HSBC

Investment Monthly

China's reopening and easing inflation support risk assets

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Key takeaways

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- US headline and core inflation both moderated in December. With bond yields off their highs and inflation easing, we now expect one further Fed rate hike of 0.25% in March. This will still keep rates at 5% before the Fed starts to reduce them in Q2 2024. We prefer investment grade and EM corporate bonds with short-to-medium maturities.
- The faster-than-expected peaking of Covid infections and the strong rebound in holiday travel support our view of a sharp rebound in China's growth in Q2 and beyond led by consumption, leading to full-year GDP growth of 5%. Valuations remain attractive. Geographically, we are now most positive on mainland Chinese, Hong Kong and ASEAN stocks.
- With improved sentiment and a more positive cyclical outlook, there is scope for risk assets to recover. In addition to Asia, Europe will also benefit from stronger Chinese demand, supporting our upgrade of Eurozone and global equities to neutral, as well as our upgrade of consumer discretionary, communication services and healthcare globally.

Asset class	6-month view	Comment
Global equities	▶↑	While slow growth continues to weigh on global equities, the Chinese reopening brings hopes for better economic growth prospects in Asia and elsewhere, which warrants our upgrade. Quality stocks are preferred.
Government bonds	▼	Yields have backed up and government bonds provide diversification, but we prefer high-rated corporate bonds.
Investment grade (IG) corporate bonds	▲	We see attractive opportunities in short-to-medium dated investment grade bonds following the back-up in yields.
High yield (HY) corporate bonds	▶	We prefer investment grade over high yield with short-to-medium maturities as spreads should remain volatile amid slowing growth. The upcoming default cycle has not really been priced in.
Gold	▶	Gold benefits from USD weakness and central bank buying but real yields are a challenge and mining output is rising.

▲ "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.

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Talking points

Each month, we discuss 3 key issues facing investors

1. Is inflation risk behind us?

- The US December headline CPI moderated to 6.5% y-o-y (down from 7.1%), while core inflation also fell to 5.7% y-o-y due to the base effects and decline in energy prices. We expect core inflation to further fall to 3.5% y-o-y by Q4 2023 because of moderating rental.
- This will set the stage for the Fed to peak rates in Q1. Following the 0.25% hike on 1 February, we expect just one final hike of 0.25% in March as inflation continues to fall and US growth is slowing. We believe rates will peak and stay at around 5% before the Fed starts to cut rates by 0.25% in each of Q2 and Q3 2024.
- We stay overweight on investment grade bonds and emerging markets corporate bonds with a preference for short-to-medium maturities as we are approaching the peak of the hiking cycle.

Chart 1: Inflation is on a downward trend in most markets

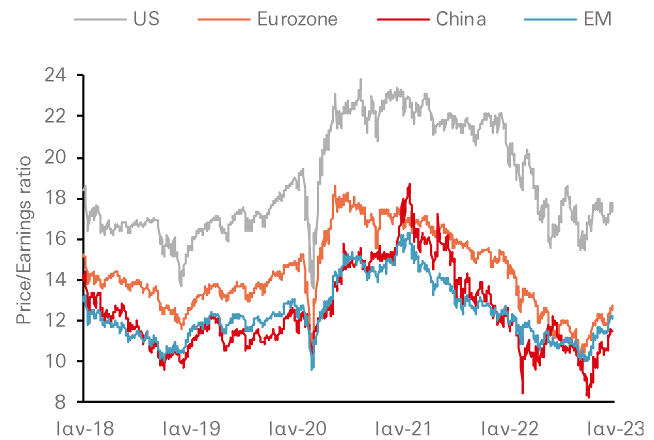
Inflation	2022f	2023f	2024f
World	8.4%	6.4%	4.6%
US	8.0%	4.0%	3.2%
Eurozone	8.4%	5.6%	2.6%
UK	9.1%	7.5%	3.6%
Japan	2.5%	1.7%	0.4%
Mainland China	2.0%	2.5%	2.8%

Source: HSBC Global Research as at 27 January 2023. Forecasts are subject to change.

2. Why should we be positive on Chinese equities?

- The faster-than-expected peaking of Covid infections and the strong rebound in holiday travel support our view of a consumption-led economic recovery in China this year. While Q1 may remain soft, we expect a sharp rebound to over 6% y-o-y growth in Q2 and beyond, leading to full-year GDP growth of 5%. Chinese consumption may also rise in excess of 8% this year.
- Moreover, Chinese equities are now trading closely to its 5-year average of 13x, relatively attractive to emerging markets. We expect further upward revisions in earnings forecasts. As inflows in the past months have been small, there is further scope for foreign buying. We also see onshore investment sentiment improving after the turn of the year.
- China's reopening is also positive for Asia, and will boost demand for healthcare services and pharmaceuticals in the region. In addition to **mainland Chinese and Hong Kong equities,** Thailand and Indonesia are also beneficiaries and stand out within ASEAN.

Chart 2: Chinese stocks trade at a discount vs EM stocks



Source: Bloomberg, HSBC Global Private Banking as at 21 January 2023. Past performance is not a reliable indicator of future performance.

3. How are risk assets affected by the macro outlook?

- While the Russia-Ukraine war continues to affect the European economy, energy supply risks have abated thanks to solid gas inventories and a warmer winter. Together with the prospect of higher exports to China, **we upgrade Eurozone equities to neutral.** In fact, China's reopening will also greatly reduce the global recession risk, and benefit energy and materials as demand ramps up.
- As a more positive outlook will help equities recover, **we move global equities to neutral**, putting more cash to work and stay positive on US equities with better prospects for earnings in H2. Backed by a more stable cyclical outlook, we upgrade consumer discretionary, healthcare and communication services globally and in some regions. They all benefit from the Chinese rebound, while communication services in the US will see consolidation and better earnings in the streaming media sector.
- For equities, earnings are mixed and we expect further downgrades but expectations have become more realistic. Typically, stocks bounce well before earnings have bottomed, so it's important to stay invested and quality stocks are preferred.

Chart 3: investor sentiment has rebounded but is still only neutral, providing further scope for a bounce in risk assets as fundamentals improve

Source: Bloomberg, HSBC Global Private Banking as at 21January 2023. 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	▶↑	While slow growth continues to weigh on global equities, the Chinese reopening brings hopes for better economic growth prospects in Asia and elsewhere, which warrants our upgrade. Quality stocks are preferred.
United States	▲	The December CPI reconfirms the easing inflation trend and our view of nearing peak rates. Growth is slowing and earnings are mixed. Balance sheets look healthy and the labour market remains tight. We have reduced exposure but remain overweight.
United Kingdom	▼	Despite a positive GDP growth for November and easing inflation for December, the cost of living, higher taxes and rising interest rates remain headwinds.
Eurozone	▶↑	Europe should benefit from China's reopening, and the energy crisis seems to ease thanks to solid gas inventories and warmer weather.
Japan	▶	Stronger JPY could challenge the recent strength of exports while domestic demand remains weak.
Emerging Markets (EM)	▶	Although concerns over Fed tightening, global growth slowdown and geopolitical tensions linger, Asia should benefit from the reopening trend, particularly from China and ASEAN, while LatAm benefits from Mexico's attractive valuations and growth prospects.
EM EMEA	▼	The region is impacted by high energy prices, weak growth in Europe and an uncertain rate outlook.
EM LatAm	▲	The end of the rate hike cycle and rising Chinese demand are positives for Brazil, while Mexico benefits from onshoring.
Asian ex Japan equities		
Asia ex-Japan	▲	Improved economic prospects due to the Chinese reopening have led to increased economic expectations and hopes for better returns in regional equities. Slowing global growth will create market volatility, and quality Asian stocks with resilient growth characteristics are preferred.
Mainland China	▲	Although China's Q4 2022 GDP slowed to 2.9% y-o-y amid negative impact from COVID disruptions, its faster-than-expected reopening and supportive policies for the property sector should drive its gradual growth recovery in 2023.
India	▶	Despite stretched valuations and inflation concerns, India's global market share in high-skill exports and the rise in digital start-ups are key growth drivers. Its green transition ambitions also present investment opportunities.
Hong Kong	▲	The lifting of most of its COVID-related restrictions and the faster-than-expected reopening with mainland China are driving a return to normalcy for visitor flows, business confidence, domestic and global investment, and consumption.
Singapore	▶	Inflation has eased but remains elevated, so further policy tightening is likely. Consumer-oriented and travel-related sectors are driving growth and offsetting intensifying trade headwinds and gradually fading re-opening effects.
South Korea	▼	Given the heavy index weighting to tech names which have been hard hit by a deteriorating earnings outlook and the sluggish global demand for memory cards and smartphones, we remain bearish on South Korean equities.
Taiwan	▼	We maintain bearish on Taiwanese equities given the weak global demand and inventory accumulation in semiconductors, smartphones and other consumer electronics. Geopolitical risk remains a concern.
Government bonds		
Developed markets (DM)	▼	Yields have backed up and government bonds provide diversification, but we prefer high rated corporate bonds.
United States	▶	Easing inflation has triggered rapid repricing in the Treasury market, as we approach peak rates.
United Kingdom	▲	Given the disinflationary pressure, together with a more dovish Bank of England, a credible fiscal policy and attractive valuations, we increase the duration to 5-7 years and maintain overweight on gilts.
Eurozone	▼	Rising energy, goods and services prices push inflation higher, forcing the ECB to continue raising rates and current absolute yield levels remain unattractive. Deficits are under pressure too as governments support households.
Japan	▼	We think inflation is likely to decelerate in the coming months and continue to expect the central bank to widen its Yield Curve Control trading band. We remain underweight on Japanese government bonds.
Emerging Markets (Local currency)	▶	Select opportunities exist as some countries are slowing rate hikes but others continue. The end of the USD bull run may become a tailwind.
Emerging Markets (Hard currency)	▶	Amid higher Treasury volatility, we still find yield but remain selective.
Corporate bonds		
Global investment grade (IG)	▲	We see attractive opportunities in short-to-medium dated investment grade bonds following the back-up in yields.
USD investment grade (IG)	▲	The imminent end of Fed rate hikes should help reduce volatility and we believe credit spreads are attractive.
EUR and GBP investment grade (IG)	▲	European and UK investment grade bonds offer a decent yield pick-up. We prefer higher quality names and short-to-medium maturities amid recession and inflation risks.
Asia investment grade (IG)	▲	Within the Asian credit markets, we stay focused on high-grade bonds to mitigate cyclical headwinds amid a global slowdown, including Hong Kong and Singapore IG bonds, and Chinese TMT (Technology, media and telecom) bonds.
Global high-yield (HY)	▶	We prefer investment grade over high yield with short-to-medium maturities as spreads should remain volatile amid slowing growth. The upcoming default cycle has not really been priced in.
US high-yield (HY)	▶	While US high-yield companies still enjoy solid credit fundamentals and low default rates, tightening financial conditions and the higher Fed fund rates create downside risks.
EUR and GBP high-yield (HY)	▶	As policy tightening continues and European economies continue to weaken, we prefer higher quality investment grade credit and maintain a neutral stance on high yield.
Asia high-yield (HY)	▶	Most Asian markets face relatively less inflationary pressure compared to the developed markets, but the Fed tightening, slowing global demand and China's property debt restructuring remain headwinds for credit spreads.
Commodities		
Gold	▶	Gold benefits from USD weakness and central bank buying but real yields are a challenge.
Oil	▶	High price levels reflect supply concerns but demand is starting to decline and US inventories are at very high levels.

Sector Views

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

Sector	Global	US	Europe	Asia	Comment
Consumer Discretionary	▲↑	▲↑	▶↑	▲↑	We upgrade the sector in all regions as easing inflation and energy price concerns together with higher wages are lifting consumer sentiment. Discretionary spending especially in the services segment (e.g. airlines, hotels, restaurants and resorts) is expected to benefit. Automakers are seeing supply issues ease. Luxury goods are also seeing strong demand and exceptional pricing power.
Financials	▶	▶	▼	▶	The sharp deceleration in investment banking and trading activity is expected to weigh on Q1 results. In addition, retail banking businesses have slower demand for loans and mortgages due to rising interest rates. Insurance companies are facing a significant rise in adverse event risks.
Industrials	▶↑	▶	▲↑	▼	Concerns as to the severity of an economic slowdown/recession have eased. Input cost inflation is also easing but will still weigh on results into Q1. China's re-opening should benefit particularly European exporters. Low valuations also make the sector attractive. Companies supporting renewable energy and electric vehicle production continue to thrive.
Information Technology	▶	▶	▶	▼	The sector continues to face multiple challenges including an over-supply in some types of semiconductors, and slowing cloud computing and digital advertising growth. Higher demand linked to work-from-home and COVID are likely tempered over the next few quarters.
Communications Services	▲↑	▲↑	▲	▲↑	After several challenging quarters, the media & entertainment industry may see some bright spots. Telecoms services are also likely to continue to benefit from higher digital content demand and roaming fees as consumers travel more and become more socially active. Valuations are more attractive following last year's sell-off. We upgrade global, US and Asia on the more positive demand outlook.
Materials	▶	▶	▲↑	▶↑	Mining stocks are trading on low valuations multiples relative to other industries but China's re-opening is likely to see modest demand recovery initially. Energy prices and oil/gas feedstock prices may have peaked potentially improving the outlook for chemicals and construction materials industries in Q2/Q3.
Real Estate	▶	▶	▼	▶	Rising interest rates and softening demand in some categories pose short-term challenges. Retail real estate suffers from long-term structural changes caused by the rise in ecommerce and this is unlikely to change. Office space is being reduced by many companies as employers reduce space and promote work-from-home. The storage and warehousing assets bubble appears to have run its course.
Consumer Staples	▲	▶↓	▲	▲	We downgrade US consumer staples to neutral as valuations remain rich and last year's above-inflation price rises are unlikely to be repeated this year, meaning that risks are skewed to the downside. We focus on quality stocks with strong brands and more resilient pricing power. After another strong quarter, food retailing may struggle with tough y-o-y comparables.
Energy	▲	▲	▲	▲	We trimmed our overweight in Europe as oil prices have plateaued and gas prices have declined sharply. We still remain overweight however as the energy sector should continue to benefit from OPEC keeping supply tight to protect profits and low inventories. An unseasonably warm weather in Europe has also eased demand-supply concerns. Valuations remain very attractive.
Healthcare	▲↑	▶	▲	▲↑	We upgrade the sector to overweight given the attractive valuations and stronger demand expected from Asia due to China's reopening and increase in travel worldwide. Biotechnology and medical technology stocks may benefit from the increasing risk appetite, but companies with higher leverage or financing costs should be avoided given elevated interest rates.
Utilities	▶	▲	▶	▶	The sector's stable earnings/cash flow characteristics and high dividend yielding stocks provide a defensive investment. We expect the US utility company margins to expand given the strong pricing environment and that the capex cycle has peaked so cash flow should improve.

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