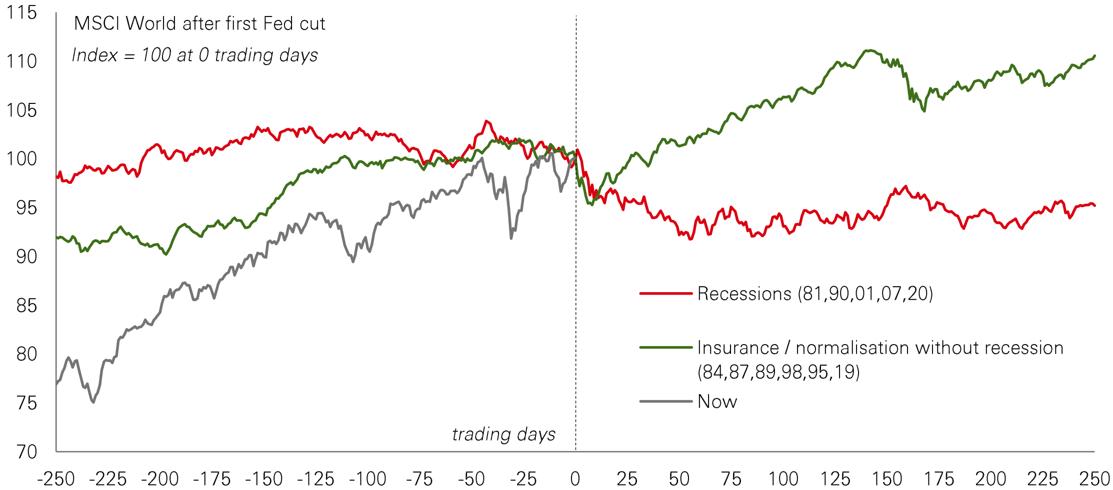
Investment Weekly

23 September 2024

Chart of the week – Fed easing and stocks



With the market pricing in a high probability of an outsized rate cut, the Fed decided it could be bold and deliver a 0.50% move at its September meeting. It reflected greater confidence that inflation is now in the rear-view mirror, and it is time for the Fed to switch its focus to maximising the chances of a soft landing.

If delivered, the soft landing would be positive for risk assets. Globally, equities typically perform well in the year following the first Fed rate cut, so long as the US economy avoids a recession. **The playbook for a soft landing is a 'great rotation' in markets**, with value, small caps, and emerging markets outperforming while Treasury yields drift lower, the yield curve 'structurally steepens' and the USD weakens.

However, while the Fed has embarked on a cutting cycle, policy is likely to remain restrictive for some time yet. Combined with the current cooling trend in the labour market, this means recession risk could remain elevated heading into 2025. Additional sources of risk, such as election uncertainty or geopolitical stress, can also come into play. **There could be a more volatile phase for investment markets**. And if the much-vaunted soft landing turns into a hard landing, risk assets will struggle even if the Fed loosens policy by far more than currently expected.

Market Spotlight

Fed easing… a boost for Private Credit

Private credit has surged in popularity among investors in recent years. And with an average yield of nearly 12%, it continues to offer a return in excess of other credits, as well as the 9.5% average 10-year total return from stocks.

With traditional banks continuing to retreat from parts of the lending market – a trend evident since the financial crisis – private credit managers have stepped in. This has given both borrowers and lenders more flexibility on terms, with investors benefitting from the asset's relatively low volatility and eye-catching returns.

New private credit fundraising slowed in 2023 and early 2024, with elevated rates putting pressure on some borrowers and reducing demand in places. But last week's move by the US Fed to kick off its easing cycle could boost the environment for both fundraising and lending. And while lower base rates will inevitably trim returns over time, private credit is expected to remain a high yield asset class (on both an absolute and relative basis) – and one that offers an illiquidity premium that suits long-term investors. It also serves as a useful portfolio diversifier.

EM Sovereign Bonds →

EM hard currency sovereign rating upgrades

Asian Equities →

Top performing sectors in India's stock market

European Macro →

Mario Draghi's vision for a more competitive EU

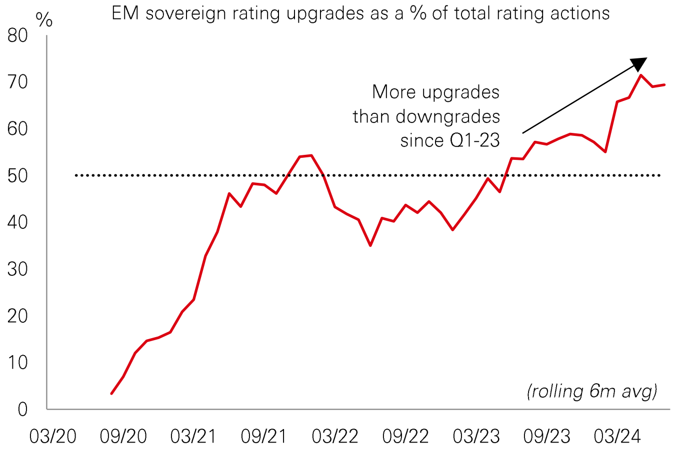
Source: HSBC Asset Management. Macrobond, Bloomberg. Data as at 11.00am UK time 20 September 2024.

Lens on...

EM sovereign rating upgrades

As global policy easing accelerates, EM hard currency bonds are in a plum position. Although EM sovereign spreads remain historically tight, they have widened relative to DM high-yield spreads – a comparable asset class. This is puzzling given that EM sovereign bonds are a high-duration asset class, with average index duration nearly double that of global high yield and exceeding that of even US Treasuries.

And according to some EM debt analysts, the story around fundamentals is also very favourable. After a decade of ratings downgrades, EM sovereigns have turned a corner. Since early last year, upgrades net of downgrades have turned positive and continue to trend up. Turkey is notable among large EMs for its upgrade momentum. There have also been ratings improvements in several frontier markets, notably Azerbaijan, Paraguay, Morocco, Namibia, Costa Rica, the Dominican Republic, and Serbia. This furthers the structural shift towards a better-quality index with more investment grade ratings, implying the potential for superior returns with lower risks.

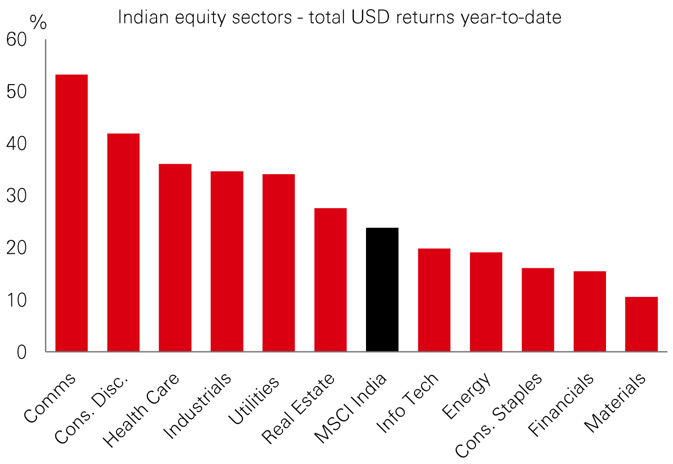


Sector picks in India

Indian stocks have outpaced most global markets this year, with the MSCI India index rising by 23%. After a bout of post-election volatility in Q2, foreign investment inflows have picked up in Q3, with investors gravitating to India's relatively low dependence on external demand, expectations of policy continuity, and exposure to secular growth trends – especially in manufacturing, infrastructure, and consumption.

At the sector level, all areas have notched-up double-digit percentage gains this year. Communications and consumer discretionary have led with returns of 53% and 42% respectively. There have also been 25%-plus rises in the healthcare, industrials, utilities, and real estate sectors.

In terms of valuations, parts of the Indian market arguably look richly-priced. **Small and mid-cap stocks, in particular, currently trade on a forward 12-month price-earnings ratio of 31.5x. But large-caps trade on a more modest 22.5x**. Sector-wise, the valuations for financials are less stretched; healthcare, which is seeing multi-year demand growth; and real estate, which is benefitting from improving demand and supply dynamics.



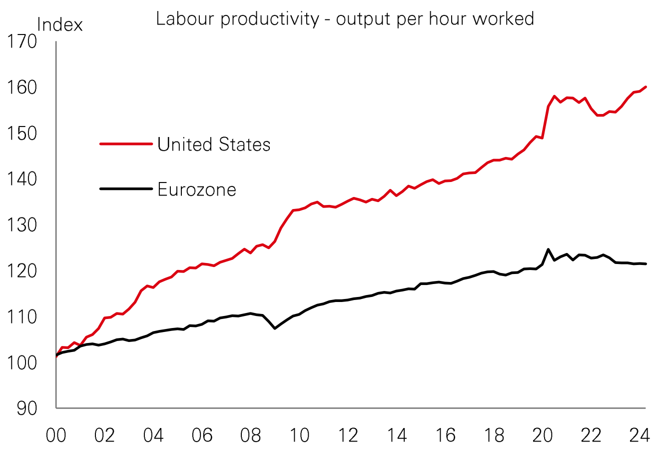
Draghi's Eurovision

A recent report by ex-European Central Bank president Mario Draghi into the EU's poor competitiveness, has blamed a yawning EU/US productivity gap over the past 20 years.

The eurozone's structural problems are well documented. Draghi mentions three: (1) low investment, outright and relative to the US; (2) the innovation gap with the US and China, with EU firms stifled by regulation, and (3) fragmented capital markets.

Draghi's recommendations range from importing foreign technologies to completing a banking union and ensuring the green transition continues. The report estimates the additional investment needs a hefty Eur750-800bn per year (around 4.5% of EU GDP).

But implementation is a tall order given rising EU political fragmentation. Not only is Germany's enthusiasm for joint bond issuance cooling but a new French government is unlikely to welcome further EU integration.



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Key Events and Data Releases

Last week

Date	Country	Indicator	Data as of	Actual	Prior
Tue. 17 September	US	Retail Sales (mom)	Aug	0.1%	1.1%
Wed. 18 September	US	Housing Starts	Aug	1.36mn	1.24mn
	US	Fed Funds Rate (upper bound)	Sep	5.00%	5.50%
	BR	Banco do Brasil SELIC Target Rate	Sep	10.75%	10.50%
	ID	Bank Indonesia Rate	Sep	6.00%	6.25%
	UK	CPI (yoy)	Aug	2.2%	2.2%
Thu. 19 September	US	Existing-Home Sales	Aug	3.86mn	3.96mn
	UK	BoE MPC Base Rate	Sep	5.00%	5.00%
	NW	Norges Bank Sight Deposit Rate	Sep	4.50%	4.50%
	TY	CBRT 1 Week Repo Lending Rate	Sep	50.00%	50.00%
Fri. 20 September	JP	CPI (yoy)	Aug	3.0%	2.8%
	JP	BoJ Policy Rate	Sep	0.25%	0.25%

US - United States, BR - Brazil, ID - Indonesia, UK - United Kingdom, NW - Norway, TY - Turkey, JP - Japan

The week ahead

Date	Country	Indicator	Data as of	Survey	Prior
Mon. 23 September	US	Composite PMI (Flash)	Sep	-	54.6
	EZ	Composite PMI (Flash)	Sep	-	51.0
	IN	S&P Global Manufacturing PMI (Flash)	Sep	-	57.5
	UK	S&P Global Composite PMI (Flash)	Sep	-	53.8
Tue. 24 September	US	Consumer Confidence Index, Conference Board	Sep	102.8	103.3
	AU	RBA Cash Target Rate	Sep	4.35%	4.35%
	GE	IFO Business Confidence Index	Sep	-	86.6
	US	S&P Case-Shiller 20 House Prices (mom)	Jul	-	0.4%
Wed. 25 September	SW	Riksbank Policy Rate	Sep	-	3.50%
Thu. 26 September	US	GDP, Final (qoq)	Q2	2.9%	3.0%
	MX	Banxico de Mexico, Overnight Lending Rate	Sep	-	10.75%
Fri. 27 September	JP	Tokyo CPI excluding food and energy (yoy)	Sep	-	1.3%
	US	PCE Price Index (yoy)	Aug	2.3%	2.5%

US - United States, EZ - Eurozone, IN - India, UK - United Kingdom, AU - Australia, GE - Germany, SW - Sweden, MX - Mexico, JP - Japan

Source: HSBC Asset Management. Data as at 11.00am UK time 22 September 2024. This information shouldn't be considered as a recommendation to buy or sell specific sector/stocks mentioned. Any views expressed were held at the time of preparation and are subject to change without notice.

Market review

The Fed's bold 0.50% rate cut boosted risk appetite, with credit spreads tightening. US Treasuries underperformed German Bunds, with the US yield curve steepening further on higher 10-year yields. Fed Chair Powell stated: "it is time to recalibrate policy", with the FOMC's median 2024 and 2025 interest rate expectations marked down by 0.75%. In the US, the S&P 500 powered to a fresh high, with the rate-sensitive Russell 2000 index also performing well. The Euro Stoxx 50 index posted strong gains, while Japan's Nikkei 225 was boosted by a softer yen as the BoJ left policy on hold amid "high uncertainties". In emerging markets, Hong Kong's Hang Seng outperformed in a holiday-shortened week, and Brazil's Bovespa index fell as the Banco de Brasil raised rates by 0.25%. In commodities, rising geopolitical tensions lifted oil prices. Gold reached an all-time high, and copper strengthened.

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