Investment Monthly

Reduced trade tensions lift optimism for US stocks

June 2025

Key takeaways

- The quick US-China agreement and the US-UK trade deal have substantially reduced downside risks. As earnings growth expectations have been lowered and valuations are more fairly valued, we think the rotation away from US assets will ease. Coupled with AI-led innovation and other structural opportunities, we move global and US equities, as well as Technology, back to overweight while cutting Europe ex-UK equities to neutral. We continue to stay diversified through multi-asset strategies and gold to manage downside risks.
- The correlation between stocks and bonds has fallen back into negative territory, reinforcing the diversification benefits of bonds. We prefer UK gilts due to their attractive real yields, and GBP/EUR investment grade credit. We expect the Fed to cut rates three more times this year, while the Bank of England is signalling more rate cuts than the market expects.
- Despite a less daunting tariff outlook, we expect the upcoming trade talks between the US and China to be lengthy and Chinese policymakers to continue ramping up policy support to boost local demand. We remain overweight on Chinese equities with a focus on AI enablers and adopters across industries and expect the market rally to broaden out to the consumption, financial and industrial sectors. Both India and Singapore stand out as relative trade safe havens.

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Asset class	6-month view	Comment
Global equities	▲↑	Given reduced US recession and tariff risks, we upgrade both global and US equities to overweight and continue to take a mild risk-on tone, focusing on large-cap and quality stocks, and preferring services over goods.
Government bonds	▶	The relatively steep DM government bond yield curves generally favour longer-than-average maturities. We prefer UK gilts over Eurozone, US and Japanese bonds. The duration preference for Japanese bonds is somewhat shorter than others.
Investment grade (IG) corporate bonds	▶	Credit spreads have been resilient as investors may prefer investment grade credit over Treasuries. We continue to see quality bonds as a good portfolio diversifier amid growth and tariff headwinds.
High yield (HY) corporate bonds	▶	We are mindful of tight valuations on global high yield bonds given the current economic backdrop and heightened market volatility and hold a shorter duration bias of 3 to 5 years.
Gold	▲	Gold remains a key portfolio diversifier amid global uncertainty and volatility. Central bank buying remains supportive.

▲ "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.

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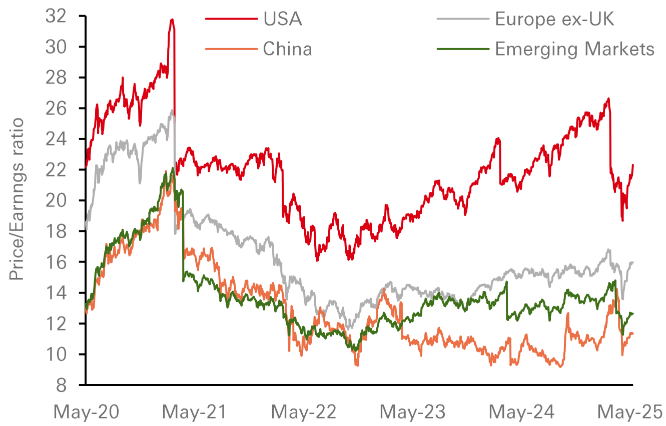
Talking points

Each month, we discuss 3 key issues facing investors

1. What is the US-China trade deal telling us?

- The quick US-China agreement resulting in a 90-day reprieve on the eyewatering trade tariffs came as a surprise. This, together with the US-UK trade deal, has substantially reduced the tariff-related headline risks in the next few months.
- These announcements illustrate to investors that policy changes can be surprising on both the positive and negative sides. From now until 9 July, we may see more trade deals, with India, South Korea and Japan potentially involved. Moreover, the US government is preparing a bill to implement tax cuts, which could lift market sentiment further.
- Therefore, we think the rotation away from US assets will slow. Earnings growth expectations are already set lower at 11% for 2025, providing upside potential, while valuations are near multi-year averages. Coupled with the unabated AI-led innovation trend and other structural drivers, such as onshoring of jobs and re-industrialisation, we move global and US equities, as well as the technology sector there to overweight, and cut Europe ex-UK equities to neutral. The reduced tariff tensions are also a tailwind for Technology, which is backed by better-than-expected Q1 earnings growth and fairer valuations. As it will take some time to see the full impact of tariffs on the economy, market volatility will linger. We remain cautious and leverage multi-asset strategies to capture growth opportunities while mitigating downside risks and continue to use gold as a diversifier.

Chart 1: US stocks are still expensive vs other markets, but valuations are in line with the 5-year average

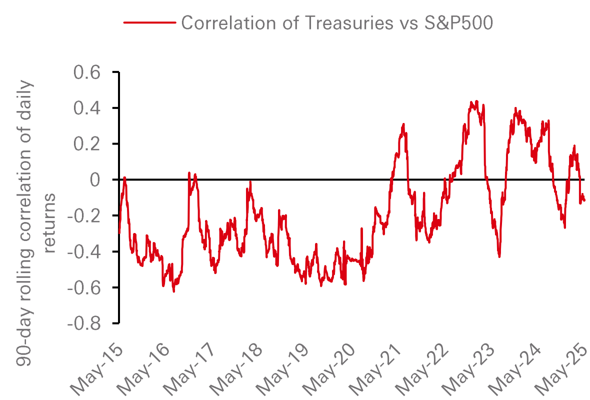


Source: Bloomberg, HSBC Global Private Banking and Wealth, as at 15 May 2025. Past performance is not a reliable indicator of future performance.

2. Are bonds losing their diversification appeal?

- While the tariff reprieve is decreasing risk for the US economy, it is also leading to less imminent inflation pressure. April inflation fell to the lowest levels since 2021, at 2.3% and 2.8% y-o-y for headline and core inflation, respectively. We think the Fed will still cut rates three more times this year.
- Bonds remain a key diversifier amid heightened market uncertainty and their correlation with equities has fallen back into negative territory, reinforcing their diversification potential. We continue to tap into the broad opportunities across sub-asset classes with a tactical and active approach. Swings in rate cut expectations and risk appetite allow active managers to adjust duration opportunistically.
- While the tax cut debate has kicked off and deficit concerns have increased following Moody's downgrade of the US rating, these deficit worries are not new, and we think bond yields will largely be determined by inflation and rate cut expectations, as before. We prefer quality bonds, such as UK gilts due to their attractive real yields, and GBP/EUR investment grade credit. The Bank of England is signalling more rate cuts than the market expects.

Chart 2: The bond / equity correlation has fallen back, improving bonds' diversification characteristics



Source: Bloomberg, HSBC Global Private Banking and Wealth, as at 15 May 2025. Past performance is not a reliable indicator of future performance.

3. Do trade talks lift hope for a more positive outlook for China?

- The US-China trade reprieve has reduced US tariffs on Chinese imports from 145% to 30% and China's tariffs on US goods from 125% to 10%, which will likely boost the front-loading of Chinese exports and support economic activity in China in the coming months.
- While the tariff outlook is now less daunting, we think the upcoming trade talks will likely be a lengthy process and do not expect Chinese policymakers to slow down the policy support for domestic consumption and structural reforms to bolster home-grown demand.
- We remain overweight in China, staying focused on its AI innovation champions, including AI enablers and adopters across industries and expect the market rally to broaden out to the consumption, financial and industrial sectors. Chinese equities are now trading at only 11.6x 12-month forward P/E. As not all the production can be brought back to the US, Asia will still have its role to play in global trade and India's manufacturing can benefit from the supply chain realignment. Both India and Singapore stand out as relative trade safe havens.

Chart 3: Valuations of Chinese stocks are near 5-year lows

Source: Bloomberg, HSBC Global Private Banking and Wealth, as at 13 May 2025. 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	▲↑	Given reduced US recession and tariff risks, we upgrade both global and US equities to overweight and continue to take a mild risk-on tone, focusing on large-cap and quality stocks, and preferring services over goods.
United States	▲↑	The trade agreement with China and positive Q1 earnings momentum, combined with continued AI-led innovation and other long-term structural opportunities, support a better outlook for the US and our upgrade of US equities to overweight.
United Kingdom	▶	Despite the trade deals with the US and India, fiscal constraints and elevated government bond yields warrant a neutral position for now.
Europe ex-UK	▶↓	Given the sudden change in the outlook for US equities and the de-escalation of trade tensions, we think the active rotation from the US into the Eurozone will ease. European equity valuations have also crept out, so we move to a neutral position.
Japan	▶	The external-oriented sectors are challenged by trade uncertainty and JPY appreciation. Domestic demand shows resilience, which tempers rate hike expectations. We remain neutral on Japanese equities and focus on domestic sectors.
Emerging Markets (EM)	▶	Lower inflation is positive for some emerging markets while an improved outlook for trade deals reinforces our preference for EM Asia, in particular.
EM EMEA	▼	While we see attractive structural opportunities in the UAE, the region is impacted by weak growth and monetary and geopolitical uncertainty.
EM LatAm	▶	The exemption from US reciprocal tariffs is a positive for Mexico while Brazil's rate hikes remain a headwind.
Asia ex Japan equities		
Asia ex-Japan	▲	Asia is supported by strong innovation and policy support for local demand. We continue to focus on domestic resilience and structural growth opportunities, overweighting China, India and Singapore.
Mainland China	▲	Despite the 90-day trade reprieve with the US, we expect more domestic stimulus to boost innovation and consumption and prefer the internet and software leaders, select consumer companies, and quality SOEs paying high dividends.
India	▲	Strong economic growth, improved international flows and trade deals are positive drivers. We prefer large-cap stocks in the financials, healthcare and industrials sectors. India is expected to benefit from the supply chain reorientation.
Hong Kong	▶	Share buybacks and dividend yields are attractive, but property market overhang and muted retail sales remain challenges. We prefer quality developers and undervalued high dividend stocks in the insurance and telecom sectors.
Singapore	▲	Singapore is relatively defensive in nature and offers an attractive yield at around 4%, making it a bright spot for investors.
South Korea	▶	While we maintain a neutral position, the upcoming election may reduce political uncertainty and a potential trade deal with the US could be a catalyst to the equity market.
Taiwan	▶	Taiwan is hurt by its high-tech exports to the US, and the impact on semiconductor manufacturing is subject to further clarity on chip tariffs. We maintain a neutral position for now.
Government bonds		
Developed markets (DM)	▶	The relatively steep DM government bond yield curves generally favour longer-than-average maturities. We prefer UK gilts over Eurozone, US and Japanese bonds. The duration preference for Japanese bonds is somewhat shorter than others.
United States	▶	We maintain our neutral view on US Treasuries amid market concerns about the government's debt problem and uncertainty over the Fed policy.
United Kingdom	▲	We continue to favour UK gilts where real yields remain attractive, providing a stable, inflation-adjusted return in a turbulent global environment. The Bank of England has also signalled more rate cuts than the market expects.
Eurozone	▶↓	As the market now expects only 0.5% in ECB rate cuts, this will limit the return potential on Eurozone sovereign bonds, so we move to a neutral position. German Bunds are less attractive following the recent rally, and rotational flows may wane.
Japan	▼	The growth slowdown supports our view that the Bank of Japan will only deliver one more hike later this year. Japanese government bonds remain unattractive.
EM (Local currency)	▶↑	We upgrade EM local currency bonds to neutral as the USD is expected to remain range-bound and falling inflation offers scope for rate cuts in the region, thanks to lower commodity prices.
EM (Hard currency)	▶	We still find yields but remain selective with a focus on quality. We think USD weakness is largely behind us.
Corporate bonds		
Global investment grade (IG)	▶	Credit spreads have been resilient as investors may prefer investment grade credit over Treasuries. We continue to see quality bonds as a good portfolio diversifier amid growth and tariff headwinds.
USD investment grade (IG)	▶	We like the diversity of US investment grade credit, particularly quality banks, insurance and technology issuers. Any back up in market rates will provide a tactical opportunity.
EUR investment grade (IG)	▲	Valuations are tight but carry makes total yields attractive. While the EU has not confirmed any trade negotiations with the US yet, European authorities have expressed willingness to support tariff-impacted sectors.
GBP investment grade (IG)	▲	GBP bonds are under-owned by international investors but offer similar yield levels to the USD market and a better risk-adjusted return trade-off from the rate outlook.
Asian investment grade (IG)	▶	The disinflation trend and solid credit fundamentals are positive for Asian investment grade credit, where we favour Asian financials, Indian local currency bonds, and Chinese hard currency bonds in the technology, media and telecom sectors.
Global high-yield (HY)	▶	We are mindful of tight valuations on global high yield given the current economic backdrop and heightened market volatility and hold a shorter duration bias of 3 to 5 years.
USD high-yield (HY)	▶	USD high yield provides a substantial overall yield, but equity volatility often feeds through into higher HY bond volatility.
EUR high-yield (HY)	▶	In line with our global high yield view, we remain selective on EUR high yield bonds and stick to a 3-5-year positioning.
GBP high-yield (HY)	▶	We have a neutral view and short duration exposure on GBP high yield as spreads are below their long-term average.
Asian high-yield (HY)	▶	The property market remains an overhang in China. We prefer quality issuers in selective areas, such as Macau gaming.
Commodities		
Gold	▲	Gold remains a key portfolio diversifier amid global uncertainty and volatility. Central bank buying remains supportive.
Oil	▶	Oil prices may remain volatile due to slowing growth and demand expectations, as well as excess output.

Sector Views

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

Sector	Global	US	Europe	Asia	Comment
Consumer Discretionary	▶↑	▶↑	▼	▲	We upgrade global and US Consumer Discretionary to neutral following a solid Q1 earnings season, as the US consumer appears to be more resilient than expected. Asian consumer sentiment continues to improve, as valuations remain attractive relative to their history and other regions. Europe saw a mixed earnings season with companies guiding flat to negative sales growth. Luxury goods and European auto companies appear most cautious.
Financials	▲	▲	▲	▲	Global Financials reported stronger-than-expected results for Q1. Net interest income is likely to remain elevated as inflation remains stubbornly higher than expected, keeping interest rates elevated. Strong trading activity and bond issuance are likely to persist in the near term. In Asia, we remain positive on China's economy and the improving sentiment in the region
Industrials	▲	▲	▲	▲	At the start of the year, US tariff concerns weighed on sentiment and guidance, but stocks gained on robust Q1 results, with many segments (machinery, construction, aerospace, trucks, trains and freight) projecting solid y-o-y growth from robust order books. Digital infrastructure, aerospace, defence and construction are likely to benefit from a pick-up in capital spending.
Information Technology	▲↑	▲↑	▶	▶	We upgrade Global and US Technology due to easing concerns over AI demand slowdown and the impact of US tariffs. First-quarter results beat expectations, with reassuring software and hardware growth outlooks. The roll-out of AI-enabled products and services is gaining momentum, together with embedded AI-enhanced processes. These should fuel additional software, hardware and IT services demand.
Communications Services	▲	▲	▶	▲	In the US, the media and entertainment industry is forecast to have above-average sales and earnings growth for 2025, even after its stellar performance over the past two years. In Europe, the outlook for the telecom services sector is plagued by strong competition, low investment returns and a lack of pan-European scale. In Asia, the sector is more balanced with attractive valuations and easing regulation.
Materials	▼	▼	▼	▼	The demand outlook is expected to remain weak amid a challenging pricing environment. Persistently high energy and feedstock costs will likely squeeze margins and profits. Mining and chemical stock valuations are undemanding, but growth is likely to remain elusive. Tariffs remain a significant risk and are hurting sentiment. Refining, processing and chemical stocks remain unappealing in the short term.
Real Estate	▶	▶	▶	▶	The sector appears to have stabilised except in China where some uncertainty remains. Retail space and older offices are particularly challenged as alternative consumer purchasing channels evolve and refurbishment costs are high. New office developments and housing are experiencing better supply-demand dynamics. The re-routing of supply chains is driving demand for new facilities in developed and some emerging markets.
Consumer Staples	▶	▶	▶	▶	Strong competition and consumers trading down have created a weak pricing environment for companies in many markets. Limited potential for sales growth and margin expansion, combined with high valuations relative to other sectors (in line with history), makes the sector unattractive. Consumers are trading down and seeking lower cost alternatives when purchasing goods.
Energy	▶	▶	▶	▶	Easing geo-political tensions, rising supply and weakening demand are expected to lead to lower oil prices in the next 12 months, although the relatively higher cost of production for shale gas may limit production and, therefore oversupply induced price declines. Gas demand is likely to remain buoyant, albeit volatile, due to seasonal demand impacting prices. Low valuations, strong cash flows and high dividends somewhat offset the sector's speculative nature.
Healthcare	▶↓	▶↓	▲	▶	We downgrade global and US Healthcare due to the rising risk of US government policy changes negatively impacting medicine prices. In Europe, the sector trades at a 20% discount to its US peers. It is somewhat less exposed to US pricing risks and is seeing improving market and earnings dynamics. In Asia, we expect healthcare stocks to perform in line with the broader market.
Utilities	▶	▶	▶	▶	Energy demand remains supportive as many economies undergo electrification of transportation and expansion of digital infrastructure. Rising affluence drives demand for air conditioning, freezers, etc. Utilities are already operating at full capacity, so substantial capital investments are required to upgrade generation capacity and transmission infrastructure. Valuations are undemanding.

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