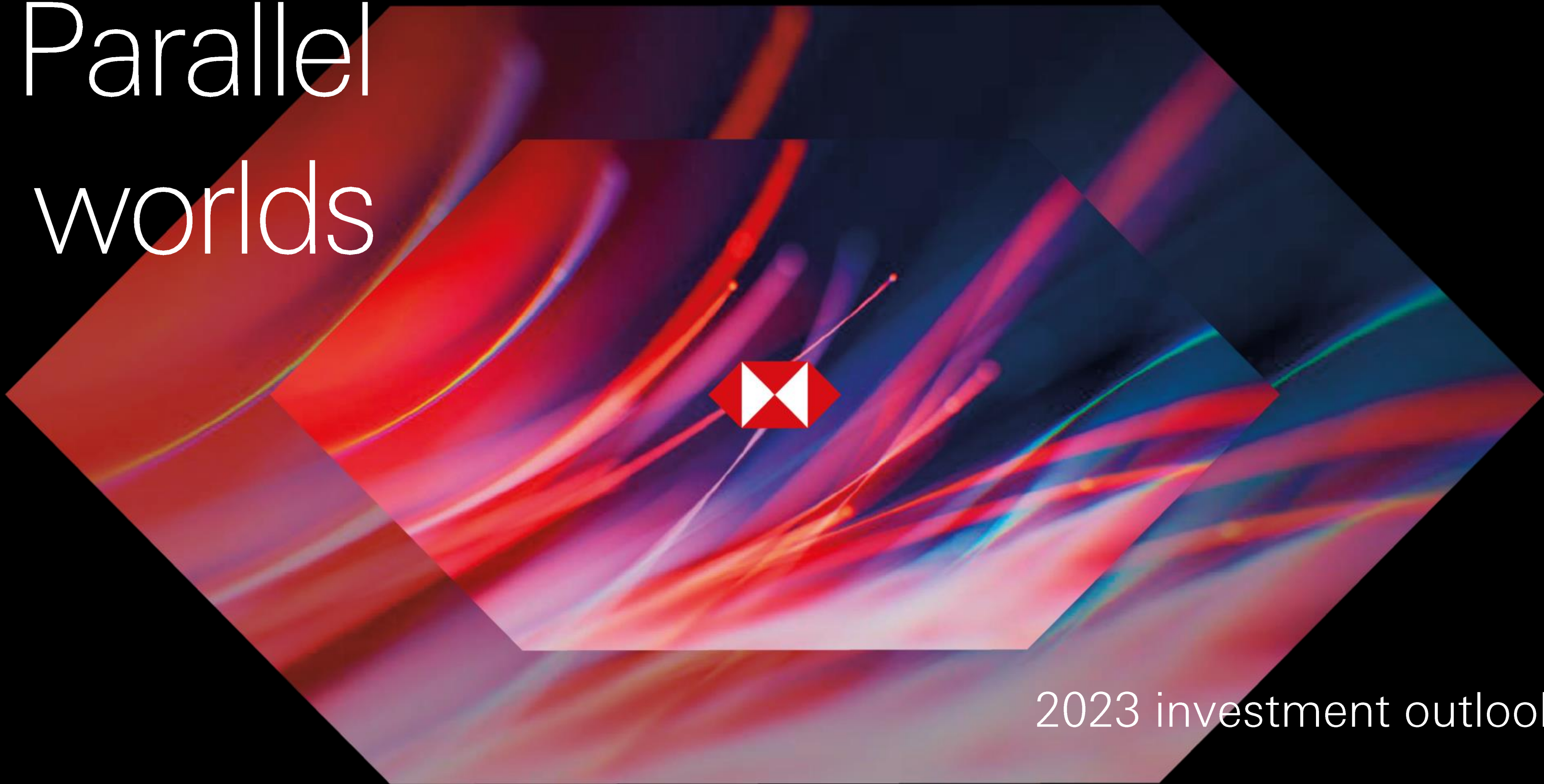
Asset Management

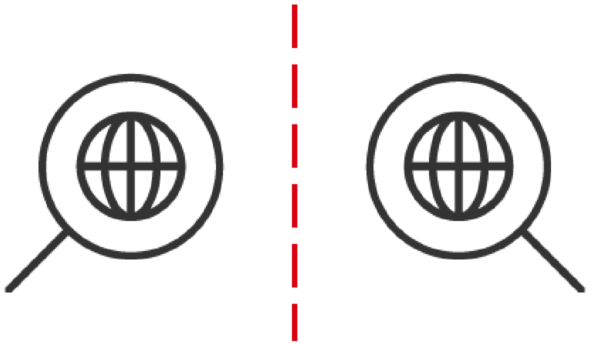
Parallel worlds



2023 investment outlook

HSBC | Opening up a world of opportunity

Today's markets feel like a 'parallel world'



The past year of turmoil has been unnerving for investors, and there are many factors preventing a simple return to what we were used to.

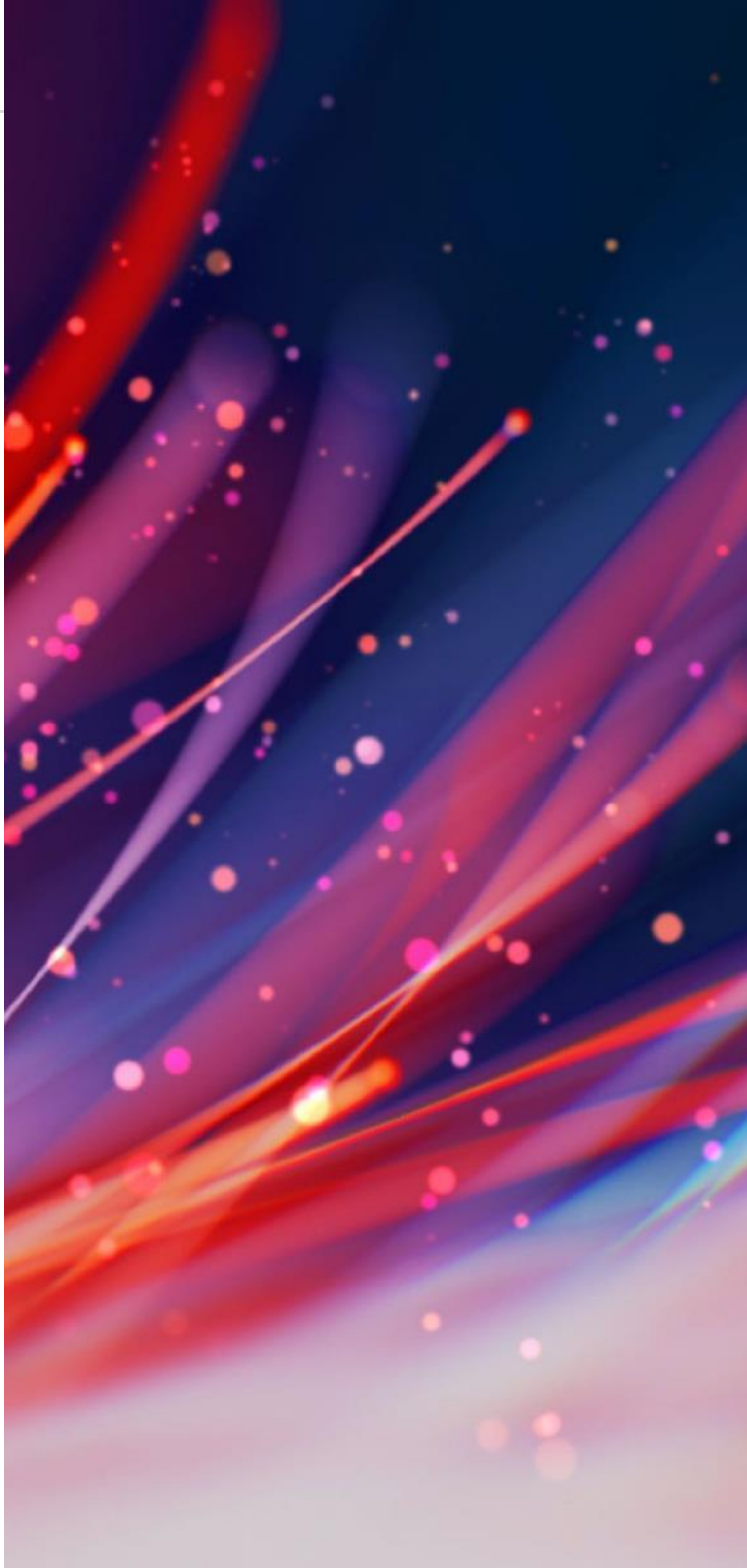
This new environment means a new approach is needed.

1 Investors have experienced a 'poly-crisis' of rolling economic and market shocks in 2022. During the year, it has often felt like a 'parallel world'.

2 The 2023 economic outlook is 'parallel'. Global inflation is slowing, and we are moving past the peak in interest rates, but while there is recession risk in the West, the East continues its recovery and re-opening.

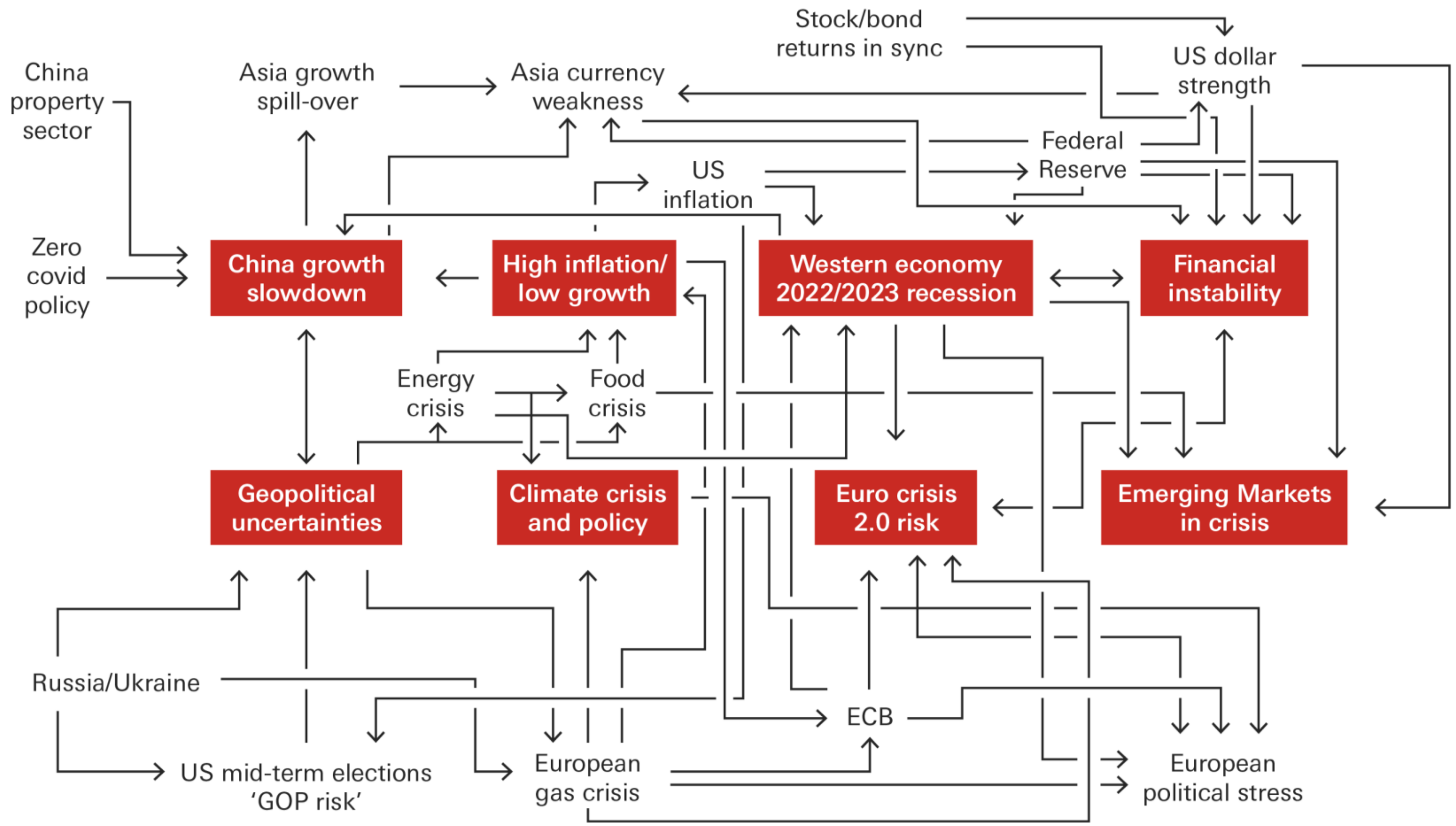
3 Longer-term forces herald a new economic and market regime. This new environment has meant a 'parallel' shift in asset valuations, changing the game for investors.

4 'Parallel Worlds' requires a new investment playbook. That includes a dynamic asset mix with a renewed focus on being active, and greater geographic diversification.



1 The global 'poly-crisis'

Rolling crises have linked together this year to create a parallel world to the one we were used to over the past decade – one where China led global growth, inflation was persistently low, and investment returns were relatively strong.



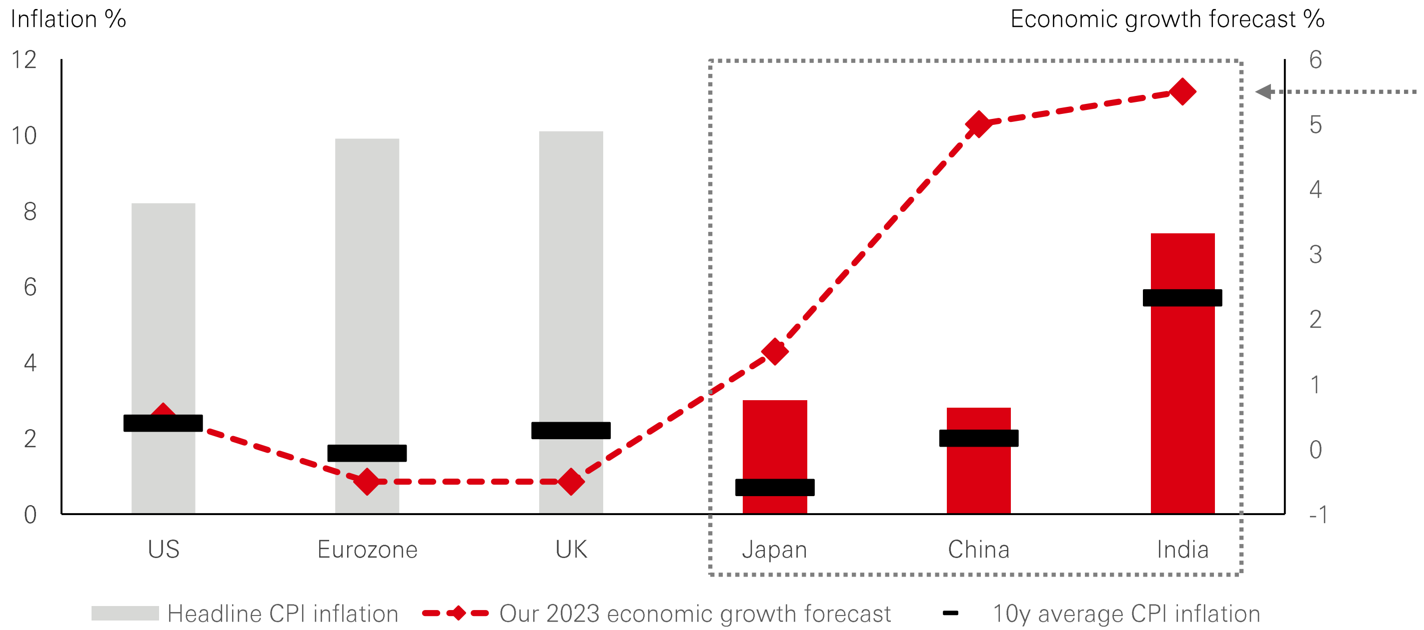
Source: HSBC Asset Management, December 2022.

2 Parallel worlds – East and West

The inflation crisis in the West has led central banks there to rapidly raise interest rates to slow their economies. Asia, on the other hand, is at a different stage of the economic cycle with less inflation pressures to worry about and a more positive growth outlook.

This makes Asia's investment markets appealing not only for potential to outperform, but also as a **source of diversification** given a much different environment.

Consumer price inflation and economic growth



- **India** continues to expand, even as the rest of the world slows
- In **China**, an imminent recovery sets the stage for growth of around the 5 per cent mark next year
- **Japan** is set to be the only advanced economy not in recession next year

Source: HSBC Asset Management, Macrobond data, November 2022. Any views expressed were held at the time of preparation and are subject to change without notice. Any forecast, projection or target is for information purposes only and is not guaranteed in any way. HSBC Asset Management accepts no liability for any failure to meet such forecasts, projections or targets.

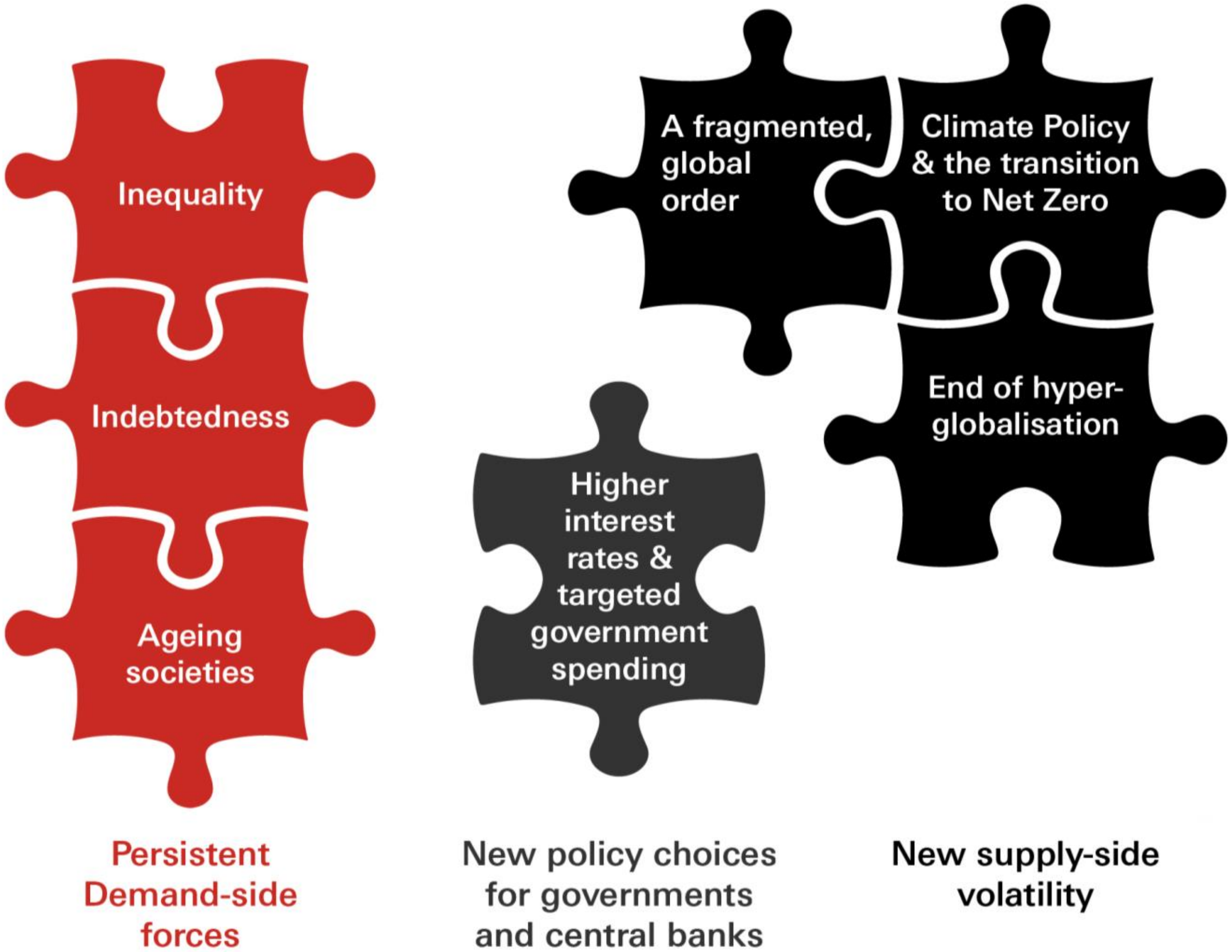
3 A new regime

In the 2010s, central banks carried out aggressive policy to stimulate sluggish economic growth, including near-zero interest rates.

This was accompanied largely by an absence of supply issues – thus low inflation – and limited government spending, leaving public demand as the economic driver.

Going forward, we face a new and different economic regime. Societal issues will impact demand, while supply will be impacted by a retreat from global cooperation and changes to how and what we consume.

A new mix of supply and demand forces, and new policy choices for the 2020s



Source: HSBC Asset Management, December 2022.

4 New investment strategy playbook

‘Parallel worlds’ require a new investment strategy playbook

Portfolio dynamism

The regime of 'no alternative to equities' is over, creating more opportunity for portfolio dynamism

Bonds now deliver yield

Shorter-term bonds are the ‘natural assets’ in the current economic phase

Lower valuations place many opportunities on the radar

Active in emerging markets

In a turbulent world, dispersion in performance between markets remains high

Valuations, a peaking US dollar and China policy support create opportunities for emerging markets

Country allocations can be a source of diversification and outperformance

New diversifiers

The hunt for new diversifiers has intensified

More defensive allocations make sense (e.g. infrastructure, property)

True-uncorrelated asset classes remain attractive. Here, alternative assets can be useful

Source: HSBC Asset Management, December 2022.
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Thinking about inflation

Inflation is expected to continue gradually falling back as supply shortages ease further, and following the recent moderation in commodity prices. Persistent housing inflation also appears to be slowing due to a jump in mortgage rates cooling the housing market.

Nevertheless, inflation isn’t disappearing entirely. In the US, wage growth and consumer demand are still relatively strong. And the central bank (Federal Reserve) likely wants to see more sustained evidence of moderating inflation before considering a pause in raising interest rates. This could require 3-4 months’ worth of inflation data. In the meantime, higher rates will be a drag on economic growth and investment markets.

In Europe, the inflation outlook seems more benign since the region is already experiencing negative economic growth, and wage growth remains contained. Thus, a pivot in central bank policy there is likely to come earlier.

We continue to have an overall cautious stance and don’t advocate an aggressive use of portfolio risk budgets yet.

Portfolios taking shape

Bonds as the natural allocation

A significant jump in bond yields has changed the equation for portfolios. European corporate bonds and emerging market bonds seem particularly appealing in our view. Even though the economic situation is difficult, corporate balance sheets are in good shape, which should be a relative support in the months to come. Yet, being very selective and managing interest rate risk carefully will be crucial. Shorter-term bonds are preferred for now, being less sensitive to interest rate changes.

Look for value in stocks

Value, or stocks whose price is based more on current earnings than future growth, still makes sense as interest rates continue to rise. Likewise, we also prefer stocks of companies with more durable earnings across economic cycles.

We think that emerging markets – especially Asia – are in a better position based on their relative value versus developed markets. A weaker US dollar would also play in their favour. Here, the risk aversion and divergence in interest rates that has driven the dollar higher is likely to abate next year.

Alternative exposures

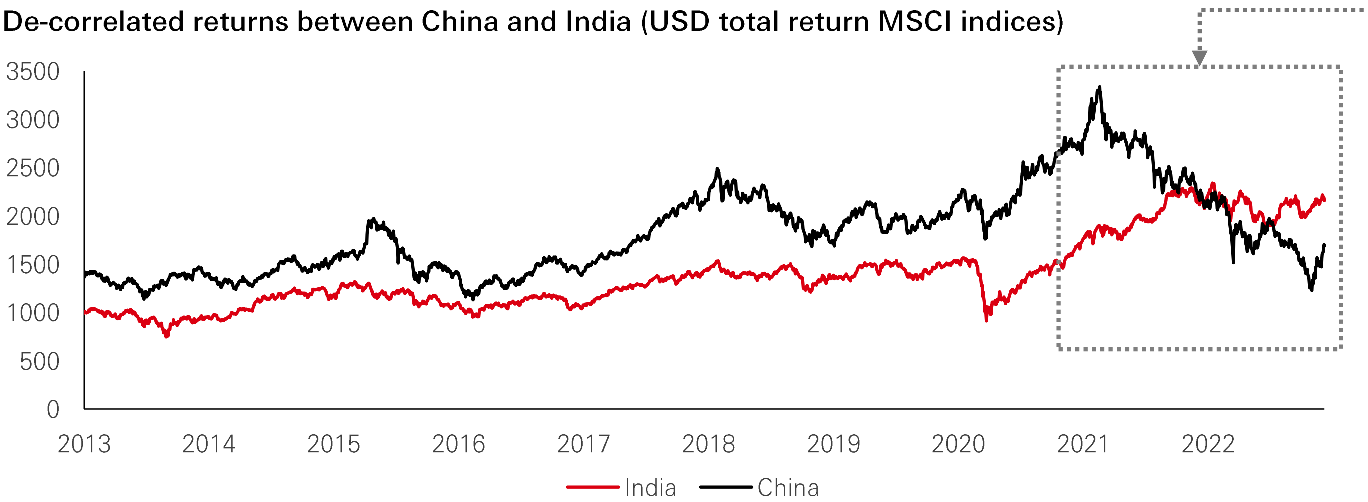
Given stock and bond correlations turned positive this year, meaning their prices have been rising or falling together, limiting portfolios to traditional asset classes can no longer be considered good enough.

We think it is important to continue to look more broadly for diversifiers. Alternatives carry their own opportunities and risks, but the more defensive or truly uncorrelated segments can bring value to the asset mix.

Be active in Asia

Our preference for Asian equities is in the context of resilient economic trends and scope for supportive policy in China. We currently opt for North Asia, over markets such as India. Importantly, divergence in returns between individual countries in the region has been expanding. This means an active approach can help portfolio returns.

De-correlated returns between China and India (USD total return MSCI indices)



Past performance is no guarantee of future returns.

Source: HSBC Asset Management, Macrobond data, November 2022. Any views expressed were held at the time of preparation and are subject to change without notice.

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