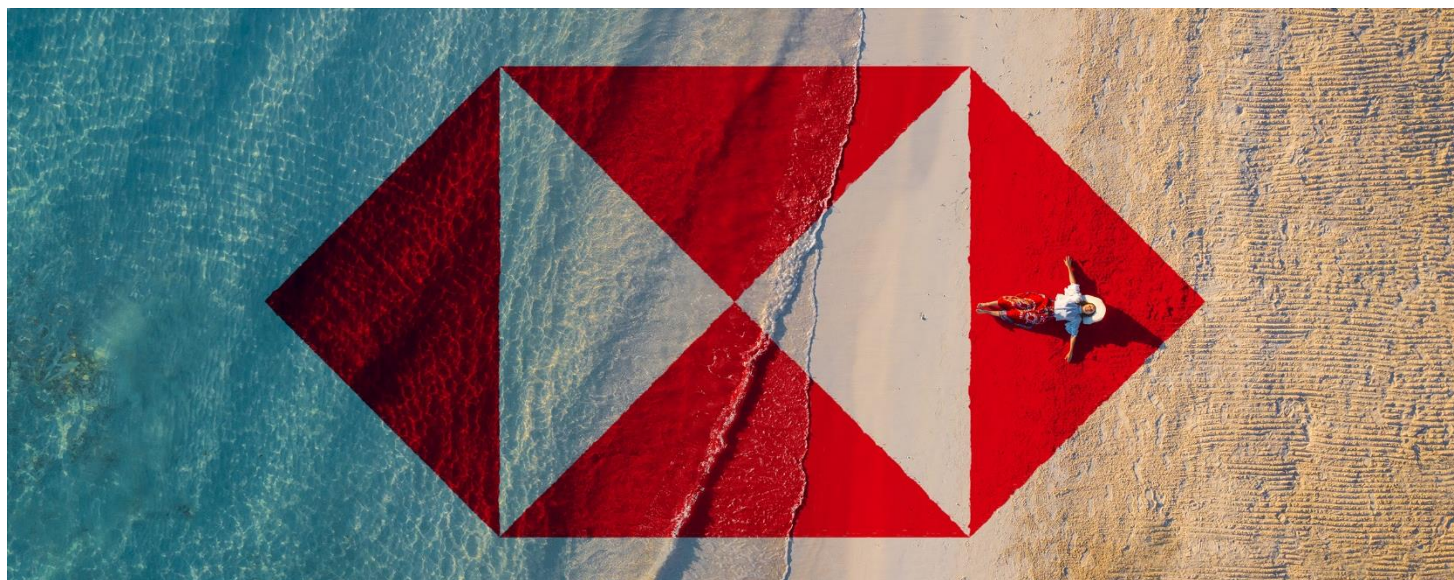
HSBC

Investment Monthly

Markets rebound on easing US recession concerns

September 2024



Key takeaways

- US recession fears have eased on solid earnings growth along with more constructive labour market data, supporting a quick rebound in US equities. A Fed rate cut is widely expected in September. While we remain bullish on US equities, we also favour UK, Indian and South Korean equities to achieve diversification amid slowing growth and rising market uncertainties.
- Investors returned to the tech sector, especially after the fall in its valuations, but we see opportunities both within and beyond the sector, such as communications, financials and healthcare. We upgrade US industrials due to re-onshoring and the support from both US presidential candidates. Consumer discretionary is facing margin pressures amid US economic growth and global activity slowing down, so we downgrade the sector to neutral across regions.
- Fed Chair Powell set the stage for the first rate cut in September at the Jackson Hole summit, with markets now pricing in 1% worth of rate cuts by end-2024, higher than our projection of 0.75%. As cash returns will be diminishing, bonds are important for income generation and diversification. We focus on locking in current bond yields near multi-year highs and prefer investment grade bonds (5-7 years) to government bonds for better yield pick-up.

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Asset class	6-month view	Comment
Global equities	▲	We think global equities can rally further on the back of solid earnings growth, rate cuts and high cash balances. We look beyond the US and IT to capture the broad-based upside.
Government bonds	▼	Given market expectations of too many Fed rate cuts, we stay neutral on US Treasuries and UK gilts. Unattractive Japanese government bonds lead our overall government bond positioning to underweight.
Investment grade (IG) corporate bonds	▲	We prefer quality bonds amid slowing global growth and rising market uncertainties. Investment grade is preferred because of its attractive credit spreads, resulting in a higher yield than on government bonds.
High yield (HY) corporate bonds	▶	High yield bonds are sensitive to potentially adverse economic developments and are trading at tighter valuations. Their yield pick-up is insufficient for rising default risks.
Gold	▶	Uncertainty has driven gold to high levels but physical demand is waning at current high price levels.

▲ "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.

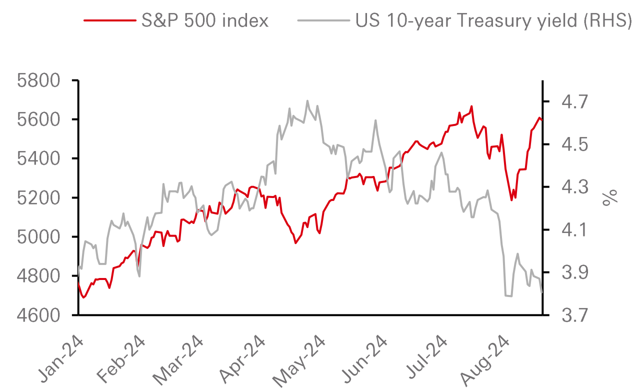
Talking points

Each month, we discuss 3 key issues facing investors

1. What is the outlook for equities following the recent sell-off?

- Following the summer tumble triggered by US recession fears, rich tech valuations, sector rotation and an unwind of the Japanese yen for the carry trade, global equity markets have rebounded quickly.
- Although activity is slowing in the US, it is not stalling. Solid earnings growth, along with some positive labour market data, have pushed US equities back to their recent highs. Meanwhile, a widely-expected Fed cut in September and the less hawkish tone of the Bank of Japan indicating gradual rather than quick hikes have restored market confidence.
- Thanks to continued earnings growth, potential rate cuts and high cash balances, we think US equities will rally further. However, markets are likely to remain volatile given moderating growth and the upcoming US election. While we remain bullish on US equities, we stay diversified with exposure to global equities, favouring the UK, Japan, India and South Korea as well. A multi-asset strategy can also help investors achieve diversification while managing market volatility.

Chart 1: Equities have rebounded sharply after the recent sell-off

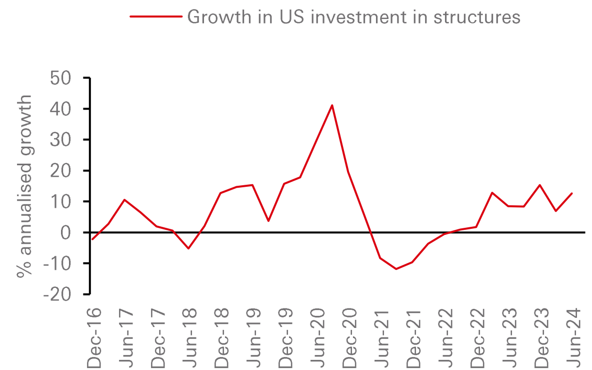


Source: Bloomberg, HSBC Global Private Banking and Wealth as at 20 August 2024. Past performance is not a reliable indicator of future performance.

2. How are sectors affected by the latest market development?

- The US economy slowing to more moderate levels temporarily led to sector rotation away from technology into small-cap stocks, but investors have returned to the sector after valuations have come down. The AI boom and structural trends continue to offer opportunities within and beyond technology, including communications services, financials and healthcare.
- We upgrade US industrials to overweight due to re-onshoring and the support from both US presidential candidates who are keen to bring production back home and support employment in the sector. Both government and corporate investment and technological innovation are also supportive.
- Although falling inflation and still low unemployment are positive for consumer discretionary, some areas (e.g. autos) are facing margin pressures amid US economic growth and global activity slowing down. We therefore downgrade the consumer discretionary sector to neutral across regions. Overall, we keep broadening our sector exposure to capture the earnings momentum.

Chart 2: US companies' capital investment continues at a solid clip

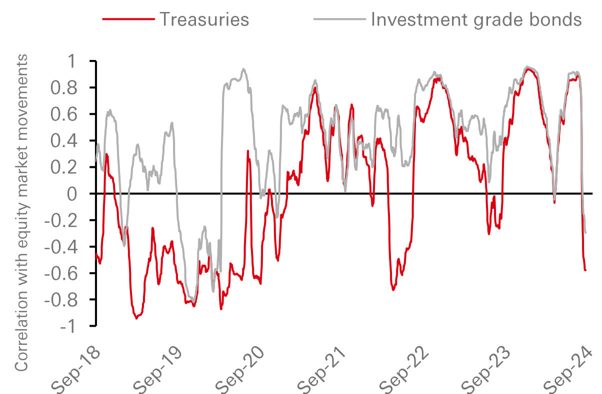


Source: US Bureau of Economic Analysis, HSBC Global Private Banking and Wealth as at 20 August 2024.

3. What did we learn from the Jackson Hole summit?

- Fed Chair Powell's statement at the Jackson Hole Economic Symposium that the "time has come for policy to adjust" set the stage for the first rate cut at the FOMC meeting on 18 September. He also pointed out that the labour market is no longer overheated with rising unemployment caused by an increase in labour supply rather than elevated layoffs.
- US Treasuries rallied sharply in early August in response to rising recession fears, with Fed rate cuts of 1.2% by end-2024 being priced in. The expectation has now fallen to 1%, which is still higher than our projection of 0.75%. Nevertheless, cash returns will come down further and lose their appeal.
- The correlation between equities and bonds has declined significantly as a reaction to weaker economic data, reinforcing the important role of bonds for income generation and diversification. We continue to focus on locking in multi-year high bond yields and favour quality bonds, particularly investment grade with 5-7 years duration, which offer more attractive credit spreads than US Treasuries with similar duration risk.

Chart 3: Bonds' diversification potential has risen sharply as bond/equity correlations are now negative



Source: Bloomberg, HSBC Global Private Banking and Wealth as at 20 August 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	▲	We think global equities can rally further on the back of solid earnings growth, rate cuts and high cash balances. We look beyond the US and IT to capture the broad-based upside.
United States	▲	Despite slowing economic growth, Fed rate cuts and long-term structural trends should support broadening of earnings growth across sectors. We believe US recession risk is overstated and maintain our biggest overweight on US equities.
United Kingdom	▲	UK equities are very cheap compared to global markets and a bit more defensive. Both growth and the earnings outlook are improving with relative political stability post-election.
Europe ex-UK	▶	We find some value in Europe but stick to global companies with strong earnings. Spain stands out with its relative resilient economic momentum and attractive valuations.
Japan	▲	Corporate governance reforms, improving earnings growth and the AI boom remain key drivers for Japanese equities.
Emerging Markets (EM)	▶	We are most positive on EM Asia where corporate earnings growth is likely to rebound sharply in 2024.
EM EMEA	▼	The region is impacted by high energy prices and global interest rates, as well as geopolitical uncertainty.
EM LatAm	▼	Political uncertainty in Mexico and slowing rate cuts in Brazil may trigger selling.
Asia ex Japan equities		
Asia ex-Japan	▲	We continue to diversify into the region to capture its structural growth opportunities, focusing on India's strong growth momentum while the global AI trend should benefit South Korea. We remain neutral in China until growth improves.
Mainland China	▶	Macro-economic data remain mixed while policy support is being ramped up to revive growth recovery. We prefer corporate governance reform winners, quality SOEs paying high dividends and internet leaders with solid earnings.
India	▲	Robust cyclical growth, strong earnings momentum and continued structural reforms continue to drive India's long-term growth, complemented by budget focus on fiscal discipline, job creation, and rural and agricultural reforms.
Hong Kong	▶	Lingering headwinds in the property market, weak consumer confidence and mixed economic data remain key challenges for Hong Kong equities. We prefer the insurance, telecom and utility sectors, as well as quality REITs and developers.
Singapore	▶	Select high-quality Singapore REITs could benefit from the global central banks' rate-cutting cycle.
South Korea	▲	The AI-driven tech investment boom has lifted higher memory prices and demand for high bandwidth memory chips while the Corporate Value-Up Programme contributes to re-rating of the equity market.
Taiwan	▶	The equity market is benefitting from the AI boom and strong demand for semiconductors. As valuations are expensive, we remain neutral.
Government bonds		
Developed markets (DM)	▼	Given market expectations of too many Fed rate cuts, we stay neutral on US Treasuries and UK gilts. Unattractive Japanese government bonds lead our overall government bond positioning to underweight.
United States	▶	The downward move in US Treasury yields has gone too quickly, leading us to hold a neutral position and shorten duration to 5-7 years.
United Kingdom	▶	With the beginning of the rate-cutting cycle, we expect policy rates to go further down but markets have priced in too many cuts. We maintain our neutral stance and focus on locking in higher rates now.
Eurozone	▶	Europe is gradually recovering but absolute yields remain relatively less attractive compared to those in the US.
Japan	▼	We expect the next rate hike to occur in Q1 next year to minimise disruption to the reflation momentum and remain bearish on Japanese government bonds.
Emerging Markets (Local currency)	▼	We remain bearish on EM local currency bonds given the strong US dollar and a slowing pace of disinflation across EM economies but stay positive on Indian local currency bonds for their attractive yields and strong liquidity support.
Emerging Markets (Hard currency)	▶	We still find yields but remain selective and generally focus on quality issuers.
Corporate bonds		
Global investment grade (IG)	▲	We prefer quality bonds amid slowing global growth and rising market uncertainties. Investment grade is preferred because of its attractive credit spreads, resulting in a higher yield than on government bonds.
USD investment grade (IG)	▲	While US growth is slowing, we remain overweight on US investment grade for their quality and attractive yield pick-up.
EUR and GBP investment grade (IG)	▲	Europe is recovering gradually, and we focus on quality issuers with medium duration, preferably companies with global business exposure.
Asian investment grade (IG)	▲	In expectation of Fed rate cuts, we focus on locking in multi-year high yields from Asian IG bonds with 5-7 years duration and favour Asian financials, Indian local currency debt, Indonesian quasi-sovereign bonds, Macau gaming and Chinese TMT.
Global high-yield (HY)	▶	High yield bonds are sensitive to potentially adverse economic developments and are trading at tighter valuations. Their yield pick-up is insufficient for rising default risks.
USD high-yield (HY)	▶	Despite low defaults and manageable refinancing risk, the risk premia of US high yield is too low versus investment grade.
EUR and GBP high-yield (HY)	▶	Although growth has bottomed, spreads in high yield remain tight compared to historical averages, so are less attractive.
Asian high-yield (HY)	▶	Given the property market challenges and mixed economic data in China, credit selection remains key and we prefer quality issuers to hedge against cyclical weakness and geopolitical risks.
Commodities		
Gold	▶	Uncertainty has driven gold to high levels but physical demand is waning at current high price levels.
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
Consumer Discretionary	▶↓	▶↓	▶↓	▶↓	We downgrade the sector in all regions on weak discretionary spending trends. Q2 results were mixed as customers became selective or traded down. Generally, companies' H2 guidance was for slower growth. Even hospitality and tourism are seeing signs of cooling demand. Autos remain in turmoil as supply chain issue re-emerges and EV demand continues to decelerate. Home appliance demand remains subdued pending a recovery in home sales.
Financials	▲	▲	▶	▶	Globally and in the US, the sector continues to benefit from an improving economic backdrop while interest rates look set to decline slowly with a modest impact on earnings. Capital market activity has picked up. Regional banks with significant exposure to the real estate sector and loans remain an area of concern. Weather related events including a forecast record Atlantic hurricane season are likely to weigh on the insurance and re-insurance segments.
Industrials	▲↑	▲↑	▶	▲	We upgrade US industrials ahead of an expected pick-up in orders in H2. We expect a re-rating on earnings to ease valuations. Asian industrials are showing tentative signs of slowly improving fundamentals. Medium term, we remain positive on the sector as government policy remains supportive in China, Europe and, especially, the US where the Inflation Reduction Act (IRA) and CHIPS Act are driving significant investment in new production capacity and infrastructure.
Information Technology	▲	▲	▲	▲	Big tech stocks have seen some pullback 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.
Communications Services	▶	▲	▼	▲	The US communications sector continues to deliver stellar earnings growth 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	▶	▶	▶	▶	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. M&A activity has sparked interest in the miners. Chemical stocks remain range-bound while the chemical business remains subdued.
Real Estate	▼	▼	▶	▼	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.
Consumer Staples	▶	▶	▶	▲	Strong competition and consumers trading down have created a weak pricing environment for companies in many markets. As a result, Q2 sales results were generally disappointing with margins squeezed by continuing wage inflation. The sector is trading in line with historical valuations limiting potential upside.
Energy	▶	▶	▲	▶	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, backed 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.
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 while new pharma products should lift sentiment and expectations. In Asia, valuations remain high, trading well above historical levels.
Utilities	▶	▶	▶	▲	Momentum is re-accelerating on renewable energy projects as governments have started to adopt more realistic pricing for new projects. 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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