

HSBC Global Private Banking – November 2022 Monthly View

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As we look into 2023 and consider the implications of the big sell-off this year, it is clear that cash rates, bond yields and equities' earnings yields have all risen considerably. But the risk-return profile of bonds looks much more attractive to us than that of equities. Bond markets now price in most of the interest rate hikes we expect and we are pleased that they no longer price in any significant cuts in 2023. In fact, the 4.6% Fed funds rate level that markets now price in for December 2023 is exactly the same as what Fed members themselves are forecasting. So we should be close to peak rates, and if central banks were to surprise with even more hikes, we think that the damage to high grade bonds would be limited, because markets are already quite worried that the spike in mortgage and corporate bond yields will hurt economic growth. In other words, the countercyclical nature of high quality bonds should protect bond investors from here. As we already stated last month, the attention of markets is increasingly focused on downside risks to growth, and this is why we increase our overall allocation to bonds to overweight, maintaining our preference for investment grade over high yield.

Now, in equities, we've seen markets like the US consolidate around the June lows. We already hold a small underweight in global equities, we're focused on quality and have a defensive sector stance. But given the economic slowdown and the quick fall in consensus earnings forecasts, we increase the extent of that underweight. The Q4 and Q1 earnings seasons could be difficult given challenging comparables. We're cutting South Korea to underweight, largely because of the challenges to the technology cycle and move Indonesian stocks to overweight. And we prefer the more defensive ASEAN region compared to North Asia. We also cut Canada back to neutral given that support from commodities is fading and the housing market slows. While we're reducing the US weight somewhat, it remains our main overweight allocation. When you add it all up, it's quite simple: we use the underweight in global equities to fund an overweight in high quality bonds and hedge funds.

We've already set out the case for bonds. As for hedge funds, we think they will continue to benefit from the high volatility, which creates relative value and income opportunities. And we'd also like to point out that many hedge fund strategies which use futures contracts, can now earn higher income on the cash they hold, raising their return potential. Bonds' diversification benefits should improve as the cycle slows, and by combining it with hedge funds, we should be able to build very well diversified portfolios, allowing us to remain invested.