

Investment Monthly

Inflation and rate outlook drive market volatility

May 2022



For Client Use

The material contained in this document is for general education information purposes only and is neither intended as, nor does it constitute, advice or a recommendation to buy or sell investments, as defined by the US Securities and Exchange Commission. For individualized tailored recommendations based on your needs or objectives, please contact your financial professional directly for more information.

Investments, annuity and insurance products

ARE NOT A BANK DEPOSIT OR OBLIGATION OF THE BANK OR ANY OF ITS AFFILIATES	ARE NOT FDIC INSURED	ARE NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY	ARE NOT GUARANTEED BY THE BANK OR ANY OF ITS AFFILIATES	MAY LOSE VALUE
--	----------------------------	--	---	-------------------

Investment Monthly

Inflation and rate outlook drive market volatility

May 2022



Key takeaways

- ◆ Geopolitical tensions, Covid lockdowns in China and rising wages continue to push inflation higher. Even though it may have peaked, persistent supply chain disruptions will support inflation to stay high into 2023. Energy and Materials stand to benefit.
- ◆ We still think a recession in 2022 is unlikely. We prefer short-dated corporate bonds, value and dividend stocks, and upgrade Healthcare stocks for their resilient properties.
- ◆ Regionally, US and Asia remain our top picks thanks to healthy earnings outlook. ASEAN is particularly attractive with strong consumer demand while Europe is challenged by high inflation, slower growth and negative macro implications from the Ukraine conflict due to the energy supply disruptions.



Xian Chan
Chief Investment Officer,
Wealth Management, HSBC



Lucia Ku
Head of Wealth Insights
HSBC Wealth and Personal
Banking

Asset class	6-month view	Comment
Global equities	►	The combination of slower economic growth with higher inflation and higher interest rates weigh on global equities but both fundamentals and earnings remain solid.
Government bonds	▼	Although yields have backed up, we see better opportunities for returns elsewhere.
Investment grade (IG) corporate bonds	▲	Investment grade bonds are key for portfolio diversification and should be resilient as risk appetite is challenged.
High yield (HY) corporate bonds	▲	Global HY can be sensitive to the global growth outlook. Spreads have widened and short-dated bonds have already priced in many rate hikes.
Gold	►	Gold is favoured as geopolitical tensions and market volatility continue but prices are high and real yields have been 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.

Talking points

Each month, we discuss 3 key issues facing investors

1. What is driving inflation to go higher?

- ◆ The geopolitical tensions in Ukraine, Covid lockdowns in China, rising wages and economic reopening pushing services prices up in some markets continue to drive inflation higher (e.g. 8.5% in the US and 7.4% in Eurozone in March). Will it go further up?
- ◆ The decline of the daily retail gasoline prices since mid-March provides favourable base effects. Some economists expect inflation to gradually fall from the current levels. Even so, supply chain disruptions are likely to linger and inflation will stay high into 2023.
- ◆ The global rise in commodity prices continues to benefit Energy and Materials stocks, and commodity-linked currencies. We maintain our preference for quality companies with strong competitive position and margin power to pass on higher input costs.

2. What are the implications of the yield curve move?

- ◆ With more aggressive rate hikes already priced in than we expect, we think the scope for further upside is limited. Short-dated corporate bonds in DM and EM hard currency markets are more attractive. The inversion of the 2-to-10 year Treasury yield curve lasted for 3 days only, reinforcing our view that it is too early to call for a recession. Labour market remains strong.
- ◆ We balance value versus growth stocks as the former is well supported by higher real yields. We also like dividend stocks in search for income. To build portfolio resilience, we upgrade Healthcare (Global & Europe) to Overweight and downgrade Industrials to Underweight in Europe. Financials is a beneficiary of rising rates across the regions.
- ◆ Despite higher real yields, gold is favoured as a diversifier to hedge inflation and geopolitical risks. But unless real yields comes down, we see limited upside, so we remain Neutral.

3. Which regions are more resilient?

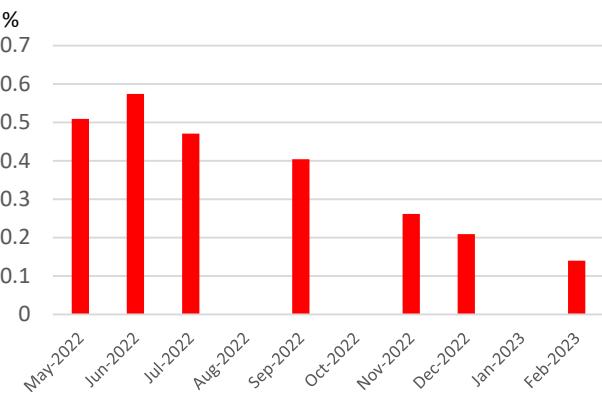
- ◆ US and Asia remain our top pick thanks to the healthy earnings outlook. US economic activity slowed in Q1 due to rising Covid cases but consumer demand and the labour markets remain strong. M&A and economic activity is expected to rebound in 2H.
- ◆ Asia is attractively priced with Australia, Malaysia and Indonesia benefitting from the rise in commodity prices and demand for raw materials, while other ASEAN markets see strong consumer demand. China's 4.8% Q1 GDP growth, attractive valuations and policy easing measures are positive but the zero-Covid policy and related lockdowns weigh on growth. We remain Neutral for now.
- ◆ Despite the policy continuity expected with Macron's re-election as French president, the European investment outlook remains challenged by high inflation and low growth, and is more vulnerable to the energy supply disruptions. We expect Europe's GDP growth to be 2.6% for 2022.

Chart 1: We expect stickier inflation in 2022, and a slower pace of decline thereafter

Country/ Region	Inflation		
	2021	2022f	2023f
Global	3.8	6.9	4.7
Developed	3.2	6.1	2.9
Emerging	4.1	7.4	5.7
United States	4.7	7.1	3.4
Eurozone	2.6	6.3	2.7
United Kingdom	2.6	8.0	4.6

Source: HSBC Global Research forecasts, HSBC Global Private Banking as at 22 April 2022.

Chart 2: Rate hikes in coming Fed meetings priced by the markets



Source: Bloomberg, HSBC Global Private Banking as at 28 April 2022.

Chart 3: Consensus earnings look strong for US & Asia

Index	Forward P/E Ratio	EPS 2022% Growth	EPS 2023% Growth
S&P 500	19.4	9.7%	9.0%
DOW	18.0	9.9%	9.1%
Nasdaq	27.5	19.2%	14.6%
MSCI Europe	13.4	5.3%	6.4%
MSCI EM Asia	12.3	11.2%	11.5%
MSCI EM Asia ex China	13.5	10.5%	8.1%

Source: Bloomberg, HSBC Global Private Banking as of 18 April 2022.
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 combination of slower economic growth with higher inflation and higher interest rates weigh on global equities but both fundamentals and earnings remain solid.
United States	▲	They are still our biggest equity overweight due to the size and quality character of US stocks. Consumer demand and labour markets remain strong.
United Kingdom	►	Attractively valued but rate & tax hikes and declining real incomes pose challenges.
Eurozone	▼	ECB tightening, high energy prices and the Russia-Ukraine war weigh on Eurozone equities.
Japan	►	Autos and industrials are hit by supply chain issues but capital goods see good demand.
Emerging Markets (EM)	►	Fed tightening is a concern while geopolitical tensions cause repositioning. Asia is relatively more resilient.
EM EMEA	▼	The region continues to be impacted by a refugee crisis, while high energy prices may dampen growth.
EM Latam	►	Commodity exposure benefits the region but there are risks around rate hikes and politics.
Asian equities		
Asia ex-Japan	▲	The region is supported by attractive valuations and healthy earnings expectations. The markets are exposed to fewer rate hikes and are well positioned to benefit from re-opening. ASEAN growth is solid.
China	►	The zero-Covid policy and related measures pose near-term challenges but the longer-term themes of technological innovation and a rising consumer class, as well as policy easing measures are supportive.
India	►	High oil prices could slow economic recovery and macroeconomic uncertainty around growth and inflation weighs on investment. New fiscal and manufacturing reforms should lift growth momentum over time.
Hong Kong	►	Many social distancing restrictions have been relaxed from 21 April onwards. We see positive economic recovery momentum spurred by more fiscal support and improved consumer sentiment.
Singapore	▲	Singapore benefits from global growth. We see positive economic recovery momentum on the back of consumption recovery, tourism rebound and infrastructure boom.
South Korea	►	The growth outlook is slower due to the Omicron wave weighing on consumption and the country's reliance on global trade. However, there could be shifts in growth drivers from exports to consumption in the coming quarters.
Taiwan	▲	We favour Taiwan equities given the market's exposure to the global semiconductor upcycle and the new wave of digital transformation. Growth in exports for Q1 is strong but a resurgence in Covid-19 cases creates uncertainty.
Government bonds		
Developed markets (DM)	▼	Although yields have backed up, they remain volatile and the asset class is unattractive.
United States	►	Yield curves are so flat and duration risk does not appear to be fully compensated.
United Kingdom	►	Inflation pressures amid supply chain disruptions support policy tightening. Risk-adjusted returns look poor.
Eurozone	▼	The hawkish market expectations of rate hikes alongside geopolitical tensions have driven up European government bond yields which remain unattractive from a cross-market perspective.
Japan	▼	Yields of Japanese government bonds have risen, following the pricing of DM monetary policy tightening. But from an international comparison, yields are still unattractive and we expect the Bank of Japan to keep loose monetary policy.
Emerging Markets (Local currency)	►	Select opportunities exist but some EM countries are hiking rates and USD remains strong.
Emerging Markets (Hard currency)	►	Amid higher Treasury volatility, we still find yield but remain selective.
Corporate bonds		
Global investment grade (IG)	▲	Investment grade bonds are key for portfolio diversification and should be resilient as risk appetite is challenged. We focus on carry opportunities.
USD investment grade (IG)	▲	We continue to keep duration short. The strong US jobs report in March bodes well for the consumer spending outlook. Corporate earnings outlook is healthy.
EUR and GBP investment grade (IG)	▲	The recent cheapening of Eurozone credit represents an opportunity for buy-and-hold investors, while GBP credit has proven to be relatively resilient in the face of geopolitical uncertainty, with a hawkish BoE already priced in.
Asia investment grade (IG)	▲	Asia IG credit is supported by strong domestic fundamentals, manageable inflation, and positive reopening outlook in the ASEAN region. We see attractive carry opportunities in Chinese SOE issuers, Chinese local currency debt and Indonesian hard currency bonds.
Global high-yield (HY)	▲	Global HY can be sensitive to the global growth outlook. Spreads have widened and short-dated bonds have already priced in many rate hikes.
US high-yield (HY)	▲	US high-yield benefits from high exposure to energy. We find attractive income generation opportunities in the short-dated high yield space. Low default rates and solid credit fundamentals are supportive.
European high-yield ex UK (HY)	▲	Spreads have widened due to the proximity of Europe and its banking system to the geopolitical uncertainty. This offers some attractive opportunities in our search for carry with a focus on quality to build resilient portfolios.
Asia high-yield (HY)	▲	Asia high-yield offers attractive carry and we gain exposure through a diversified quality-focused approach. Short-dated HY offers more resilient returns.
Commodities		
Gold	►	Gold is favoured as geopolitical tensions and market volatility continue but prices are high and real yields have been rising.
Oil	►	High price levels reflect supply concerns but demand is starting to decline.

Sector Views

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

Sector	Global	US	Europe	Asia	Comment
Consumer Discretionary	►	►	►	►	Inflation, labour shortages, persistent supply chain issues and geopolitical tensions limit the sector's recovery. Pent-up demand provides some room for optimism with many companies raising prices to recover higher input costs (Q1 results). Unless inflation can be contained soon, rising cost of living may start to soften demand.
Financials	▲	▲	▲	▲	As inflationary pressures increase, rate-rise expectations support banking stocks. In Europe and Asia, low valuations, robust capital markets activity, rising insurance premiums and thriving mortgage loans are drivers. In contrast, US financials are trading at a significant premium to their peers after many quarters of strong results.
Industrials	▼	►	▼↓	▼	Slowing growth and rising input costs (commodities, labour and energy) weigh on profits and sentiment, accelerating the trend for greater automation. Supply chain issues persist from multiple causes. Valuations have declined, but given the greater challenges now faced in the region, we downgrade European Industrials.
Information Technology	▲	▲	►	▲	The slowing growth in the US, China and Europe pose challenges. Valuations remain elevated but are no longer rich. We remain positive as digitalisation, electrification and automation should drive long-term, above average growth for the next decade. We focus on companies with strong cash-generative businesses.
Communication Services	▲	▲	►	►	The sector benefits from increased data usage as more activity shifts on-line and business digitises. The 5G roll-out is positive for telecom equipment providers but neutral/negative initially for service providers. As the 5G roll-out in Asia is well advanced, we see fewer opportunities in the region.
Materials	▲	▲	▲	►	Despite slowing growth in China, under investment to increase capacity to meet surging demand as economies reopen, as well as ongoing geopolitical instability will drive commodity prices. Valuations appear attractive. In contrast, the outlook for chemical and cement stocks is more mixed given rising feedstock and energy prices.
Real Estate	►	►	►	►	Private residential real estate is seeing strong demand supported by high savings rate and lower interest rates. Commercial real estate is suffering low demand as corporates look to reduce office space and retail moves online.
Consumer Staples	►	►	►	►	The sector contains many quality stocks with good dividend yields. However, valuations are somewhat elevated, so a selective approach focusing on quality stocks with strong brands and/or pricing power is important. This will enable them to protect margins and earnings as inflationary pressures mount.
Energy	▲	▲	▲	▲	Geopolitical uncertainties, low inventories and supply-demand imbalances continue to drive prices higher. We expect energy prices to either stabilise at these elevated levels or push higher. Chronic under-investment is likely to support prices in the medium term despite the energy transition gaining momentum.
Healthcare	▲↑	▲	▲↑	►	Pharma stocks are characterised by strong cash flows and resilient business models. While medical technology sector should benefit from pent-up demand for elective surgical procedures in 2022/23, the biotechnology sector provides more speculative investment opportunities with their innovative medicines.
Utilities	▼	▼	►	►	Renewable stocks are gaining attention after stock prices and valuation pulled back significantly from overly optimistic levels. Caution is still required as companies may not be able to pass on rising energy prices which may impact margins negatively.

Important information

The contents of this document may not be reproduced or further distributed to any person or entity, whether in whole or in part, for any purpose. All non-authorized reproduction or use of this document will be the responsibility of the user and may lead to legal proceedings. The material contained in this document is for general education information purposes only and is neither intended as, nor does it constitute, advice or a recommendation to buy or sell investments, as defined by the US Securities and Exchange Commission. For individualized tailored recommendations based on your needs or objectives, please contact your financial professional directly for more information.

Some of the statements contained in this document 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. We 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 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 herein are those of HSBC Global Asset Management Global Investment Strategy Unit and HSBC Securities (USA) Inc. at the time of preparation, and are subject to change at any time. These views may not necessarily indicate current portfolios' composition. Individual portfolios managed by HSBC Global 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 is not a reliable indicator of future performance while 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. Mutual fund investments are subject to market risks, read all related documents carefully.

Please consider the investment objectives, risks, charges and expenses carefully before investing. The prospectus, which contains this and other information, can be obtained by calling an HSBC Securities (USA) Inc. Financial Consultant or call 888-525-5757. Read it carefully before you invest. Bonds are subject generally to interest rate, credit, liquidity and market risks. Investors should consider the investment objectives, risks and charges and expenses associated with bonds before investing. Further information about a bond is available in the issuer's official statement. The official statement should be read carefully before investing.

Investment, annuities, and variable life insurance products are offered by HSBC Securities (USA) Inc. ("HSI"), member NYSE/FINRA/SIPC. In California, HSI conducts insurance business as HSBC Securities Insurance Services. License #: **OE67746**. HSI is an affiliate of HSBC Bank USA, N.A. Whole life, universal life, term life, and other types of insurance are offered by HSBC Insurance Agency (USA) Inc., a wholly owned subsidiary of HSBC Bank USA, N.A. Products and services may vary by state and are not available in all states. California license #: **OD36843**. **Investments, Annuity and Insurance Products: Are not a deposit or other obligation of the bank or any of its affiliates; Not FDIC insured or insured by any federal government agency of the United States; Not guaranteed by the bank or any of its affiliates; and subject to investment risk, including possible loss of principal invested.**

All decisions regarding the tax implications of your investment(s) should be made in consultation with your independent tax advisor.