HSBC

# Investment Monthly

## Invest resiliently amid growth slowdown

July 2022

### Key takeaways

- As inflation in the US (8.6% in May) reaccelerated and is more broad-based, we think it will go higher and take longer to decline. Markets will remain volatile while growth is moderating. Investors should focus on quality, income and diversification to stay resilient.
- Low unemployment and high savings in the US support our view of no global recession this year. However, to manage the downside risks from further tightening and slowing growth, we downgrade Global and US Financials and Technology to Neutral.
- Challenged by tightening financial conditions and more broad-based spread widening, we moved high yield (US, Europe and UK) to Neutral and prefer investment grade bonds with short-to-medium maturities.

**Willem Sels**
Global Chief Investment Officer, HSBC Global Private Banking and Wealth

**Lucia Ku**
Head of Wealth Insights
HSBC Wealth and Personal Banking

| Asset class | 6-month view | Comment |
|---|---|---|
| Global equities | ► | Equity valuations have become more attractive but uncertainty remains high, leading to a neutral stance. |
| Government bonds | ▼ | Although yields have backed up, we see better opportunities for returns elsewhere. |
| Investment grade (IG) corporate bonds | ▲ | We see attractive opportunities in short-to-medium dated IG following the back-up in yields. |
| High yield (HY) corporate bonds | ►↓ | Slowing growth, tighter financial conditions and widening spreads increase the downside risks for global HY bonds. |
| Gold | ► | Despite high inflation and market volatility, we don't foresee much upside due to rising rates and a strong USD. |

▲ "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 are the implications of rising inflation?

- US inflation reaccelerated to 8.6% in May (8.3% in April) driven not only by rising oil prices but also food prices and rent. This showed that inflation is more broad-based than before. High inflation expectations will also trigger higher wage demands and prolong the inflation pressures.
- We expect inflation to be **higher and take longer to come down**. US CPI may rise to over 9% in September and start to fall only in 2023. This will affect Fed policy and we now expect a 0.75% rate hike in July, 0.5% in September and November, and 0.25% in December. Market volatility is likely to persist.
- Investors should **stay invested and diversified with a focus on quality companies with high cash positions, resilient margins and dividend payouts**. Geographically, we still prefer the **US, Hong Kong and ASEAN markets**.

## 2. How to invest resiliently amid growth slowdown?

- Rising rates will hurt demand, and we have therefore lowered our global GDP forecast for 2022 from 3.5% to 3% but are not forecasting a recession in the US and global economy this year, although this cannot be ruled out either.
- The historically-low US unemployment which supports consumption (accounting for 68% of US GDP) and high savings accumulated during the COVID crises are key drivers for the US economy. The Fed is also looking to balance the labour supply/ demand to achieve a soft landing. Moreover, the rate level after the Fed completes the expected hikes should still be relatively low in the historical context.
- However, to manage the downside risks from rising rates and slowing growth, **we downgrade Global and US Financials and Technology to Neutral.** US Financials see lower mortgage lending volumes and declining fee income on reduced corporate activity, while weaker demand for some tech items (e.g. semi-conductors) globally and reduced investment spending weigh on Technology. We also **moved high yield to Neutral and prefer short-to-medium investment grade bonds following the recent significant spread widening.**

## 3. What is the outlook for high yield?

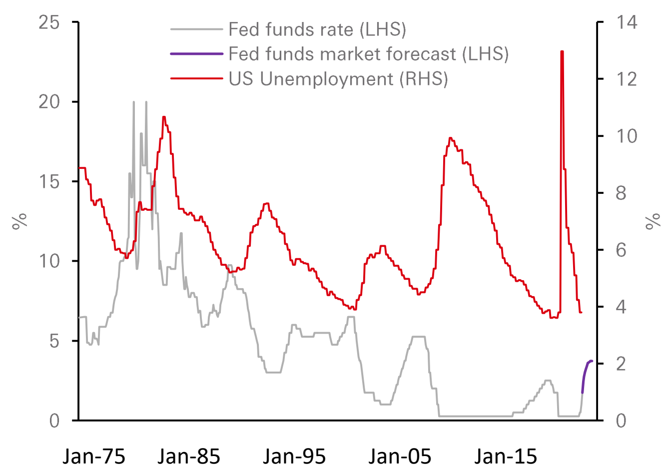
- Although DM high-yield companies still enjoy healthy credit fundamentals, especially in the US, and low default rates, tightening financial conditions and spread widening are headwinds for high-yield bonds.
- European high yield remains vulnerable to the Ukraine war and its ripple effects on energy provisioning and economic growth. Considering the macro challenges, **we downgrade US, UK and Europe high yield to Neutral,** with Asia remaining Overweight due to the region's more resilient growth outlook and attractive spreads (e.g. energy-export markets).
- We focus on the **quality issuers in the BB-rating segment and carry opportunities at the short-to-medium part of the credit curves** (i.e. 2-5 years).

**Chart 1: We expect growth to slow and inflation to be high for longer**

| | GDP | | Inflation | |
|---|---|---|---|---|
| % Year | 2021 | 2022f | 2021 | 2022f |
| World | 5.8 | 3.0 | 3.9 | 8.3 |
| US | 5.7 | 2.3 | 4.7 | 8.6 |
| Eurozone | 5.3 | 2.6 | 2.6 | 7.6 |
| UK | 7.4 | 3.2 | 2.6 | 8.7 |
| Japan | 1.7 | 1.5 | -0.2 | 1.9 |
| Mainland China | 8.1 | 4.1 | 0.9 | 2.3 |

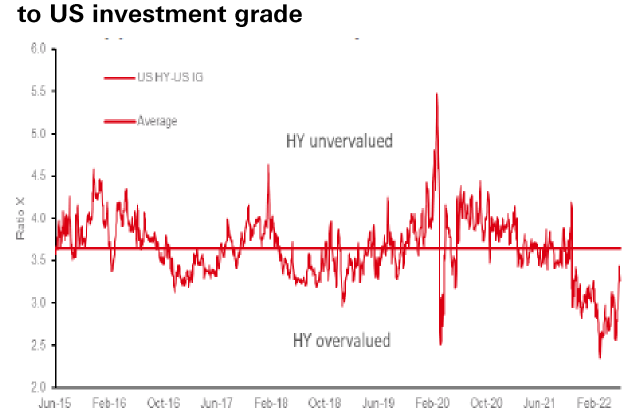
Source: HSBC Global Research forecasts as at 24 June 2022. Forecasts are subject to change.

**Chart 2: Unemployment is much lower than typical recessionary periods and rates will remain low vs history**




Source: Bloomberg, HSBC Global Private Banking as at 20 June 2022. Past performance is not a reliable indicator of future performance.

**Chart 3: US high yield appears overvalued compared to US investment grade**




Source: Bloomberg, HSBC Global Private Banking as at 17 June 2022. 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 | ▶ | Equity valuations have become more attractive but uncertainty remains high, leading to a neutral stance. |
| United States | ▲ | We like the diversity and quality character of US stocks but are defensively positioned. |
| United Kingdom | ▶ | Attractively valued but the local economy is challenged and high cost of living weighs on consumption. |
| Eurozone | ▼ | ECB tightening, high energy prices and the region's geographical proximity to the Ukraine war are key challenges. |
| Japan | ▶ | Autos and industrials are hit by supply chain issues but capital goods see good demand. |
| Emerging Markets (EM) | ▶ | Fed tightening is a concern while geopolitical tensions cause repositioning. Asia is relatively more resilient with its healthy economic outlook. |
| EM EMEA | ▼ | The region is impacted by a refugee crisis while high energy prices may dampen growth. |
| EM Latam | ▶ | Commodity exposure benefits the region but there are risks around rate hikes and politics. |
| **Asian equities** | | |
| Asia ex-Japan | ▲ | This remains our most preferred EM region supported by solid growth in ASEAN and Hong Kong. The region has lower inflation pressure and therefore fewer rate hikes than elsewhere but they should also see slower demand for technology products. |
| China | ▶ | The economic growth is challenged by COVID and the zero tolerance policy, but the fiscal and monetary policies are expected to bolster growth in H2 when the impact of lockdowns starts to ease. |
| India | ▶ | Higher oil prices weigh on growth. The RBI is expected to continue with rate hikes amid inflationary pressures. The current account deficit is likely to widen. |
| Hong Kong | ▲ | The economic reopening, cheap valuations and its higher exposure to the defensive sectors are key drivers for a rebound in Q2 and Q3. The second half of the consumption vouchers will be distributed in August. |
| Singapore | ▲ | The recovery momentum continues to be supported by the travel and tourism related services, resilient manufacturing and strong private consumption. |
| South Korea | ▶ | Growth is set to slow on external weakness. Domestic consumption has become the key driver after the social distancing measures have been lifted. Rising inflation remains a key risk. |
| Taiwan | ▶ | The market is challenged by weaker global demand for consumer electronics products and supply chain issues. Household spending is unlikely to rebound in the near term due to the Omicron wave at home. |
| **Government bonds** | | |
| Developed markets (DM) | ▼ | Although yields have backed up, we see better opportunities for returns elsewhere. |
| United States | ▶ | US Treasury yields rose on the back of rising inflation and policy tightening. |
| United Kingdom | ▶ | Although the market seems to be priced in for more hikes than the economy can handle due to weak growth, inflation in the UK is likely to rise even further, implying that Gilt volatility may remain elevated. |
| Eurozone | ▼ | Inflation has resulted in a more hawkish ECB, with current valuations not appealing enough. Widening of yield differential between Germany and the periphery needs to be convincingly addressed by the ECB. |
| Japan | ▼ | The ultra loose monetary policy and a weaker yen are set to further steepen the longer-end of the government bond segment. |
| Emerging Markets (Local currency) | ▶ | Select opportunities exist but USD strength and rate hikes in some EM countries are headwinds. |
| Emerging Markets (Hard currency) | ▶ | Amid higher Treasury volatility, we still find yield but remain selective. |
| **Corporate bonds** | | |
| Global investment grade (IG) | ▲ | We see attractive opportunities in short-to-medium dated IG following the back-up in yields. |
| USD investment grade (IG) | ▲ | US jobs and consumer spending data have been strong, while corporate earnings are resilient. All in yields have become attractive again with many rate hikes priced in, and we see opportunities in short-to-medium dated quality bonds. |
| EUR and GBP investment grade (IG) | ▲ | The recent cheapening of Eurozone credit represents an opportunity for buy-and-hold investors, while GBP credit has proven to be relatively resilient. We emphasise however a preference for short-to-medium dated quality issuers. |
| Asia investment grade (IG) | ▲ | Asia credit offers attractive carry opportunities and stays relatively resilient to the energy supply shock. We prefer quality issuers in Indonesian hard currency bonds, Chinese SOEs, Chinese financials, etc. |
| Global high-yield (HY) | ▶↓ | Slowing growth, tighter financial conditions and widening spreads increase the downside risks for global HY bonds. |
| US high-yield (HY) | ▶↓ | While US high-yield companies still enjoy solid credit fundamentals and low default rates, tightening financial conditions and faster Fed fund rate hikes create downside risks. |
| EUR and GBP high-yield (HY) | ▶↓ | Despite indirect support from the ECB, European high yield remains vulnerable to the developments of the Ukraine war and its impact on energy provisioning and economic growth. |
| Asia high-yield (HY) | ▲ | Asia high yield is more resilient within the HY universe thanks to its more diversified economies and supportive domestic policies. Oil and gas issuers stand to benefit from elevated energy prices. |
| **Commodities** | | |
| Gold | ▶ | Despite high inflation and market volatility, we don't foresee much upside due to rising rates and a strong USD. |
| Oil | ▶ | High price levels reflect supply concerns but demand is starting to decline. |

# Sector Views

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

| Sector | Global | US | Europe | Asia | Comment |
|---|---|---|---|---|---|
| Consumer Discretionary | ▶ | ▶ | ▼ | ▶ | Demand continues to soften on rising inflation, financing and energy costs. Margins remain under pressure from same factors and labour shortages. Pent-up demand allows some companies to raise prices to recover higher input costs. Earnings growth is likely to be challenging. Luxury goods remain a bright spot. |
| Financials | ▶↓ | ▶↓ | ▶ | ▲ | Central banks are forced to tackle inflation by raising rates, which should support bank earnings in the short term but this is more than offset by weaker investment banking and brokerage revenues. Retail banks should be less impacted. The earnings outlook may weaken on lower trading activity. |
| Industrials | ▼ | ▶ | ▼ | ▼ | Slowing growth and rising input costs (commodities, labour and energy) weigh on margins and sentiment. This should accelerate the trend for greater automation. Supply chain issues persist from multiple causes. Valuations have declined but given the slowing growth environment, sentiment is likely to remain subdued. |
| Information Technology | ▶↓ | ▶↓ | ▶ | ▶ | Although we downgrade Global and US IT to Neutral on slowing growth and lower investment spending, we remain constructive on the sector's growth prospects as digitalisation, electrification and automation should drive above-average growth for the next decade. We focus on high quality, cash-generative businesses. |
| Communication Services | ▲ | ▲ | ▶ | ▶ | The sector benefits from steady cash flows and growth from increased data usage as more activity shifts on-line and business digitises. The 5G roll-out is positive for telecom equipment providers but neutral/negative initially for service providers. |
| Materials | ▲ | ▲ | ▲ | ▶ | Despite slowing growth in China, commodity prices are supported by geopolitical instability and under-investment in new capacity to meet surging demand as economies reopen. Demand for commodities linked to the electrification of the economy should support mining stocks. Valuations look attractive. The outlook for chemical and cement stocks is mixed given rising feedstock and energy prices. |
| Real Estate | ▶ | ▶ | ▶ | ▶ | Private residential real estate is seeing strong demand supported by high savings rate and lower interest rates. Commercial real estate is suffering low demand as corporates look to reduce office space and retail moves online. |
| Consumer Staples | ▲ | ▶ | ▲ | ▲ | The sector contains many quality stocks with good dividend yields. Valuations are somewhat elevated so we prefer companies with strong brands and/or pricing power which can protect margins and earnings as inflationary pressures mount. |
| Energy | ▲ | ▲ | ▲ | ▲ | Geopolitical uncertainties, low inventories and supply-demand imbalances continue to drive prices higher. We expect energy prices to either stabilise at these elevated levels or push higher. Chronic under-investment is likely to support prices in the medium term despite the energy transition gaining momentum. |
| Healthcare | ▲ | ▲ | ▲ | ▶ | Pharma stocks are typically defensive investments being less geared to the economic cycle and are more insulated from inflationary pressures while offering decent dividend yields. Medical technology sector should benefit from pent-up demand for elective surgical procedures in 2022/23 while the biotechnology sector provides more speculative investment opportunities with their innovative medicines. |
| Utilities | ▼ | ▼ | ▶ | ▶ | Renewable stocks are attracting attention after stock prices and valuation pulled back significantly from overly optimistic levels. Caution is still required as companies may not be able to pass on rising energy prices which may impact margins negatively. |

Important Information:

**This document has been issued by The Hongkong and Shanghai Banking Corporation Limited and HSBC Savings Bank (Philippines), Inc.** (“the Bank”) in the conduct of its regulated business in the Philippines with information provided by The Hongkong and Shanghai Banking Corporation Limited, 1 Queen's Road Central, Hong Kong. It must not be distributed to the United States, Canada, or Australia or to any other jurisdiction where its distribution is unlawful. The contents of this document may not be reproduced or further distributed to any person or entity, whether in whole or in part, for any purpose.
All non-authorised reproduction or use of this document will be the responsibility of the user a nd may lead to legal proceedings.

**The information contained in this document is general market information.** As such, it has no contractual value and should not be taken as an offer, the solicitation of an offer, a recommendation, or advise for the purchase or sale of any investment, product or service.

**We do not have any obligation to issue any further publications to you or update the contents of this document.** Contents are subject to changes at any time without notice. We make no guarantee, representation or warranty and accept no responsibility for the timeliness of receipt, accuracy, and/or completeness of the information contained in this document.

**Investment involves a variety of risks and investors may not get back the amount originally invested.** Hence, information contained in this document such as past performance, forecasts, projections, simulations, and other forward-looking statements should not be relied upon as an indication of future performance or results. If you are considering making an investment, please conduct your own due diligence.