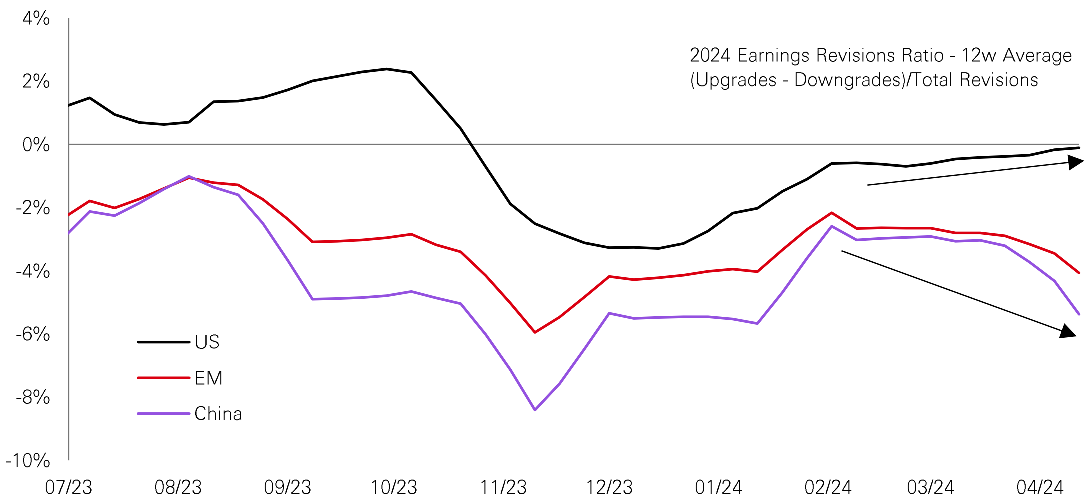
Investment Weekly

29 April 2024

Chart of the week – Diverging earnings momentum



Investor sentiment continues to be hobbled by a higher-for-longer US interest rate outlook. **This makes this Q1 earnings season especially important**. On this front, results have been mixed so far, with Q1 EPS growth now expected at just 0.5% year-on-year, lower than the 3.4% predicted as recently as last month. It's still early days and a lot will hinge on the performance of the 'Magnificent Seven' technology mega-caps.

US profits expectations for the full year 2024 have been on an improving trend over the past few months. This has come amid ongoing economic resilience. And analysts expect EPS growth to become less dependent on the big tech names as the year progresses.

Most EM stock markets have seen a downward trend in earnings revisions. This divergence reflects the strain of higher-for-longer Fed rates, as well as FX volatility caused by the strong US dollar. Add to that mainland China's macro challenges, which are still dragging on regional sentiment, it's no wonder analysts have been cooling on the outlook.

But it's not all bad. Q1 earnings in Asia have so far modestly surprised to the upside. Trade flows are improving amid a recovery in chip demand. And policy support in mainland China is showing signs of success. If that continues, the earnings outlook can stabilise.

Gold is Shining →

Exploring the drivers behind the recent winning streak in the gold price

Return of the 60/40 →

How a classic diversified strategy could still be working for investors

Asia Rates Outlook →

What Indonesia's surprise rate hike means for policy across Asia

Market Spotlight

Frontier resilience

Frontier market stocks have been caught up in the global equity sell-off this month. Nevertheless, the drawdown has been relatively minor (-4%) despite the prospect of higher-for-longer US rates weighing on performance.

One possible reason for this is that the frontier basket benefits from low intra-country correlations. This implies diversified performance and lower volatility. Frontier markets are generally dominated by domestic investors with idiosyncratic local issues also driving sentiment, and are relatively under-owned by global investors (and seemingly undervalued).

But that's not all. Correlations vis-a-vis EMs and DMs are also low, making exposure a potential source of portfolio diversification. Frontiers are also some of the world's fastest growing economies – including Asian giants such as the Philippines and Vietnam (22% and 16% of MSCI Frontier Emerging, respectively). The former is expected to see further benefits from 'friend-shoring', while the latter is expected to lead the way in Asia's policy easing cycle.

The value of investments and any income from them can go down as well as up and investors may not get back the amount originally invested. Past performance does not predict future returns.

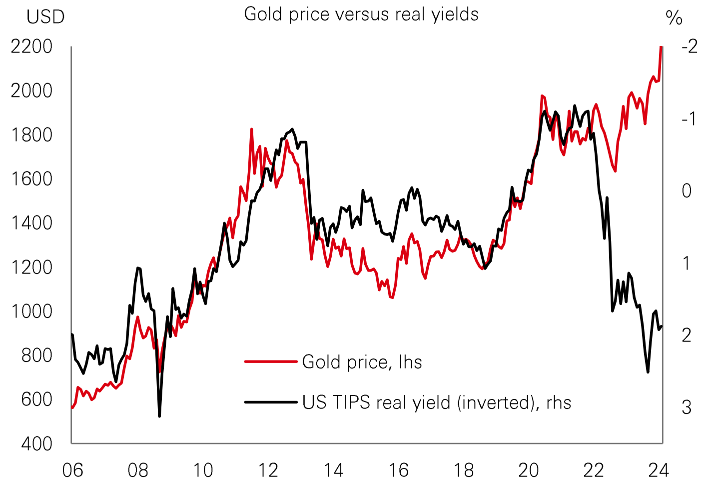
Source: HSBC Asset Management. Macrobond, Bloomberg. Data as at 11.30am UK time 26 April 2024.

All that glitters

Gold has broken higher since the start of March, rising by as much as 15%. Renewed concern about persistent inflation is likely to have played a role, given that gold has historically been an inflation hedge. But gold also tends to benefit from investor anxiety, which has been rising on recent geopolitical tensions.

On a more structural basis, gold has done well recently as investors confront longer-term challenges such as climate change, economic fragmentation, and resource nationalism – which are all inflationary and raise economic uncertainty. We have also seen major EMs diversify their FX reserves away from dollar-denominated assets amid geopolitical tensions and discomfort with the US fiscal position.

One consequence of these developments is that the historically close inverse correlation between the gold price and real US Treasury yields has, for now, broken down. This is one reason to be cautious on the yellow metal even if it is likely to remain in favour by investors looking for a potential portfolio hedge in the 'multi-polar world'.

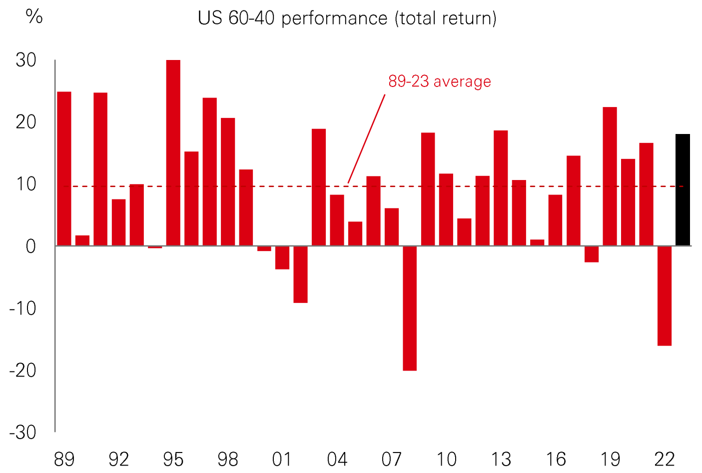


Putting cash to work in portfolios

The classic 60/40 stock-bond portfolio – which balances upside exposure to equities with the downside protection of bonds – has been a historically reliable way of delivering solid risk-adjusted returns. But it stopped working in 2022, as the two usually uncorrelated assets both fell. Amid elevated inflation and an uncertain outlook, the risk of persistently high stock-bond correlations has been cited as a reason to give up on the strategy.

But its death seems greatly exaggerated. Last year, the 60/40 saw a solid gain of 18% on a total return basis and is up year-to-date. In part, that's been driven by a rebound in stocks. But with the market pricing-in a higher-for-longer rates outlook, bond yields remain elevated. This makes the income component from bonds a meaningful source of returns in the mix.

And if we get an adverse growth shock or policy rate cuts, there is potential for capital gains from bonds. What will be crucial, however, is further progress on disinflation. This would bring back the idea of central bank 'policy puts' that can lower the stock-bond correlation.

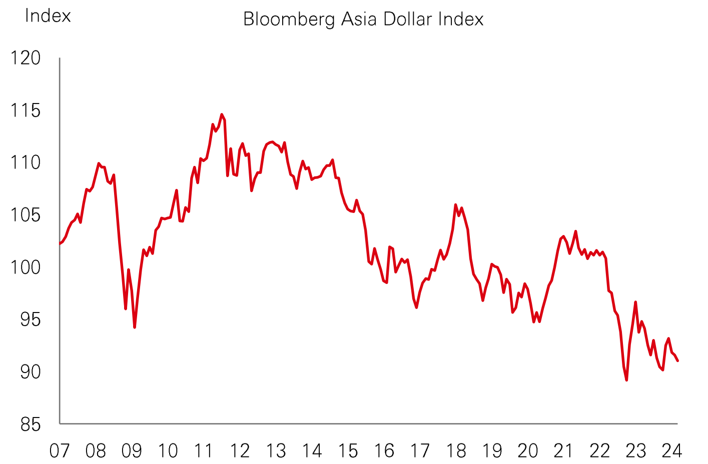


Surprise in Indonesia

Against a backdrop of a growing number of global central banks cutting interest rates, headlines about a surprise rate hike in Indonesia last week were attention-grabbing. Bank Indonesia Governor Warjiyo justified the decision to raise interest rates to 6.25% as a response to "worsening global risks" and as a "pre-emptive and forward-looking" measure to assert inflation control.

Across Asia, the key macro discussion is about the implication of higher-for-longer US interest rates and the stronger oil price. A hawkish Fed and 'king dollar' push Asian currencies lower and casts doubt over any rate cutting cycle.

Recent data in Asia have shown some modest inflation surprises, and favourable base effects are set to fade during Q2. That means that there is little urgency for Asian central banks to follow the lead of the LatAm and East European early rate cutters. Crucially, last week's BI move shouldn't be seen as a turn in strategy back to rate hikes; that's not warranted on growth and inflation trends. Instead, the Asia rate cut cycle looks delayed and, when it comes, could be shallower than analysts had assumed.



Past performance does not predict future returns. The level of yield is not guaranteed and may rise or fall in the future.
Source: HSBC Asset Management. Macrobond, Bloomberg. Data as at 11.30am UK time 26 April 2024.

Key Events and Data Releases

Last week

Date	Country	Indicator	Data as of	Actual	Prior
Mon. 22 April	CN	Loan Prime Rate (1yr)	Apr	3.45%	3.45%
	MX	IGAE Economic Activity Index (mom)	Feb	1.4%	-0.9%
Tue. 23 April	EZ	HCOB Eurozone Composite PMI	Apr (P)	51.4	50.3
	US	S&P Global Composite PMI	Apr (P)	50.9	52.1
	IN	Composite PMI	Apr (P)	62.2	61.8
Wed. 24 April	GE	IFO Business Climate Index	Apr	89.4	87.9
Thu. 25 April	US	GDP (q-o-q annualised)	Q1	1.6%	3.4%
	TK	Turkey Central Bank Interest Rate Decision	Apr	50.0%	50.0%
Fri. 26 April	JP	BoJ Monetary Policy Meeting	Apr	0.10%	0.10%
	US	Core PCE Deflator (y-o-y)	Mar	-	2.8%

P – Preliminary, Q – Quarter **EZ – Eurozone, TK – Turkey, IN – India, GE – Germany, CN – China, MX – Mexico, JP – Japan**

The week ahead

Date	Country	Indicator	Data as of	Survey	Prior
Mon. 29 April	US	Q1 US earnings			
Tue. 30 April	JP	Industrial Production (mom)	Mar (P)	3.5%	-0.6%
	CN	Official Manufacturing PMI	Apr	50.3	50.8
	EZ	Eurozone CPI (y-o-y)	Apr (P)	2.4%	2.4%
	EZ	Eurozone GDP (q-o-q)	Q1 (P)	0.2%	-0.1%
	US	Employment Cost Index (q-o-q)	Q1	1.0%	0.9%
	US	Conference Board Consumer Confidence Index	Apr	104.1	104.7
	MX	GDP (q-o-q)	Q1 (P)	-	0.1%
Wed. 1 May	US	ISM Manufacturing Index	Apr	50.1	50.3
	US	FOMC Interest Rate Decision	Jun	5.50%	5.50%
Fri. 3 May	EZ	Eurozone Unemployment Rate	Mar	6.5%	6.5%
	US	Change in Non-Farm Payrolls	Apr	250k	303k
	US	ISM Services Index	Apr	52.0	51.4

P – Preliminary, Q – Quarter **CN – China, EZ – Eurozone, IN – India, MX - Mexico, JP – Japan**

Source: HSBC Asset Management. Data as at 11.30am UK time 26 April 2024.

Market review

Rising US inflation worries weighed on core government bonds, with risk markets resilient and the DXY index softer. The US core PCE deflator surprised on the upside in Q1 2024, reinforcing the current market narrative of higher-for-longer US rates ahead of FOMC meeting this week. US equities posted decent gains in choppy trading amid mixed Q1 earnings. The Euro Stoxx 50 index eked out small gains on improving sentiment towards the eurozone economy. Broad-based yen weakness boosted the Nikkei as the BoJ left policy on hold in April, with the FY24 inflation forecast upgraded to 2.8%. In EM, the Shanghai Composite index fell modestly amid lingering economic concerns in China, but India's Sensex remained in positive territory. In commodities, oil snapped a two-week losing streak on persistent supply concerns. Easing geopolitical concerns weighed on gold.

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