Investment Monthly

Positive on markets despite Omicron and higher rates

January 2022

Key takeaways

- Policy normalisation is a sign of central banks' confidence in the economy. Historically, stock markets have done well at the start of and during previous tightening cycles.
- Global growth should continue albeit at a slower pace in 2022. Asia remains our top geographic pick due to its favourable demographics and opportunities in the north and southeast regions.
- Rising Omicron cases, high inflation and supply chain issues are key risks. Review your portfolio with a focus on large, high-quality companies. Explore long-term structural opportunities, such as green investing and digitalisation.

Xian Chan
Chief Investment Officer, Wealth Management
HSBC Wealth and Personal Banking

Lucia Ku
Head of Wealth Insights
HSBC Wealth and Personal Banking

Asset class	Short-term view (3-6 months)		Long-term view (>12 months)	
Global equities	▲	The outlook is still positive for equities although inflation, supply chain constraints and the new Omicron variant remain headwinds and may lead to market volatility in the short run.	▲	Risk assets can still provide decent returns in the expansion phase of the cycle, albeit lower than in the past as upside growth surprises are limited and policy normalisation begins. Sticky inflation is a key risk.
Government bonds	▼	Low bond yields and unattractive valuations support our underweight position.	▼	Valuations have recently improved amid a repricing of inflation and interest rate risks, but both valuations and yields are still not attractive.
Investment grade (IG) corporate bonds	▶	Corporate bonds are more attractive than government bonds because of higher yields and improving rating trends. We prefer shorter bond duration due to the risks of Fed rate hikes.	▼	Prospective return are unattractive, particularly for longer-duration bonds, although spreads are likely to remain tight on the back of accommodative monetary policy. Shorter-duration bonds and Asia IG are preferred.
High yield (HY) corporate bonds	▲	US Treasury yields will stay "low but volatile" as markets look for clues about the tapering plan. We prefer short-dated Global High Yield to mitigate interest rate volatility.	▼	Defaulted-adjusted spreads are at multi-year lows. This implies an asymmetric return profile where positive surprises have limited impact on performance. We continue to prefer Asia credits to DM.
Gold	▶	Gold offers diversification and hedging benefits but further upside is limited by higher bond yields, a stronger USD, and a reduction in global economic and geopolitical uncertainty.	▶	The environment of "lower-for-even-longer" interest rates and inflation risks remains supportive. However, performance as a risk-off diversifier is unreliable due to economy recovery, higher bond yields, etc.

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.

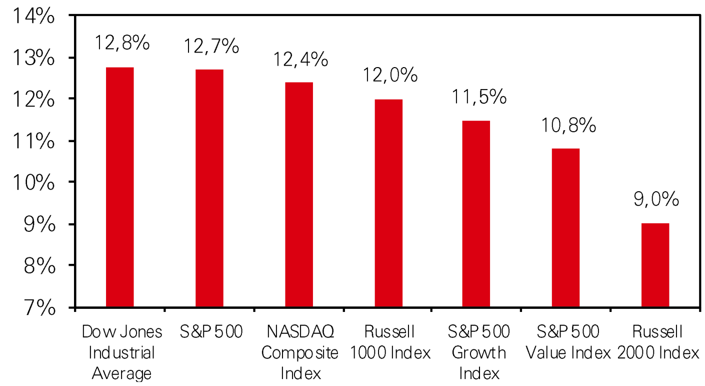
Talking points

Each month, we discuss 3 key issues facing investors

1. Can stocks rise further if rates go up?

- Central banks have started a gradual normalisation process. The Federal Reserve will end its QE program in March thanks to a positive outlook and we now expect three 0.25% rate hikes in 2022. The Bank of England also raised its policy rate to 0.25% in December.
- Our analysis of the six previous Fed tightening cycles show that the US equity market delivered an average return of 7.4% during the six months before tightening and 12.7% p.a. during the actual tightening process.
- **We expect stock market returns to stay positive thanks to a resilient economy and corporate profitability.** Policy normalisation is a signal that the economy is strong enough to withstand higher interest rates.

Chart 1: Historically markets continue to advance during Fed tightening cycles



Source: Bloomberg, HSBC Private Banking as of 12/15/2021. Past performance is not a reliable indicator of future performance.

2. Will global growth be positive in 2022?

- We expect global recovery to continue but growth will moderate this year (GDP forecast of 4.1% compared to 5.7% in 2021).
- Equity returns will remain positive supported by solid earnings growth but pace will be slower. Interest rates, while likely to rise, are expected to stay low to sustain the economy. This favours equities and **we prefer US, European and Asian equities.**
- **Asia remains our top geographic pick** because of its favourable demographics and opportunities in the north and southeast regions (e.g. Singapore, Malaysia and Indonesia). There is also room for a resurgence in consumption among its middle-income consumers.

Chart 2: Economic growth is expected to moderate in 2022, as part of the next phase of recovery

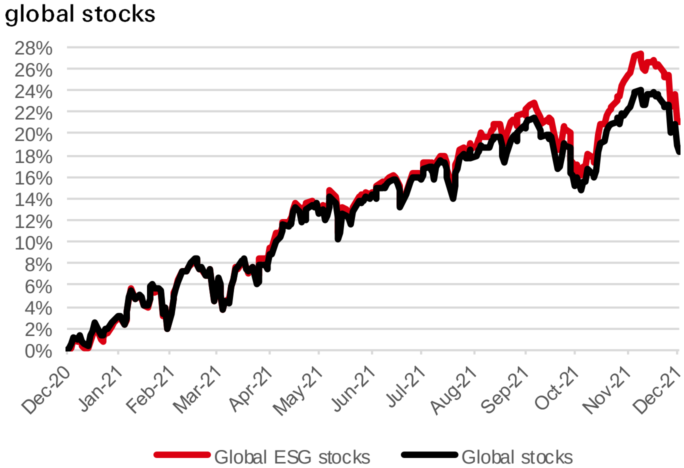
	GDP		Inflation	
	2021f	2022f	2021f	2022f
World	5.7	4.1	3.8	4.6
US	5.6	3.8	4.7	4.7
Eurozone	5.2	3.8	2.6	2.9
UK	7.1	4.5	2.6	4.6
Japan	1.6	2.2	-0.2	0.4
Mainland China	8.0	5.6	0.9	2.0

Source: HSBC Global Research, as of 5 January 2022. GDP aggregates use chain nominal GDP (USD) weights and inflation aggregates calculated using GDP PPP (USD) weights.

3. How should investors structure their portfolio?

- The new Omicron variant may keep markets volatile. Further, inflation concerns, supply chain disruption and upcoming elections all add uncertainty to the investment landscape.
- Stay invested in equities but focus on **large, high-quality companies that pay attractive dividends.** Invest selectively in areas which benefit from long-term structural growth, such as **sustainable investing and digitalisation.** For the next 3 months, we also favour consumer discretionary and financials over industrials and materials sectors. For bonds, **Global High Yield** and **Emerging Markets (USD)** are our preferences.
- It's a good time to **review your portfolio at the start of the year** to ensure it remains diversified and resilient while capturing the growth opportunities.

Chart 3: Companies with robust ESG practices outperformed global stocks



Source: Refinitiv Datastream, as at 21 December 2021. Rebased to 100.
Note: Asset class performance is represented by different indices – Global Equities: MSCI World (USD); Global ESG stocks: MSCI ESG World Leaders (USD).

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	▲	▲	The outlook is still positive for equities although inflation, supply chain constraints and the new Omicron variant remain headwinds and may lead to market volatility in the short run.
United States	▲	▲	Infrastructure, health technology and climate change spending support growth. US stocks provide a hedge against weaker growth and higher inflation due to its high quality characteristics and exposure to the digital economy.
United Kingdom	▶	▲	Labour shortage, supply chain disruption, rate hikes, tax rises and Brexit related pressures pose short-term risks. Longer term, UK indices are heavily exposure to the value factors which offer upside potential.
Eurozone	▲	▲	Rising Omicron cases and supply chain disruption are headwinds but the outlook of the region remains constructive. The economic recovery is supported by the EU Next Generation grants and loans but further upside is limited.
Japan	▶	▲	Japan benefits from good earnings performance and a decent macro outlook as vaccination accelerates and global capex spending increases. The uncertainty of the structural reforms under the new government is to be seen.
Emerging Markets (EM)	▶	▶	Policy headwinds and challenges in vaccine distribution are likely to weigh on EM equities. Valuations are not particularly cheap. EM fixed income valuations are more attractive.
Central & Eastern Europe, Latin America	▼	▶	Higher commodity prices have benefited Latin America recently but we do not see further upside. Longer term, the new virus variants, slow vaccine rollout and relatively constrained policy space remain key challenges.
Asian equities			
Asia ex-Japan	▲	▶	Favourable demographics and positive structural opportunities in the north and southeast regions (e.g. Singapore, Malaysia and Indonesia) such as sustainable investing and digitalisation should support growth. Longer-term, policy normalisation and regulatory headwinds are to be monitored.
China	▶	▶	We expect more favourable policies to support the strategic growth model with focus on capex spending in high-end manufacturing and green investments. Moderating domestic growth and regulatory uncertainty are key concerns.
India	▶	▶	India's economy benefits from market reopening. The medium-term growth outlook remains intact amid continued fiscal support, and recent progress with land and labour reforms. Valuations remain stretched.
Hong Kong	▶	▲	The economy is being hit by the restrictions of tourism from mainland China and other markets. However, Hong Kong remains an attractive listing hub underpinned by greater primary and secondary market activity.
Singapore	▲	▲	Singapore benefits from being home to high-quality companies supported by the government in the tech space.
South Korea	▶	▶	Korea can offer exposure to electric vehicle and battery themes, but exposure to growth stocks implies vulnerability to higher global bond yields. A tighter monetary policy outlook further weighs on valuations.
Taiwan	▲	▶	Global recovery and demand growth in tech, 5G and semi-conductors warrant our positive stance. Taiwan equities have significant exposure to growth/tech sectors which are sensitive to US yields. Geopolitical risks remain.
Government bonds			
Developed markets (DM)	▼	▼	Valuations have recently improved amid a repricing of inflation and interest rate risks, but both valuations and yields are still not attractive.
United States	▶	▼	Further upside in US Treasuries yields are unlikely given the pricing in of inflation risks and the Fed's normalisation plans. The pick-up in yields has improved longer-dated Treasuries but we remain neutral short term.
United Kingdom	▶	▼	Inflation pressures amid supply chain disruption support policy tightening. Risk-adjusted returns look poor.
Eurozone	▼	▼	Prospective returns and diversification benefits are limited. The ECB's bond-buying is also set to decrease in 2022.
Japan	▼	▼	Given Bank of Japan's accommodative policy stance, government bonds yields are likely to remain low.
Emerging Markets (Local currency)	▶	▲	The EM currency component in the asset class adds to its volatility as US dollar is expected to strengthen. Longer term, prospective returns are relatively high due to EM currencies being undervalued. Being selective is key.
Emerging Markets (Hard currency)	▲	▶	This asset class is supported by attractive yields and USD strength, with resilient quality names preferred. Longer term, prospective returns do not compensate for risks such as limited EM policy space and vaccine challenges.
Corporate bonds			
Global investment grade (IG)	▶	▼	Prospective returns are still unattractive, particularly for longer-duration bonds. We remain defensive and are more positive on shorter-duration bonds and Asia IG.
USD investment grade (IG)	▶	▼	Valuations are relatively unattractive especially for longer duration bonds.
EUR and GBP investment grade (IG)	▶	▼	Spreads are at historically tight levels and it is important to monitor trends in corporate fundamentals. The ECB is still engaged in substantial corporate bond purchases and the GDP growth should remain robust in the coming quarters.
Asia investment grade (IG)	▲	▲	Asia investment grade offers quality names and issuers with strong implicit government support.
Global high-yield (HY)	▲	▼	US Treasury yields will stay "low but volatile" as markets look for clues about the tapering plan. We prefer short-dated Global High Yield to mitigate interest rate volatility. Default-adjusted spreads are at multi-year lows.
US high-yield (HY)	▲	▼	High energy prices have boosted the cash flows of oil & gas companies, which is a major constituent of the USD HY index. Longer term, spreads are at levels consistent with an underweight view.
European high-yield ex UK (HY)	▲	▼	Monetary policy is ultra-accommodative, including ECB measures to support the market. However, valuations support our long-term underweight position.
Asia high-yield (HY)	▲	▲	Default rates should remain low and spreads look relatively attractive. China's economy and default rates need to be monitored in the context of tightening policy, deleveraging efforts and regulatory pressures.
Commodities			
Gold	▶	▶	Gold offers diversification and hedging benefits but further upside is limited by higher bond yields, a stronger USD, and a reduction in global economic and geopolitical uncertainty.
Oil	▶	▶	Near-term demand is strong and oil prices are expected to drop in 2022 with the US and OPEC+ resuming supply. But the outlook for global spare capacity is a concern over a longer term.

Sector Views

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

Sector	Global	US	Europe	Asia	Comment
Consumer Discretionary	▲	▲	▲	▲	Rising wages, robust employment prospects, high levels of savings and lower debt levels support consumer sentiment. We expect further upward earnings revisions. Domestic travel and hospitality is being hit by the Omicron variant restrictions, while auto makers see robust demand but production is constrained by supplies chain issues, especially semi-conductors.
Financials	▲	▲	▲	▲	Banking stocks benefit from inflationary pressures lifting rate hike expectations. The economic outlook is positive on stimulus packages in the US and Europe, low valuations, as well as higher trading revenues and M&A activity. Another strong set of quarterly results has exceeded expectations on higher capital markets activity, lower loan provisions and a hot real estate market.
Industrials	▼	▶	▶	▼	Rising input costs (labour, materials and energy) and supply chain issues continue to weigh on margins and profits for the coming quarters. Historically, low inventories and the shift to greater automation ensure future potential once the immediate issues are addressed.
Information Technology	▲	▲	▶	▲	The trend of digitalisation and new technologies driving long-term, above-average growth remains intact. Shortage in semi-conductors is still challenging but infrastructure spending should benefit digital infrastructure. Regulatory authority actions could potentially weigh on sentiment but the focus has shifted from the US to Asian companies.
Communication Services	▲	▲	▶	▲	Steady cash flows and increased data usage as more activity shifted online and business digitalised are key drivers. The 5G roll-out is positive for telecom equipment providers but is neutral/negative initially for service providers. Media companies see continued robust demand.
Materials	▶	▶	▶	▶	The constructive economic outlook is reflected in valuations. Metal prices continue to loose momentum. In the medium term as infrastructure spending related to fiscal stimulus plans in Europe, Asia and the US, demand is likely to grow.
Real Estate	▶	▶	▶	▶	High savings and low interest rates are positive for private residential real estate, while commercial real estate is suffering from corporates looking to reduce office space and retail moving online. High dividend yield provides attraction in a low yield environment.
Consumer Staples	▼	▼	▼	▶	Although valuations looks relatively more attractive than the cyclical sectors, slower growth is expected in 2021 due to stock piling of consumer essentials in 2020. Rising Input costs and labour shortage may hurt margins in some industries.
Energy	▶	▶	▶	▶	Energy prices and stocks will remain volatile. Low inventories and supply-demand imbalances will likely keep prices high. In the medium term, continuing chronic under-investment will support prices despite the clean energy transition gaining momentum.
Healthcare	▶	▶	▶	▶	Medical technology companies stand to benefit from large backlogs in elective surgical procedures, while new innovative medicines drive sales and positive news flow for the biotechnology sector. Pricing remains a headwind for pharmaceutical companies due to policy and regulations.
Utilities	▼	▼	▶	▼	Renewable stocks look more attractive after stock prices and valuation pulled back significantly from overly optimistic levels. However, margins may be under pressure as companies may not be able to pass on rising energy prices.

Disclaimer

This document or video is prepared by The Hongkong and Shanghai Banking Corporation Limited ('HBAP'), 1 Queen's Road Central, Hong Kong. HBAP is incorporated in Hong Kong and is part of the HSBC Group. This document or video is distributed and/or made available by HSBC Bank Canada (including one or more of its subsidiaries HSBC Investment Funds (Canada) Inc. ("HIFC"), HSBC Private Investment Counsel (Canada) Inc. ("HPIC") and HSBC InvestDirect division of HSBC Securities (Canada) Inc. ("HIDC")), HSBC Bank (China) Company Limited, HSBC Continental Europe, HBAP, HSBC Bank (Singapore) Limited, HSBC Bank Middle East Limited (UAE), HSBC UK Bank Plc, HSBC Bank Malaysia Berhad (127776-V)/HSBC Amanah Malaysia Berhad (807705-X), HSBC Bank (Taiwan) Limited, HSBC Bank plc, Jersey Branch, HSBC Bank plc, Guernsey Branch, HSBC Bank plc in the Isle of Man, HSBC Continental Europe, Greece, The Hongkong and Shanghai Banking Corporation Limited, India (HSBC India), HSBC Bank (Vietnam) Limited, PT Bank HSBC Indonesia (HBID), HSBC Bank (Uruguay) S.A. (HSBC Uruguay is authorised and oversought by Banco Central del Uruguay), HBAP Sri Lanka Branch, and The Hongkong and Shanghai Banking Corporation Limited – Philippine Branch and HSBC Savings Bank (Philippines), Inc. (collectively, the "Distributors") to their respective clients. This document or video is for general circulation and information purposes only.

The contents of this document or video may not be reproduced or further distributed to any person or entity, whether in whole or in part, for any purpose. This document or video must not be distributed in any jurisdiction where its distribution is unlawful. All non-authorised reproduction or use of this document or video will be the responsibility of the user and may lead to legal proceedings. The material contained in this document or video is for general information purposes only and does not constitute investment research or advice or a recommendation to buy or sell investments. Some of the statements contained in this document or video may be considered forward looking statements which provide current expectations or forecasts of future events. Such forward looking statements are not guarantees of future performance or events and involve risks and uncertainties. Actual results may differ materially from those described in such forward-looking statements as a result of various factors. HBAP and the Distributors do not undertake any obligation to update the forward-looking statements contained herein, or to update the reasons why actual results could differ from those projected in the forward-looking statements. This document or video has no contractual value and is not by any means intended as a solicitation, nor a recommendation for the purchase or sale of any financial instrument in any jurisdiction in which such an offer is not lawful. The views and opinions expressed are based on the HSBC Global Investment Committee at the time of preparation, and are subject to change at any time. These views may not necessarily indicate HSBC Asset Management's current portfolios' composition. Individual portfolios managed by HSBC Asset Management primarily reflect individual clients' objectives, risk preferences, time horizon, and market liquidity.

The value of investments and the income from them can go down as well as up and investors may not get back the amount originally invested. Past performance contained in this document or video is not a reliable indicator of future performance whilst any forecasts, projections and simulations contained herein should not be relied upon as an indication of future results. Where overseas investments are held the rate of currency exchange may cause the value of such investments to go down as well as up. Investments in emerging markets are by their nature higher risk and potentially more volatile than those inherent in some established markets. Economies in emerging markets generally are heavily dependent upon international trade and, accordingly, have been and may continue to be affected adversely by trade barriers, exchange controls, managed adjustments in relative currency values and other protectionist measures imposed or negotiated by the countries with which they trade. These economies also have been and may continue to be affected adversely by economic conditions in the countries in which they trade. Investments are subject to market risks, read all investment related documents carefully.

This document or video provides a high level overview of the recent economic environment and has been prepared for information purposes only. The views presented are those of HBAP and are based on HBAP's global views and may not necessarily align with the distributors' local views. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of its dissemination. It is not intended to provide and should not be relied on for accounting, legal or tax advice. Before you make any investment decision, you may wish to consult a financial adviser. In the event that you choose not to seek advice from a financial adviser, you should carefully consider whether the investment product is suitable for you. You are advised to obtain appropriate professional advice where necessary.

We accept no responsibility for the accuracy and/or completeness of any third party information obtained from sources we believe to be reliable but which have not been independently verified.

Important Information about HSBC Global Asset Management (Canada) Limited ("AMCA")
HSBC Asset Management is a group of companies, including AMCA, that are engaged in investment advisory and fund management activities, which are ultimately owned by HSBC Holdings plc. AMCA is a wholly owned subsidiary of, but separate entity from, HSBC Bank Canada.

Important Information about HSBC Investment Funds (Canada) Inc. ("HIFC")
HIFC is the principal distributor of the HSBC Mutual Funds and offers the HSBC Mutual Funds and/or the HSBC Pooled Funds through the HSBC World Selection® Portfolio service. HIFC is a subsidiary of AMCA, and indirect subsidiary of HSBC Bank Canada, and provides its products and services in all provinces of Canada except Prince Edward Island. Mutual fund investments are subject to risks. Please read the Fund Facts before investing.

®World Selection is a registered trademark of HSBC Group Management Services Limited.

Important Information about HSBC Private Investment Counsel (Canada) Inc. ("HPIC")
HPIC is a direct subsidiary of HSBC Bank Canada and provides services in all provinces of Canada except Prince Edward Island. The Private Investment Counsel service is a discretionary portfolio management service offered by HPIC. Under this discretionary service, assets of participating clients will be invested by HPIC or its delegated portfolio manager, AMCA, in securities, including but not limited to, stocks, bonds, mutual funds, pooled funds and derivatives. The value of an investment in or purchased as part of the Private Investment Counsel service may change frequently and past performance may not be repeated.

Important Information about HSBC InvestDirect ("HIDC")
HIDC is a division of HSBC Securities (Canada) Inc., a direct subsidiary of, but separate entity from, HSBC Bank Canada. HIDC is an order execution only service. HIDC will not conduct suitability assessments of client account holdings or of the orders submitted by clients or from anyone authorized to trade on the client's behalf. Clients have the sole responsibility for their investment decisions and securities transactions.

The following statement is only applicable to HSBC Bank (Taiwan) Limited with regard to how the publication is distributed to its customers: HSBC Bank (Taiwan) Limited ("the Bank") shall fulfill the fiduciary duty act as a reasonable person once in exercising offering/conducting ordinary care in offering trust services/ business. However, the Bank disclaims any guarantee on the management or operation performance of the trust business.

THE CONTENTS OF THIS DOCUMENT OR VIDEO HAVE NOT BEEN REVIEWED BY ANY REGULATORY AUTHORITY IN HONG KONG OR ANY OTHER JURISDICTION.

YOU ARE ADVISED TO EXERCISE CAUTION IN RELATION TO THE INVESTMENT AND THIS DOCUMENT OR VIDEO. IF YOU ARE IN DOUBT ABOUT ANY OF THE CONTENTS OF THIS DOCUMENT OR VIDEO, YOU SHOULD OBTAIN INDEPENDENT PROFESSIONAL ADVICE.