HSBC

Investment Monthly

Build resilience with quality and income

June 2022

Key takeaways

- Growth is slowing but remains resilient in the US and ASEAN. We don't expect a global recession this year and remain Neutral on equities. We upgrade HK stocks to Overweight but downgrade European Consumer discretionary and Financials, while upgrading Consumer staples globally to add resilience.
- The US Federal Reserve's May meeting has lowered expectations on more aggressive rate hikes. We see value in short-dated corporate, EM hard currency and quality high-yield bonds. Rising real yields favour value and high dividend stocks.
- We downgrade Taiwan equities and Asian Technology due to the headwinds in the smartphone and semiconductor space. A balanced approach which captures the strengths of both value and growth stocks, with a focus on quality, is preferred.

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Asset class	6-month view	Comment
Global equities	▶	The global momentum is slowing, but the earnings season has shown that many quality companies still manage to achieve solid profit growth despite the macro challenges.
Government bonds	▼	Although yields have risen, we see better opportunities for returns elsewhere.
Investment grade (IG) corporate bonds	▲	Investment grade bonds are key for portfolio diversification and could add resilience to portfolio. Yields are now more attractive.
High yield (HY) corporate bonds	▲	Short-dated bonds have already priced in many rate hikes and we focus on quality within the HY universe.
Gold	▶	Despite geopolitics and heightened uncertainty, rising real rates and strong dollar are headwinds for gold.

▲ "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 growth outlook for the second half?

- US Inflation dropped to 8.3% in April (8.5% in March) but remained elevated in the UK and Eurozone. We think global inflation will gradually ease, albeit remaining high short-term.
- High inflation affects profit margins and consumption which weigh on growth. Recent market sell-offs reflect concerns about a hard landing, **but we don't think a global recession is likely as some regions and sectors remain resilient.**
- The strong labour market and energy-related activity support a rebound in the US in H2. In Asia, ASEAN sees positive consumption and earnings momentum. We upgrade **HK stocks to Overweight** due to the economic reopening and attractive valuations (Forward P/E at 14.1x). Mainland China's policy stimulus are likely to revive growth in H2. In view of slowing growth in Europe, we **downgrade Consumer discretionary and Financials there, and upgrade Consumer staples (Global, Europe & Asia)** to be more defensive.

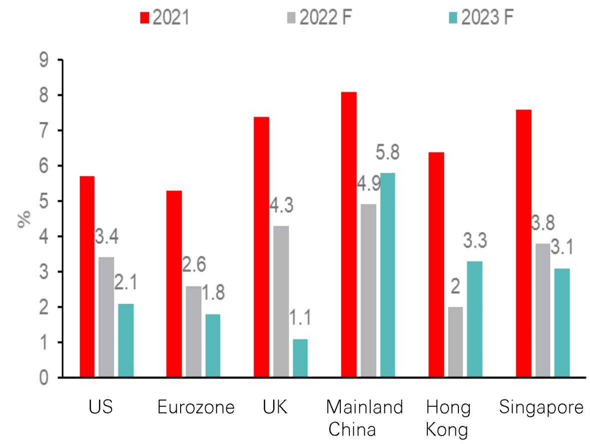
2. What does higher real yield mean to investors?

- As expected, the Federal Reserve raised policy rates by 0.5% at its May meeting, and will reduce the size of its balance sheet from June onwards to curb inflation.
- Expectations on more aggressive interest rate hikes are lower. Following the recent spike in bond yields, we see value in **short-dated corporate bonds, particularly in the investment-grade space, as well as EM hard currency bonds and quality high yield.**
- We believe real yields could continue to rise, which will **support value stocks and high dividend stocks for their stable earnings.** Rising real yields is a headwind for gold but should keep the US dollar at elevated levels.

3. Should we move out of growth stocks?

- Growth stocks are characterised by their higher-than-average earnings potential with key drivers such as innovation (e.g. Technology), while value stocks are attractive for their low valuations and dividend payouts (e.g. Healthcare). Investors generally prefer value stocks in a rising rate environment.
- Due to the concerns over smartphone demand, logistics and supply chain issues in the semiconductor space, and slower growth in consumer electronics products, **we downgrade Taiwan equities and Asia Technology to Neutral.** However, it does not mean that we should move out of growth stocks completely. For example, we remain Overweight on Global and US Technology, where we see opportunities in automation and artificial intelligence.
- A balanced approach to capturing resilient income from value stocks while not missing out on opportunities in the growth space is preferred. Quality is key for both investment styles.

Chart 1: GDP growth is slowing in 2022 but remains positive

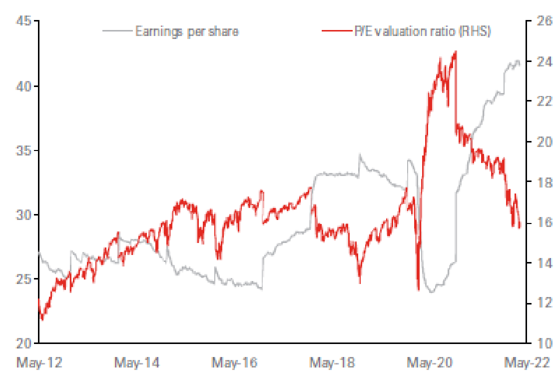


Source: HSBC Global Research, HSBC Global Private Banking as of 18 May 2022.

Chart 2: Rising real yields continue to tactically favour value vs growth stocks

Source: Bloomberg, HSBC Global Private Banking as of 11 May 2022.
Past performance is not a reliable indicator of future performance.

Chart 3: Global equity valuations have come down. We pick quality companies that can sustain earnings



Source: Refinitiv, HSBC Global Private Banking as of 17 May 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	▶	The global momentum is clearly slowing, but the earnings season has shown that many quality companies still manage to achieve solid profit growth in spite of the cost challenges.
United States	▲	They are still our biggest equity overweight due to their size and quality character. Consumer demand and labour markets remain strong and we expect the economy to rebound in Q2 and Q3.
United Kingdom	▶	Attractively valued but the high cost of living weighs on consumption and local growth.
Eurozone	▼	ECB tightening, high energy prices and the region's geographical proximity to the Ukraine war warrant our underweight position.
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 continues to be 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 is our most preferred EM region with fewer rate hikes than elsewhere and growth in ASEAN and Hong Kong remain solid.
China	▶	China's slowing economy has taken a further knock from Covid-related restrictions, but we think that any easing of those restrictions and the lagged effect of policy stimulus should help the economy to recover later in the year.
India	▶	The high commodity price burden weighs on growth. The RBI is expected to continue on the path of raising policy rates amid inflationary pressures. Fiscal deficit could be higher than expected.
Hong Kong	▲↑	The economic reopening, cheap valuations and its higher exposure to the defensive sectors are key drivers for an overweight position. Retail, retail property and financial companies should stand to benefit.
Singapore	▲	We see positive economic recovery momentum on the back of consumption recovery, tourism rebound and infrastructure boom.
South Korea	▶	The country's reliance on global trade is a challenge but the economy is shifting its growth drivers from exports to domestic consumption, with more easing pandemic measures put in place.
Taiwan	▶↓	There are concerns over smartphone demand, logistics and supply chain issues in the semiconductor space, as well as slower growth in consumer electronics products.
Government bonds		
Developed markets (DM)	▼	Although yields have backed up, we see better opportunities for returns elsewhere.
United States	▶	Although inflation may be peaking, it is likely to remain elevated. While the yield curve is no longer inverted, it remains very flat as the market has already priced in many hikes. We see more value in the short end, keeping duration low.
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	▼	Europe is more vulnerable to downside risks to growth linked to high commodity prices and spillover from the Russia-Ukraine war. Meanwhile inflation has resulted in a more hawkish ECB, with current valuations not appealing enough.
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 some EM countries are hiking rates and USD remains strong.
Emerging Markets (Hard currency)	▶	Amid higher Treasury volatility, we still find yield but remain selective.
Corporate bonds		
Global investment grade (IG)	▲	Investment grade bonds are key for portfolio diversification and should be resilient as risk appetite is challenged. We focus on carry opportunities at the short end of the corporate credit curve.
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-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-dated, quality issuers.
Asia investment grade (IG)	▲	Asian credit market offers attractive carry opportunities and stay 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)	▲	Their spreads are well compensated for the relatively low level of default rates. Short-dated bonds have already priced in many rate hikes and we focus on quality within the HY universe.
US high-yield (HY)	▲	Supported by a recovery of economic activity and deleveraging, the average net leverage of US high-yield companies has improved with default rates below 1%.
European high-yield ex UK (HY)	▲	We favour European and UK high yield for their strong balance sheets across the energy and consumer oriented sectors but in a very selective manner.
Asia high-yield (HY)	▲	Cheap valuations and expectations of easing measures are positive for China's high-yield property sector but sentiment remains fragile. Short-dated bonds and quality issuers are preferred.
Commodities		
Gold	▶	Despite geopolitics and heightened uncertainty, rising real rates and strong dollar are headwinds for gold.
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	▶	▶	▼↓	▶	Inflation, rising financing and energy costs weigh on consumer demand in Europe. Margins remain under pressure from same factors plus labour shortages. Pent-up demand provides some room for optimism with many companies raising prices to recover higher input costs (Q1 results). Earnings growth is likely to be challenging.
Financials	▲	▲	▶↓	▲	Rate hike expectations under soaring inflationary pressures support banking stocks. In Asia, low valuations make the sector attractive, while US Financials are trading at a significant premium to their peers after many quarters of strong results. We downgrade Europe given the macroeconomic and geopolitical challenges.
Industrials	▼	▶	▼	▼	Slowing growth and rising input costs (commodities, labour and energy) weigh on profits and sentiment. This should accelerate the trend for greater automation. Supply chain issues persist. Despite lower valuations due to the slowing growth environment, sentiment is likely to remain subdued.
Information Technology	▲	▲	▶	▶↓	The sector in Asia is under pressure from the slowing growth in the US, China and Europe. Valuations remain elevated but are not rich. Digitalisation, electrification and automation should drive long-term, above average growth for the next decade. We prefer companies with strong cash-generative businesses and market positions.
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. As the 5G roll-out in Asia is well advanced, we see less attractive opportunities there.
Materials	▲	▲	▲	▶	Commodity prices are supported by under-investment to increase capacity for surging demand as economies reopen, as well as ongoing geopolitical instability. The outlook for chemical and cement stocks is mixed given rising feedstock and energy prices, but mining stocks are supported.
Real Estate	▶	▶	▶	▶	The demand for private residential real estate is supported by high savings rate and lower interest rates, while commercial real estate suffers 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. We upgrade Europe and Asia as these stocks may show greater resilience.
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 better positioned with their strong cash flows and resilient business models. While the medical technology sector should benefit from pent-up demand for elective surgical procedures in 2022/23, the biotechnology sector provides more speculative investment opportunities with their innovative medicines.
Utilities	▼	▼	▶	▶	Although renewable stocks are gaining 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.

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