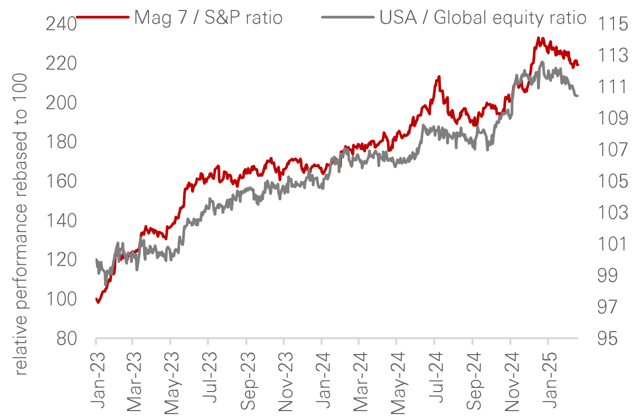
# Talking points

Each month, we discuss 3 key issues facing investors

## 1. Should investors reduce exposure to US equities?

- Recent inflation and consumer sentiment and services PMI data amid market concerns over inflationary pressure and policy uncertainty have put US equity performance under pressure, which is lagging behind its global peers year-to-date.
- We think this is not a reflection of worsening fundamentals in the US but a sign of investors rotating to other sectors or markets. In fact, US equities remain well supported by AI-led innovation and pro-growth policies, which support our strategy to broaden exposure outside of tech, particularly the Magnificent 7 stocks, in the communications, financials, industrials and healthcare sectors. Consensus earnings growth is expected to accelerate to almost 13% for 2025. Proposed tax cuts and deregulation should lift earnings expectations higher.
- We remain overweight on global and US equities. As short-term market volatility will linger, we leverage multi-asset strategies and quality bonds with duration flexibility to help stabilise portfolios while capturing growth opportunities globally.

**Chart 1: The Mag-7 stocks have dragged the year-to-date performance of US equities**

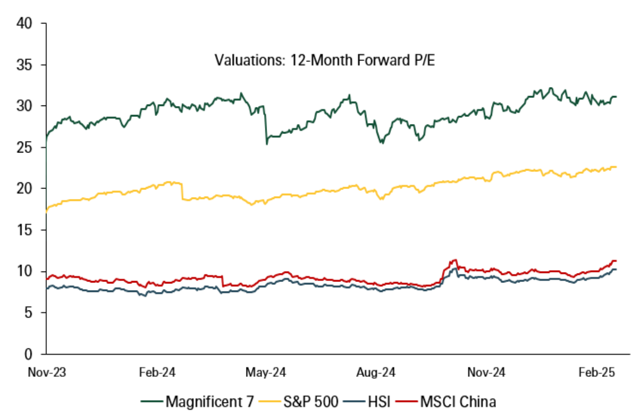



Source: Bloomberg, HSBC Global Private Banking and Wealth, as at 22 February 2025. Past performance is not a reliable indicator of future performance.

## 2. Should investors turn more positive on China's growth outlook?

- The rapid AI development in China led by DeepSeek's breakthrough in producing cheaper LLMs (Large Language Model) fuels the momentum in AI investment, adoption and monetisation across the country and brings optimism in a more sustained and broad-based recovery of China's economic growth and equity valuations.
- The high-level symposium recently chaired by Chinese President Xi Jinping with prominent tech leaders reassured government support towards private enterprises and tech innovation. We expect an acceleration of mass deployment of generative AI devices, autonomous driving, and humanoid robotics in a scalable way. Currently, the Hang Seng Index (P/E at 10.3x) and the MSCI China (P/E at 11.3x) are trading at a deep discount to the S&P 500 (P/E at 22.6x). We expect to see a re-rating opportunity, driven by substantial investments in the tech space and potential earnings upgrades.
- Hence, we have recently upgraded Chinese equities, and subsequently, Asia ex-Japan equities, to overweight. We are looking for more policy catalysts to be announced at the National People's Congress that help broaden the tech-driven market rally. We prefer internet and technology leaders and quality Chinese SOEs paying high dividends. Broadly in Asia, we continue to favour India, Singapore and Japan.

**Chart 2: The Hang Seng Index and MSCI China are trading at steep valuation discounts to S&P 500 and Mag-7**

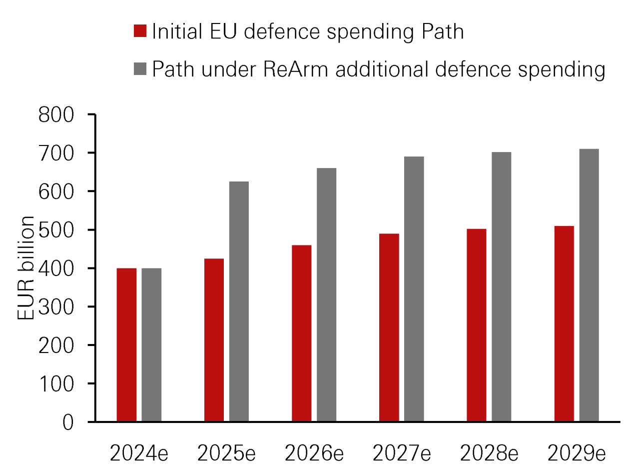



Source: Bloomberg, HSBC Global Private Banking and Wealth, as at 17 February 2025. Past performance is not a reliable indicator of future performance.

## 3. Has Europe come out of the woods yet?

- Economic indicators in Germany seem to be improving and the new government's intention to borrow more to invest has spurred hopes for better economic growth. Furthermore, European nations have been under pressure to raise defence spending (by up to EUR 800bn) for equipment in the next four years amid trade and foreign policy risks. Plans to exempt it from fiscal budgets could unleash multi-billion fiscal stimuli in the region. We upgrade Europe ex-UK equities to neutral and European Industrials to overweight.
- Economic growth concerns and looser labour market conditions have dominated in the UK. Gilt yields are currently priced with a total rate cut of 0.6% this year, far below our expectations of 1.25%. Valuations look attractive from a spread perspective vs Treasuries and Bunds, supporting our upgrade to overweight, which aligns with our view on EUR/GBP investment grade.
- While in EMEA, we see attractive opportunities in the UAE due to its strong growth in the financial, housing and tourism sectors, AI-driven infrastructure investments and growing activities outside of oil.

**Chart 3: The ReArm efforts could unleash up to EUR 800bn in additional defence spending**




Source: European Defence Agency (EDA), European Council, HSBC Global Private Banking and Wealth, as at 10 March 2025.

# Asset Class Views

## Our latest house view on various asset classes

| Asset class | 6-month view | Comment |
|---|---|---|
| **Global equities** | | |
| Global | ▲ | Despite ongoing geopolitical and tariff concerns, global equities are supported by diverse opportunities thanks to AI-innovation, easing interest rates and robust earnings growth. We broaden our exposure to capture growth across regions. |
| United States | ▲ | Resilient US economic outlook and earnings tailwinds from AI development and pro-growth policies are positive for US equities across sectors. We see a rotation from Technology to Communication, Financials, Industrials and Healthcare. |
| United Kingdom | ▶ | Despite undemanding valuations, lingering economic challenges, higher government bond yields and likely spending cuts are obstacles. |
| Europe ex-UK | ▶↑ | In addition to an improved economic and political outlook for Germany and France, the EU defence spending efforts should provide tailwinds to growth and sentiment in the region. We upgrade Europe ex-UK equities to a neutral position. |
| Japan | ▲ | Robust wage momentum, corporate governance reforms, sustainable reflation trend and reasonable valuations remain growth drivers for Japanese equities. |
| Emerging Markets (EM) | ▶ | Market expectations of rates staying high for longer and geopolitical uncertainty are headwinds for EM markets. |
| EM EMEA | ▼ | While we see opportunities in the UAE, weak EU growth and geopolitical uncertainty continue to weigh on the region. |
| EM LatAm | ▼ | We see increased challenges for Mexico, including trade tariffs and the border issues with the US, while Brazil's rate hikes remain a headwind. |
| **Asia ex Japan equities** | | |
| Asia ex-Japan | ▲↑ | Asia's earnings growth prospect for 2025 remains stronger than its global peers. The upgrade of Chinese equities to overweight supported by the AI-led re-rating opportunity raises our allocation to Asia ex-Japan equities to overweight. |
| Mainland China | ▲↑ | The re-rating opportunity led by DeepSeek's breakthrough and the positive government stance supports our upgrade of Chinese equities to overweight. We prefer internet and technology leaders for growth and quality Chinese SOEs for high dividends. |
| India | ▲ | The Union Budget's focus on supporting consumption and capex while maintaining fiscal prudence is positive for Indian equities. Strong fundamentals, robust earnings growth and continued domestic inflows continue to be supportive. |
| Hong Kong | ▶ | The Hong Kong budget addressed the growth headwinds through initiatives such as bond issuance and further cuts to recurrent government expenditure. We think a neutral stance is justified before we see an improvement in fundamentals and prefer quality developers and undervalued high dividend stocks in the insurance and telecom sectors. |
| Singapore | ▲ | The Singapore Budget strived to balance between lifting the cost-of-living pressures of Singaporeans and supporting long-term growth priorities. Attractive valuations and dividend yield remain positive drivers for equities. |
| South Korea | ▶ | While monetary easing should help offset some growth pressure, structural weakness, political uncertainty and US trade policies continue to weigh on market sentiment. |
| Taiwan | ▶ | Taiwan remains a leader in AI hardware but is lagging in AI adoption. Valuations are also stretched, limiting further upside. |
| **Government bonds** | | |
| Developed markets (DM) | ▼ | The recent decline in DM rates supports our call for a longer duration. We have moved UK gilts to overweight but remain bearish on Japanese government bonds. |
| United States | ▶ | US Treasuries are supported by the announcement to keep coupon bond supply stable this year and foreign demand at the current yield levels. We expect the next Fed cut to come in June and prefer a longer duration of 7-10 years. |
| United Kingdom | ▲↑ | Attractive valuations and market underestimates of the number of rate cuts bode well for the gilt outlook. We maintain our duration preference for 7-10 years and expect the Band of England to accelerate the pace of policy easing in H2. |
| Eurozone | ▶ | Slow growth and manageable inflation should cause the ECB to continue with their rate cuts, supporting bonds. |
| Japan | ▼ | We expect two additional hikes in Q3 2025 and Q1 2026, taking the policy rate to 1.0%. Low yields and possible intervention from the Bank of Japan support our underweight position. |
| Emerging Markets (Local currency) | ▶ | EM rate cuts will likely continue but the scope hinges on the US Federal Reserve. |
| Emerging Markets (Hard currency) | ▶ | We remain selective and generally focus on quality. Despite the recent USD weakness, we expect the currency to resume its uptrend in the medium-to-long term. |
| **Corporate bonds** | | |
| Global investment grade (IG) | ▶ | Although credit spreads are relatively tight and we foresee reduced scope for price gains, we still favour global investment grade for diversification and income generation by locking in elevated yields. |
| USD investment grade (IG) | ▶ | We still expect a few rate cuts this year and see opportunities in IG credit in financials as well as non-financials. |
| EUR and GBP investment grade (IG) | ▲ | The expectation of slower growth and more policy rate cuts than currently priced in the region support our positive stance. |
| Asian investment grade (IG) | ▶ | We expect rising inflows into Chinese hard currency corporate bonds to capture the AI-led opportunities. Continued easing by central banks is supportive of Asian financials, Indian and Indonesian local currency, and quality Chinese TMT bonds. |
| Global high-yield (HY) | ▶ | The rise in defaults may be mild as growth is resilient, but spreads remain tight. We remain selective in high yield bonds with a shorter duration preference for 3-5 years. |
| USD high-yield (HY) | ▶ | USD high yield provides a substantial overall yield. Refinancing activity and defaults remain manageable. |
| EUR and GBP high-yield (HY) | ▶ | Even though spreads in high yield remain tight compared to historical averages, they offer a good pickup over government bond yields. |
| Asian high-yield (HY) | ▶ | We continue to look for more forceful policy measures to further stabilise the housing market in China and maintain our cautious stance on its property sector. We prefer quality issuers in selective areas, such as Macau gaming in the region. |
| **Commodities** | | |
| Gold | ▲ | Gold prices remain elevated amid trade tariff and geopolitical uncertainties, while ongoing buying from central banks to diversify their holdings is also supportive. |
| Oil | ▶ | While geopolitics provide support for oil, spare capacity limits the upside. |

# Sector Views

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

| Sector | Global | US | Europe | Asia | Comment |
|---|---|---|---|---|---|
| **Consumer Discretionary** | ▶ | ▶ | ▶ | ▶ | Consumer spending remains weak except in the US. Globally, tepid EV demand, except in China, is hurting many auto firms. Luxury goods companies are awaiting tentative signs of a recovery in demand in China, even as US and European sales remain robust. Seasonal demand may lift leisure and hospitality stocks as a result of consistent higher wage growth. |
| **Financials** | ▲ | ▲ | ▲↑ | ▶ | We upgrade European Financials on improving sentiment and low valuations relative to their US peers. Globally, capital market businesses and large international banks are well positioned to benefit from a pick-up in activity. Net interest income is likely to remain elevated as inflation remains stubbornly high, keeping interest rates elevated. Early positive signs show that advisory services, M&A, listings, bond issuance and trading flows are good in H1, if not the full year. Regional banks remain unattractive. |
| **Industrials** | ▲ | ▲ | ▲↑ | ▲ | The sector has started the year modestly even as company guidance was upbeat with many segments (machinery, construction, aerospace, trucks, trains and freight) expecting solid YoY growth from robust order books. Digital infrastructure and essential physical infrastructure-related businesses seem set to benefit from a pick-up in capital spending. We upgrade European Industrials as generous defence and infrastructure plans should improve earnings momentum. |
| **Information Technology** | ▲ | ▲ | ▲ | ▲ | The sector continues to experience high volatility as investors fret over high valuations. News flow remains reassuring, with strong demand from digital infrastructure, data centres, AI semiconductors, software, etc. The roll-out of digitally-enabled products and services is generating a positive buzz across all sectors even at this early stage. Some early signs of overcapacity in low-end semiconductors are hurting pricing. |
| **Communications Services** | ▲ | ▲ | ▶ | ▲ | In the US, the media and entertainment industry is forecast to have above-average sales and earnings growth for 2025, even after its stellar performance over the past two years. In Europe, the telecom services sector outlook is plagued by strong competition, low investment returns and a lack of pan-European scale. In Asia, the sector is more balanced with attractive valuations and easing regulation. |
| **Materials** | ▼↓ | ▼↓ | ▼↓ | ▼↓ | We downgrade the sector as demand growth is expected to remain weak for this year and pricing is challenging. Mining stock valuations appear attractive, but revenue/earnings growth forecasts are uninspiring. Tariffs remain a significant risk and are hurting sentiment. Refining, processing and chemical stocks remain unappealing in the short-term. |
| **Real Estate** | ▶ | ▶ | ▶ | ▶ | Globally, the sector may be at a low point although select markets and segments offer better potential than others. Retail space and older offices are particularly challenged as alternative consumer purchasing channels evolve and refurbishment costs are high. New office developments and housing are experiencing better supply-demand dynamics. The re-routing of supply chains is driving demand for new facilities in developed and some emerging markets. |
| **Consumer Staples** | ▶ | ▶ | ▶ | ▶ | Strong competition and consumers trading down have created a weak pricing environment for companies in many markets. Limited potential for sales growth and margin expansion, combined with high valuations relative to other sectors (in line with history), make the sector unattractive. |
| **Energy** | ▶ | ▶ | ▶ | ▶ | The unfavourable supply-demand dynamics are expected to lead to lower oil prices in the next 12 months, although the relatively higher cost of production for shale gas may limit production. Gas demand will likely remain buoyant, albeit volatile from seasonal demand impacting prices. Low valuations, strong cashflow and high dividends somewhat offset the sector's speculative nature. |
| **Healthcare** | ▲ | ▲ | ▲ | ▶ | At the end of last year, the market over-reacted to negative news flow and uncertainty regarding US healthcare policy. The sector has now started to recover. The healthcare sector in Asia sees improving market dynamics and strong earnings growth expectations for this year. In the US, we expect earnings growth to be among the highest of the sectors with new and recently launched products driving earnings. European healthcare stocks have a more mixed outlook. |
| **Utilities** | ▲ | ▶ | ▶↓ | ▲ | Although power demand is growing, we downgrade European Utilities given regulatory and substantial ongoing capital investment needed to transition and expand both generation and transmission capacity. US renewable projects face an uncertain future, but elsewhere, renewable project momentum and energy demand remain robust. Revenues continue to surprise positively with some companies raising guidance on robust demand from data centres and other related AI activities. |

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