2nd Half 2021

Issue date: 26 May 2021

Think Future

2021 Mid-year edition

Your guide to the global investment landscape

HSBC

Together we thrive

More upside but time to be selective

Welcome to the mid-year edition of Think Future. We're delighted to bring you our thoughts to help you position your portfolio for the second half of the year.

At the midpoint of 2021, the overall outlook continues to be positive, albeit with some countries battling new waves and variants of Covid-19. Since January, financial markets have benefited from a strong cocktail of monetary and fiscal stimuli mixed with positive vaccine sentiment. Service-related industries are either reopening or have opened in several countries. However, the improving outlook has also raised concerns around higher inflation, resulting in temporary volatility.

Selectively positive on markets over the next 3-6 months

Against this backdrop, our tactical outlook remains firmly pro-risk. Inflation concerns persist, even though we think that this will be transitory. Our belief is that corporate earnings will continue to be strong over the coming months, driven by the re-opening of the services sector. This should support equity performance in the second half of the year, looking beyond the prevailing market sentiments.

However, it's time to be selective. Markets have done well this year and there is an argument that the "easy money" may have been made already. Valuations are now higher, meaning that there is less margin for error if things don't go to plan. We think the rally will continue, but investors need to be selective on sectors and geographies that are well-positioned for recovery.

Services sector to drive the next phase of recovery

Cyclical investments remain the place to be. Within this space, the services sector stands to benefit from consumers being able to go out and spend again. We think that this wave of pent up demand is particularly positive for the consumer discretionary sector.

Geographically, we prefer the US, UK, Mainland China and Singapore equity markets as these economies have done relatively well in navigating the pandemic. Their progress is advantageous for the next phase of recovery, and while the pandemic remains a risk, the services sector in these geographies have started to open up and are poised to gain from consumer spending.

Tech and sustainability remain the cornerstones

Thinking longer-term, structural trends such as technology and sustainability are here to stay. Tech is an area that may face headwinds, particularly if bond yields remain relatively high in the short term. Nonetheless, digital behaviours adopted during the pandemic are unlikely to reverse fully, meaning that tech should remain a core part of one's portfolio in the long run.

It's a similar story with sustainability. As the transition to a low carbon society gathers pace, a focus on Environmental, Social, and Governance (ESG) factors can give rise to interesting investment opportunities, while also providing an alternative lens through which to view risk management.

To conclude, we believe that equities are still the place to be for the coming months. But more than ever, investors need to ensure their portfolios are appropriately diversified. Concerns around inflation and the pandemic are by no means over, and volatility may very well rear its head periodically.

Best wishes for a safe and fruitful investment journey.

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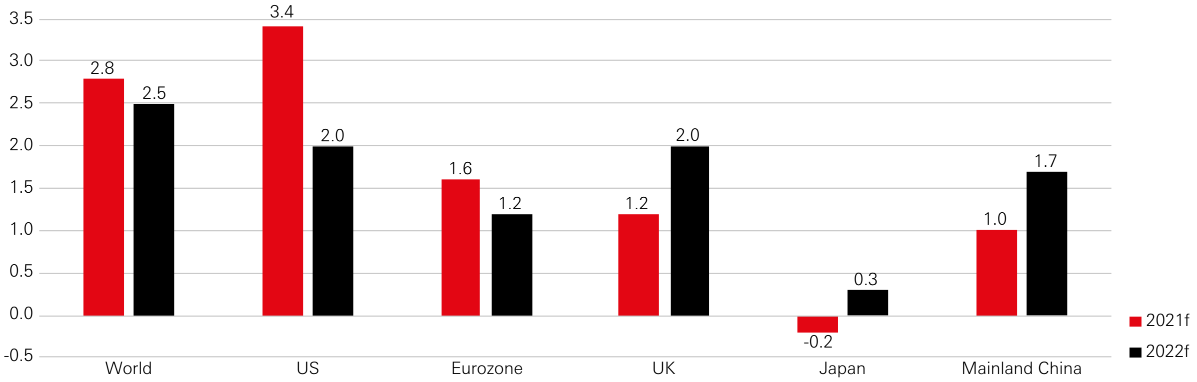
Key charts to watch

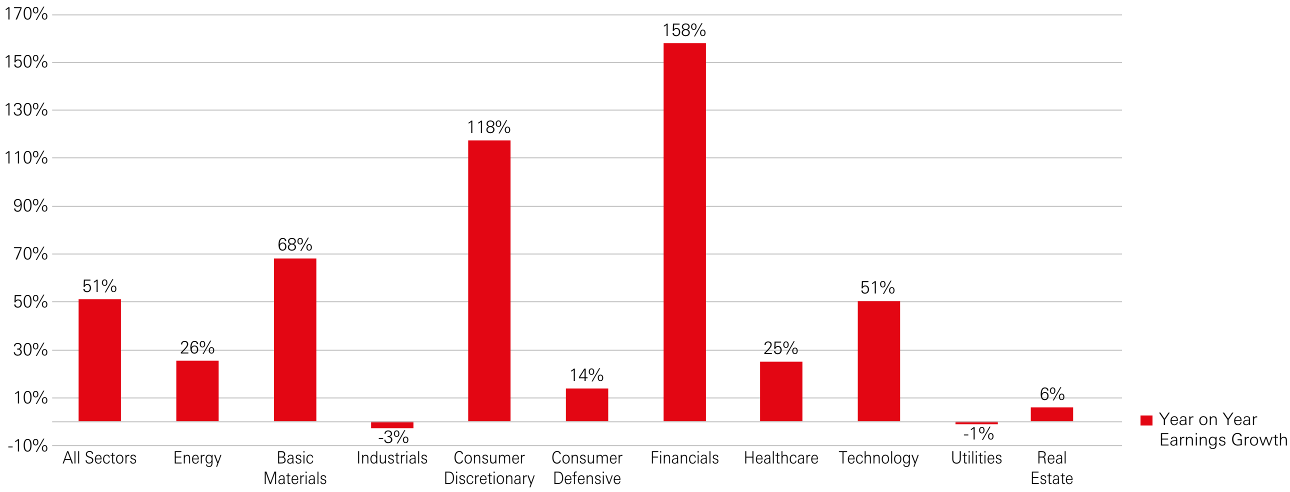
Higher inflation expected to normalise towards end 2021



Source: HSBC Economics. *GDP aggregates use chain-weighted nominal USD and inflation is calculated using Nominal USD PPP weights, now chain-weighted from 2018.

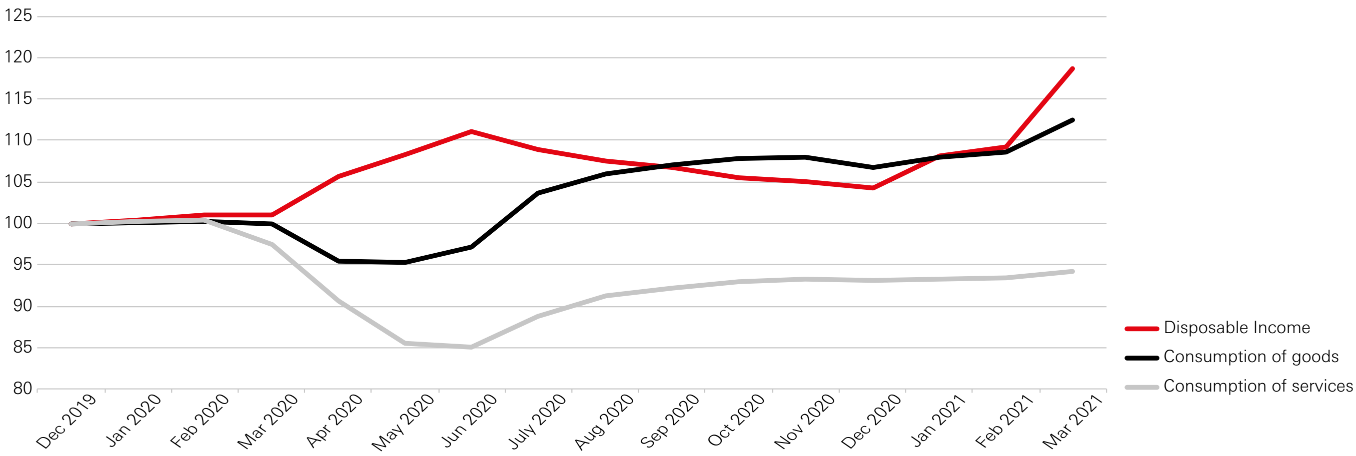
The Consumer Discretionary and Financials sectors have led US earnings higher

Q1 corporate earnings growth rate y-o-y (%)



Source: Refinitiv Datastream; Q1 Earnings Report; S&P 500 Index; Data as of 20 May 2021

Consumption expected to recover to drive next phase of recovery



Source: Refinitiv Datatstream; US Personal Income and Consumption; Data from Dec 2019 - Mar 2021; Indexed to 100

Four investment themes to help shape your portfolio

1. Stay invested, but time to be selective

We're still positive on equities, but stress the need to be meticulous in positioning your portfolio. Why? Markets have already done well this year and with valuations now higher, there is arguably less margin for error. Bear in mind that volatility could arise in certain pockets of the economy, due to ongoing concerns about inflation and the pandemic.

Looking ahead however, corporate earnings are expected to remain strong. We like equities in the **US**, where fiscal stimulus is a powerful driver, and in the **UK** thanks to its attractive valuations. We also favour stocks in **Mainland China**, where high growth catalysts dominate, and **Singapore** for its strong exposure to global manufacturing and the recovery.

Over the next 3 months, we are Overweight on equities in the US, UK, Mainland China and Singapore. Covid-19 remains a risk but we expect the services sector to drive the next phase of the rally in these economies.

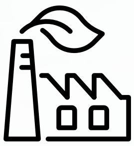
2. Skew portfolios towards service-related sectors

Right now, our preference is for **cyclical sectors**, particularly those in the **consumer discretionary** space. The sector has underperformed but stands to benefit from businesses reopening in services and hospitality over the coming months. The key factor in its favour? Household savings have been accumulating and consumers are expected to deploy this in a wave of pent-up consumption.

We also remain positive on the **materials**, **industrials** and **financials** sectors. Materials and industrials companies can still benefit even if they are now more expensively valued. Financials offer another way to lean into the recovery and can also act as a useful inflation hedge.

Looking elsewhere, we believe that **technology** is a structural success story with enormous long-term potential. However, higher bond yields mean that the sector may face short-term headwinds. It now makes sense to focus on specific areas, particularly in Asia, where tech and the consumer intersect. E-commerce is a good example. The reasons are simple: the rise of the middle class and a tech-savvy generation of consumers will play a key part in ongoing recovery.

Cyclical sectors remain the place to be and our preference is for the consumer discretionary sector over the coming months.



3. Keep riding the long-term sustainability wave

With more than 110 countries already pledged to achieve carbon neutrality by 2050, **sustainability** has taken centre stage globally. The US, Europe and Mainland China have also committed to investing significantly in the transition to low carbon, thereby encouraging new innovation and growth in areas exposed to infrastructure, transport and beyond. We expect lots of "green" investment opportunities to arise over the coming years.

Embedding **Environmental**, **Social** and **Governance (ESG)** metrics into your portfolio is an effective way to manage risk, enhance the potential for resilience and tap into green innovation to generate long-term capital growth. Companies with strong ESG practices are able to offer investors greater transparency, while those that fall short in this area risk falling foul of future regulation. As things stand, **sustainability** is becoming embedded among governments, companies and investors, with the aim of building a better future through positive change.

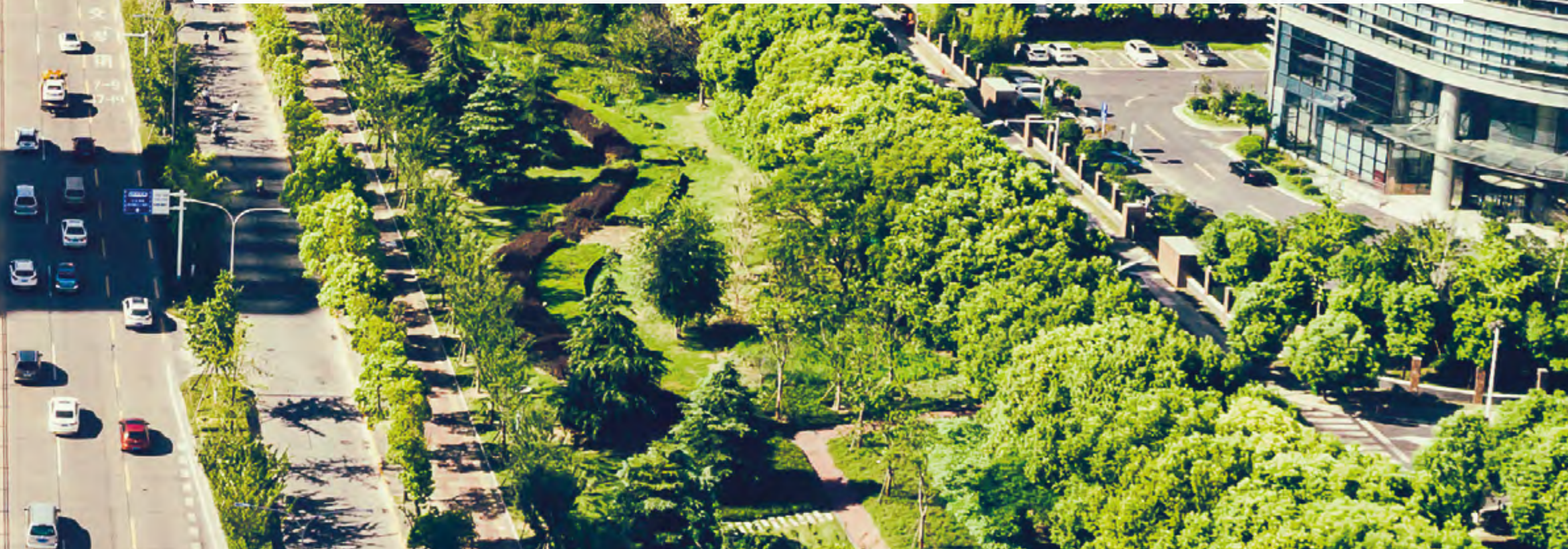
We advocate exploring ESG opportunities in "green" sectors like clean energy, green infrastructure, transportation, buildings, industrials and broadband technology.

4. Review your portfolio to ensure diversification

After a long period of lockdown followed by the market rally, investors may be sitting on large amounts of cash or enjoying significant recent gains. Either way, a timely mid-year review should now be a priority to ensure your portfolio is appropriately diversified and positioned.

What's the best way to do this? Cash offers poor returns and erodes your purchasing power over time, while bond yields, despite rising slightly as of late, are still at record lows globally. More than ever, a multi-asset approach that has appropriate allocations to high quality bonds alongside riskier asset classes is the best way to approach investing.

Adopting a multi-asset approach that is spread across different asset classes, geographies and sectors is the best way to invest at the current time.



▲ Asia (excluding Japan)

Corporate earnings in Asia are expected to grow strongly by about 30% in 2021. Consumption, particularly in the services sector, continues to recover albeit with some risks around new waves of Covid-19.

Mainland China, meanwhile, has shown strong first-quarter GDP growth of 18%, although its domestic stock market has been relatively weak due to poorer market sentiment of late. We think Chinese equities are poised for a bounceback.

We are still positive on Singaporean equities, which continue to prosper from the global recovery, despite recent tightening of restrictions from a new wave of the virus.

Over the next 3-6 months, we like:

- **The following sectors in Asia:** materials, consumer discretionary, real estate, communications, industrials and technology
- **Chinese and Singaporean equities**
- **Chinese local and hard currency bonds**

Regional market outlook

▶ Japan

Japan's vaccine rollout has been slower than in other developed countries, while uncertainty prevails around the Suga administration and the upcoming Olympics. Our stance remains cautious, given that the country's economic growth is structurally weak and the Bank of Japan has limited policy room. The export sector, meanwhile, is heavily reliant on machinery, making it vulnerable to an expected shift towards services in the second half of the year. We're currently Underweight on Japanese government bonds (JGBs) which we believe are overvalued.

Our Neutral stance on Japan as a whole remains unchanged, as its economic growth is structurally weaker than that of its Asian neighbours.

▲ United States

US equities have seen strong earnings in Q1 (up over 50% YoY) and expectations are for this to continue over the coming months as the services sector opens up again.

In addition to the USD1.9trn American Rescue Plan bill, President Biden's announcements on the USD2.3trn American Job Plans and USD1.8trn American Families Plan (both pending approval by Congress) amount to USD6trn to restore the economy. As vaccination rates and consumer optimism continue to rise, we expect companies targeting the pent-up consumer demand to do well.

Over the next 3-6 months, we like:

- **US equities in general, particularly the following sectors:** consumer discretionary, financials, communications and technology
- **US investment grade and high yield corporate bonds**

▶ Eurozone and UK

The UK's lead in vaccine rollout had enabled a faster re-opening of its economy, which is heavily reliant on the services industry. The economy's universe of large and mid-cap stocks has a good mix of domestic-focused, value-oriented and multinational companies, some of which offer attractive dividend yields. The UK's equities trade at lower valuations than those of its European peers, making them more attractive from a valuation perspective.

The Eurozone has faced challenges around vaccine rollout, making us slightly cautious. However in some areas, demand for export manufacturers could pick up over time. We would need to see further signs of the region bringing Covid-19 under control before we can be more broadly positive.

Over the next 3-6 months, we like:

- **UK equities in general**
- **The following European & UK sectors in particular:** consumer discretionary, industrials, materials and financials

▼ Central & Eastern Europe (CEE) and Latin America (LatAm)

Emerging Markets (EMs) outside Asia could perform well against the backdrop of global economic recovery and higher commodity prices. But slow vaccine rollout and the possibility of vaccine shortages in some economies, new coronavirus variants, and limited policy scope continue to present challenges.

Our Underweight position on CEE and LatAm equities remains unchanged for the next 3-6 months. Political uncertainties, viral spread, slower vaccine rollouts and the region's uneven path to economic recovery are our primary concerns.

Notes:

Short-term view (3-6 months): a relatively short-term view on asset classes for tactical asset allocation.

For a full listing of HSBC's house views on asset classes and sectors, please refer our Investment Monthly issued at the beginning of each month.

▲ "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.

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