HSBC

Investment Monthly

Increasing equity allocation on synchronised policy pivot

April 2024

Key takeaways

- The synchronised dovish messages from the central banks (FOMC, ECB and BoE) have reinforced market expectations of rate cuts in June, which are positive for equities. We upgrade Europe ex-UK equities to neutral based on economic fundamentals appearing to have bottomed out. As the pivot should also cap the upside for bond yields, we continue to extend bond duration in major government bonds (7-10 years) and investment grade credit (5-7 years).
- Long-term fundamentals, strong earnings growth and secular trends continue to drive the US equity rally beyond IT and communications. While US equities tend to perform well before the first rate cut, and in an election year, it's critical to stay diversified to mitigate downside risks. A multi-asset strategy may help.
- The aggressive wage hike of 5.3% from the Shunto wage negotiations should support a more sustainable reflation trend in Japan. Despite putting an end to its negative interest rate policy and yield curve control, the Bank of Japan emphasised that financial conditions should stay accommodative, making further rate hikes unlikely until end-2024. Together with improved corporate governance and the AI investment boom, we remain positive on Japanese equities.

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Asset class	6-month view	Comment
Global equities	▲	The synchronised central bank pivot, combined with continued disinflation and an improving earnings outlook should provide a boost to equity fundamentals. US and Asia remain our preferred regions with a focus on quality companies.
Government bonds	▶	We expect major DM government bond yields to resume their downward trend in anticipation of rate cuts and maintain our duration preference for up to 10 years. Japanese government bonds remain unattractive.
Investment grade (IG) corporate bonds	▲	As interest rate risk is more attractively priced than credit risk, we continue to favour quality bonds. Current yield levels represent an attractive entry point for 5-7 years' maturities.
High yield (HY) corporate bonds	▶	Credit spreads are too tight to compensate even for a small pickup in defaults. We maintain our preference for investment grade over high yield bonds.
Gold	▶	Geopolitical uncertainties and central bank buying have recently pushed up gold prices but high real rates and the strong USD remain headwinds.

▲ "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. What does the central bank pivot mean for investors?

- While inflation data have been mixed, the dovish tone of the central banks (FOMC, ECB and Bank of England) has reinforced market expectations that a policy pivot is approaching. We now expect these central banks to start cutting rates in June, following a surprise cut by the Swiss National Bank. The BoE may even start earlier as February inflation fell further than expected.
- This supports our strategy of putting cash to work in both bonds and equities as they tend to rally around 8 months before the first rate cut. We have further added to equities by upgrading Europe ex-UK equities to neutral this month while maintaining overweight in the US and Asia. Europe's economic growth seems to have bottomed in Q1, with signs of cyclical improvement in Spain and Italy in particular. Other positive factors include cheap valuations, the exposure of European companies to improving global growth, and better PMI data. We see opportunities in the IT, financials, energy and healthcare sectors.
- As the pivot should cap the upside for bond yields, we continue to like major government bonds up to 10 years and investment grade credit of 5-7 years' maturities to lock in current attractive yields.

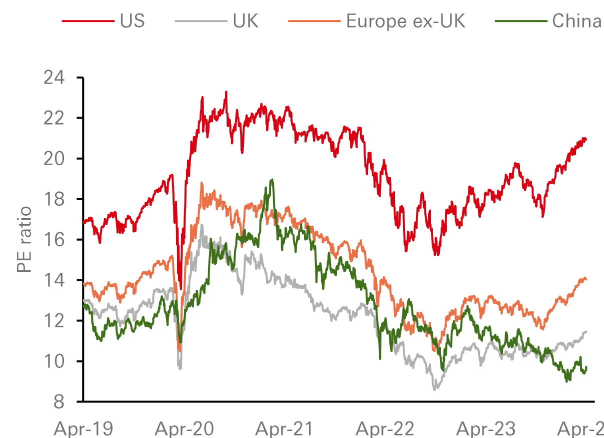
2. Should we be concerned about the US market overheating?

- The US market hit a new record high in March, led by technology and communications services. Long-term fundamentals remain supportive and analysts expect healthy earnings growth for US companies at around 11% in 2024.
- Secular drivers such as technology and healthcare innovation, nearshoring of industry and the North American re-industrialisation should provide tailwinds for economic growth, earnings and return on capital. The rally should broaden out to consumer discretionary, financials, industrials and healthcare.
- During the last 12 presidential election years, the S&P500 has outperformed global markets 75% of the time by an average of 4%. A healthy economy has traditionally favoured the incumbent party with the Democrats focusing on environmental issues, alternative energy and social policy. However, if the Republicans win, the focus would likely shift to a more traditional petroleum-based energy policy, defence and technology companies. Despite some market volatility ahead of the election, the markets tend to respond positively once a clear winner emerges. Nevertheless, investors should adopt a diversified approach to balance risks and opportunities. A multi-asset strategy can help generate returns from multiple sources while mitigating downside risks.

3. What are the implications of the latest developments in Japan?

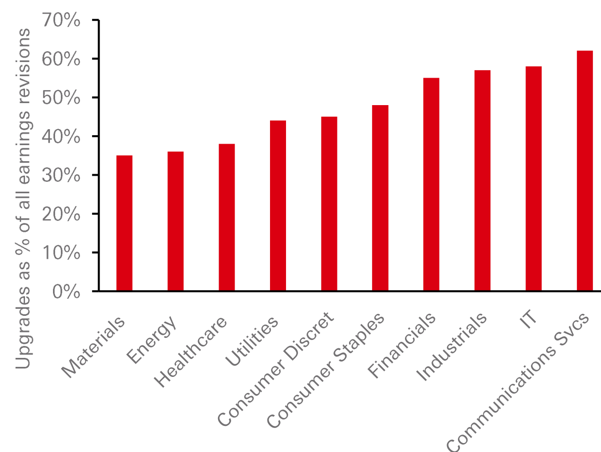
- The Shunto wage negotiations have agreed an average wage increase of 5.3% for 2024 (up from 3.8% in 2023), representing the country's most aggressive pay rise in 33 years. This should support a more sustainable reflation trend and boost domestic consumption.
- On the monetary front, the Bank of Japan (BoJ) ended its 8-year negative interest rate policy by setting a new policy rate range between 0.0% and 0.1% and removed the yield curve control in March However, the BoJ also emphasised the importance of financial conditions staying accommodative, making further rate hikes unlikely until the end of 2024.
- Furthermore, the monthly list published by the Tokyo Stock Exchange that discloses companies having plans to improve capital efficiency has prompted more companies to increase dividend payouts. Given the reflationary trend, improved corporate governance and the AI investment boom, we remain positive on Japanese equities.

Chart 1: Cyclical optimism and cheap valuations support our upgrade of Europe ex-UK equities



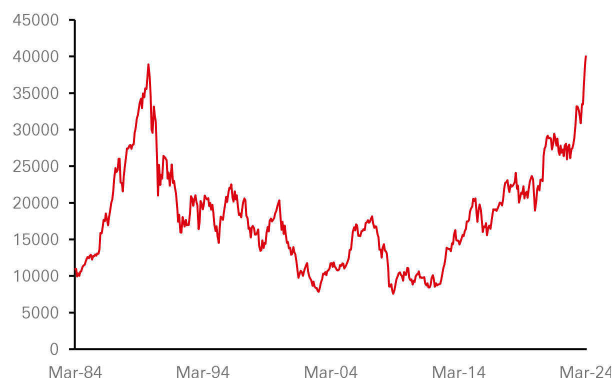
Source: Bloomberg, HSBC Global Private Banking as at 2 April 2024. Past performance is not a reliable indicator for future performance.

Chart 2: We favour those sectors with strong earnings momentum



Source: LSEG, HSBC Global Private Banking as at 26 March 2024. Past performance is not a reliable indicator of future performance.

Chart 3: BoJ's dovish guidance supports the rally of Japanese equities to an all-time high



Source: Bloomberg, HSBC Global Private Banking as at 19 March 2024. 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	▲	The synchronised central bank pivot, combined with continued disinflation and an improving earnings outlook should provide a boost to equity fundamentals. US and Asia remain our preferred regions with a focus on quality companies.
United States	▲	US earnings should benefit from the resilient economy and rate cuts in 2024 while structural trends create opportunities beyond IT to include consumer discretionary, financials, industrials, communications and healthcare.
United Kingdom	▶	Valuations are cheap but weak growth remains a headwind. It's too early to look for a cyclical recovery.
Europe ex-UK	▶↑	Despite weak economic growth in Europe, we upgrade Europe ex-UK equities due to the bottoming of local economic indicators and the exposure of European companies to improving global growth. Valuations are attractive.
Japan	▲	Corporate governance reforms, the end of deflation and the AI investment boom are tailwinds for the equity market. We favour the consumption, financials and technology sectors.
Emerging Markets (EM)	▶	We expect more emerging markets to cut rates following some of the Latin American countries. Corporate earnings growth is expected to rebound sharply for EM Asian markets in 2024.
EM EMEA	▼	The region is impacted by high energy prices and global interest rates, as well as geopolitical uncertainty.
EM LatAm	▶↓	While Mexico continues to benefit from the North American re-industralisation trend, we downgrade the Latin American region to neutral due to slowing earnings and price momentum in Brazil.
Asia ex Japan equities		
Asia ex-Japan	▲	Asia remains a key engine for global growth supported by exceptional growth in India, stable performance of ASEAN and more decisive policy stimulus from China.
Mainland China	▶	We stay neutral and wait for more positive momentum in earnings and economic data and look for opportunities in service consumption leaders, high-end manufacturing winners driven by AI and EV innovation, and beneficiaries of SOE reforms.
India	▲	With a strong cyclical and structural growth outlook, we view short-term pullback in the equity market led by small-and mid-cap stocks as an attractive buy-on-dip opportunity. Large-cap stocks are preferred.
Hong Kong	▶	Despite relaxation of the housing austerity policy, domestic commercial real estate market remains a concern. We remain neutral amid attractive valuations with a preference for the insurance, telecom and utility sectors.
Singapore	▶	A rebound in industrial production and travel-related services support a stronger GDP growth this year.
South Korea	▲	South Korea is well placed to benefit from the digital transformation trend and the wider adoption of AI. The recently announced Value-Up plan could be a new catalyst for the stock market.
Taiwan	▶	The semiconductor and tech hardware sectors will stand to benefit from AI innovation of digital consumption and the cyclical recovery in the broader tech sector, but much is already in the price.
Government bonds		
Developed markets (DM)	▶	We expect major DM government bond yields to resume their downward trend in anticipation of rate cuts and maintain our duration preference for up to 10 years. Japanese government bonds remain unattractive.
United States	▲	Treasury yields remain volatile as markets are reassessing the rate cut path from the Fed. We remain overweight on US Treasuries and see volatility as entry opportunities.
United Kingdom	▲	The Bank of England acknowledged that circumstances are progressing in a favourable direction, with inflation likely to dip below 2% this quarter before marginally rising again towards year end. We retain a positive bias in UK gilts up to 10 years.
Eurozone	▶	The recent cut from the Swiss National Bank paves the way for the ECB to cut rates this summer, which should provide some relief to European bond yields, where we maintain a neutral stance.
Japan	▼	Despite negative interest rate policy coming to an end and removal of the yield curve control, we expect the BoJ to maintain a 0.0% policy rate until the end of 2024. We remain underweight on Japanese government bonds.
Emerging Markets (Local currency)	▼	Given the strong US dollar and a slowing pace of disinflation across EM economies, we remain underweight on EM local currency bonds but favour Indian local currency bonds due to India's robust structural and cyclical growth outlook.
Emerging Markets (Hard currency)	▶	We prefer developed market investment grade on a relative basis, however we still find opportunities in selective emerging markets focusing on quality issuers, where the yields remain appealing.
Corporate bonds		
Global investment grade (IG)	▲	As interest rate risk is more attractively priced than credit risk, we continue to favour quality bonds. Current yield levels represent an attractive entry point for 5-7 years' maturities.
USD investment grade (IG)	▲	USD investment grade credit offers attractive spreads with the deepest liquidity.
EUR and GBP investment grade (IG)	▲	Although spreads have tightened, yields remain attractive and should be supported by the prospect of rate cuts this summer. Our preference for quality warrants our overweight on EUR and GBP investment grade credit.
Asia investment grade (IG)	▲	We focus on locking in attractive yields from quality Asian bonds, favouring Asian financials, Indian local currency bonds, Indonesian quasi-sovereign bonds, South Korean IG bonds, Macau gaming and Chinese technology, media and telecom.
Global high-yield (HY)	▶	Credit spreads are too tight to compensate even for a small pickup in defaults. We maintain our preference for investment grade over high yield bonds.
US high-yield (HY)	▶	Although defaults remain low and refinancing risk is manageable, risk premia are too low in our view, so we continue to prefer investment grade on a relative basis.
EUR and GBP high-yield (HY)	▶	European high yield issuers often have lower leverage than in the US, but economic growth is lower, hurting cash flows. Our neutral stance reflects our preference for quality, even though growth may have bottomed at the end of last year.
Asia high-yield (HY)	▶	We stay cautious about Chinese property high yield bonds and prefer quality issuers for higher total returns.
Commodities		
Gold	▶	Geopolitical uncertainties and central bank buying have recently pushed up gold prices but high real rates and the strong USD remain headwinds.
Oil	▶	In spite of production cuts, global growth concerns are weighing on oil prices.

Sector Views

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

Sector	Global	US	Europe	Asia	Comment
Consumer Discretionary	▲	▲	▶	▲	Inflation continues to fall in many regions but high interest rates remain a headwind for new investment projects. Tourist activity continues to pick up, which helps to lift hard luxury demand in most regions. Hospitality and restaurants should benefit from these trends. The auto sector is seeing signs of improving demand although EV demand has dropped. The low valuations of European and US automakers reflect concerns about the competitiveness of their EV products compared to their Asian counterparts.
Financials	▲	▲	▲	▶	An improving economic and corporate outlook combined with solid fundamentals and low valuations should support the sector, in particular capital markets, which have had a good start to the year with a pick-up in trading volumes, M&A activity, IPOs and bond issuance. Interest rates look set to decline only slowly with a modest impact on earnings in 2024. Regional banks with significant exposure to the real estate sector are experiencing some challenges.
Industrials	▲	▲	▶	▶	US industrials are benefitting both from robust domestic demand and the reshoring/nearshoring initiatives fuelled by the Inflation Reduction Act (IRA) and CHIPS Act. In other regions, Q4/Q1 results and management guidance provide some optimism for a demand pick-up. Aerospace, defence and automation remain potential bright spots.
Information Technology	▲	▲	▲	▲	Fundamentals are strong with AI-related developments being a major growth catalyst for productivity and new applications. As a result, high-end semiconductors, digital infrastructure, software and related supply areas are all seeing growth. Consumer sentiment is also improving as new intelligent, AI-enabled products and services are introduced. Digital advertising growth is showing signs of improving.
Communications Services	▶	▲	▼	▲	US Communications continue to deliver stellar earnings growth with the strongest sector growth forecast for this year as fundamentals and attractive prices continue to attract investors. In Asia, the stabilising regulatory environment and low valuations offer an attractive risk-return profile. In contrast, Europe's telecom services have little room for optimism.
Materials	▶	▶	▶	▶	Iron ore and steel prices remain soft, but copper and aluminium prices have remained flat for the last 18 months. Nickel's long decline has paused. Electric vehicle demand has declined as insufficient charging infrastructure has impacted consumers appetite, reducing demand for battery metals. Chemicals stocks remain range-bound. Construction materials are seeing some improvements in early demand but weak infrastructure spending remains a headwind.
Real Estate	▼	▼	▶	▼	The outlook for commercial real estate is mixed with retail and office segments still looking unattractive, while warehousing is seeing improved demand and prices after a sustained period of weakness. The sentiment of the housing sector in some markets is improving in anticipation of lower interest rates. Chinese real estate remains problematic. Easing inflation and interest rates may lift sentiment and activity.
Consumer Staples	▶	▶	▶	▲	Consumer staples cost margins appear secure as cost pressures have eased. The sector should benefit from strong seasonal demand with solid results going forward despite tough YoY comparables. The sector trades in line with historical valuations. We focus on quality stocks with strong brands and more resilient pricing power.
Energy	▶	▶	▲	▶	Low valuations, strong cashflow and high dividends appear to be insufficient to change sentiment towards the sector as energy prices remain range-bound. On a seasonally adjusted basis, supplies appear plentiful and inventories adequate, helped by the relatively mild winter in Europe. In 2024, energy prices may not benefit from geopolitical uncertainties as they have over the last two years.
Healthcare	▲	▲	▲	▼	New product launches, a less hostile pricing environment and the ebbing wave of major product patent expirations should help lift the sector after a period of under-performance. Healthcare sales growth should start to benefit from easier comparables and new pharma products should lift sentiment and expectations. In Asia, valuations remain elevated, trading well above historical levels.
Utilities	▶	▼	▶	▲	The outlook for European and US renewable energy projects continues to improve as governments have started to adopt more realistic pricing for new project auctions following a period of unprecedented cost increases. Interest rate cuts could provide a tailwind and improve sentiment further. Utilities may benefit as interest rates fall and investors look for high dividend paying stocks.

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