Video Transcript

HSBC Investment Outlook – March 2023
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Markets have been shifting and turning since the start of the year. Early in the year, risk appetite bounced sharply, after a very weak 2022, and that lifted global equities across geographies with cyclicals outperforming defensives and growth stocks recovering some of last year's losses.

But there has been some retracement of the gains recently, and we've also seen plenty of flip-flopping and volatility because there are many issues, of course, on which investors cannot make up their minds and the Western economies are still slowing down.

So how should we position around this? Well, we think that there are some very good fundamental reasons for markets to take a more optimistic tone compared to 2022.

Inflation is falling in the developed markets, we are approaching the end of the Fed rate hike cycle, China is reopening faster than expected, the US economy is more resilient than people thought and Europe's energy crisis has eased.

So last year's stagflation fears have faded, and of course, that means that investors are adjusting their positions and their views.

Now, we have gradually been doing the same since the start of Q4 2022. We've extended our investment grade bond duration to 5-7 years as we approach that peak of the interest rate hike cycle.

And we've moved our USD view from bullish to bearish due to peak rates, a bottoming of global growth expectations and improving global risk appetite.

Our allocation to China and actually Asia more broadly has moved to the largest overweight in several years. And in the developed markets equities space, we upgraded Eurozone stocks to neutral and narrowed the gap compared to the US, where we still maintain a small overweight however.

All of these changes, of course, generally reflect a more constructive view and indeed we have put more money to work and our cash position has dropped. But our risk-on position still remains selective because we fully expect continued market volatility around important economic data releases and central bank meetings.

And geopolitical issues and volatile energy prices, of course, can feed through into market volatility too. We can manage that uncertainty through portfolio diversification and through volatility strategies which can help generate income or provide downside protection.

But we also continue to like hedge funds, especially developed market macro and multi-strategy approaches, because volatility, of course, provides hedge funds with a rich opportunity set.

Now the other way we deal with uncertainty is by focusing on a limited number of key views that we can have conviction in, whilst we take a more neutral stance or smaller positions where there is less visibility.

So what are those key calls we believe we can make for the next six months? Well, firstly, we continue to believe that we are close to US peak rates.

We agree with Fed chair Powell, who suggested that rental inflation should start to fall as rents tend to follow house prices, which have been declining for some time.

Some investors are concerned that China's reopening will lead to a reacceleration of US and global inflation, but we don't think that that will be the case.

China's growth pick up is mostly related to consumption and services this time around, which are much less commodity intensive than the construction led growth spurts of the past.

So as global inflation continues to fall, the prospect of peak rates is bearish for the USD, positive for bonds and good for global risk appetite.

Now there is a bearish aspect to our rate outlook too, unfortunately. Although rates should peak soon, we're very unlikely to see Fed rate cuts till Q2 2024. The longer rates stay high, the longer the stress on highly levered borrowers, because each day more and more loans need to be reset and bonds need to be refinanced.

This is a key reason why we look for quality in all asset classes: we prefer investment grade over high yield, we focus on quality in emerging markets and are careful to avoid excessive leverage in real estate or in equities.

On the flipside, this should lead to distressed opportunities and we think that those investors who want and can take a long term approach in private markets will find that the 2023 vintage should be benefiting from good entry points.

Our third key view is that China's reopening is being underestimated by markets. We have observed in other countries how sharply consumption can spike in a post-COVID reopening. And what's more, Chinese consumers have accumulated almost 1 trillion USD of excess savings during the zero COVID period, and much of which they will be eager to spend.

So we therefore primarily execute our full overweight on Chinese stocks through consumer related themes such as e-commerce and hospitality, entertainment and travel, geographically speaking, Thailand and Indonesia should benefit from increased Chinese travel too.

The acceleration of Chinese growth should go beyond the reopening, and we view the policy shift back to growth as strategic in nature, and that should support our Asian high conviction themes and some key industries such as advanced manufacturing and clean energy.

Talking of which, our fourth key theme is that the sustainability train is unstoppable. Now, the Russia-Ukraine war has forced many governments to intensify energy security efforts.

We think that energy security and energy transition can go hand-in-hand. We therefore continue to incorporate sustainability throughout our investment process in our stock and bond analysis and in our high conviction themes.

So in summary, our focus is on investing in quality assets, select areas of conviction and key long term themes such as the energy transition, infrastructure, aerospace, AI and automation. To that we add hedge funds for diversification.

And that approach, we believe, allows us to remain invested, but also to manage some of the volatility and the unpredictable shifts and turns in markets that we're very likely to continue to see.