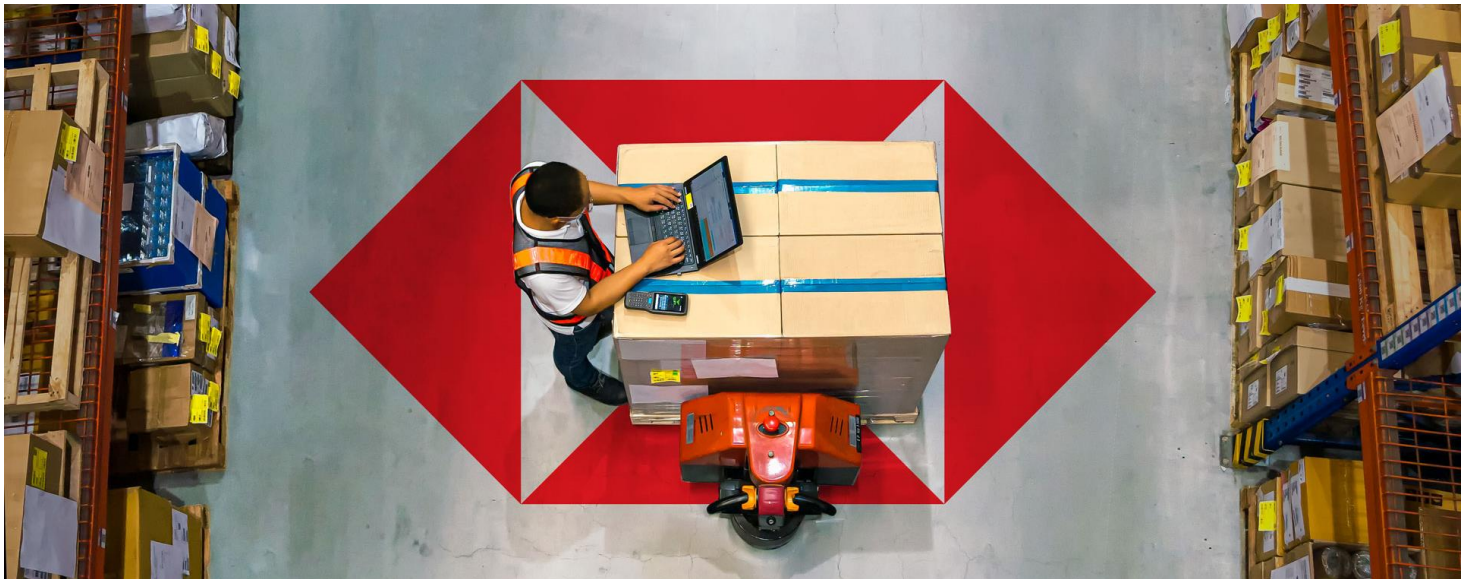


Investment Monthly

[Update] Focus on earnings while rising US recession fears and Fed rate cut expectations seem overdone

August 2024



Key takeaways

- ◆ Weaker-than-expected US job data and mixed earnings for some big tech companies have raised recession fears and Fed rate cut expectations. We think both are exaggerated. While we remain overweight on US equities with a balanced sector exposure, we downgrade US Treasuries and UK gilts. We still favour investment grade for their attractive spreads and diversification benefits.
- ◆ While China's Third Plenum focused on 1) new quality productive forces; 2) technological innovation; 3) macroeconomic policy governance; 4) integrated urban and rural development; and 5) further opening-up foreign trades and investment, we think more near-term policy stimulus would be needed to sustain economic recovery. We stay neutral on Chinese stocks and favour corporate governance reform winners, quality SOEs and internet leaders.
- ◆ The 2024 Indian Budget centred on driving fiscal discipline, as well as near and medium-term growth. Projected FY25 fiscal deficit is now down to 4.9% while gross and net borrowing will be lowered to INR14tr and INR11.6tr, respectively. Other positive measures, such as employment and skilling programmes for the youth, loan limit increases for small firms, and capital expenditure should help boost the consumption, industrials and financials sectors.



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 | ▲ | Long-term fundamentals remain positive. Future central bank easing should be accretive to corporate earnings while technology helps lower costs and lift revenues. We look beyond the US and IT to capture the broad-based upside. |
| Government bonds | ▼↓ | We downgrade US Treasuries and UK gilts to neutral as markets price in too many Fed rate cuts. We remain underweight on Japanese government bonds, leading to an underweight government bond positioning as a whole. |
| Investment grade (IG) corporate bonds | ▲ | We stick to quality amid slowing global growth and rising geopolitical uncertainty and prefer investment grade for its shorter duration than government bonds and its attractive credit spreads. |
| High yield (HY) corporate bonds | ▶ | High yield bonds are more sensitive to negative economic developments, higher financial leverage ratios and tighter valuations. Their yield pick-up is insufficient for rising defaults. Valuations remain stretched. |
| Gold | ▶ | A USD rebound could halt gold upside while demand is also starting to struggle at current high prices. |

▲ "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. How should investors position amid recent US market volatility?

- ◆ Weaker-than-expected US job data have caused recession fears, leading to aggressive rate cut expectations and a sharp rally in US Treasuries recently. Mixed earnings for some of the big tech companies and high-tech valuation concerns have also triggered a sector rotation.
- ◆ The US economy is slowing but not contracting. While job creation is falling, layoffs are low, and healthy real wage growth remains positive for consumption. With continued earnings surprises and corporate margins at a record high, we maintain our US equity overweight and balanced sector exposure, broadening within tech and across sectors including financials, communications, consumer discretionary and healthcare. In fact, the structural growth in tech and rate cuts should remain supportive of its performance.
- ◆ As markets have now priced in 1.25% cuts this year, and 2.25% by late 2025, which we think are overdone though, we downgrade US Treasuries to neutral, and do the same with UK gilts, while reducing our duration to medium (5-7 years). We still favour investment grade credit for their attractive spreads and solid income stream. Quality bonds remain a good diversifier amid cyclical weakness and geo-political risks.

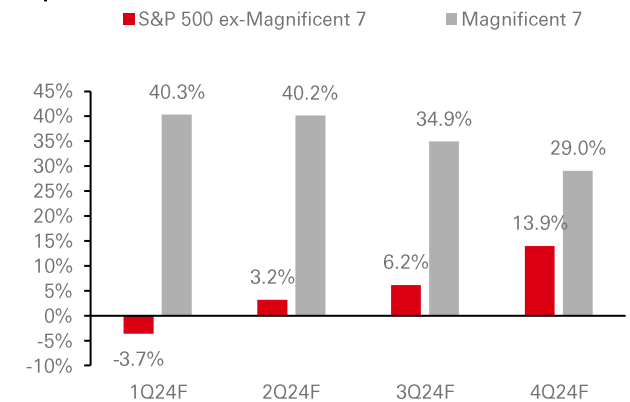
2. What are the investment implications of China's Third Plenum?

- ◆ China's Third Plenum focused on the quality development in five key areas: 1) new quality productive forces; 2) technological innovation; 3) macroeconomic policy governance; 4) integrated urban and rural development; and 5) further opening-up foreign trades and investment. It also reiterated the commitment to mitigate risks in real estate, local government debt, and small-and-medium financial institutions.
- ◆ Enhanced market access in the services sector and the domestic capital markets (including the expansion of Stock Connect and Bond Connect for offshore investors) should help attract more foreign investment.
- ◆ However, we think more near-term and broad-based stimulus would be helpful to achieve this year's 5% GDP growth target. We remain neutral on Chinese stocks and prefer corporate governance reform winners, quality SOEs and internet leaders with solid earnings. Service consumption is preferred due to its high resilience versus general goods sales. The high-tech sector and high-end manufacturers should also benefit from supportive policies on innovation. The reduction of the 7-day reverse repo rate and the 1-year medium-term lending facility (MLF) rate is seen as a positive move by the government to revive the economy.

3. What should investors note from India's Union budget?

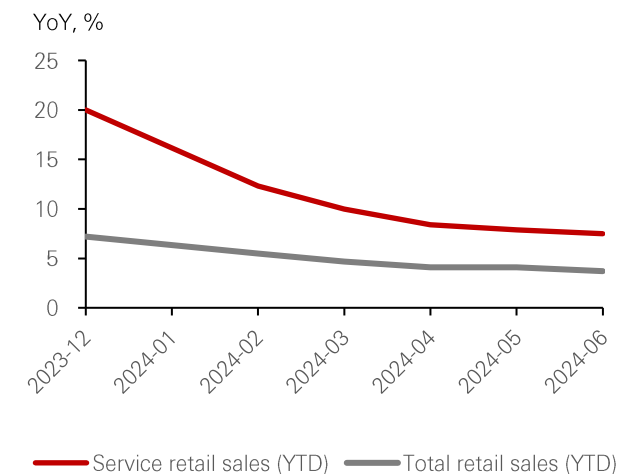
- ◆ The first budget under the Modi 3.0 government centred on driving fiscal discipline, as well as near and medium-term growth via nine priorities: 1) productivity and resilience in agriculture; 2) employment and skilling; (3) inclusive human resource development and social justice; (4) manufacturing services; (5) urban development; (6) energy security; (7) infrastructure; (8) innovation and R&D; and (9) next generation reforms.
- ◆ Projected FY25 fiscal deficit is now down to 4.9% (from 5.1%) and FY26 fiscal deficit target remains at 4.5%, while FY24 fiscal deficit was also lowered to 5.6%. Gross and net borrowing will be reduced to INR14tr and INR11.6tr respectively. Other measures include employment and skilling programmes for the youth, loan limit increases for small firms, as well as capital expenditure and massive home build.
- ◆ These measures help boost the consumption, industrials and financials sectors, complementing India's robust economic growth, strong earnings growth and sticky domestic investor base. We remain positive on Indian equities while Indian government bonds should benefit from the country's manageable borrowing needs and strong foreign inflows.

Chart 1: As earnings momentum outside of the Mag7 improves, we continue to broaden our exposure



Source: LSEG, I/B/E/S, HSBC Global Private Banking and Wealth as at 5 August 2024. Forecasts are subject to change. "Mag 7" refers to Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia and Tesla.

Chart 2: Growth of service consumption has stayed stronger than general retail sales in China



Source: WIND, HSBC Global Private Banking and Wealth as at 19 July 2024. Past performance is not a reliable indicator of future performance.

Chart 3: Consensus 12-month forward P/E ratio and EPS growth estimates

| | P/E Ratio | 2024 EPS(g) | 2025 EPS(g) |
|------------------------|-------------|--------------|--------------|
| MSCI India | 25.8 | 31.5% | 18.7% |
| Financials | 17.9 | 24.8% | 23.4% |
| IT | 29.3 | 7.6% | 9.9% |
| Energy | 17.3 | 56.9% | 7.2% |
| Consumer Discretionary | 32.8 | 144.2% | 14.7% |
| Industrials | 45.2 | 71.7% | 23.6% |
| Consumer Staples | 54.3 | 22.4% | 15.0% |
| Materials | 25.1 | 4.9% | 35.1% |
| Healthcare | 34.7 | 34.8% | 16.2% |
| Utilities | 21.1 | 36.5% | 10.0% |
| Communication Services | 46.7 | 118.4% | 52.5% |
| Real Estate | 67.4 | 107.1% | 26.8% |

Source: Bloomberg, HSBC Global Private Banking and Wealth as at 23 July 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 | ▲ | Long-term fundamentals remain supportive. Future central bank easing should be accretive to corporate earnings while technology helps lower costs and lift revenues. We look beyond the US and IT to capture the broad-based upside. |
| United States | ▲ | While earnings and the prospect for rate cuts are supportive of US equities, we are broadening exposure to a wider variety of sectors. We think US recession risk is overstated but short-term volatility remains. |
| United Kingdom | ▲ | Amid an improving growth and earnings outlook, undemanding stock valuations, easing interest rates and political stability after the election, we remain overweight on UK equities. |
| Europe ex-UK | ▶ | Despite an improvement in the services sector, manufacturing remains a drag. However, we still see opportunities in attractively-priced leading global companies. |
| Japan | ▲ | Wage growth continues to sustain the reflationary outlook and consumption recovery, supporting the BoJ to further raise interest rates gradually. Corporate governance reforms, strong earnings growth and the AI boom remain key drivers. |
| 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. We maintain our underweight stance on EM LatAm equities. |
| 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 and the global AI trend which benefits South Korea. |
| Mainland China | ▶ | We believe a durable re-rating would require more sustained fundamental improvement and remain selective, focusing on corporate governance reform winners, quality SOEs paying high dividends and blue-chip internet leaders with solid earnings. |
| India | ▲ | The Indian Budget focused on fiscal discipline, rural and welfare reforms and job creation, benefitting the consumption, financials and industrials sectors. Valuations have re-rated but are justified by strong earnings and economic growth. |
| Hong Kong | ▶ | The government's latest initiatives should support investment sentiment amid economic and capital market challenges. We prefer the insurance, telecom and utility sectors, as well as quality REITs and developers. Valuations are attractive at 11.7x. |
| Singapore | ▶ | We expect the central bank to keep interest rates on hold in 2024 and prefer high-quality REITs on their undemanding valuations. |
| South Korea | ▲ | Corporate earnings expectations remain bullish while valuations are also attractive. The "Corporate Value-Up Programme" is expected to bring attractive re-rating opportunities. |
| Taiwan | ▶ | The equity market is benefitting from the AI boom, but valuations are expensive, so we remain neutral. |
| Government bonds | | |
| Developed markets (DM) | ▼↓ | We downgrade US Treasuries and UK gilts to neutral as markets price in too many Fed rate cuts. We remain underweight on Japanese government bonds, leading to an underweight government bond positioning as a whole |
| United States | ▶↓ | With markets pricing in aggressive rate cuts which push yields down further, we downgrade US Treasuries to neutral and reduce duration to medium. We hold our view that the first Fed rate cut should come in September. |
| United Kingdom | ▶↓ | Although the Bank of England has now started its rate cut cycle, it was a split decision. Given sticky service price inflation, we do not think the Bank will cut as much as markets expect. Hence, we move our view from positive to neutral. |
| Eurozone | ▶ | Although the market has priced in a likelihood of a rate cut in August, we maintain our view of two rate cuts in September and December. Absolute yields remain relatively less attractive compared to those in the US. |
| Japan | ▼ | We think the BoJ will further normalise its monetary policy via rate hikes and by reducing its bond buying as inflation and wage growth is moving in the right direction. As bond yields remain unattractive, we remain underweight. |
| Emerging Markets (Local currency) | ▼ | A high-for-longer US rate environment weighs on several EM currencies and affect bond returns. We stay positive on Indian local currency bonds for yield pick-up and diversification benefits. |
| Emerging Markets (Hard currency) | ▶ | We still find opportunities in selected quality issuers in emerging markets, where the yields remain appealing. |
| Corporate bonds | | |
| Global investment grade (IG) | ▲ | We stick to quality amid slowing global growth and rising geopolitical uncertainty and prefer investment grade for its shorter duration than government bonds and its attractive credit spreads. |
| USD investment grade (IG) | ▲ | Ahead of the Fed policy pivot, we continue to focus on locking in the attractive yields at multi-year highs from quality issuers. |
| EUR and GBP investment grade (IG) | ▲ | As a ceiling on yields has likely been reached, we continue to favour European credit, preferably large-cap companies with well diversified business models across countries and regions. |
| Asian investment grade (IG) | ▲ | The fundamentals for Asian IG bonds remain solid with the current valuations well supported by the tight supply. We prefer Asian financials, Indian local currency bonds, Indonesian quasi-sovereign bonds, Macau gaming and Chinese TMT. |
| Global high-yield (HY) | ▶ | High yield bonds are more sensitive to negative economic developments, higher financial leverage ratios and tighter valuations. Their yield pick-up is insufficient for rising defaults. Valuations remain stretched. |
| 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 challenging environment of the property market and mixed economic recovery data in China, we focus on quality issuers in the region. |
| Commodities | | |
| Gold | ▶ | A USD rebound could halt gold upside while demand is also starting to struggle at current high prices. |
| 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 | ▲ | ▲ | ▲ | ▲ | Consumers have adapted to the higher interest rate environment backed by easing inflation and higher wages. The outlook for hospitality and tourism looks particularly positive although luxury goods sales growth is more muted. Unseasonal weather is again disrupting seasonal buying patterns. Autos remain in turmoil as supply chain issue re-emerges and EVs demand troughs due to poor EV charging infrastructure. 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 | ▶ | ▶ | ▶ | ▲ | US Industrials remain steady, but near-term momentum potential is limited given present 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 a pull-back as markets worry about high valuations and earnings have been mixed. In the medium-term, though, we think 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 | ▶ | ▶ | ▶ | ▲ | Consumers are still trading down in some markets as cost-of-living pressures continue to bite. 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 some pricing power. |
| 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 uncertainty 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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