

HSBC Investment Outlook – Q4 (Issued 5 September 2024)**Equities – key topics and focus areas** – Willem Sels and Kevin Lyne-Smith

Willem

I'm here with Kevin Lyne-Smith, Global Head of Equities, to discuss the outlook for global stock markets.

And of course, what's going to be critical there is the outlook for US stocks, in particular technology because they have been leading. So what are the fundamentals looking like for technology, can they continue to generate those superior earnings? And how can they actually make money with AI?

Kevin

On your earnings question, the S&P 500 earnings in the second quarter were up 9.3%. And that was similar for tech, which is up 8.9% year on year. Looking ahead, analysts are looking for further modest improvements in both sales and earnings, but they may well be conservative given our constructive view of the US economy and the potential of these new technologies.

Turning to AI specifically, just a handful of Mega-cap stocks have been behind the roller coaster ups and downs of equity markets over the last 12 to 18 months. The recent market pullback was triggered by investors asking "Nice Software but where and when are we going to see the commercial returns for all the billions that are being invested?"

But in reality, the transition from models that are embedding the AI to capabilities into the products and services, this is already well underway in many companies. Various sectors look at how to deploy these new capabilities to drive productivity gains. It is surprising that the markets reacted so negatively to the announcements of higher investments by the AI software companies on the data centers, cloud and other digital infrastructure. The AI honeymoon period that drove up the stocks so much, has been short and sweet, but the AI ecosystem is rapidly evolving, creating many opportunities for investors.

Willem

That sounds quite positive. If those large companies continue to invest, they will continue to innovate, and that should lead to, you know, more and more applications for other sectors to then improve their productivity.

But I think the other spillover is through infrastructure or what we call digital architecture. Presumably you need a big build-out of, for example, data centers and communications. How do you look at that?

Kevin

That's correct. As you were saying, there's already a big pickup today in the demand for digital architectures such as data centers, cloud services, cooling infrastructure and programmers. Utilities are another important elements of the mix too as they need to carefully plan to expand capacity for the increasing amounts of energy and water that are demanded for things like data centers and the cooling.

That's on top of the demand that's already coming from the electrification of the transport sector. Investments in essential generation capacity and transmission infrastructure such as cables, pylons, transformers, will provide ongoing opportunities for investors. And let's not forget the reshoring and onshoring of manufacturing and the changes in the supply chain, which also require infrastructure.

Willem

So a lot of opportunities in this area of digital architecture, not just in the US, but also in Europe and in Asia. And when I look at Asia, I see a very diverse region, both from the economic front and from a market perspective. What drives the economy, the interest rate policy, the valuations, the market composition, they're all very different when you look at China, India, Japan or ASEAN. So where should investors focus in Asia?

Kevin

Well, we like Japan as it has increasingly moved to higher value added businesses such as automation and specialist technology components, which fit well with our global megatrends we discussed earlier. At the same time, companies have taken significant steps to improve shareholder rights and governance standards.

Japanese stocks like Indian stocks, trade on valuations that are above the other regional markets but are more in line with the US, and both have reported strong sales and earnings growth.

India is a fast developing economy with the strongest economic growth in the region and the market is domestically focused, so the country's 400 million middle income consumers and the growing spending power provide strong impetus for the Indian market. Also, India has a large IT services sector that is well placed with its huge pool of programmers to ride the AI wave.

And it plays a pivotal role in the manufacture of many of the world's medicines. It's Serum Institute played a critical global role in vaccine production during the Covid pandemic. India provides both an interesting investment opportunity in itself, but also as part of a diversification strategy that includes Japan and Korea.

Willem

Thanks Kevin. This fits very well as well with our thematic framework, which I think our clients are familiar with, which is that this disruptive technology creates productivity growth, earnings growth and economic growth, but also requires that investment spending that infrastructure build-out, which happens in the digital space, but also coincides, you know, with that build-out of infrastructure for the sustainability revolution and also for the re-onshoring.

So a very interesting world out there and a lot of opportunities for investors.