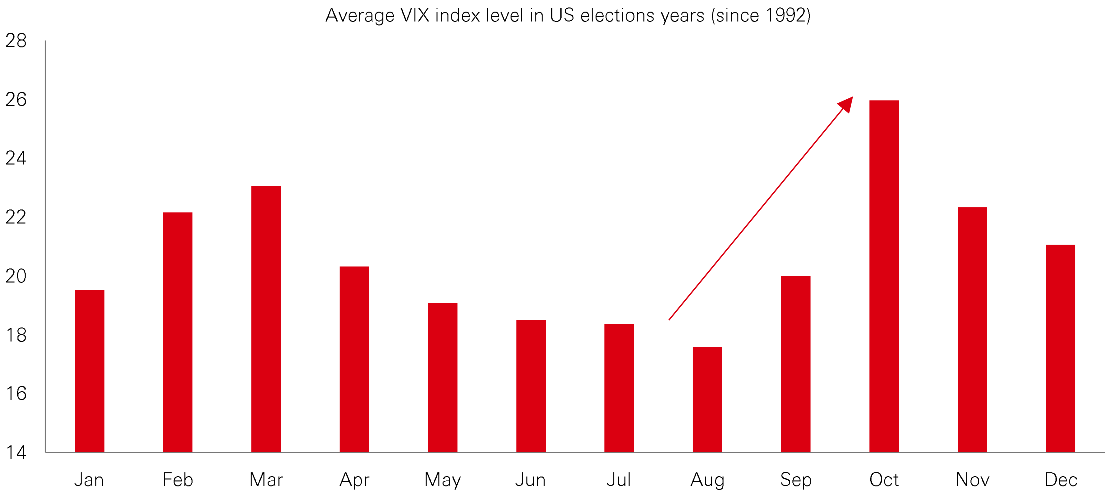
Investment Weekly

29 July 2024

Chart of the week – Buckle up for H2



This year's market action has been characterised by exceptionally low levels of volatility. One of the most followed gauges of equity market volatility – the VIX – has averaged 13.9 in 2024 so far, versus 21.2 over the past five years. But the VIX has picked up recently. The index jumped last week to reach 19.2 at one point.

As H2 progresses, there may be plenty of potential developments that could create a more volatile market environment. As we've seen over the past fortnight**, stretched valuations in US big tech stocks have made prices vulnerable to any disappointment on earnings and the general news flow in the sector**.

And although the economic backdrop remains robust, further cooling is likely as restrictive policy continues to dampen housing and manufacturing activity, and the consumption of lower-income households, which is more dependent on access to credit. Despite the recent good news, the disinflation path is likely to remain bumpy with uncertainty on the extent of Fed easing over the next few quarters. Geopolitics and politics also matter. The global environment is becoming less predictable. And we know from history that equity market volatility typically rises ahead of US elections. Buckle up.

Equities →

Looking at defensive value strategies

Yield Curve →

Positioning for potential moves in bond yields

Frontier Markets →

Strong regional performance in a mispriced asset class

Market Spotlight

India's 'reset budget'

Last week marked India's first Union Budget since the country's hotly contested general election earlier this year. Ahead of the announcement, there were concerns about whether Narendra Modi's BJP, which failed to secure a majority in parliament, could balance competing political demands and still maintain fiscal prudence. As it turned out, the budget committed to reducing the fiscal year 2025 (April 2024 through March 2025) central government deficit target to 4.9% of GDP from 5.6% in FY24. It also addressed pressing issues on growth, reforms, and employment.

This 'reset budget' should be positive for the medium-term macro and market outlook. For stocks, plans for a simplified tax code should boost the earnings outlook. Likewise, a shift in capex spending to 'soft infrastructure' like education and training – while maintaining a focus on hard infrastructure – are encouraging. These themes should be a plus for sectors like industrials and manufacturing. And efforts to boost job creation should prove positive for the consumer staples sector and autos segment, too. **While equity valuations are fairly stretched at 24x forward price-earnings, robust earnings growth means India can still perform well in 2024.**

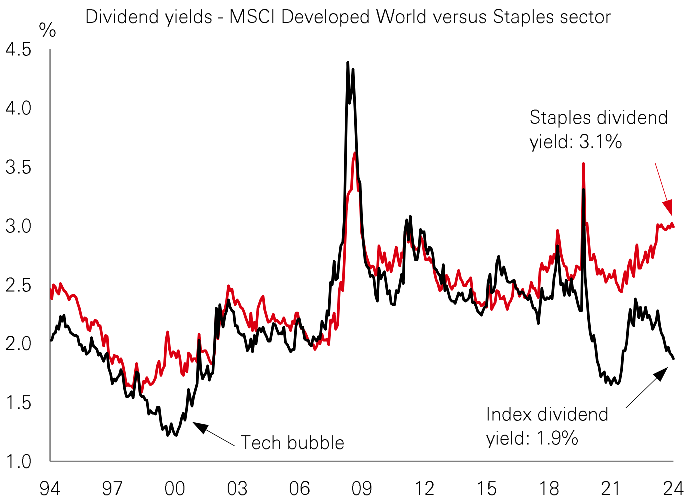
Source: HSBC Asset Management. Macrobond, Bloomberg. Data as at 11.00am UK time 26 July 2024.

Defensive value

In recent weeks, stocks have seen a major factor rotation from Growth into Value involving the biggest switch out of the tech-heavy Nasdaq into the small-cap Russell 2000 since 1979. This has been largely driven by growing expectations of lower rates amid some disappointing news in the tech sector.

From here, the hunt for value in stocks could well continue. But there are risks if economic growth disappoints. For the risk averse, it could make sense to take a more defensive value approach, with some bond-like equities potentially offering protection from macro headwinds alongside high dividend yields.

Looking at Fed cycles since 1994, defensive stocks normally outperform between the last Fed hike and first rate cut. This time around has been different, with defensives like staples and utilities underperforming the market since the last hike in July 2023. This has contributed to the significant gap in dividend yields between the staples sector versus the wider market.

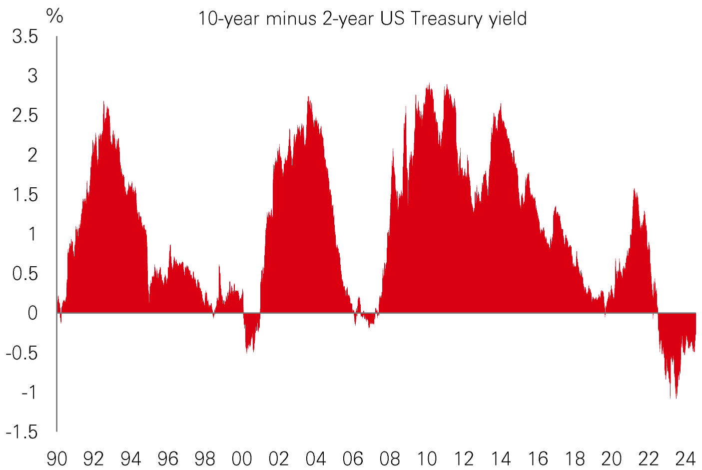


Curve ball

Recent US macro data have led investors to become far more comfortable with the idea that the Fed can cut rates twice, or possibly more, this year. The initial triggers for this reassessment were some softer-than-expected ISM surveys, a moderation in private sector payrolls and further gradual increase in the unemployment rate. A second consecutive lower-than-expected core CPI inflation print then reinforced the downtrend in rates.

Disinflation and a cooling labour market create a bond-positive environment, with investors able to benefit from still-attractive yields and the potential for capital gains, particularly if growth disappoints.

For investors, yield curve strategies are also an option. Despite short-term rate expectations coming down, the 10y-2y curve remains inverted**. This inversion is likely to be unsustainable**. In the mid-to-late 1990s – when a soft landing was achieved – the slope of the curve was typically positive, peaking at over 80bp. And in the event of downside growth risks materialising, the curve could steepen very quickly as policy rates are slashed.

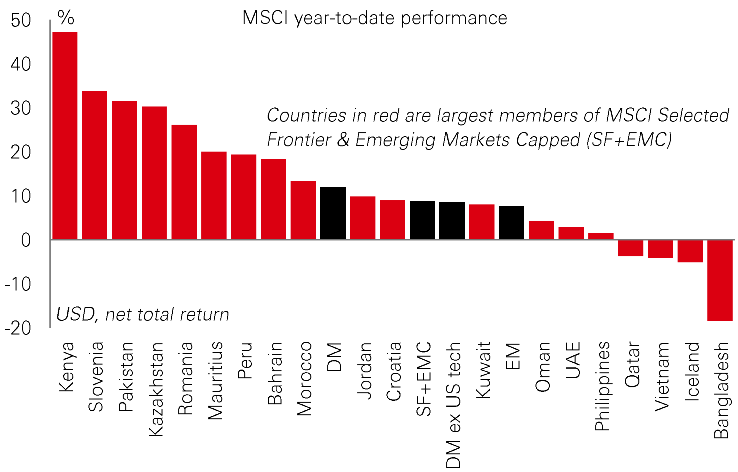


Frontier on the front foot

Equity markets in several frontier and small-emerging market regions have delivered impressive returns this year, outperforming both emerging and developed markets – with strong performances from markets in Kenya, Kazakhstan, Slovenia, and Romania.

In the current economic cycle, for many frontier markets, relative GDP growth is accelerating, and inflation is falling (along with domestic interest rates). This is leading to a pick-up in the outlook for markets where valuations have been deeply discounted. **The frontier market is potentially one of the most mispriced asset classes**. On a price-to-earnings valuation basis, it trades at a 30% discount to emerging markets and 53% discount to developed markets currently, well below the five-year average.

Driving future performance, frontier regions are benefitting from strong structural trends, including the relocation of manufacturing hubs, re-routing of supply chains, social reforms, and digitisation. These regions offer lower correlation to other asset classes, lower volatility, and are increasingly taking a politically neutral stance amid rising geopolitical tensions. Yet they continue to be under-owned.



Past performance does not predict future returns. The level of yield is not guaranteed and may rise or fall in the future.
Source: HSBC Asset Management. Macrobond, Bloomberg, Datastream. Data as at 11.00am UK time 26 July 2024.

Key Events and Data Releases

Last week

Date	Country	Indicator	Data as of	Actual	Prior
Mon. 22 July	CN	Loan Prime Rate (5yr)	Jul	3.85%	3.95%
Tue. 23 July	US	Existing Home Sales (mom)	Jun	-5.4%	-0.7%
	TY	Turkish Central Bank Interest Rate Decision	Jul (P)	50.00%	50.00%
	IN	Indian government presents FY25 Budget	Jul		
Wed. 24 July	IN	HSBC Composite PMI	Jul (P)	61.4	60.9
	EZ	HCOB Composite PMI	Jul (P)	50.1	50.9
	UK	S&P Global Composite PMI	Jul (P)	52.7	52.3
	US	S&P Global Composite PMI	Jul (P)	55.0	54.8
	CA	Bank of Canada Interest Rate Decision	Jul	4.50%	4.75%
Thu. 25 July	GE	IFO Business Climate Index	Jul	87.0	88.6
	US	GDP (q-o-q annualised)	Q2 (P)	2.8%	1.4%
Fri. 26 July	JP	Tokyo CPI excluding fresh food & energy (y-o-y)	Jun	1.5%	1.8%
	US	Core PCE Inflation (y-o-y)	Jun	-	2.6%
	US	University of Michigan Consumer Confidence Index	Jul (F)	-	66.0

P – Preliminary, Q – Quarter, F – Final **CN – China, TY – Turkey, IN – India, EZ – Eurozone, UK – United Kingdom, CA – Canada, GE – Germany, JP – Japan**

The week ahead

Date	Country	Indicator	Data as of	Survey	Prior
Mon. 29 July	US	Earnings Update	Q2		
Tue. 30 July	EZ	Eurozone GDP (q-o-q)	Q2 (P)	0.2%	0.3%
	US	Conference Board Consumer Confidence Index	Jul	99.8	100.4
	MX	GDP (q-o-q)	Q2 (P)	-	0.3%
Wed. 31 July	JP	BoJ Interest Rate Decision	Jul	0.10%	0.10%
	EZ	Eurozone CPI (y-o-y)	Jul (P)	2.4%	2.5%
	US	Employment Cost Index (q-o-q)	Q2	1.0%	1.2%
	US	Federal Reserve Interest Rate Decision	Jul	5.50%	5.50%
	CN	China Official Manufacturing PMI	Jul	49.3	49.5
	BR	COPOM Interest Rate Decision	Jul	10.50%	10.50%
	CH	Chile Central Bank Interest Rate Decision	Jul	-	5.75%
Thu. 1 August	UK	BoE Interest Rate Decision	Aug	5.00%	5.25%
	US	ISM Manufacturing Index	Jul	49.0	48.5
Fri. 2 August	US	Change in Payrolls (000s)	Jul	185	206

P – Preliminary, Q – Quarter **EZ – Eurozone, MX – Mexico, JP – Japan, CN – China, BR – Brazil, CH – Chile, UK – United Kingdom**

Source: HSBC Asset Management. Data as at 11.00am UK time 29 July 2024. Any forecast, projection or target where provided is indicative only and not guaranteed in any way.

Market review

Data showed that the US economy expanded faster than expected in the second quarter, with GDP up 2.8% annualised. Inflation pressures also continued to ease, cementing expectations of a Fed rate cut in September. Core government bonds were range-bound during last week, with shorter-dated US Treasuries finishing slightly higher. Equities were volatile, with US mega-cap technology stocks selling-off sharply. The S&P 500 and Nasdaq indices were hardest hit, while the small-cap Russell 2000 gained ground. In Europe, the Stoxx Europe 600 was down modestly on mixed earnings news. In Asia, India's Sensex reversed early weakness to finish higher, while China's Shanghai Composite was down on concerns over the country's slow economic recovery. In commodities, oil was on course for its third weekly decline, with gold and copper prices also falling.