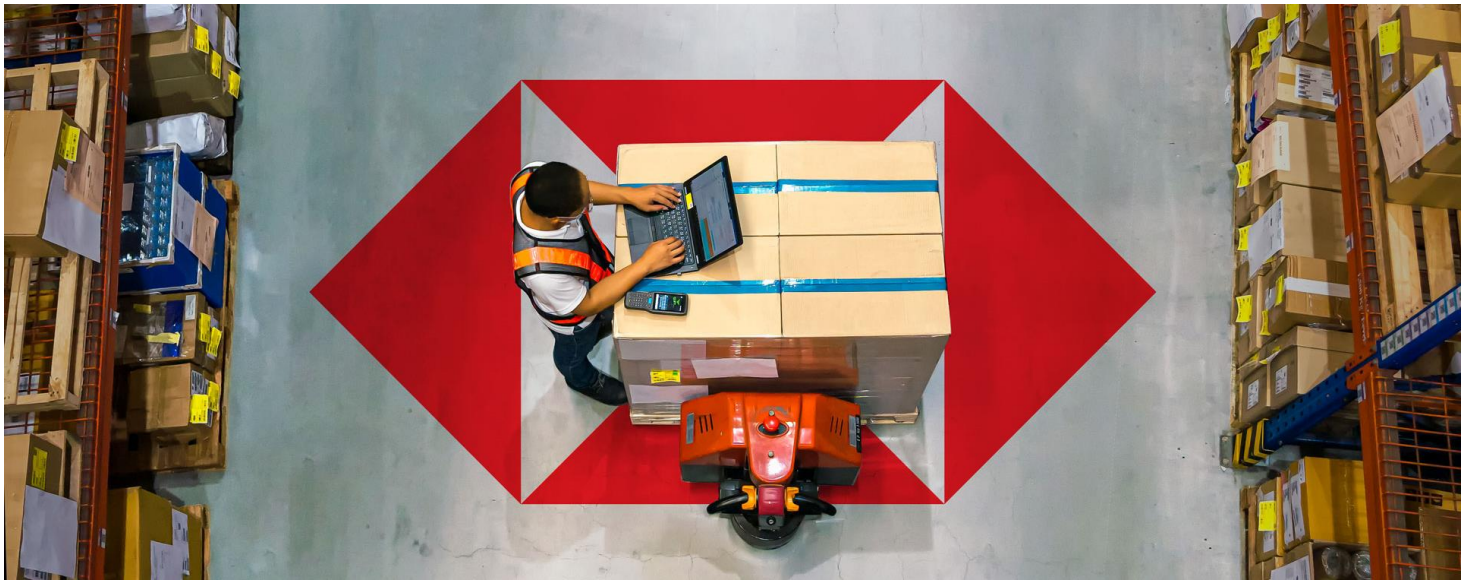


Investment Monthly

Earnings, rates and growth remain supportive amid political uncertainty

August 2024



Key takeaways

- ◆ Despite media headlines about the US election, investors should focus on earnings, rates and growth fundamentals which remain supportive. As a Fed rate cut in September is largely priced in, we focus on locking in bond yields from quality bonds and broaden our sector exposure to include IT, financials, consumer discretionary and healthcare stocks.
- ◆ While China's Third Plenum focused on 1) new quality productive forces; 2) technological innovation; 3) macroeconomic policy governance; 4) integrated urban and rural development; and 5) further opening-up foreign trades and investment, we think more near-term policy stimulus would be needed to sustain economic recovery. We stay neutral on Chinese stocks and favour corporate governance reform winners, quality SOEs and internet leaders.
- ◆ The 2024 Indian Budget centred on driving fiscal discipline, as well as near and medium-term growth. Projected FY25 fiscal deficit is now down to 4.9% while gross and net borrowing will be lowered to INR14tr and INR11.6tr, respectively. Other positive measures, such as employment and skilling programmes for the youth, loan limit increases for small firms, capital expenditure and raising capital gains tax should help boost the consumption, industrials and financials sectors.



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Asset class	6-month view	Comment
Global equities	▲	Long-term fundamentals remain positive. Future central bank easing should be accretive to corporate earnings while technology helps lower costs and lift revenues. We look beyond the US and IT to capture the broad-based upside.
Government bonds	▶	As the global rate cut cycle has started, we expect DM sovereign bond yields to continue moving lower and focus on locking in current bond yields. We favour US Treasuries and UK gilts with medium-to-long duration.
Investment grade (IG) corporate bonds	▲	We stick to quality amid slowing global growth and rising geopolitical uncertainty, and prefer investment grade to high yields as interest rate risk is more attractively priced than credit risk.
High yield (HY) corporate bonds	▶	High yield bonds are more sensitive to negative economic developments, higher financial leverage ratios and tighter valuations. Their yield pick-up is insufficient for rising defaults. Valuations remain stretched.
Gold	▶	A USD rebound could halt gold upside while demand is also starting to struggle at current high prices.

▲ "Overweight" implies a positive tilt towards the asset class, within the context of a well-diversified, typically multi-asset portfolio.

▼ "Underweight" implies a negative tilt towards the asset class, within the context of a well-diversified, typically multi-asset portfolio.

▶ "Neutral" implies neither a particularly negative nor a positive tilt towards the asset class, within the context of a well-diversified, typically multi-asset portfolio.

Icons: ↑ View on this asset class has been upgraded; ↓ View on this asset class has been downgraded.

Talking points

Each month, we discuss 3 key issues facing investors

1. How should investors react to US election-related news?

- ◆ While investors' minds may be occupied by what happened in the US – the election debate, assassination attempt on Trump and Biden's dropping out, we think investors should focus on earnings, rates and growth fundamentals which remain supportive. Q2 earnings are forecast to rise 9.8%, which is the fastest earnings growth rate since Q1 2022.
- ◆ Although bond markets may start to focus more on the rising deficit, regardless of who will win the election, we think the short-term focus remains on central bank policy and inflation. Lower-than-expected inflation for June reinforces the Fed's first rate cut in September in our view. Therefore, investors should focus on locking in bond yields before they come down. We prefer quality bonds, preferably investment grade (5-7 years) and Treasuries (7-10 years).
- ◆ The "Trump trade" rhetoric, which includes tax cuts and a rotation into small caps, has gained momentum. We believe the move has been exaggerated by investors' heavy exposure to the "Magnificent 7" stocks. As earnings growth is broadening out, we still favour IT but also the financials, communications, consumer discretionary and healthcare sectors to mitigate political uncertainty.

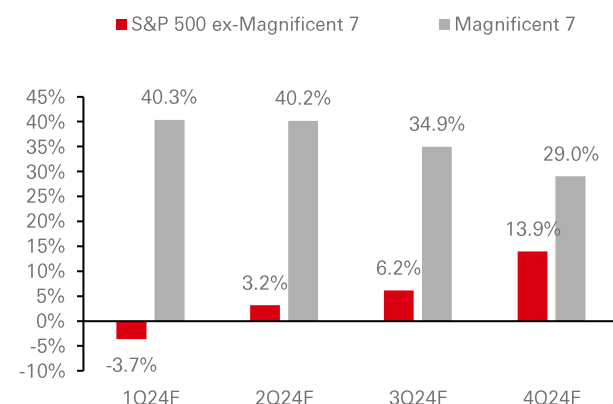
2. What are the investment implications of China's Third Plenum?

- ◆ China's Third Plenum focused on the quality development in five key areas: 1) new quality productive forces; 2) technological innovation; 3) macroeconomic policy governance; 4) integrated urban and rural development; and 5) further opening-up foreign trades and investment. It also reiterated the commitment to mitigate risks in real estate, local government debt, and small-and-medium financial institutions.
- ◆ Enhanced market access in the services sector and the domestic capital markets (including the expansion of Stock Connect and Bond Connect for offshore investors) should help attract more foreign investment.
- ◆ However, we think more near-term and broad-based stimulus would be helpful to achieve this year's 5% GDP growth target. We remain neutral on Chinese stocks and prefer corporate governance reform winners, quality SOEs and internet leaders with solid earnings. Service consumption is preferred due to its high resilience versus general goods sales. The high-tech sector and high-end manufacturers should also benefit from supportive policies on innovation. The reduction of the 7-day reverse repo rate and the 1-year medium-term lending facility (MLF) rate is seen as a positive move by the government to revive the economy.

3. What should investors note from India's Union budget?

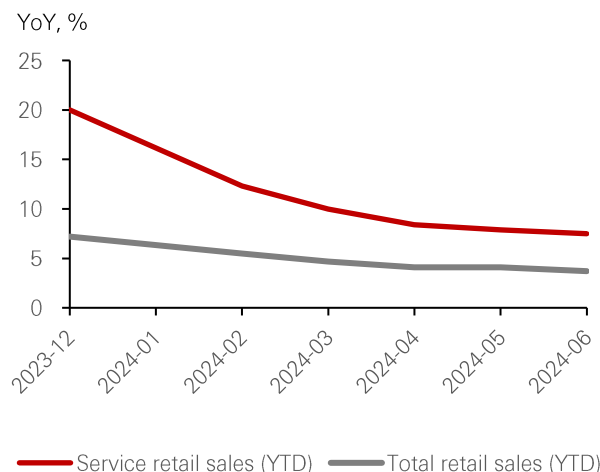
- ◆ The first budget under the Modi 3.0 government centred on driving fiscal discipline, as well as near and medium-term growth via nine priorities: 1) productivity and resilience in agriculture; 2) employment and skilling; (3) inclusive human resource development and social justice; (4) manufacturing services; (5) urban development; (6) energy security; (7) infrastructure; (8) innovation and R&D; and (9) next generation reforms.
- ◆ Projected FY25 fiscal deficit is now down to 4.9% (from 5.1%) and FY26 fiscal deficit target remains at 4.5%, while FY24 fiscal deficit was also lowered to 5.6%. Gross and net borrowing will be reduced to INR14tr and INR11.6tr respectively. Other measures include employment and skilling programmes for the youth, loan limit increases for small firms, capital expenditure and massive home build, and raising capital gains tax, securities transaction tax on derivatives and personal income tax buckets.
- ◆ These measures help boost the consumption, industrials and financials sectors, complementing India's robust economic growth, strong earnings growth and sticky domestic investor base. We remain positive on Indian equities while Indian government bonds should benefit from the country's manageable borrowing needs and strong foreign inflows.

Chart 1: As earnings momentum outside of the Mag7 improves, we broaden our exposure and focus on company's fundamental quality



Source: LSEG, I/B/E/S, HSBC Global Private Banking and Wealth as at 23 July 2024. Forecasts are subject to change. "Mag 7" refers to Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia and Tesla.

Chart 2: Growth of service consumption has stayed stronger than general retail sales in China



Source: WIND, HSBC Global Private Banking and Wealth as at 19 July 2024. Past performance is not a reliable indicator of future performance.

Chart 3: Consensus 12-month forward P/E ratio and EPS growth estimates

	P/E Ratio	2024 EPS(g)	2025 EPS(g)
MSCI India	25.8	31.5%	18.7%
Financials	17.9	24.8%	23.4%
IT	29.3	7.6%	9.9%
Energy	17.3	56.9%	7.2%
Consumer Discretionary	32.8	144.2%	14.7%
Industrials	45.2	71.7%	23.6%
Consumer Staples	54.3	22.4%	15.0%
Materials	25.1	4.9%	35.1%
Healthcare	34.7	34.8%	16.2%
Utilities	21.1	36.5%	10.0%
Communication Services	46.7	118.4%	52.5%
Real Estate	67.4	107.1%	26.8%

Source: Bloomberg, HSBC Global Private Banking and Wealth as at 23 July 2024. Past performance is not a reliable indicator of future performance.

Asset Class Views

Our latest house view on various asset classes

Asset class	6-month view	Comment
Global equities		
Global	▲	Long-term fundamentals remain supportive. Future central bank easing should be accretive to corporate earnings while technology helps lower costs and lift revenues. We look beyond the US and IT to capture the broad-based upside.
United States	▲	While earnings and the prospect for rate cuts are supportive of US equities, we are broadening exposure to a wider variety of sectors. US elections tend to benefit US stocks historically, but short-term volatility remains.
United Kingdom	▲	Amid an improving growth and earnings outlook, undemanding stock valuations, easing interest rates and political stability after the election, we remain overweight on UK equities.
Europe ex-UK	▶	Despite an improvement in the services sector, manufacturing remains a drag. However, we still see opportunities in attractively-priced leading global companies.
Japan	▲	Wage growth continues to sustain the reflationary outlook and consumption recovery, supporting the BoJ to further raise interest rates gradually. Corporate governance reforms, strong earnings growth and the AI boom remain key drivers.
Emerging Markets (EM)	▶	We are most positive on EM Asia where corporate earnings growth is likely to rebound sharply in 2024.
EM EMEA	▼	The region is impacted by high energy prices and global interest rates, as well as geopolitical uncertainty.
EM LatAm	▼	Political uncertainty in Mexico and slowing rate cuts in Brazil may trigger selling. We maintain our underweight stance on EM LatAm equities.
Asia ex Japan equities		
Asia ex-Japan	▲	We continue to diversify into the region to capture its structural growth opportunities, focusing on India's strong growth momentum and the global AI trend which benefits South Korea.
Mainland China	▶	We believe a durable re-rating would require more sustained fundamental improvement and remain selective, focusing on corporate governance reform winners, quality SOEs paying high dividends and blue-chip internet leaders with solid earnings.
India	▲	The Indian Budget focused on fiscal discipline, rural and welfare reforms and job creation, benefitting the consumption, financials and industrials sectors. Valuations have re-rated but are justified by strong earnings and economic growth.
Hong Kong	▶	The government's latest initiatives should support investment sentiment amid economic and capital market challenges. We prefer the insurance, telecom and utility sectors, as well as quality REITs and developers. Valuations are attractive at 11.7x.
Singapore	▶	We expect the central bank to keep interest rates on hold in 2024 and prefer high-quality REITs on their undemanding valuations.
South Korea	▲	Corporate earnings expectations remain bullish while valuations are also attractive. The "Corporate Value-Up Programme" is expected to bring attractive re-rating opportunities.
Taiwan	▶	The equity market is benefitting from the AI boom, but valuations are expensive, so we remain neutral.
Government bonds		
Developed markets (DM)	▶	As the global rate cut cycle has started, we expect DM sovereign bond yields to continue moving lower and focus on locking in current bond yields. We favour US Treasuries and UK gilts with medium-to-long duration.
United States	▲	With the Fed starting the rate cut cycle in September fully priced in, we continue to extend duration and lock in higher long-term market rates.
United Kingdom	▲	We continue to favour UK gilts as the BoE could provide more dovish guidance post-election, offering investors an opportunity to lock in the current attractive yields.
Eurozone	▶	Although the market has priced in a likelihood of a rate cut in August, we maintain our view of two rate cuts in September and December. Absolute yields remain relatively less attractive compared to those in the US.
Japan	▼	We think the BoJ will further normalise its monetary policy via rate hikes and by reducing its bond buying as inflation and wage growth is moving in the right direction. As bond yields remain unattractive, we remain underweight.
Emerging Markets (Local currency)	▼	A high-for-longer US rate environment weighs on several EM currencies and affect bond returns. We stay positive on Indian local currency bonds for yield pick-up and diversification benefits.
Emerging Markets (Hard currency)	▶	We still find opportunities in selected quality issuers in emerging markets, where the yields remain appealing.
Corporate bonds		
Global investment grade (IG)	▲	We stick to quality amid slowing global growth and rising geopolitical uncertainty, and prefer investment grade to high yields as interest rate risk is more attractively priced than credit risk.
USD investment grade (IG)	▲	Ahead of the Fed policy pivot, we continue to focus on locking in the attractive yields at multi-year highs from quality issuers.
EUR and GBP investment grade (IG)	▲	As a ceiling on yields has likely been reached, we continue to favour European credit, preferably large-cap companies with well diversified business models across countries and regions.
Asian investment grade (IG)	▲	The fundamentals for Asian IG bonds remain solid with the current valuations well supported by the tight supply. We prefer Asian financials, Indian local currency bonds, Indonesian quasi-sovereign bonds, Macau gaming and Chinese TMT.
Global high-yield (HY)	▶	High yield bonds are more sensitive to negative economic developments, higher financial leverage ratios and tighter valuations. Their yield pick-up is insufficient for rising defaults. Valuations remain stretched.
USD high-yield (HY)	▶	Despite low defaults and manageable refinancing risk, the risk premia of US high yield is too low versus investment grade.
EUR and GBP high-yield (HY)	▶	Although growth has bottomed, spreads in high yield remain tight compared to historical averages, so are less attractive.
Asian high-yield (HY)	▶	Given the challenging environment of the property market and mixed economic recovery data in China, we focus on quality issuers in the region.
Commodities		
Gold	▶	A USD rebound could halt gold upside while demand is also starting to struggle at current high prices.
Oil	▶	While geopolitics provide support for oil, spare capacity limits the upside. We expect oil prices to trade sideways.

Sector Views

Global and regional sector views based on a 6-month horizon

Sector	Global	US	Europe	Asia	Comment
Consumer Discretionary	▲	▲	▲	▲	Consumers have adapted to the higher interest rate environment backed by easing inflation and higher wages. The outlook for hospitality and tourism looks particularly positive although luxury goods sales growth is more muted. Unseasonal weather is again disrupting seasonal buying patterns. Autos remain in turmoil as supply chain issue re-emerges and EVs demand troughs due to poor EV charging infrastructure. Home appliance demand remains subdued pending a recovery in home sales.
Financials	▲	▲	▶	▶	Globally and in the US, the sector continues to benefit from an improving economic backdrop while interest rates look set to decline slowly with a modest impact on earnings. Capital market activity has picked up. Regional banks with significant exposure to the real estate sector and loans remain an area of concern. Weather related events including a forecast record Atlantic hurricane season are likely to weigh on the insurance and re-insurance segments.
Industrials	▶	▶	▶	▲	US Industrials remain steady, but near-term momentum potential is limited given present valuations. Asian Industrials are showing tentative signs of slowly improving fundamentals. Medium term, we remain positive on the sector as government policy remains supportive in China, Europe and, especially, the US where the Inflation Reduction Act (IRA) and CHIPS Act are driving significant investment in new production capacity and infrastructure.
Information Technology	▲	▲	▲	▲	Big tech stocks have seen some pull-back as the rally broadens. AI will be the key driver for the sector as the technology becomes increasingly embedded, leading to product and service capability enhancements, productivity gains and competitive differentiation. The next wave of AI development should benefit digital infrastructure companies focused on cloud, data centres, software and cooling technologies.
Communications Services	▶	▲	▼	▲	The US Communications sector continues to deliver stellar earnings growth as fundamentals and attractive prices continue to attract investors. In Asia, the stabilising regulatory environment and low valuations offer an attractive risk-return profile. In contrast, Europe's telecom services sector has little room for optimism.
Materials	▶	▶	▶	▶	Copper prices remain the bright spot in the commodity markets on rising renewables, electrical and digital infrastructure demand, plus some strategic inventory building in China. Iron ore, steel and EV battery materials remain lacklustre. M&A activity has sparked interest in the miners. Chemical stocks remain range-bound while the chemical business remains subdued.
Real Estate	▼	▼	▶	▼	The outlook for commercial real estate is mixed, with retail and office segments still looking unattractive, while warehousing is seeing improved demand and prices after a sustained period of weakness. The housing sector in some markets is showing tentative signs of improving sentiment in anticipation of lower interest rates. Chinese real estate remains problematic. Easing inflation and interest rates may lift sentiment and activity.
Consumer Staples	▶	▶	▶	▲	Consumers are still trading down in some markets as cost-of-living pressures continue to bite. The sector should benefit from strong seasonal demand with solid results going forward, despite tough YoY comparables. The sector is trading in line with historical valuations. We focus on quality stocks with strong brands and some pricing power.
Energy	▶	▶	▲	▶	Low valuations, strong cashflow and high dividends appear to be insufficient to change sentiment towards the sector as energy prices remain range-bound. On a seasonally-adjusted basis, supplies appear plentiful and inventories adequate, backed by the relatively mild winter in Europe. In 2024, energy prices may not benefit from geopolitical uncertainty as they have over the last two years.
Healthcare	▲	▲	▲	▼	New product launches, a less hostile pricing environment and the ebbing wave of major product patent expirations should help lift the sector after a period of under-performance. Healthcare sales growth should start to benefit from easier comparables while new pharma products should lift sentiment and expectations. In Asia, valuations remain high, trading well above historical levels.
Utilities	▶	▶	▶	▲	Momentum is re-accelerating on renewable energy projects as governments have started to adopt more realistic pricing for new projects. Interest rate cuts could provide a tailwind and improve sentiment further. Utilities may benefit as interest rates fall and investors look to high dividend paying stocks.

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