Mid-Year Investment Outlook

Pivotal moments

June 2019

HSBC
Global Asset
Management

What has happened in markets and the economy this year?

Investment markets have experienced a strong rebound, delivering robust performance so far in 2019

- Performance thus far has been positive across global equities and bonds[1]
- This, however, reflects a rebound from the disappointing end to 2018
- For us, the ‘pivotal’ moment in investment markets thus far has been the change in central banks’ policies
- The US Federal Reserve (Fed) and other central banks ‘pivoted’ at the start of the year towards a more favourable stance
- As a result, corporates and consumers have had access to affordable credit, which has facilitated growth

The unexpected 'policy pivot' by the US Federal Reserve, coupled with better-than-expected economic data and good corporate results, drove the turnaround to start 2019. In fact, since December 2018, global growth has started to show signs of stabilisation led by a recovery in the US, China, and emerging markets.

The Fed and other key central banks are adopting more accommodative policies for economic growth.

The economic impact of these decisions is a continuation of lower interest rates and cheaper borrowing costs for consumers and corporations, which are supportive of growth.

Low inflation is the underlying factor that has enabled central banks to keep their focus on stimulating economic growth.

While growth remains modest, we believe we are in the midst of a long-term moderate global expansion.

Chinese domestic demand is now beginning to recover from last years’ slump and this should support growth elsewhere.

Going forward we expect growth to moderate in the US, and to gradually improve in other economies.

Investment involves risk. **Past performance is not a reliable indicator of future performance.**

1. Source: MSCI All Country World Index (equities) and Barclays Global Aggregate Treasuries Total Return Index (bonds), as at end of April 2019.

What are the key economic themes for the remainder of 2019?

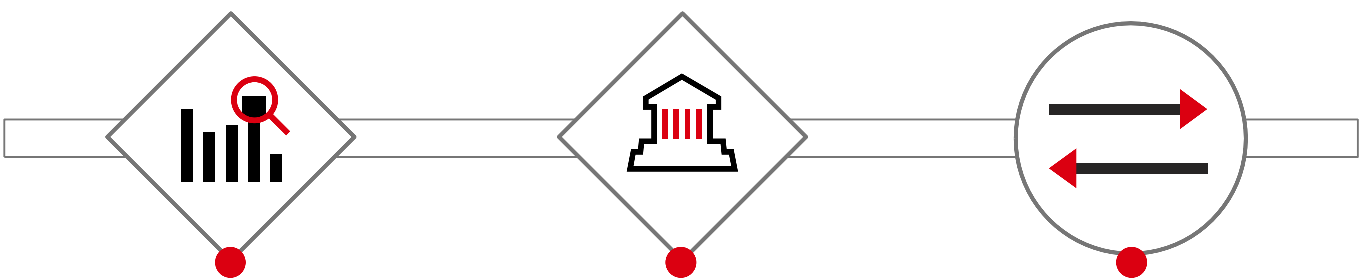
Global growth continues at a modest pace

- Markets remain anxious about global growth and the risk of a recession
- In our view, a combination of moderate global growth, reasonable corporate performance, and supportive monetary policy means that the prospect of a recession looks more like a risk for 2021
- While US growth may be slowing slightly, we don't expect it to drop below its long-term trend pace[2]
- Outside the US we expect other major economies to see stable or improving growth, led by China, where supportive policies implemented last year have been successful in driving a growth recovery

Supportive monetary policy

- The policy shift by the Fed resulted in lower interest rate expectations, favouring equity markets
- But the Fed was not the only central bank to pivot in its approach
- The European Central Bank (ECB) and other central banks across developed and emerging economies have also implemented policies more supportive of growth
- This provides a boost to global growth prospects as we move into the second half of the year, although the outcome of trade tensions and geopolitical uncertainty may challenge these prospects

What are the key risks looking forward?



Right now the US and China are still driving global growth. A material slowdown in either economy would have a significant impact on asset classes more sensitive to growth, such as equities.

Another pivot by the Fed, returning to less accommodating monetary policies, could drive interest rates higher and risk a sharp correction in investment markets.

We view this as unlikely. If the US economy performs better than expected and inflation rises, the Fed is likely to tolerate some inflation above its target.

Political risks are a challenge for investors because they are unpredictable and therefore difficult to manage.

In our view, the key political risks remain the US-China trade rivalry captured in protracted negotiations, along with Brexit, and the current European and US political backdrops.

It's important to follow a diversified investment strategy and to be adaptive to any changes in the environment. This is a sensible approach to navigating bouts of volatility, pursuing opportunities and mitigating risks.

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2. Source: HSBC Global Asset Management, US long-term growth trend around 2%, May 2019.

Multi-asset outlook

We think market pessimism is overdone and we continue to favour equities to gain exposure to potential growth

Our asset allocation views are based on our macro-economic analysis and an evaluation of what financial markets are already taking into account (i.e. the price of equities and bonds). From here we can leverage our insights to identify more and less appealing opportunities for a multi-asset portfolio.

We have identified a few key multi-asset themes as we enter the second half of 2019.

Misplaced macro pessimism

Many remain anxious about global growth and the risk of a recession or bear market. However, our fundamental analysis on the economy and corporate sector tells us that these worries are excessive. A combination of reasonable global growth, OK corporate fundamentals, and supportive policy means that the prospect of a recession looks more like a risk for 2021 or beyond. We, as investors retain a pro-risk allocation.

Even though corporate profit growth has deteriorated versus last year, we think global equities continue to offer relatively-attractive forward-looking returns. Looking ahead, we believe stabilising global economic activity should support corporate revenue growth.

Many bond segments offer poor rewards today

Inflation is the neglected risk

We don't expect inflation to increase significantly in the near term, but it wouldn't take much of an upward surprise in inflation or interest rates to change the current pricing in fixed income assets, such as bonds. The main problem is that our own analysis suggests investors are not being rewarded for their exposure to interest rate risks in several sectors of the bond market.

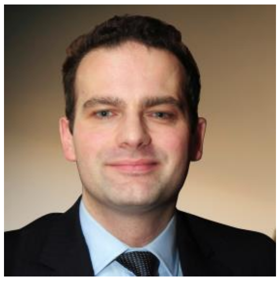
In our view, emerging market government debt and Asian corporate higher risk bonds offer some of the better value in bond markets, at present.

The upside is in emerging markets

A key aspect of our role as multi-asset investors is to manage risk while identifying and aiming to capture rewarding opportunities. Currently, we see significant opportunity in emerging markets.

We see potential in emerging markets

Growth in emerging economies seems to be recovering, led by improvements in China. Trade tensions will still pose challenges, but we think that a number of emerging market asset classes are relatively attractively-priced and have the potential to outperform if key risks don't materialise. Nonetheless, worries over risks may limit return potential in the near-term.



Joseph Little

Global Co-CIO for Multi-Asset;
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We are positive on equities, with companies continuing to deliver stable profitability

Equities outlook

How has the year started?

As highlighted earlier, the US Federal Reserve's monetary policy pivot provided a boost to equity markets to start the year. This, combined with an improvement in global growth, alleviated concerns of a larger economic slowdown.

And although global equities rallied at the beginning of the year, some of those gains were given up due to the latest round of trade frictions in May.

What is your outlook for equities?

Based on the most recent round of talks between the US and China, which resulted in mutual tariffs and no definite timeline for any sort of resolution, it looks like the potential for a full-fledged trade conflict will spill over into the second half of 2019.

In our opinion, the uncertainty and negative sentiment that comes with a protracted negotiation is a bigger threat to companies and markets than the potential increase in tariffs. Investors will need to adjust to a longer period of geo-political uncertainty, especially as we move closer to the campaign for the 2020 US Presidential elections where US-China relations are likely to be on the agenda.

What does this mean in terms of investment opportunities?

In the immediate future we have to be prepared for some bouts of uncertainty in the markets. However, we are buyers of equities in this environment, focusing on the intrinsic value of companies and their fundamentals (e.g. profits and debt levels); these are still favourable - the slowdown in economic growth has moderated, corporate profitability remains intact and inflation is still low.

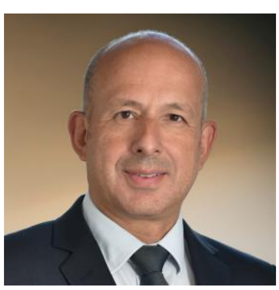
We like emerging markets - particularly Asia. Japan and Europe also present opportunities, in our view

In terms of markets, while US equities have run ahead in recent years, Japan and Europe still look attractive to us. Within emerging markets, Asia stands out, where we again see strong value. Furthermore, the region doesn't have some of the political and economic uncertainties that other emerging market countries currently have, via new regimes, pending elections or inconsistent growth.

And what are the key risks for equities?

Unpredictable as they might be, it is clear that geopolitical uncertainties have a huge impact on sentiment and can drive markets in powerful ways in the short term.

Inflation is another risk we are monitoring. Although it remains below target in developed markets and low in emerging markets, the trade conflict between the US and China could change that. Tariffs are inflationary (i.e. they increase the cost of goods), and so are palliative measures such as moving manufacturing onshore. We don’t expect inflation to come back in a big way in 2019, but we will continue to monitor it as other risk factors play out.



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Global CIO Equities
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After such a strong start to the year we expect more muted returns in the second half

Bonds outlook

What happened in bond markets to start the year?

We continue to live in a world of moderate economic growth and low inflation, along with significant political uncertainty and geopolitical tensions. This environment is not particularly adverse for fixed income. The Fed, and other central banks' policy pivot coupled with continued global expansion have helped generate strong performance in all fixed income segments in 2019, with high yield, emerging market bonds, and Asian bonds leading the way.

Asia and emerging countries have benefited from a better policy mix (tax cuts and public investment in China, as an example), along with global commodity prices creeping up. A more patient Fed and tame inflation, have also paved the way for more accommodative monetary policies across emerging markets.

In Europe, we continue to see some value in the periphery countries as economic growth recovers or at least holds up. Italy however, remains volatile, justifying a cautious approach in our selection.

We see value in higher risk bonds, where we favour Europe for relative value, and also like emerging market bonds

How do we see the remainder of 2019 for bonds?

A lot of potential has been materialising already this year with strong performance across bond segments. Investors should be expecting a more muted second half where we see little value in government and well-rated (investment grade) corporate bonds.

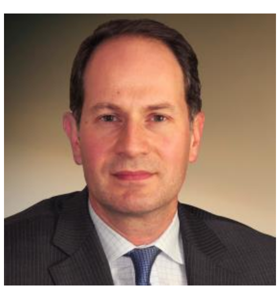
We continue to see some value in higher risk (high yield) bonds, with a bias in Europe. We still prefer emerging markets bonds thanks to the strong combination of fundamentals and improving recovery stories.

While we are positive on emerging markets, especially Asia, we are very careful with our selection – particularly country selection. This is because individual vulnerabilities will be a major driver of currency movements and returns.

What are the key risks to our outlook for bonds?

Geopolitics and trade tensions will continue to pose challenges, and we will be paying close attention to developments in Europe regarding Brexit and the Italian budget.

Separately, corporate default rates, that is companies failing to meet their debt obligations, could start to creep up if any slowdown in the US economy drives notable earnings declines in the second half of the year. A keen eye should be kept on developments in the loan markets and the balance of upgrades and downgrades in company credit ratings, as an indicator of the strength of corporate balance sheets.



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