HSBC

Video Transcript

HSBC IO Q2 2022 – March 2022 (Issued 23 March 2022)
Willem Sels Video

Global equity and bond markets have had a very challenging first quarter. Inflation has risen more sharply than most economists expected, which has caused markets to anticipate more rate hikes from the Fed and from other central banks.

And on the growth side supply chain bottlenecks still pose problems, and the re-opening has had its ups and downs. And in recent weeks, the tragic events in Ukraine have hit investor confidence and exacerbated the existing concerns over global inflation and growth.

Now, in light of all of this, our investment strategy has evolved over the past three months to make our portfolios even more resilient to volatility and uncertainty.

But we remain invested because we believe that the fundamentals are still generally supportive. First, we think that we're still in the mid-cycle rather than at the end of the cycle, because inventory rebuilding, consumption and investment will prolong the economic cycle.

We would therefore consider the short term weakness in the economic data that we're likely to see as a mid-cycle slowdown, and even in Europe, which is more vulnerable to the conflict and energy supplies we do not expect to go into recession.

So within our neutral allocation to global equities, we underweight Eurozone stocks and overweight the US and Asia, and we balance the sector views to be neutral on cyclicality.

The second key market driver is inflation, which will be driven up even further by commodity prices, peak later and then fall less sharply than previously expected, and that will force central banks to hike in spite of the global uncertainties, create volatility around central bank meetings and support the US Dollar and commodity currencies.

But a positive for markets is that a solid number of rate hikes are already priced in, so combining our views on growth and on inflation, we don't think that investors should position for recession or stagflation scenarios.

We continue to believe that companies' earnings outlook is benefiting from the economic re-opening and the fundamental outlook for equity markets and credit is healthy.

But it's clear that the conflict and the uncertainty around the timing of rate hikes creates scope for continued volatility, and the result, in our view, is that we need to be invested but in resilient portfolios that can weather volatility.

And we do this by introducing our 3x3 strategy.

First, we focus on quality earnings whilst we take some artistic freedom to redefine the concept.

So typically, quality refers to companies with strong margin power and healthy balance sheets. But we also think that companies that align closely to our high conviction themes should continue to see strong structural demand for their products and services.

And lastly, it's clear that ESG aspects influence whether a company's business model is futureproof. And there's been recently a great focus on corporate responsibility.

Now, the second aspect of our 3x3 strategy is the search for income. And it's not just because most investors do need income from their portfolio, but also because income is generally more stable than price appreciation and can therefore lead to some stabilisation of portfolio returns.

Now, of course, we can find income in the bond markets and we currently overweight investment grade, high yield and EM hard currency corporate bonds.

Given the uncertain rate outlook, of course, we keep duration short. And we complement the search for income through dividend stocks, which are often less volatile than aggregate market indices, and often are value-style stocks, and thereby helping balance the value versus growth exposure.

And lastly, we point out that the high implied volatility in the markets can help investors generate more income too, whilst often also providing some level of protection.

Now, the third element of our 3x3 strategy is diversification, which remains key to portfolio resilience.

Now, correlations between equities and bonds are higher than the historical average, but any asset class that is not perfectly correlated with stocks, of course, still provides a degree of diversification. And therefore we advocate broad based exposure starting from our strategic asset allocation, which also includes gold and other alternatives.

Hedge funds currently form our biggest overweight due to their non directional nature and because they can find opportunities in volatile times.