HSBC

Video Transcript

HSBC Global Private Banking – Top Questions from our Clients – February 2024

CIOs Virtual Roundtable: Top Questions from our Clients and 2024 Investment Outlook

Willem -

Hello everyone, and welcome to our inaugural CIO Virtual Roundtable, where I'm bringing together our four regional CIOs from Asia, EMEA, the UK and the US, to tap into their expertise on the ground and also to answer the most important client questions that we have encountered during our client meetings. And we've had a lot of them in the past month as we presented and discussed our 2024 Outlook.

So, we're going to cover quite a bit of material today, in a short period of time. We'll talk about the global economy, the US, the US equity markets, and whether the US presidential elections are going to change anything to that. We'll turn to Asia then, and then afterwards, talk about portfolio construction and how to diversify bond and equity portfolios.

Now, if I were to try to summarise current client sentiment, I would say that people are encouraged by the prospect of rate cuts from the Fed and other central banks, but that they are also a bit concerned about the rally that we've already had in November and December. And then of course, there are those geopolitical risks and that makes people hesitate as well.

Anything to add to that client sentiment, Fan?

Cheuk Wan Fan -

Indeed, during our recent three-week investment outlook roadshow in Asia, we heard many clients expressing their concerns about high valuations of US stocks and geopolitical uncertainty surrounding US-China tensions. Asian clients are also worried about China's weaker growth and its impact on the broader Asian economy and market outlook.

Willem -

A fair point and Jonathan, anything to add from your side?

Jonathan -

Yes, there are some lingering recession fears, less than before, and in the UK, we haven't completely dispelled the idea of stagflation. And this also raises, I think, the question amongst many clients whether to move out cash while rates are still very competitive.

Willem -

That's a fair point, because when we did our LinkedIn poll just ahead of this roundtable, it seemed indeed that those inflation concerns were one of the reasons why some people are not putting their cash to work yet.

So, let's try to address all of those questions and let's start with this global macro-outlook. Georgios, can I ask you to summarise our global view on the economy and on inflation?

Georgios -

Yes, absolutely, so, first of all 2023 delivered growth which was well above expectations. A reminder that a year ago most economists were expecting a recession that did not materialise. It seems that a lot of that momentum and the strength that we saw in the US economy in particular, is being carried over in the first month of the year.

We continue to see tight labour markets as well as the appetite to consume still in place. We have to consider that real wages have also improved, in the sense that wage growth is now above inflation, and that eases some of the squeeze in terms of living costs that the consumer had to face.

We do expect growth to slow down from last year's level, but our expectation is that the consensus is a little bit too pessimistic, and we should be able to witness a little bit better growth than what is priced in the market.

In terms of inflation the battle against inflation is not yet over, but the recent trends have shown substantial improvements compared to last year. Six-month data annualised across all three regions suggest that we are much closer to target, and we're certainly heading in the right direction.

Willem -

Now, one of the things that stands out is indeed that US resilience. So, let me turn to you, Jose, as the man on the ground there, what is really creating that US resilience?

Jose –

Thank you, Willem.

Well, first of all, the unemployment rate remains near 60-year lows. And for the consumer, inflation has fallen a lot more rapidly than wages. So, we're seeing real disposable incomes are positive again - we haven't seen that in a while.

On the investment side, construction of manufacturing facilities is growing at 73% year over year. And we have four major secular themes. Number one is the technology revolution that is just beginning, really. Number two is the innovation that is coming out of that technology revolution. It's going to manifest in certain sectors in particular, like healthcare and financials and technology itself. And number three is near shoring, where we're seeing a lot more effort in resilient supply chain and therefore bringing jobs closer to the US markets. Then number four is the re-industrialisation of the US. And we are seeing tremendous spending, like I mentioned before, in new plants, and they will be heavily technologically driven. But those four themes will provide a tailwind for the US economy, and they're very supportive of our overweight on US equities.

Willem -

So, several engines really keeping that economy going, giving us additional confidence.

Now the elephant in the room is the US Presidential elections, any impact on that economic growth picture or on the markets?

Jose -

Well, you know, historically Presidential election years have been good for the markets. And if you look at where we are today, fiscal policy again, historically has been loose during Presidential election years.

We don't expect a lot of contraction there, and then on the monetary side, we look for the Fed to cut rates this year, as you know. But more importantly, we expect them to become less restrictive overall, which should be a better environment for growth.

If the Democrats win, led by President Biden, we look for more of the same with the Inflation Reduction Act, the CHIPS act, the Infrastructure Investment and Jobs Act. All of those have created investment, and have led to more jobs, which is good. But we expect the focus to be heavily focussed on alternative energy and social policy.

If the Republicans win the White House, led by former President Trump, then I think you should expect a couple of things. Number one, they will either try to extend or make permanent the Trump tax cuts of 2017. In addition, you should expect them to try to lower regulatory hurdles with a real focus on the energy and defence industries.

And remember Willem, it's very important that in the last 12 presidential elections, 75% of the time, the S&P has outperformed all global markets and by about 4% on average. So, pretty heady stuff and supportive again of our overweight position here.

Willem -

So, indeed, if I take that relative resilience of the US compared to other economies, and also the political picture that you've just painted, the experience of a Presidential election - that still supports our overweight on US equity markets within the global context, doesn't it Jonathan?

Jonathan -

Yes, it does, I mean the fundamentals look good. But the big question we often get, and the pushback is on valuations. But I would push back against that and actually say that if you break down the US market it is not that expensive. Really, it's just in the tech companies, and those tech companies are actually expensive for a reason. You really are seeing a great earnings growth potential there. And if we look at valuations a bit further out, so if we factor in those higher earnings, then actually those valuations really start to come down as well.

And then actually looking at growth nearer term, so if you look at the GDP growth this year, we're expecting it to be three times more in the US than say, Europe. So actually, even outside of tech, those companies with valuations a bit cheaper, those more cyclical companies can also get a boost there, from that stronger growth momentum.

And then also actually in the US, it's quite a resilient market and there's a lot of quality stocks in there as well, so that is the kind of style bias that we like as well. So, it ticks that box. So, it all boils down to as you say, that overweight in the US, a preference for that over Europe and within Europe we have a neutral for the UK, and then we're underweight the Eurozone.

Willem -

Interesting, so obviously we need to be nimble this year as so much is happening. What could trigger an upgrade of Europe in your view?

Jonathan -

So, the valuations are very interesting. They're more attractive, and if you look at some of those domestic stocks say in the UK, you really are seeing very, very attractive valuations we think.

But again, good growth is a bit more precarious in Europe. So, you want to see a bit more of a turnaround there. Also, some of those exporters as well in Europe are very tied to say the demand from China. So, we'd really like to see a pickup in China as well, so a bit more of a broader economic rebound I think will really help Europe.

So perhaps we'll see that later this year, and then we can consider an overweight then.

Willem -

But the bottom line being that in spite of the higher valuations of the US, that still remains our favourite market in the West.

The other area where clients bring up valuations is in the bond market. Obviously, bond yields have come down late last year, then they have increased a little bit, but nevertheless still quite a lot below their peak. What will drive bond yields further down from here, Georgios?

Georgios -

Yes Willem, so even though the market does anticipate a hefty number of cuts this year, we believe that the market is still expecting a longer-term equilibrium rate, which is still well above where the dot plot suggests that yields should go over the longer term.

We should also keep in mind that real yields are rarely as high as they are today. And also compared to US growth estimates, we believe that there is still some value left. So as the year progresses, we should expect the potential for yields to decline further.

There's also a lot of cash sitting on the sidelines. Record amounts in money market funds. We believe that there will be room for cash to be put to work, in the fixed income market, especially as expected cash rates also decline when the Fed is expected to start cutting rates.

Finally, there is an asymmetric return profile in the bond market where we stand. Given the fact that absolute yields are still elevated from a historical point of view, it means that if yields were to rise at this point in time, the expected losses would be relatively contained. Whereas on the other hand, if yields were to go down, we can see that there is room through duration to realise quite attractive total returns in the bond market still.

Willem -

So, we remain overweight, therefore on investment grade, and indeed as you're saying, we should have enough duration in bond portfolios. Now at the same time some clients pointed out indeed high yield did quite well last year, but we prefer investment grade.

Georgios -

Absolutely. Ultimately, spreads are not cheap enough. In fact, they're quite expensive when compared to investment grade. So, in light of cyclical risks, a steeper maturity wall, which is expected next year, we just don't find adequate compensation in high yield and therefore we prefer investment grade on a relative basis.

Willem -

So, a very clear preference in the West.

Turning to Asia, Fan, where are the opportunities in fixed income there?

Cheuk Wan Fan -

The Asian credit market will also benefit from the disinflation trend in the region, and we expect interest rate cuts in most Asian economies this year.

So, we favour Asian investment grade bonds, which offer attractive bond yields and decent pick-up over Treasury. We like Asian financials, Korean Investment Grade corporate bonds, Macao gaming and Chinese technology credit. We are currently overweight on Indian local currency bonds, which are well supported by favourable liquidity driver from the global bond index inclusion. As we expect, the RBI will cut interest rates, and we also have a positive view on INR and the structural growth in India also supports the local currency bond market.

Willem -

Very clear in terms of your fixed income recommendations. So, if we switch to the Asian equity markets, how can people handle this view that we believe that Chinese economic growth will basically hover around the current growth level?

Cheuk Wan Fan -

We remain concerned about the property market stress and debt deflation pressure in China. So, we currently hold a neutral view on China equities, because the property market challenge will remain a drag on the economy.

But at the same time, the Chinese government is now stepping up policy stimulus to stabilise the domestic economy and the capital markets. So, the recent reserve requirement ratio cuts announced by the PBoC, together with the Bloomberg report on the 2 trillion RMB stock market stabilisation fund, will likely provide near-term support for the China equity market. So, we have a neutral position.

However, we find more promising growth opportunities outside China, and we favour the structural growth leaders in Asia. We are overweight equities in India and Indonesia. The two countries stand out as the most compelling structural growth stories in Asia. And in North Asia, we are overweight South Korean equities, which is expected to deliver a sharp earnings turnaround of 67% EPS growth in 2024. And this is mainly attributable to the AI-driven recovery of the memory sector.

I want to highlight India and ASEAN stand out as the biggest beneficiaries of the supply chain diversification and the falling global export market share of China as a result of geopolitical tension. We favour winners of the strong investment boom, the rise of middle-class consumer, manufacturing upgrade and young demographic in India and Southeast Asia.

Willem -

So, if I summarise what we've said so far, we have a diverging global growth picture, but no global recession, and the US being that more resilient economy, supporting our overweight in US equities.

But the rate cuts and the falling inflation will move both bonds and equity markets together, as the market focuses so much on what the Fed is going to do. So, bonds and equities are currently very highly correlated and that creates a difficulty in portfolios because it's more difficult to get that diversification. So how can we deal with that in terms of portfolio construction, Jonathan?

Jonathan -

Yes, like you say, highly correlated but not perfectly correlated, so any diversification is definitely better than none. But ideally your diversification wouldn't stop just at your simple equity / bond mix. You would also add other asset classes, such as alternative asset classes, we call them, like hedge funds or private markets.

Hedge funds have the kind of greater flexibility, they can use more complex instruments. Same for things like structured investments as well. They could do things like; you can harvest the yield during volatile times in market.

So again, it's all about these different sources of income, and as well going to private equity or private credit, again they are ways of having more control over a company as well. So, you could add more value there, again a different source of return.

And then finally infrastructure is a good investment. Direct infrastructure. There you're looking at strong cash flows and these are real cash flows typically. So that can be good in an environment of say slightly higher inflation. So, if you weigh all these up, these are all different ways of getting those extra returns, extra sources of returns. And then put together you can lower your overall volatility.

Willem -

Diversification as well as extra source of returns. Georgios, any further thoughts on how to manage that volatility?

Georgios -

Well, equity volatility is relatively cheap. So, for investors who are a little bit nervous, with regards to geopolitics or with regards to equity valuations, we can obviously buy volatility and protect positions.

On the other hand, if uncertainty were to rise, that can also provide opportunity to sell volatility and generate a little bit of income, put some downside barriers on the portfolio, and basically incorporate positions that can behave a little bit differently than equities and bonds, protecting us from the elevated correlation of those two asset classes.

In currencies, we also prefer the dollar versus the euro and sterling due to the divergent growth outlook that we have.

Willem -

Okay. Thank you very much for that. Some ideas to create that resilience.

So let me summarise what we've so far discussed. Actually, it brings us back, to our four priorities, that we published in our 2024 Investment Outlook.

The first priority being to put that cash to work, well ahead of the first interest rate cuts in bond markets in portfolios with enough duration and high-quality bonds.

Secondly, in the US equity market, our main overweight: to look beyond just technology because there are opportunities in other sectors as well and better valuations.

Thirdly, not to be out of the market but be invested whilst hedging, and managing the tail risks, and very much through multi-asset portfolios, including alternatives.

And lastly, Fan presented some opportunities in Asia. In spite of Chinese growth probably flatlining, there are still many opportunities there.

That's the summary of our core portfolio strategy, but I wanted to get to those thematic ideas that Georgios very briefly mentioned. Now we have too many thematic ideas to go through all of them, so what I wanted to do is a very quick discussion and ask each of you to pick their favourite theme and pitch it to me. So, maybe Jonathan, starting with you.

Jonathan -

Okay, you've asked me first, so I think one of the most exciting is Generative AI and Robotics. Over the last couple of years, the progress has been absolutely mind blowing. So, it's visible what difference that Generative AI can make. Also, we're seeing it in terms of investment, money pouring into the industry and that's really fuelling more growth. So, it's an easy one for me, Generative AI and Robotics.

Willem -

Georgios?

Georgios -

I like Opportunities in sustainable energy. After all, 2023 was the hottest year on record. Some people are talking about global boiling rather than warming. And in the recent World Economic Forum in Davos, the top four out of ten risks over the next decade were all associated with the potential impact of catastrophic event, climate risks, as well as depletion of biodiversity. Throw in geopolitics and energy insecurity, and I think the sense to act now, certainly raises opportunities for investors.

Willem -

Jose, I'm sure you have got a US opportunity?

Jose –

Yes, I would focus on the American Resilience theme sort of bundled together with those secular drivers. Consumer is healthy, positive income flows, investment in manufacturing. Construction is growing at 73%. The tech revolution, the near shoring and the re-industrialisation of the US all bundled together point to some healthy economic growth, and more importantly, a solid year for US financial markets.

Willem -

And turning to Asia, Fan, what is your top pick?

Cheuk Wan Fan -

I want to highlight our high conviction theme on the rise of India and ASEAN because this market is the biggest beneficiary of global supply chain reorientation and the China+1 strategy in the market. Recently, the Indian and Indonesian stock market saw some volatility due to the concern over the general elections in the two countries, but we view every dip driven by geopolitical concern as a buying opportunity, as we are bullish on the fiscal and long-term growth outlook in India and ASEAN.

Willem -

Interesting opportunity and a way to diversify as well within Asia.

So, thank you all for that. We packed quite a lot in this relatively short video still, and I hope that it helps

address your questions and summarises our investment strategy.

So, to conclude, we do think that dips related to short term uncertainties are buying opportunities because 2024 should be a good year to put that cash to work on the back of those Fed rate cuts and also our view that we won't have a global recession. The way that we would prefer to do that is through diversified portfolios, including bonds, equities, and alternatives, which should allow us to weather volatility and open up a great opportunity set.

So, thank you very much Fan, Georgios, Jonathan, and Jose for your insights. And to our clients, I hope that you've enjoyed this video and thank you all for watching.