HSBC

Investment Monthly

Staying the course to new heights

May 2021

Key Takeaways

- **We think equities can still push higher** over the coming 3 months thanks to fiscal stimulus and strong corporate earnings. Covid-19 related risks remain and investors should stay diversified
- Over 3-6 months, we are **Overweight US, UK, China and Singapore equities.**
- **We downgrade Gold to Neutral** because we think it will be difficult for the precious metal to rally strongly from current prices amid now higher bond yields.

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Asset class	Short-term view (3-6 months)		Long-term view (>12 months)	
Global equities	▲	Strong earnings season, vaccine development and fiscal stimulus support a strong global recovery. Cyclical stocks are well poised to benefit from this.	▲	Economic outlook remains constructive, low rates, ample fiscal support continue to provide fuel to confidence of key economic surveys and sentiment indicators.
Government bonds	▼	We are still underweight government bonds even though yields are now higher and slightly more attractive.	▼	Relative to cash, bond risk premium for developed markets remains negative. Although bond prices are unlikely to be volatile and treasury yields have picked up, prospective returns are still low.
Investment grade corporate bonds	▲	We are positive in the near-term as global IG bonds have a place in portfolio diversification.	▼	Spreads have decreased and are likely to remain tight due to ongoing central bank purchases. Outlook for longer-duration IG bonds are poor.
High yield corporate bonds	▲	As real yields have moved up and the search for yields continue, we favour high yield credit and have upgraded European high yield, in line with US high yield bonds.	▶	Although defaults are expected to trend downward in 2021, there are uncertainties on certain issuers within the high yield space. We prefer Asia high yields, and note that the Fed and ECB are still supportive
Gold	▶↓	Gold is facing pressure under a 'risk-on' environment and we reduce it to neutral as yields have moved up and demand remains subdued.	▶	On the back of gold's recent retracement, a risk-on environment and a prolong economic recovery, we remain neutral on gold as there are currently limited diversification benefits in a multi-asset context.

Note: Short-term view (3-6 months): a relatively short-term tactical view on asset classes. Long-term view (> 12 months): a relatively long-term strategic view on asset classes.
▲ "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

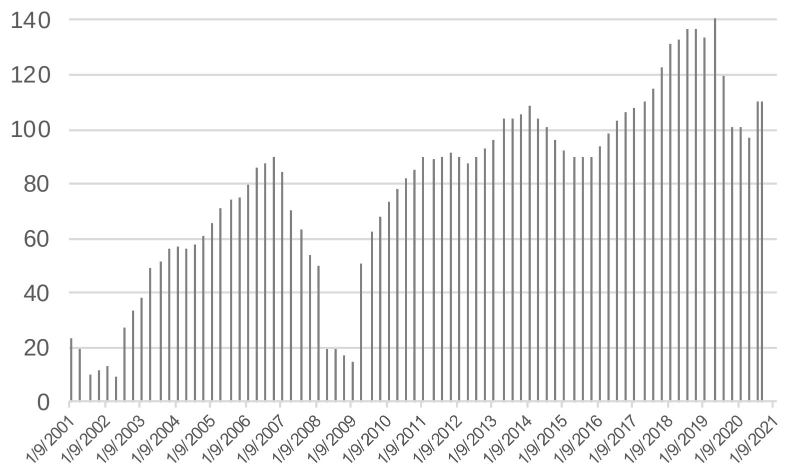
1. Do we think the rally can carry on?

- **Yes**, we think equities can rally further over the coming few months, although clients should stay diversified in light of Covid-related risks.
- Fiscal stimulus and improved corporate earnings should push the market higher. At time of writing, 38% of companies in the S&P 500 have reported quarterly earnings with over 80% beating expectations*. We remain overweight **US, UK and Asian equities,** focussing on cyclical sectors like materials, industrials and financials.
- Over the next 3-6 months, we have **upgraded European High Yield bonds to Overweight** as we expect corporate default rates to fall and for these bonds to benefit from the corporate earnings recovery. We are already overweight US Investment Grade and High Yield bonds.

*Source: Refinitiv DataStream as of 28 April 2021

Chart 1: US corporate earnings are staging a comeback

S&P 500 earnings per share (EPS)

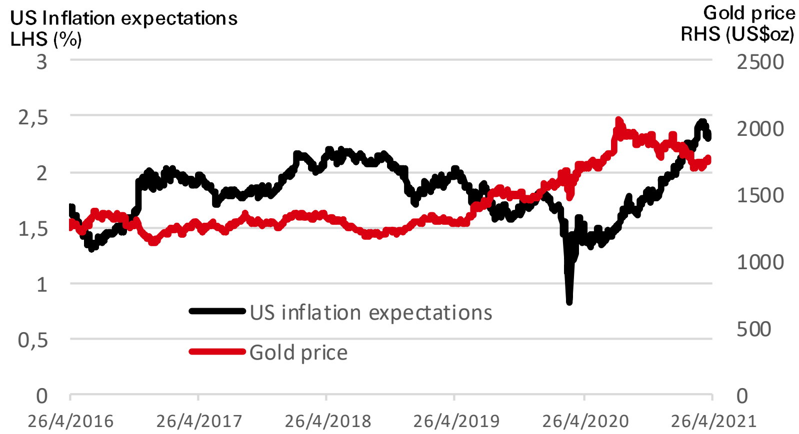


Source: Refinitiv Datastream, Bloomberg, data as of 29 April 2021. Forecasts are subject to change. Investment involves risks. Past performance is not an indication for future. For illustrative purpose only.

2. What are our views on inflation and gold?

- Inflation expectations remain elevated but appear to have peaked. **We think inflation concerns will be temporary** and mild with central banks still committed to keeping loose monetary policy.
- The US 10 Year Treasury yield appears to have stabilised around 1.6% after hitting recent highs of 1.75% at end-March signaling that **inflation concerns may be abating for the time being.**
- Short-term, we have **downgraded Gold to neutral** as we don't expect significant capital appreciation over the next 3-6 months, especially with bond yields still elevated.

Chart 2: Gold has been weak as inflation expectations have pushed higher



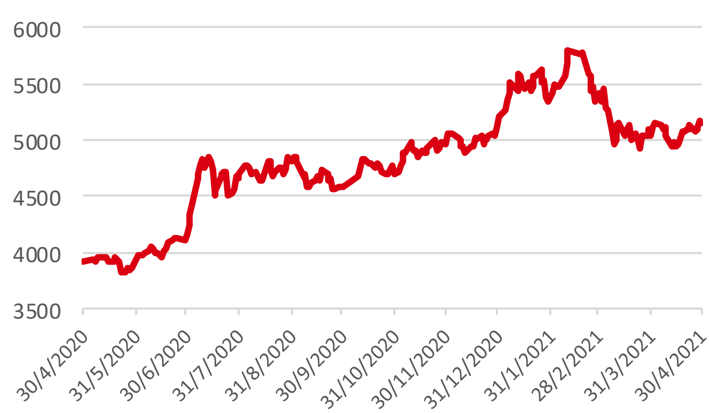
Source: Bloomberg, data as of 27 April 2021. Investment involves risks. Past performance is not an indication for future. For illustrative purpose only.

3. Will Chinese equities pick up again?

- Chinese equities have struggled to rally after reversing some gains over February and March. **We think this weakness will be temporary** and has been driven by profit taking, poor sentiment around some tech stocks and concerns around leverage in the system.
- **We think these concerns are temporary and do not fairly represent the strong fundamentals** in China. Economic growth remains strong (18% year on year GDP growth in Q1), and should carry on over the course of the year.
- **Chinese equities are ripe to recover and we see recent weakness as an opportunity.** We like the consumer and technology sectors in the Chinese market. Companies exposed to the digital consumer are primed for high growth in the coming years.

Chart 3: Chinese equities have been weak recently

Shanghai Shenzhen CSI 300 Index



Source: Bloomberg, data as of 29 April 2021. Investment involves risks. Past performance is not an indication for future. For illustrative purpose only.

House views

Our latest short-term (3-6 months) and long-term (>12 months) views on various asset classes

Asset class	Short-term view	Long-term view	Comment
Global equities			
Global	▲	▲	Global economic recovery prospects are bolstered by vaccine rollout and fiscal stimulus. We remain pro-risk in our investment positioning as markets exposed to cyclical sectors can continue to perform well even if bond yields rise. Value stocks can also do well in this environment. Uncertainty of Covid remains on the horizon.
United States	▲	▶	US fundamentals are still improving, first quarter earnings are forecast to be up 25%. Recent announcement of the $2.3 trillion infrastructure plan in addition to the $5.3 trillion, strong vaccine take-up, cash hand-out are all impetus for the equities markets to power ahead. US indices' have a heavy weight to 'growth and tech stocks.
United Kingdom	▲	▲	Domestic-focused stocks can benefit from the UK's strong cyclical rebound amid successful vaccination and re-opening. UK equities index is exposed to value stocks and the BoE remains dovish.
Eurozone	▶	▲	The region underperformed and may catch up through its high exposure cyclical and value stocks.
Japan	▶	▶	Vaccination is progressing slowly, economic growth is structurally weak and BoJ's policy is constrained.
Emerging Markets (EM)	▶	▲	Although EM underperformed, the outlook for remains broadly positive against a backdrop of global economic recovery and directionless USD. Within EM, we prefer ASEAN due to its underperformance and higher growth.
Central & Eastern Europe, Latin America	▼	▶	Higher commodity prices can help this region but new virus variants, lagging vaccine progress and political uncertainty are headwinds.
Asian equities			
Asian ex-Japan	▲	▲	Rebound in Asia's manufacturing and consumer spending is evident. Valuations are attractive relative to the US and offers high growth potential. We still like China and Singapore.
China	▲	▲	China's activity slowed in 1Q after leading the recovery in 2020. There are downside risks from weaker credit and tighter regulations on the back of recent risk events, but we main optimistic as consumer demand is buoyant.
India	▶	▶↓	With surging Covid cases crippling the country's economy, we downgrade India in the long term given less attractive valuation, lower expected returns and a significantly deteriorating economy.
Hong Kong	▶	▲	Cyclical and financial sector exposure benefits HK from reflation. Strong deal-related liquidity supports the equity markets. In the near-term, HK's economic growth contracted on prolonged lock-downs and lacklustre tourism.
Singapore	▲	▲	Singapore stands to benefit from a global rotation into cyclical sectors and may benefit from travel bubbles.
South Korea	▶	▶	We have a neutral view on South Korean equities although the semiconductor cycle, electric vehicle growth and chips shortage tells a strong structural story, we are concerned with the vulnerability to higher US interest rates.
Taiwan	▶	▶	Taiwan tech plays still benefit from margin uplift and strong digital demandbut we are neutral on high valuation.
Government bonds			
Developed markets (DM)	▼	▼	We are underweight as yields are simply unattractive and we estimate that the bond risk premium remains negative in a number of DM government bonds (German bunds, Japanese JGBs, and UK gilts).
United States	▶	▼	Biden government's $2 trillion fiscal stimulus, along with higher commodity prices, increase the potential for higher US inflation. If real rates remain low, US treasury bonds are deemed unattractive even at 1.6%.
United Kingdom	▲	▼	Returns look poor in the long run given lower for longer rates but gilts look better in the near term.
Eurozone	▼	▼	Valuations look unattractive and the ECB is issuing high levels of debt but bond repurchase program support prices and spreads could tighten due to the EU recovery fund.
Japan	▼	▼	Negative risk-premium, Japanese Government bonds face limited policy room and risk-rewards are unattractive.
Emerging Markets (local currency)	▲	▲	Real rates are higher in the Emerging world and potential returns look attractive as we anticipate EM currencies to strengthen against the USD.
Emerging Markets (Hard currency)	▲	▼	The higher return profile of Emerging Markets (USD) credit should be supported by the search for carry and yield.
Corporate bonds			
Global investment grade (IG)	▲	▼	For longer-dated bonds, returns are not attractive and spreads have come down materially over the past few months. In the short term, high quality investment grade bonds are useful in diversifying episodic volatility.
USD investment grade (IG)	▲	▼	Valuations are relatively high for longer-duration bonds and in the long run US IG may come under pressure from any unexpected worsening of corporate fundamentals. In the near-term, credit markets enjoyed a strong performance over the past 4 weeks as US Treasury yields fell and stabilise around the 1.6% mark.
EUR and GBP investment grade (IG)	▶	▼	Spreads are at historically tight levels and we should manage risks by keeping a close watch on the trends in corporate fundamentals. The ECB and the BoE however are engaged in substantial corporate bond purchases.
Asia investment grade (IG)	▲	▲	We favour Asia IG as it represents value versus developed markets IG and there is likely to be outperformance from Asian corporates that operate in high-growth sectors capitalizing on the digital and stay-at-home themes.
Global high-yield (HY)	▲	▶	Year-to-date, global HY has outperformed, consistent with economic recovery and our positive outlook in the search for yield. The Fed and ECB actions bolster the HY markets, although spreads are compressed over 12 months.
US high-yield (HY)	▲	▶	In the long run, spreads have tightened and credit risk premium has fallen but near-term upside remains.
European high-yield ex UK (HY)	▲↑	▶	We upgraded European HY as there is value to be extrapolated and credit spreads are on average 90bp higher from their lowest levels post 2008 financial crisis. The ECB's bonds repurchasing program extends until the end of 2021.
Asia high-yield (HY)	▲	▲	Default rates should remain low and spreads look attractive relative to other global opportunities.
Commodities			
Gold	▶↓	▶	Gold underperformed year-to-date as economic recovery and risk-on sentiment continues. Softer demand from central banks and jewellery would cap any upside in the near term despite low bond yields, hence our downgrade.
Oil	▶	▶	OPEC+'s supply discipline has been supportive of oil prices, but demand remains muted until mobility resumes.

Sector Views

Global and regional sector views based on a 3-6 month horizon

Sector	Global	US	Europe	Asia	Comment
Consumer Discretionary	▲	▲	▲	▲	A cyclical play into the anticipated robust recovery in consumer discretionary expenditure across autos, leisure, hospitality and luxury goods, thanks to pent-up demand supported by high levels of household savings, consumer confidence, falling debt levels, and readily available credit facilities. We expect additional earnings upgrades as re-opening continues.
Financials	▲	▲	▲	▶	The improving economic outlook offset the lower interest rate environment and the potential for higher taxes in the US. Q1 2021 earnings in the US highlights the sector's ride on record levels of IPOs/Special Purpose Acquisition Company deals and trading revenue. Financials can benefit from steeper yield curves, resumption of dividend pay-outs and lower loan provisions.
Industrials	▲	▲	▲	▲↑	We upgraded Asia Industrials on rising economic and construction activity especially in China. Capex expectations continue to improve, and investment is picking up especially with respect to automation and manufacturing. 2021 forecasts have been upgraded on the back of robust Q1 results.
Information Technology	▲	▲	▲	▲	Digitalization trends support the tech story and long-term fundamentals remain structurally sound. Covid has accelerated trends in automation, cloud computing, 5G, health-tech, fin-tech and sustainability. Sector sees compelling growth opportunities, high cash and low debt levels. Valuations though elevated, are not in bubble territory.
Communication Services	▲	▲	▶	▲	Communication services and social media benefit from steady cash flows and growth from increased data usage as activities shifted on-line and business digitalised. The 5G roll-out is positive for equipment providers and enablers in the long run, but we downgraded Europe with its high mix of telco service providers that may see margin pressure from the 5G roll-out.
Materials	▲	▲	▲	▲	Consistent to our cyclical tilt, economic backdrop is turning incrementally more constructive for the material sector as commodity prices rebounded, in particular base metals such as copper and the CRB index. Infrastructure-focused fiscal stimulus plans, rebounding Chinese economy, and relative attractive valuation should support this sector going forward across all regions.
Real Estate	▶	▶	▼	▲	Private residential real estate is seeing strong demand supported by high savings rate, home upgrades and low interest rates. In contrast, commercial real estate sees lower demand as corporates look to reduce office space as work from home continues and retail shifts online. The sector provides high dividend yield, which is compelling in a low yield environment.
Consumer Staples	▼	▼	▼	▼	We anticipated the continuous rotation out of defensives into cyclical sectors with the rebound of economic activity and the roll-out of vaccines as countries eased restrictions. Slower year-on-year growth is expected in 2021 after an extraordinary 2020 which benefitted from pandemic fears that spurred panic buying and stock piling of consumer essentials.
Energy	▶	▶	▶	▶	Supply-demand imbalances have improved and this trend may continue with the re-opening of the economy in the second half when global demand improves slightly. We expect further volatility in traditional energy stocks as green initiatives become more mainstream. We upgrade US to neutral on the improving demand outlook as supply remains under control.
Healthcare	▶	▶	▶	▶↓	After the ongoing roll-out of mass vaccination programs, tougher regulations may resurface in relation to drug pricing brought on by the Biden administration. Healthcare spending should remain a priority for households and governments as large backlogs in elective surgical procedures should drive strong growth in 2021. We downgrade Asia Healthcare.
Utilities	▼	▼	▶	▼	We are underweight defensive sectors as clear signs of economic recovery create rotation towards a more risk-on bias. Investors have been positioned in more cyclical exposures and cheaper sectors which results in the utilities' sector's underperformance. The recent pull-back in alternative energy companies provides a more reasonable entry point.

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