HSBC

Investment Monthly

A stronger case for equities on improved fundamentals and positive growth

March 2024

Key takeaways

- The recent upside surprise on US inflation data does not change our view that the Fed will cut rates in June. Improved margins and secular drivers (e.g. technological and healthcare innovation) should support US earnings growth. Historically, US equities have performed well in an election year. All of these make us comfortable to add US equity exposure in a broad range of sectors.
- We expect Japanese equities to further outperform thanks to the reflation trend and corporate governance reforms. Companies are encouraged to improve capital efficiency and are increasing spending on AI technologies, digitalisation, and automation. With an upgrade in Japanese equities and a more bullish view on the US, we also upgrade global equities to overweight.
- Bonds remain in favour amid a disinflationary environment, falling real yields and increased geopolitical risks. They are still in demand for income generation and diversification benefits. Markets have lowered their Fed rate cut expectations more realistically to 0.8% for 2024, close to our forecast of 0.75%. We continue to favour quality bonds with extended duration for major DM government bonds (7-10 years) and see good value in US investment grade credit (5-7 years).

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

Lucia Ku
Global Head of Wealth Insights
HSBC Wealth and Personal Banking

Asset class	6-month view	Comment
Global equities	▲↑	Solid earnings growth and slowing inflation are supportive of global equities. While market sentiment in the US remains strong, we also see structural opportunities in Japan and EM Asia, supporting us to upgrade global equities.
Government bonds	▶	The current levels of yields justify our overweight on most DM government bonds with a preference for medium-to-long maturities. Japanese government bonds remain unattractive due to likely policy normalisation ahead.
Investment grade (IG) corporate bonds	▲	Interest rate risk is more attractively priced than credit risk, so we stick to quality with a preference for 5-7 year maturities.
High yield (HY) corporate bonds	▶	We favour investment grade over high yield bonds as the spread pick-up in high yield is insufficient with default risks rising somewhat.
Gold	▶	Despite continued risks in the Middle East, oil prices remain range-bound amid global growth concerns and broadly balanced supply and demand. Falling yields should support gold to range trade, but USD strength is an obstacle.

▲ "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.

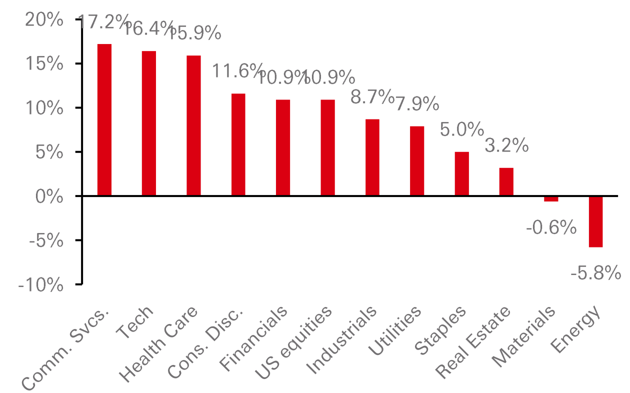
Talking points

Each month, we discuss 3 key issues facing investors

1. Is higher-than-expected inflation in the US a concern?

- Despite upside surprises on US inflation data in January, which caused us to lift our average headline inflation forecast to 3.4% in 2024 (previously 3.1%), we continue to see a disinflation trend and hold the view that the Fed will start cutting rates in June this year. The prospect of lower policy rates should support margins, which continue to grow, especially in the US.
- US earnings growth remains strong with a full-year forecast of 10.9%, well above its long-term historical average of 7%. Secular drivers such as technological and healthcare innovation, the nearshoring of industry and US re-industrialisation, provide tailwinds for economic growth, earnings and return on capital across sectors. US equities have also historically performed well in an election year.
- With all of these positive drivers, we have further added to our existing overweight in US equities, favouring a broad range of sectors including IT, Industrials, Communications, Financials, Consumer Discretionary and Healthcare.

Chart 1: Despite downward revisions, US earnings are expected to rise almost 11% in 2024

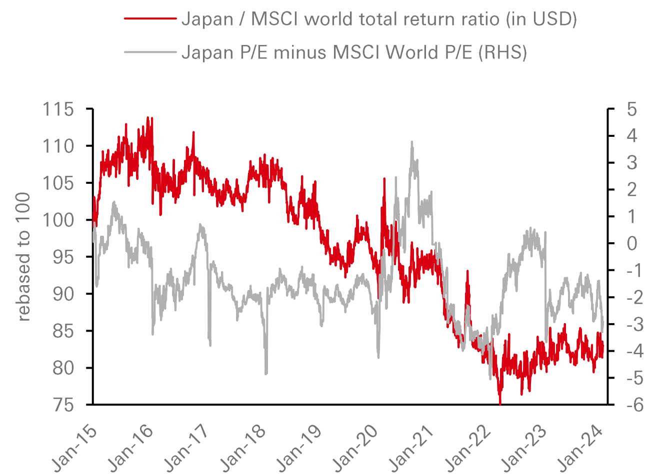


Source: FactSet, HSBC Global Private Banking and Wealth as at 20 February 2024. Past performance is not a reliable indicator of future performance.

2. Why are we more positive on global equities?

- Apart from the US, we see structural opportunities in Japan, driven by the reflation trend and corporate governance reforms. The rally of the Japanese equities is likely to continue.
- The announcement of the Tokyo Stock Exchange to publish a monthly list of companies that have disclosed plans to improve their capital efficiency has prompted more Japanese companies to reduce cash on their balance sheets via share buybacks and increased dividend payouts. The Nippon Individual Savings Account (NISA) programme, which exempts retail investors from paying capital gains taxes on stocks, is another catalyst.
- As high profits are driving corporate spending on wages and capital expenditure on AI technologies, digitalisation and automation, we expect a solid 9.9% EPS growth for Japanese companies in 2024. Therefore, we upgrade Japanese equities to overweight. In China, the PBoC's 5-year loan prime rate (LPR) cut by 0.25% to 3.95% came as a positive surprise but more forceful policy actions to mitigate structural headwinds are needed. We continue to diversify into Asia by focusing on Japan, India, Indonesia and South Korea. The overall supportive macro outlook gives us confidence in also upgrading global equities to overweight.

Chart 2: The outperformance of Japanese stocks has been mild, leaving further scope

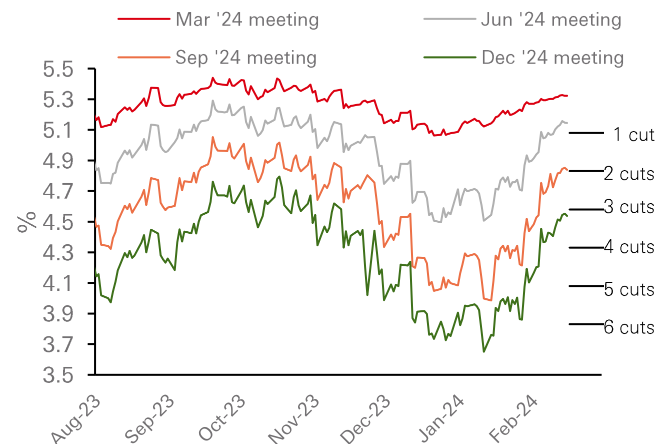


Source: LSEG, HSBC Global Private Banking as at 20 February 2024. Past performance is not a reliable indicator of future performance.

3. Will bonds become less attractive?

- We continue to favour bonds amid a disinflationary environment, falling real yields and continued geopolitical risks, which should boost demand for highly rated bonds. Trillions of US dollars sitting in money market funds and cash also means that bonds should still be in demand for income generation and diversification benefits.
- Higher-than-expected inflation for January, strong earnings reports and comments from Fed officials have driven markets to reassess the Fed rate cut expectations. But they are now more realistic, pricing in just 0.8% of cuts by year end (close to our 0.75% forecast) instead of the 1.5% they were looking for in January.
- We still prefer quality bonds for a better risk-adjusted return and expect the short-end of the yield curve to remain volatile, hence are focusing on the medium-to-long end (7-10 years) of DM sovereign debt and the medium duration (5-7 years) of investment grade (IG) credit. We see better value in the US IGs than in its EUR and GBP counterparts.

Chart 3: Markets have become more realistic about the prospect of rate cuts, now pricing the first cut in June



Source: Bloomberg, HSBC Global Private Banking as at 20 February 2024. 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	▲↑	Solid earnings growth and slowing inflation are supportive of equities. While market sentiment in the US remains strong, we also see structural opportunities in Japan and emerging Asia, supporting us to upgrade global equities to overweight.
United States	▲	With a resilient economy, strong earnings and margin power, we expect the US equity rally to continue and broaden beyond big tech to other areas including consumer discretionary, industrials, financials and healthcare stocks.
United Kingdom	▶	Valuations are cheap but sticky inflation and weak growth remain headwinds. It's too early to look for a cyclical recovery.
Europe	▼	Valuations have lagged other global markets, but growth and risk appetite remain challenged. Sticky inflation, the reliance on energy imports, geopolitical uncertainty and high exposure to China are also obstacles.
Japan	▲↑	We upgrade Japanese equities to overweight as corporate reforms, the AI investment boom and the end of the deflationary trend should create scope for further re-rating.
Emerging Markets (EM)	▶	We expect more emerging markets to cut rates following some of the Latin American countries. We prefer structural growth leaders including India, Indonesia and South Korea in Asia, as well as Mexico and Brazil in Latin America.
EM EMEA	▼	Weak growth in Europe and high global interest rate levels continue to pose challenges for the region.
EM LatAm	▲	Local rate cuts and the re-industrialisation of North America are positive drivers. Mexico benefits from the supply chain diversification while valuations of Brazil remain attractive.
Asia ex Japan equities		
Asia ex-Japan	▲	Valuations and earnings growth remain attractive despite moderating economic growth. We continue to diversify in Asia with a focus on earnings and structural leaders including India, Indonesia and South Korea.
Mainland China	▶	Recent monetary policy intervention is a positive but concerns about the structural headwinds remain. We prefer quality service consumption leaders, IT hardware linked with AI innovation, and winners in the EV supply chain.
India	▲	The recent budget announcement reinforced the trend of rising infrastructure spending while keeping fiscal discipline. Global supply chain diversification, foreign and domestic investment and young demographics are key growth drivers.
Hong Kong	▶	The property market remains under pressure. In view of the potential rate cuts by the Fed, we focus on quality developers and banks with strong balance sheets and competitive positions.
Singapore	▶	The 2024 Singapore budget indicated a return to fiscal surplus as the growth outlook improves. We expect Singapore's GDP growth to bounce back this year, supported by a rebound in industrial production and travel-related services.
South Korea	▲	South Korean equities will benefit from stronger demand for chips and related hardware thanks to the wider adoption of AI, and a recovery of the memory market. The recently announced Value-Up plan could be a new catalyst for the stock market.
Taiwan	▶	In view of strong global AI-related demand and the cyclical recovery in the broader tech sector, we continue to prefer the semiconductor and tech hardware sectors in Taiwan.
Government bonds		
Developed markets (DM)	▶	The current levels of yields justify our overweight on most developed markets government bonds with a preference for medium-to-long maturities. Japanese government bonds remain unattractive due to likely policy normalisation ahead.
United States	▲	While real yields remain elevated, we expect them to come down in coming months. Volatility can offer entry opportunities and we maintain our preference for 7-10 years.
United Kingdom	▲	As wage growth remains elevated, we expect the Bank of England to keep policy rates on hold and start cutting in summer. We stay positive on gilts and would seek opportunities to extend duration up to 10 years.
Eurozone	▶	Aggressive rate cut expectations have pushed European sovereign bonds to decline but hawkish rhetoric of most ECB governors has forced markets to consolidate. We maintain a neutral stance on sovereign debt.
Japan	▼	We expect the Bank of Japan to remove yield curve control in March and end the negative interest rate policy in Q2. This may push up bond yields and hence returns on Japanese government bonds could be hit.
Emerging Markets (Local currency)	▼	Policy rate expectations are changing, with a rebuild of risk premia. Amid USD strength, returns could be hit.
Emerging Markets (Hard currency)	▶	Amid higher Treasury volatility, we still find yield but remain selective, focusing on quality issuers.
Corporate bonds		
Global investment grade (IG)	▲	Interest rate risk is more attractively priced than credit risk, so we stick to quality with a preference for 5-7 year maturities.
USD investment grade (IG)	▲	More attractive US real yields are driving flows into USD investment grade credit compared to other markets. We favour companies with strong cash flows.
EUR and GBP investment grade (IG)	▲	EUR and GBP investment grade bond spreads are tighter relative to their US counterparts. We have taken some profit after one year of continuous spread compression but remain overweight.
Asia investment grade (IG)	▲	The fundamentals for Asian credit remain solid with attractive valuations supported by tight supply. We favour Asian financials, Indonesian quasi-sovereign IGs, South Korean IGs, Macau gaming, and Chinese technology, media and telecom.
Global high-yield (HY)	▶	We favour investment grade over high yield bonds as the spread pick-up in high yield is insufficient with default risks rising somewhat.
US high-yield (HY)	▶	Although defaults remain low and refinancing risk is manageable, risk premia are too low in our view.
EUR and GBP high-yield (HY)	▶	European HY issuers often have lower leverage than in the US, but economic growth is lower, hurting cash flows.
Asia high-yield (HY)	▶	We expect default rate to stay high in 2024 and hold the view that investment grade can deliver higher total returns versus high yield in the region.
Commodities		
Gold	▶	Despite continued risks in the Middle East, oil prices remain range-bound amid global growth concerns and broadly balanced supply and demand. Falling yields should support gold to range trade, but USD strength is an obstacle.
Oil	▶	Oil prices should remain volatile due to geopolitical reasons and uncertainties around supply and demand.

Sector Views

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

Sector	Global	US	Europe	Asia	Comment
Consumer Discretionary	▲	▲	▶	▲	Inflationary pressures have eased in many regions, but spending remains selective, benefitting only certain areas of the sector. Tourist activity helps to lift luxury demand in most regions. Hospitality and restaurants should benefit from these trends. The auto sector is seeing signs of improving demand although EV demand has dropped. European and US automaker valuations are very low reflecting concerns about their EV products being unable to compete with Asian products.
Financials	▲	▲	▲	▶	An improving economic and corporate outlook combined with solid fundamentals and low valuations should support the sector, in particular, capital markets which see an expected pick-up in trading volumes and new issuance volumes. Interest rates look set to decline but only slowly, with a modest impact on earnings. Regional banks with significant exposure to the real estate sector are experiencing some challenges.
Industrials	▲	▲	▶	▶	US Industrials are benefitting both from robust domestic demand and the reshoring/near-shoring initiatives fuelled by the US's Inflation Reduction Act (IRA) and CHIPS Act. Industrials in other regions continue to see soft demand as sentiment remains muted and capital investments are below trend. Aerospace, defence and automation remain potential bright spots.
Information Technology	▲	▲	▲	▲	Fundamentals are strong, with AI-related developments being a major growth catalyst for productivity and new applications. As a result, high-end semiconductors, digital infrastructure, software and related supply areas are all seeing growth. Consumer sentiment is also improving as new intelligent, AI-enabled products and services are introduced. Digital advertising growth is showing signs of improving.
Communications Services	▶	▲	▼	▲	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.
Materials	▶	▶	▶	▶	Iron ore and steel prices have softened in the last month, and copper and aluminium prices have remained flat for the last 18 months. Nickel's long decline has paused. Electric vehicle demand has declined as insufficient charging infrastructure has impacted consumer appetite, reducing demand for battery metals. Chemicals stocks remain range-bound. Construction materials are seeing some improvement in early demand, but weak infrastructure spending remains a headwind.
Real Estate	▼	▼	▶	▼	The outlook for commercial real estate is mixed, while retail and office segments still look unattractive. Warehousing is seeing improved demand and prices after a sustained period of weakness. The sentiment of the housing sector in some markets is improving in anticipation of lower interest rates. Chinese real estate remains problematic. Easing inflation and interest rates may lift sentiment and activity.
Consumer Staples	▶	▶	▶	▲	Consumer staples cost margins appear secure as cost pressures have 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.
Energy	▶	▶	▲	▶	Energy price momentum has stalled in oil and natural gas with unseasonably warm weather, and reserves and supplies remaining strong. Low valuations, strong cashflows and high dividend yields will attract investors, but sales and earnings growth are likely to be muted given last year's higher prices. In 2024, energy prices may not benefit from geo-political uncertainties as they have over the last two years.
Healthcare	▲	▲	▲	▼	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.
Utilities	▶	▼	▶	▲	The outlook for European and US renewable energy projects has started to improve as governments have started to adopt more realistic pricing for new project auctions following a period of unprecedented cost increases. Utilities may benefit as interest rates fall and investors look for high dividend paying stocks.

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