HSBC

Investment Monthly

Position for rate cuts and slow but positive growth in 2024

January 2024

Key takeaways

- In view of falling inflation and growth deceleration, we now expect the first rate cut to start earlier in June 2024 for the US and Europe and in August for the UK. This should support asset valuations but lower cash returns. It's therefore sensible to put cash to work in quality assets. We overweight US and Asia ex-Japan stocks, and DM government bonds (7-10 years) and IG credit (5-7 years).
- China's Politburo meeting indicated a pro-growth stance with a strategic focus on technology and innovation, industrial upgrading and green transformation. We expect to see proactive fiscal and monetary measures that will deliver solid GDP growth of 4.9% in 2024. While remaining neutral on Chinese equities, we see select opportunities in the consumption, internet and EV sectors.

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- Although 2024 is expected to be a complex year for investors, we have identified four investment themes to capture opportunities while managing market uncertainties: 1) Optimise bond returns with quality and duration; 2) Focus on large-cap stocks with attractive earnings potential; 3) Exploit opportunities from a broad range of sectors; and 4) Integrate sustainability to capture green potential. Please refer to our "Think Future 2024" for more information.

Asset class	6-month view	Comment
Global equities	▶	While falling inflation and peak policy rates support valuations and margins, we focus on quality companies amid slower global economic growth and market uncertainty, and prefer the US, Asia and LatAm in particular.
Government bonds	▶	The current levels of yields still represent an attractive entry point and this justifies our overweight on most developed markets government bonds (except for Japan) with a preference for medium-to-long maturities.
Investment grade (IG) corporate bonds	▲	With credit spreads just close to the 5-year average, we do not take excessive credit risk and favour investment grade bonds which tend to outperform amid slow but positive economic growth.
High yield (HY) corporate bonds	▶	Global high yield remains expensive relative to both future economic prospects and to investment grade, especially in USD.
Gold	▶	Real yields and our strong USD view are challenges but uncertainties and slow global growth provide support.

▲ "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.

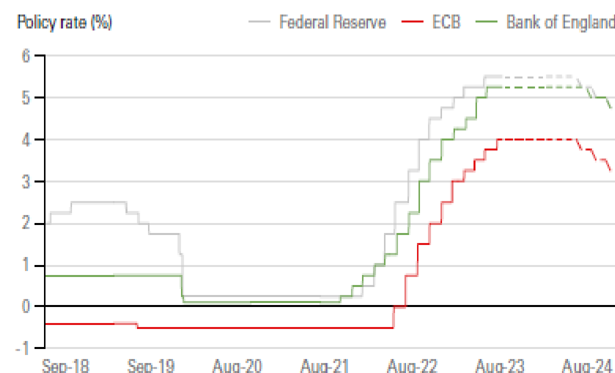
Talking points

Each month, we discuss 3 key issues facing investors

1. When will developed markets start cutting rates?

- Central banks of developed markets (DM) continued to hold policy rates unchanged in December, reaffirming our view that peak policy rates have been achieved.
- In view of further disinflation and growth deceleration, we think rate cuts will occur in 2024. However, as the Fed is now forecasting the average Fed funds rate at 3.6% in 2025, which implies an almost 2% rate cut over the next two years, we now expect the first cut in June 2024 (vs Q3 previously) with rates falling 0.75% this year. In Europe, the lower inflation backdrop has led us to also move forward the rate-cutting cycle to June. As for the UK, wage growth continues to fall but inflation is slightly stickier, so we foresee the first rate cut in Q3 2024. These cuts will weigh on cash returns.
- It therefore makes sense to put cash to work in quality stocks and bonds, as they are better positioned to withstand weaker global growth and higher capital costs. We favour US and Asia ex-Japan equities with a preference for large caps, as well as DM government bonds (7-10 years) and investment grade credit (5-7 years).

Chart 1: Policy rates seem to have peaked and we expect rate cuts later in 2024

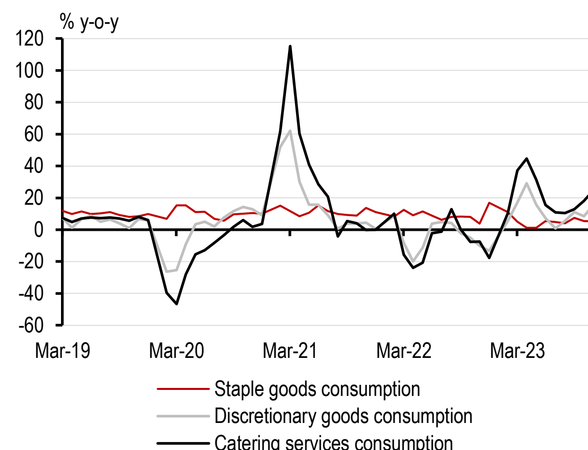


Source: Bloomberg, HSBC Global Private Banking as at 20 December 2023. Forecasts are subject to change.

2. What did China's Politburo meeting indicate?

- In the December Politburo meeting, the Chinese government exhibited its pro-growth stance with a more optimistic tone than in its July meeting, pushing for a stronger strategic focus on technology and innovation, industrial upgrading and green transformation.
- On the fiscal side, while a "big bang" stimulus package is unlikely, we expect to see ongoing bond issuance and deployment of funds for infrastructure development and maintenance, raising the official deficit to 4% of GDP in the coming years, up from 2023's 3.8%. On the monetary side, liquidity injections will be added via the medium-term lending facility (MLF), reserve requirement ratio (RRR) cuts and Pledged Supplementary Lending. The Central Economic Work Conference also pledged to provide more support for private and state-owned enterprises as well as other proactive measures (e.g., direct funding support to increase affordable housing supply) to address property market issues.
- We expect China to deliver solid GDP growth of around 4.9% in 2024. As property market stress remains a key challenge, we stay neutral on both mainland Chinese and Hong Kong equities but see select investment opportunities in the consumption, internet and EV sectors.

Chart 2: Consumption has been the pillar of China's economic recovery throughout 2023



Source: WIND, HSBC Global Private Banking and HSBC Global Research, as at 19 December 2023. Past performance is not a reliable indicator of future performance.

3. What is the outlook for 2024?

- Although the rate hike challenges in major economies are finally fading away and the likelihood of a US soft landing mitigates the risk of a global recession, slower global growth and lingering geopolitical risks, including a busy election calendar, mean that 2024 will be a complex year for investors.
- Yet, we remain positive and expect to see a mild acceleration in global growth in the second half of 2024, thanks to falling inflation which should boost consumption, while rate cuts will be positive for asset valuations and corporate earnings. We also see long-term structural trends turning into attractive investment opportunities.
- We have identified four investment themes where we see the best opportunities while managing volatility in 2024: 1) Optimise bond returns with quality and duration; 2) Focus on large-cap stocks with attractive earnings potential; 3) Exploit opportunities from a broad range of sectors; and 4) Integrate sustainability to capture green potential. The start of the year is always a good time to review your portfolio. For more information on how these themes can fit into your portfolio, please refer to our "Think Future 2024" publication and video.

Chart 3: Global economic growth is expected to slow in 2024, as is inflation in most economies

	GDP		Inflation	
	2023f	2024f	2023f	2024f
World	2.7	2.4	6.4	5.9
US	2.4	1.7	4.1	3.1
Eurozone	0.5	0.5	5.4	2.5
UK	0.3	0.6	7.3	2.4
Japan	1.9	0.8	3.3	2.6
Asia ex-Japan	4.4	4.1	2.2	2.1
Mainland China	5.2	4.9	0.2	0.5
India	7.0	6.0	5.4	5.0

Source: HSBC Global Research as at 5 January 2024. Estimates and forecasts are subject to change. India inflation forecasts are fiscal year.

Asset Class Views

Our latest house view on various asset classes

Asset class	6-month view	Comment
Global equities		
Global	▶	While falling inflation and peak policy rates support valuations and margins, we focus on quality companies amid slower global economic growth and market uncertainty, and prefer the US, Asia and LatAm in particular.
United States	▲	Continued disinflation and rate cuts should support earnings growth. Historically, US equities tend to rally well before the Fed starts cutting rates. We expect the rally to broaden beyond IT to industrials, healthcare and consumer discretionary.
United Kingdom	▶	The economy has been struggling with high costs and interest rates, leading to negative growth in Q3. Lower inflation and potentially lower rates may give more room for fiscal easing. The equity market remains relatively cheap.
Europe	▼	Weak economic activity data and slow earnings growth remain key challenges for European equities. We maintain a defensive sector positioning and favour companies in the healthcare and energy sectors.
Japan	▶	While cyclical indicators are supportive, valuations and positioning are elevated, and monetary policy is uncertain.
Emerging Markets (EM)	▶	Weaker Chinese growth, high rates and a rising USD impact EM markets to different degrees. We prefer Asia due to its positive cyclical momentum and structural growth.
EM EMEA	▼	The region is impacted by high energy prices and sluggish growth in Europe. Turkey's macroeconomic policies have improved and valuations are attractive but serious challenges remain.
EM LatAm	▲	Local rate cuts and the re-industrialisation of North America are positives. Mexico benefits from the supply chain diversification trend while valuations of Brazil remain attractive.
Asia ex Japan equities		
Asia ex-Japan	▲	Asia should remain attractive because of its improving fundamentals, strong domestic momentum in a number of markets and less inflationary pressures. India, Indonesia and South Korea are the most preferred markets.
Mainland China	▶	While the latest PMI data indicated mixed recovery momentum, proactive government policies should continue to drive a broad-based economic recovery. We prefer select opportunities in the internet, consumer discretionary, travel and Macau gaming sectors.
India	▲	The structural tailwinds from strong foreign and domestic private investments, young demographics, the technology boom and green transformation make India a bright spot to invest.
Hong Kong	▶	The weak external trade and high interest rates remain headwinds but increased cross-border activity and expected Fed rate cuts should benefit the financial services and the insurance sectors. Domestic consumption remains robust.
Singapore	▶	We see some signs of Singapore's economy bottoming out driven by an ongoing recovery in travel services and an improved trade cycle.
South Korea	▲	South Korea benefits from the AI-driven memory demand growth and DRAM price recovery. We expect to see a broad-based earnings recovery in 2024 as both the global tech cycle and global risk appetite improve.
Taiwan	▶	The equity market should benefit from the AI related themes but may see short-term volatility driven by local elections and geopolitics.
Government bonds		
Developed markets (DM)	▶	The current levels of yields represent an attractive entry point and this justifies our overweight on most developed markets government bonds (except for Japan) with a preference for medium-to-long maturities.
United States	▲	US Treasury yields have fallen from recent highs amid increased expectations of rate cuts in 2024. We nevertheless still see attractive value in long maturities and maintain our preference for 7-10 years.
United Kingdom	▲	We expect the Bank of England to keep policy rates on hold and remain positive on gilts with medium-to-long maturities.
Eurozone	▶	With the lagged impact of the rate hiking campaign yet to be fully uncovered and policy uncertainty remaining high, we prefer Eurozone sovereign with a medium-to-long duration to lock in the current attractive yields for longer.
Japan	▼	Japanese government bonds remain unattractive in our view. We expect the Bank of Japan to keep its policy rate unchanged and might exit its negative interest rate policy in Q2 2024.
Emerging Markets (Local currency)	▼	Increased volatility driven by recent fund outflows, a stronger USD and unattractive valuations warrant our underweight positioning.
Emerging Markets (Hard currency)	▶	Amid high Treasury volatility, we still find yield but remain selective, focusing on quality issuers.
Corporate bonds		
Global investment grade (IG)	▲	With credit spreads just close to the 5-year average, we do not take excessive credit risk and favour investment grade bonds which tend to outperform amid slow yet positive economic growth.
USD investment grade (IG)	▲	We prefer quality bonds for better risk-adjusted returns as yields for taking on more risks are not attractive.
EUR and GBP investment grade (IG)	▲	We favour investment grade of medium duration for better risk-adjusted returns.
Asia investment grade (IG)	▲	We focus on locking in attractive yields from quality issuers and favour Asian financials, Indian local currency bonds, Indonesian quasi-sovereign IGs, South Korean IGs, Macau gaming, and Chinese technology, media and telecom credits.
Global high-yield (HY)	▶	Global high yield remains expensive relative to both future economic prospects and to investment grade, especially in USD.
US high-yield (HY)	▶	Tight financial conditions weigh on company margins and increase the risk of defaults. We remain selective and prefer quality issuers with strong market positions and manageable debt.
EUR and GBP high-yield (HY)	▶	Economic growth momentum remains weak, and elevated rates are weighing on financing conditions.
Asia high-yield (HY)	▶	China's property related sector remains a drag on Asian high-yield bonds and we expect default rate to stay high in 2024.
Commodities		
Gold	▶	Real yields and our strong USD view are challenges but uncertainties and slow global growth provide support.
Oil	▶	In spite of production cuts, global growth concerns are weighing on oil prices.

Sector Views

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

Sector	Global	US	Europe	Asia	Comment
Consumer Discretionary	▲	▲	▶	▲	Despite easing inflation pressures in many regions, spending remains selective, benefitting only some areas of the sector. Demand for car registrations is improving although EV demand has softened on growing frustrations over the slow roll-out of charging infrastructure outside major cities. Tourist activity is also showing some signs of a seasonal pick-up. After a disappointing Q3, luxury has seen some positive signs of growth.
Financials	▲	▲	▶	▶	Valuations remain attractive while high interest rates continue to lift profits. Although the interest rate cycle may have peaked, rates may remain elevated for some time. Regional banks face headwinds as mortgage and loan activity declines mainly due to higher interests. The capital markets business remains buoyant in selected markets with new issuance and listings driving activity.
Industrials	▲	▲	▶	▶	Sector sentiment appears to be slowly improving following weaker-than-expected Q2/Q3 results, but valuations are elevated. China's growth momentum seems to be improving as greater government support is lifting demand. US industrials are gaining momentum as reshoring, fuelled by the US's Inflation Reduction Act (IRA) and CHIPS Act, is boosting activity. Europe remains in the doldrums. Automation and related businesses are seeing a sharp improvement in orders.
Information Technology	▲	▲	▲	▲	Fundamentals continue to improve, with AI being a major catalyst for new areas of growth. Digital infrastructure and software are seeing solid activity. Strong demand for high-end semis is being driven by buoyant automation and AI as business and consumer sentiment are improving. Cloud computing and digital advertising growth remain muted.
Communications Services	▶	▶	▼	▲	US sector fundamentals remain positive, with one of the strongest earnings growth rates forecast over the next 12 months driving a strong YTD performance. The outlook in Europe, which is more focused on telecom services, remains challenging. Asia offers a more attractive risk-return profile given the low valuations and stabilising regulatory environment.
Materials	▶	▶	▶	▶	Commodity prices have stabilised with iron ore, copper and steel prices partially recovering over the last few months. For other metals, prices have been flat or negative. Sector valuations are full. Overall, the outlook has improved marginally with government capital programmes and electrification (EVs, tech and renewables) lifting demand in some areas.
Real Estate	▼	▼	▶	▼	Real estate remains in a difficult place with the dual pressures of higher interest rates and inflation hurting margins and consumers alike. Financing is expensive and default risk has increased. Construction activity remains slow, but may have troughed, with some early signs of an increase in activity from iron, steel and cement producers.
Consumer Staples	▶	▶	▶	▲	Cost margins 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 is trading in line with historical valuations. We focus on quality stocks with strong brands and more resilient pricing power.
Energy	▲	▲	▲	▲	Geopolitical risks remain high as OPEC+ has kept oil and gas supplies tight, but high prices seen in 2022, particularly in Europe, have not recurred so far. Further cuts from OPEC+ could drive prices higher. Valuations are very low relative to other sectors despite robust cash flow and stable high dividends.
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 underperformance. New pharma products should lift sentiment and expectations. In Asia, valuations remain elevated, trading well above historical levels.
Utilities	▶	▼	▶	▶	European and US renewable energy companies are facing headwinds on anticipated new and existing development projects as rising costs are severely eroding expected returns and projects are facing long delays in grid connections. As a result, US's IRA and Europe's green initiatives have slowed.

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