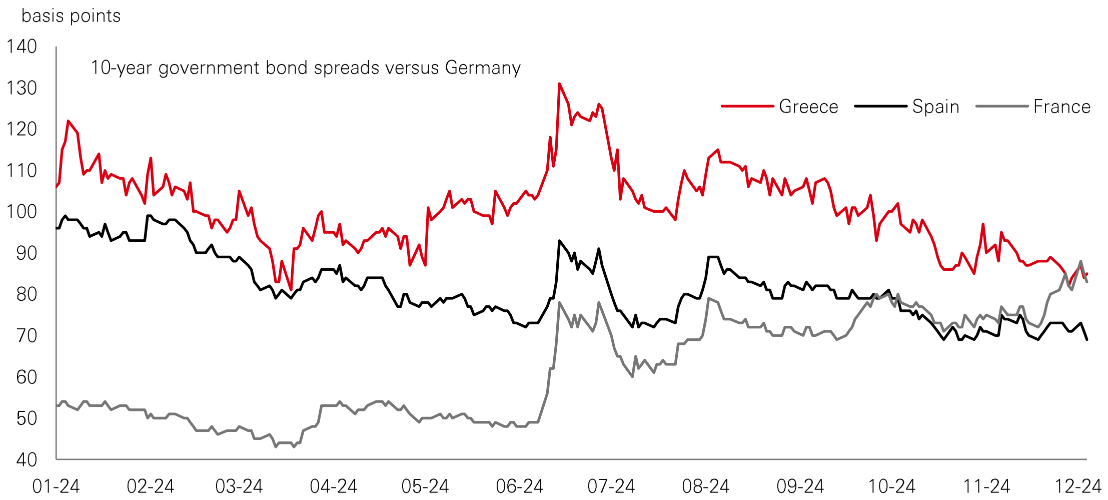
HSBC

Investment Weekly

9 December 2024

Chart of the week – Political realities bite in France



Are good economics now bad politics? Recent developments in France are a case in point. IMF forecasts show the country's public finances are on an unsustainable path, with the debt ratio expected to reach almost 130% of GDP by the end of the decade. But with the French parliament split into three blocs, there is limited political will to find a solution. French Prime Minister Barnier's proposed EUR60bn budget consolidation saw him swiftly ejected from office.

Amid the political impasse, France's 10-year government bond spread over Germany has moved higher, and is now above that of Spain and Portugal. Yet, this is not a marker of an imminent crisis. In the words of financial wags, it's not a "Truss moment". Spreads in France have not blown out in the same way they did in the UK in September 2022, when then-Prime Minster Truss introduced a budget that incorporated significant unfinanced tax cuts, worsening debt sustainability. No such measures are being touted in France for the time being.

The market reaction to last week's events in France has been sanguine. That reflects today's better economic reality versus 2022 – ongoing disinflation, central bank rate cuts, and decent global growth. The ECB also provides an ultimate backstop against disorderly market dynamics in the eurozone via the Transmission Protection Instrument (TPI), even if this comes with strings attached. So, although events require monitoring, and the distinction between the eurozone core and periphery is blurring, **this is likely to be a slow-burn issue rather than the start of a new crisis**.

Market Spotlight

Hedge funds in a higher-for-longer world

With inflation remaining a bit sticky in places, and fiscal activism still in play, it makes sense that investors expect a fairly shallow rate cutting cycle in 2025. The ability of central banks to insulate the economy and markets against adverse shocks – the so called "Fed put" – looks constrained.

We think many alternative asset classes offer an attractive solution. **Hedge funds, for example, have exhibited consistently low correlations to stocks over the past three years**. This coincides with a period of higher rates and a higher dispersion of equity returns which typically benefits "stock picking" strategies that hedge funds embed. This contrasts with the 2010s when record-low interest rates were causing nearly all stocks to rise in unison. For 2025, an environment of rising uncertainty and market volatility would likely to keep dispersion high. And for those hedge funds with significant unencumbered cash balances, higher rates would provide a further boost to their total return.

US stock valuations →

Stretched US valuations and the 2025 outlook

European Equities →

European challenges but also opportunities

Asian high-yield →

Increased diversification for Asian credit investors

 Source: HSBC Asset Management. Macrobond, Bloomberg. Data as at 7.30am UK time 06 December 2024.

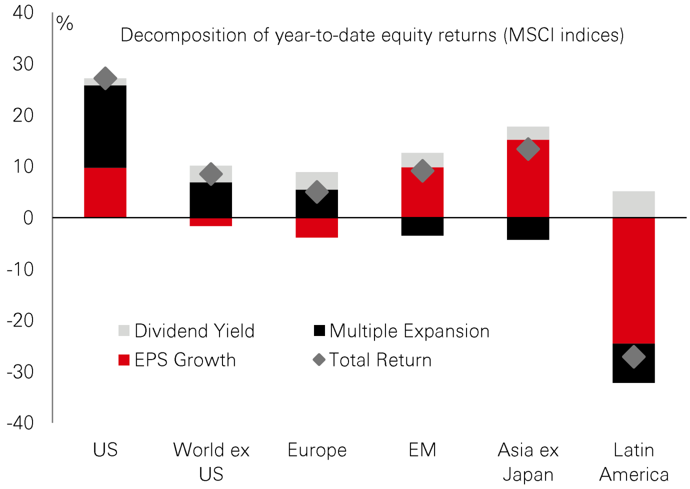
Lens on...

Multiple concerns

Barring a major shock between now and the new year, US stock markets are set to notch up world beating performance in 2024. To many, this comes as no surprise in a year where the soft landing was delivered, profit growth rebounded, and AI started delivering on its huge potential. But where does this leave us for 2025?

We think US markets can continue to perform well. The prospects of tax cuts and deregulation is the icing on top of the cake that is a resilient US economy. Profit growth is likely to remain strong, even if current expectations of c. 15% for 2025 EPS growth look somewhat optimistic.

But a key challenge will be valuations. Decomposing year-to-date equity returns shows multiple expansion has been responsible for the bulk of US gains this year, unlike in emerging markets – particularly in Asia - where profits and dividends have driven stocks higher. This leave US stocks trading on a 12-month forward PE of 22.0x, well above the last 10-year average of 18.6x. Stretched US valuations, along with a "broadening out" of profit growth across the world, make it important to look beyond recent winners.

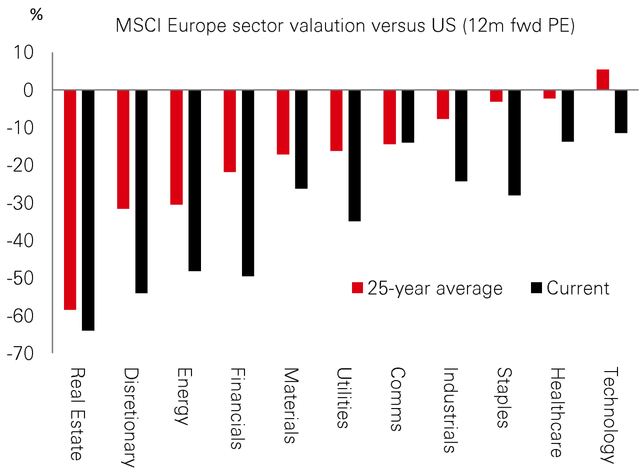


Europe on sale?

Despite a good start to 2024, European equities have struggled for momentum since the summer, while US stocks have zipped ahead. Year-to-date, this leaves European stocks experiencing their worst relative performance to the US in close to 50 years.

Investor pessimism around Europe is perhaps unsurprising. The export-dependent bloc is weighed down by weak global trade growth, exposure to soft Chinese demand, and competition from China's lower cost carmakers. German Fortune 500 companies have announced over 60,000 layoffs this year with more expected to come. On top of the bad economic news, the region's politics looks troubling (see main story).

The outcome is a European market that now looks very cheap. MSCI Europe is on a trailing PE of 15.3x versus 30x for the US. At the sector level, discounts look particularly pronounced for consumer staples, healthcare, financials and industrials. So, although caution is warranted, some re-rating is possible – triggered perhaps by scope for China's reflation, or government support for domestic "world-class" brands. A weaker euro helps. And bargain hunters are likely to be out in force, making **M&A and buyback activity a potential boost in 2025**.

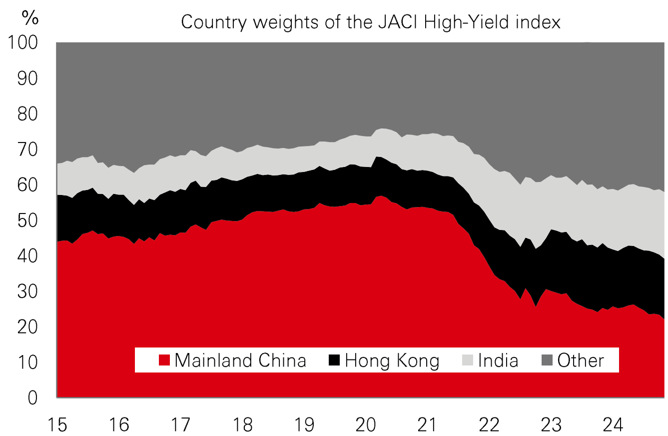


Asian high yield's evolution

2024 has been a great year for Asia's credit markets, especially for high-yield bonds. The benchmark JACI high-yield index has delivered double-digit returns. Following a tough period for the market post-pandemic, several factors have reignited investor enthusiasm.

Firstly, **exposure to China has fallen considerably as troubled real estate names have defaulted and dropped off indices**. This "flushing out" process has resulted in a market that is not only more geographically and sectorally diverse, but also has a much lower average default rate. Many companies now operate with healthy balance sheets and easy access to cheap local funding channels.

This leaves the asset class in a strong position for 2025. Yields remain higher versus historical levels and DM equivalents, providing room for further spread compression. Of course, China's macro situation is a key risk to monitor, and there is likely to be noise around tariffs. But improved diversification – including increased exposure to fast-growing India – and ongoing China's stimulus measures should limit the downside.



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Key Events and Data Releases

Last week

Date	Country	Indicator	Data as of	Actual	Prior
Mon. 02 December	US	ISM Manufacturing Index	Nov	48.4	46.5
	BR	S&P Global Manufacturing PMI	Nov	52.3	52.9
	MX	S&P Global Manufacturing PMI	Nov	49.9	48.4
Tue. 03 December	US	JOLTS Job Openings	Oct	7.74mn	7.37mn
	BR	GDP (qoq)	Q3	0.9%	1.4%
Wed. 04 December	US	ISM Services Index	Nov	52.1	56.0
	US	Fed Chair Powell	Dec	-	-
Fri. 06 December	IN	RBI Repo Rate	Dec	6.50%	6.50%
	US	Change in Non-Farm Payrolls	Nov	-	12.0k
	US	Univ. of Michigan Sentiment Index (Prelim)	Dec	-	71.8

US - United States, BR - Brazil, MX - Mexico, IN - India

The week ahead

Date	Country	Indicator	Data as of	Survey	Prior
Mon. 09 December	CN	CPI (yoy)	Nov	0.5%	0.3%
Tue. 10 December	US	NFIB Index of Small Business Optimism	Nov	94.1	93.7
	BR	CPI (yoy)	Nov	4.8%	4.8%
	AU	RBA Cash Target Rate	Dec	4.35%	4.35%
	CN	Trade Balance (USD)	Nov	92.0bn	95.7bn
Wed. 11 December	US	CPI (yoy)	Nov	2.7%	2.6%
	BR	Banco de Brazil SELIC Target Rate	Dec	12.00%	11.25%
	CA	BoC Policy Rate	Dec	3.25%	3.75%
Thu. 12 December	US	PPI (mom)	Nov	0.3%	0.2%
	EZ	ECB Deposit Rate	Dec	3.00%	3.25%
	JP	TANKAN Business Conditions Manufacturing Index	Q4	13.0	13.0
	IN	Industrial Production (yoy)	Oct	3.5%	3.1%
	IN	CPI (yoy)	Nov	5.7%	6.2%

CN - China, US - United States, BR - Brazil, AU - Australia, CA - Canada, EZ - Euro Zone, JP - Japan, IN - India

Source: HSBC Asset Management. Data as at 7.30am UK time 06 December 2024. For informational purposes only and should not be construed as a recommendation to invest in the specific country, product, strategy, sector or security. Any views expressed were held at the time of preparation and are subject to change without notice.

Market review

Positive risk market appetite persists despite increased political tensions, and the US Dollar index consolidated. Core government bonds were range-bound, as Fed Chair Powell stated the Fed "can afford to be a little more cautious" on the path to a neutral policy stance. In US equities, the S&P500 touched an all-time high but lagged the Nasdaq. The Euro Stoxx 50 rallied, with France's CAC rebounding. The Nikkei 225 strengthened on higher machinery makers as the yen traded sideways (vs USD). EM stock markets were broadly higher, led by India's Sensex index. The Shanghai Composite and Hang Seng advanced ahead of China's Central Economic Work Conference whereas rising political worries weighed on South Korea's Kospi index. In commodities, oil edged higher as the OPEC+'s decided to delay a plan to roll back production cuts to April 2025. Gold edged lower, while copper gained.

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