HSBC

Video Transcript

HSBC Investment Outlook Q4 2022 (Released 7 September 2022)
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The first half of 2022 was dominated by stagflation fears, which sent equity and bond markets sharply lower, while the second half of the year started with a sharp bounce. Now, it's quite natural for markets to bounce somewhat after such a pronounced sell-off, but we think we need to wait for an improvement in the fundamentals to see a more extended rally. Till then, markets should consolidate, trading up and down with the economic data and central bank policy announcements.

The number one driver of markets will remain the inflation and rate outlook. There are signs that US inflation has peaked, but there are some sticky elements too, such as rents, food and services. The Fed and other central banks will want to see inflation come down for several months before they slow the pace of their rate hikes and so we wouldn't get too excited about a quick 'pivot' to a more dovish interest rate policy. On the growth side – the other aspect of the stagflation debate – the global economy continues to slow, but with much more resilience in the US than in the Eurozone and the UK, and China where we think policy support will help the economy recover, but with some delay.

So this waiting game for better fundamentals should cap the upside for stocks and riskier assets, but at the same time, there are some positives as well that should limit the downside. The main positive is that a lot of bad news is already priced in, such as recession risks, most of the Fed rate hikes we foresee, the devastating headlines around the Russia-Ukraine war and global geopolitical risks. Equity markets are also supported by the recent earnings season, which illustrated that there are many companies that still manage to growth their earnings, in spite of all the challenges.

So how should investors position in such a period of consolidation, with little market direction but still elevated volatility? We see three priorities.

First, we take a position on those topics which we think will matter most for portfolio performance. The US equity market outlook is much more resilient than the recessionary Eurozone, where we see substantial risks this winter. This is not priced in markets, and so we've moved even further out of Europe into the US. Our strategy also focuses on quality stocks, because inflation will still remain high and growth is slowing, so we need to select companies with margin power. And with inflation still remaining elevated, it's important to have a substantial income component to portfolio returns, which we find in dividend stocks and investment grade bonds. In the currency markets, we are more optimistic than the market consensus that the US dollar will remain well supported.

Our second priority is to realise that in this consolidation period, volatility is not just an enemy but can be exploited. Selling volatility when it spikes can generate income. In fixed income, investors may look at floating rate notes (FRNs) when rate expectations drop too far, and, conversely, lock in yields with fixed rate bonds after market rate expectations spike. In equities, they can use temporary weakness to accumulate their favourite stocks. And they can also use swings in relative performance of value and growth stocks to balance their portfolio between these two styles. Hedge funds remain a big overweight for us as they are well placed to exploit volatility.

Thirdly, those investors who cannot get excited over sideways trading markets can position for some key long term themes. The recent focus on energy independence provides further support to clean energy and the energy transition process, so we have broadened our sustainable investment theme around this topic. More broadly, the recent drought, flooding and fires are highlighting that our lives and investment fundamentals are affected by these factors, not just in the future but right now, keeping sustainability at the core of our investment process. A related theme amid global uncertainty is that of Total Security, which includes food supply security, cybersecurity, supply chain diversification and reonshoring. Finally, in spite of the short term obstacles, we continue to see long-term return potential in Asia. Our theme of Asian Champions at Great Value focuses on companies with strong market positions that are a key component of globally diversified portfolios.

So, in summary, it’s by taking some key views, by exploiting volatility and by capturing long term trends that we can protect portfolios and generate income, while positioning for the market rebound we foresee after this period of consolidation.