HSBC

Investment Monthly

Focus on quality and Asia amid increasing downside risks

April 2023

Key takeaways

- As a result of recent financial turmoil, markets are hopeful that there will be fewer rate hikes than previously thought. We expect policy rates to pause after two more hikes of 0.25% by the Fed and the ECB in May and June. Amid a "high for longer" rate outlook, we continue to favour investment grade (IG) bonds with medium maturities to lock in yields at recent multi-year highs.
- With strong capital and liquidity positions, we don't expect a repeat of the 2008 credit crisis and remain neutral on financials. Asian banks are well-positioned with their diversified business models and stable deposits. Central banks and regulators' decisive and quick actions have helped to restore calm.
- As tighter lending conditions will lead to lower investment spending and further earnings downgrades weighing on equity markets, we remain invested in quality companies and are most positive on Asia due to China's strong growth momentum. We adopt a balanced sector approach favouring energy, healthcare, communications, consumer discretionary and industrials.

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Asset class	6-month view	Comment
Global equities	▶	Despite a potential Fed pause and accelerating growth in Asia, global equities are challenged by softening global economic activity and recent banking volatility weighing on growth. We remain neutral and focus on quality stocks.
Government bonds	▼	Government bonds benefit from a flight to safety amid the financial turmoil but as rate expectations have fallen too much, we see better opportunities in investment grade bonds.
Investment grade (IG) corporate bonds	▲	As we expect rates to peak soon, we maintain a medium duration (5-7 years) to lock in higher yields for longer and focus on quality amid growth slowdown and market uncertainty.
High yield (HY) corporate bonds	▶	As spreads should remain volatile amid higher for longer rates, and high yield is sensitive to growth slowdown, we remain neutral.
Gold	▶	Gold benefits from USD weakness and central bank buying but real yields are a challenge and mining output is rising.

▲ "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.

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Talking points

Each month, we discuss 3 key issues facing investors

1. How will recent market volatility affect the rate outlook?

- The financial turmoil triggered initially by SVB's deposit withdrawals, and later by UBS's takeover of Credit Suisse, caused liquidity and financial stability concerns. Fortunately, the rapid action by central banks and regulators has helped to restore some calm.
- Markets are hopeful that there will be fewer rate hikes, and that central banks may not want to hike more forcefully than necessary amid current market concerns. But as the inflation fight is not yet over, we hold the view that there will be two more rate hikes of 0.25% by the Fed and the European Central Bank in May and June, lifting rates to 5.5% and 3.5%, respectively. After that, we do not expect to see any rate cuts until Q2 2024. The Bank of England will probably pause at the current level, given the weakening economy and the significant fiscal tightening in the UK.
- In anticipation of a "high for longer" rate outlook, **we continue to favour investment grade (IG) bonds with medium maturities** to lock in yields at recent multi-year highs, and solid issuers of USD bonds in emerging markets on USD weakness. IG has proven a relative safe haven lately but spreads could tighten a bit.

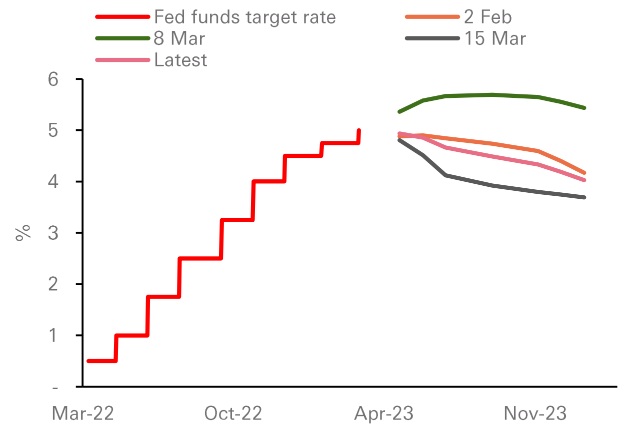
2. How should investors position their banking exposure?

- With strong capital and liquidity positions, as well as low delinquency rates, we believe that the fundamentals of the banking sector in the US and Europe are robust enough to avoid a systemic crisis, unlike in the 2008 credit crisis. Many banks are likely to raise deposit rates to shore up liquidity and will see slower loan growth, but we also see attractive valuations of some quality banks after the recent sell-off.
- We think the contagion risk for Asia banks is relatively low because of their diversified business models with broad and stable retail deposits, which have increased significantly, particularly in Hong Kong and Singapore, while Chinese banks are more domestic-oriented with exposure to a more stable rate environment with attractive dividend yields.
- **We maintain neutral on US, European and Asian financials under our base case of no systemic crisis and substantial valuations discounts.** Panic-selling is not a sound strategy but a portfolio review on the overall sector allocation is a prudent approach.

3. Should we be bearish on equities?

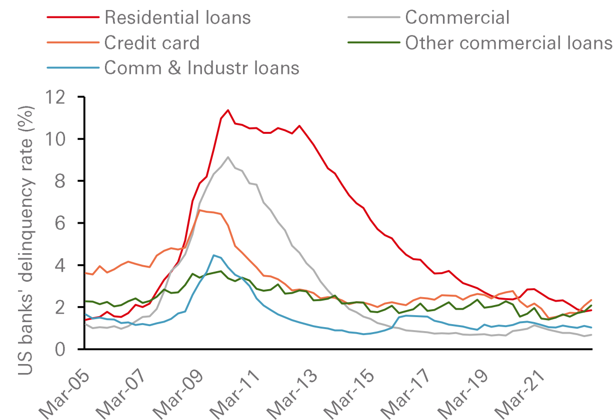
- Historically, tighter lending conditions will lead to lower investment spending and higher default rates, so uncertainty and earnings downgrades may accelerate in the coming months. We see limited scope for a sharp equity market rally but remain invested in quality companies with strong balance sheets and market positions.
- We still prefer the US over Europe as we expect the US economy to stay more resilient and earnings to rebound in H2. Easing gas prices and a rebound in demand from China and more broadly Asia, support our view that an imminent recession in the UK and Europe is unlikely. We upgrade European utilities to overweight, as they are negatively correlated with higher rates and are trading below historic premiums.
- **Asia remains our top pick geographically led by mainland China**, which sees policy tailwinds to support growth and stabilise the property sector. Not only are Asian banks well capitalised, but China's reopening has also helped lift pent-up consumption and tourism in the region, with Hong Kong, Thailand and Indonesia being key beneficiaries. We have lifted our Asia ex-Japan GDP growth forecast for 2023 from 4.5% to 4.7%.
- Overall, we adopt a balanced approach between cyclicals and defensives, **favouring energy, healthcare, communications, consumer discretionary and industrials** in most regions.

Chart 1: Markets seem to expect few rates hikes but central banks stay committed to the inflation fight



Source: Bloomberg, HSBC Global Private Banking as at 27 March 2023. Past performance is not a reliable indicator of future performance.

Chart 2: The turmoil was driven by liquidity issues rather than credit concerns. Delinquencies remain low



Source: New York Federal Reserve, HSBC Global Private Banking as at 27 March 2023.

Chart 3: Focusing on quality has helped a lot in the past few weeks

Source: Bloomberg, HSBC Global Private Banking as at 27 March 2023. 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	▶	Despite a potential Fed pause and accelerating growth in Asia, global equities are challenged by softening global economic activity and recent banking volatility weighing on growth. We remain neutral and focus on quality stocks.
United States	▲	We like the diversity and quality character of US stocks but short-term consolidation is likely as the recent turmoil in the US banking and IT sectors leads to further downgrade in earnings expectations, which should improve in H2 though.
United Kingdom	▼	The cost of living crisis, higher taxes and rising interest rates create big headwinds. Latest composite PMIs and retail sales volumes continue to improve, supporting our view that an imminent recession is unlikely.
Eurozone	▶	Falling energy prices and China's reopening are positive for Eurozone stocks. However, as credit conditions are tightening, equity markets will remain volatile.
Japan	▶	The economy is facing headwinds of weak domestic consumption and demand for exports especially in capital goods despite China's reopening alleviating some pressures. JPY strength is also a challenge for exports.
Emerging Markets (EM)	▶	Despite elevated inflation and slowing global growth, China's reopening and USD weakness will help EM assets to recover, particularly EM Asia which benefits from a rebound in Chinese demand and tourism.
EM EMEA	▼	The region is impacted by high energy prices, weak growth in Europe and an uncertain rate outlook.
EM LatAm	▲	The end of the rate hike cycle and rising Chinese demand are positives for Brazil, while Mexico will benefit from onshoring.
Asian ex Japan equities		
Asia ex-Japan	▲	Better intraregional trade and China's reopening are two key growth drivers in the region, with the latter likely to have spillover effects to its Asian peers in terms of tourism, consumption, investments and normalisation of supply chains.
Mainland China	▲	The supportive policy messages from the NPC on growth recovery, private economy, high-quality development and further opening up should bode well for China's growth led by consumption from Q2 onwards. Valuations are attractive.
India	▶	Tight fiscal and monetary policies drag on growth but the macroeconomic fundamentals remain intact. Valuations are still stretched but we see longer-term opportunities in the digital economy, green transition and smart manufacturing.
Hong Kong	▲	Consumption and travel related companies are major beneficiaries of the border reopening. An improved outlook for the property market on expectations of peaking interest rates also reaffirms our overweight on Hong Kong equities.
Singapore	▶	Global trade slowdown will drag on growth. As price pressures remain elevated across both goods and services, we expect the MAS to continue tightening in April. Travel and tourism is likely to be the growth engine.
South Korea	▼	We expect growth to slow further on sluggish semiconductor exports and weak private consumption amid a softening labour market.
Taiwan	▶	As the earnings cycle bottoms out, we expect to see a gradual recovery in Asian semiconductors and the technology hardware industry. However, global credit concerns may add downside risk to external demand.
Government bonds		
Developed markets (DM)	▼	Government bonds benefit from a flight to safety amid the financial turmoil but as rate expectations have fallen too much, we see better opportunities in investment grade bonds.
United States	▶	Lower inflation expectations have pushed US Treasury yields and rate expectations to decline. We maintain our neutral view and prefer investment grade credit.
United Kingdom	▲	UK gilts are supported by the forecasts of peaking UK rates. GBP strength vs USD can help returns for foreign investors.
Eurozone	▼	We maintain underweight on Eurozone sovereigns given higher rates in other bond markets or investment grade.
Japan	▼	The new Bank of Japan governor could adopt a more hawkish monetary policy which could hurt bond performance.
Emerging Markets (Local currency)	▶	Select opportunities exist as some economies are slowing rate hikes but others continue. USD weakness remains a tailwind.
Emerging Markets (Hard currency)	▶	Amid higher Treasury volatility, we still find yield but remain selective.
Corporate bonds		
Global investment grade (IG)	▲	As we expect rates to peak soon, we maintain a medium duration (5-7 years) to lock in higher yields for longer and focus on quality amid growth slowdown and market uncertainty.
USD investment grade (IG)	▲	The recent upside surprises in macroeconomic data support our overweight on investment grade medium maturity credit.
EUR and GBP investment grade (IG)	▲	With increasing evidence that we are at the end of the global credit cycle, we continue to favour EUR and GBP investment grade within the medium duration space.
Asia investment grade (IG)	▲	Yields are attractive and we prefer high-grade credit amid a global slowdown, preferably Hong Kong and Singapore IG bonds, and Chinese TMT (Technology, media and telecom) bonds with short to medium maturities.
Global high-yield (HY)	▶	As spreads should remain volatile amid higher for longer rates, and high yield is sensitive to growth slowdown, we remain neutral.
US high-yield (HY)	▶	While US high-yield companies still enjoy solid credit fundamentals and low default rates, spreads are not particularly generous and markets could price in slightly higher default rates ahead as financial conditions tighten.
EUR and GBP high-yield (HY)	▶	Despite improved optimism on Europe's growth outlook, tighter monetary policy remains a challenge. We prefer higher quality investment grade credit and maintain a neutral stance on high yield amid expectations for rising default rates.
Asia high-yield (HY)	▶	Inflation, Fed tightening and slowing global demand remain headwinds for credit spreads. We stay cautious on Chinese property high yield and prefer state-owned developers due to their stronger financial positions and lower leverage.
Commodities		
Gold	▶	Gold benefits from USD weakness and central bank buying but real yields are a challenge and mining output is rising.
Oil	▶	Russia's softer output and strong demand from China will boost oil prices, which could be controlled by OPEC unwinding supply cuts and the recent banking sector turmoil weighing on growth expectations.

Sector Views

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

Sector	Global	US	Europe	Asia	Comment
Consumer Discretionary	▲	▲	►	▲	Inflation has eased in many regions including Europe where energy prices are more elevated. Rising wages are helping to lift consumer sentiment. Discretionary spending especially in the services segment with airlines, hotels, restaurants and resorts expected to benefit. Automakers are seeing supply issues ease. Luxury goods segment is seeing strong demand and exceptional pricing power.
Financials	►	►	►	►	Positive momentum in the banking sector in earlier months was sharply reversed with the events surrounding Silicon Valley Bank in the US and Credit Suisse in Europe. The sector appears to be stabilising but while valuations look tempting, further clarity is needed so we hold a neutral view across the sector.
Industrials	▲↑	▲↑	▲	▼	Concerns as to the severity of an economic slowdown have eased but input cost inflation will still weigh on earnings results. China's reopening should benefit European exporters. US domestic demand is also seeing some improvement supported by rising global activity, which warrants our upgrade to overweight. Low valuations also make the sector attractive. Companies supporting renewable energy and electric vehicle production continue to thrive.
Information Technology	►	►	►	►	Although the sector faces multiple challenges, the overall fundamental outlook appears to be slowly improving. We remain cautious on the sector given the current over-supply in some types of semiconductors, slowing cloud computing and digital advertising growth, as well as higher relative valuations than other industries.
Communications Services	▲	▲	►↓	▲	After several challenging quarters, the media & entertainment industry may be seeing some bright spots. Telecoms services are also likely to continue to benefit from higher digital content demand and roaming fees as consumers travel more and become more socially active. Valuations are more attractive following last year's sell-off except in Europe, prompting us to downgrade to neutral.
Materials	►	►	▲	►	Mining stocks are trading on low valuations multiples relative to other industries but China's reopening is likely to see modest demand recovery initially. Energy prices and oil/gas feedstock prices have also declined recently, improving the outlook for chemicals and construction materials industries in Q2/Q3.
Real Estate	►	►	▼	►	Rising interest rates and softening demand in some categories pose short-term challenges. Retail real estate suffers from long-term structural changes caused by the rise in ecommerce and this is unlikely to change. Office space is being reduced by many companies as employers reduce space and promote work-from-home. The storage and warehousing assets bubble appears to have run its course.
Consumer Staples	►	►	►	▲	Global and European consumer staples face a more challenging pricing environment after last year's above inflation rises and rich sector valuations. We focus on quality stocks with strong brands and more resilient pricing power. Dividends are also recommended where attractive.
Energy	▲	▲	▲	►	Oil prices have declined but remain range bound, and gas prices have declined sharply, but company earnings should remain buoyant and the sector should continue to benefit from OPEC keeping supply tight to protect profits. Unseasonably warm weather in Europe has eased demand-supply concerns, but colder snaps in the US have driven increased demand. Valuations remain attractive.
Healthcare	▲	►	▲	▲	We remain constructive on the sector given the attractive valuations and stronger demand expected from Asia due to China's reopening and increase in travel worldwide. Biotechnology and medical technology stocks may benefit from the increasing risk appetite, but companies with higher leverage or financing costs are impacted by elevated interest rates.
Utilities	►	►	▲↑	►	We upgrade our European utilities exposure as energy prices fall and the sector is at attractive valuation levels. Earnings revisions for the sector are also supportive. The sector's stable earnings/cash flow characteristics and high dividend yielding stocks appeal to more cautious investors.

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