HSBC
Private Banking

Volatility, but key conditions for a major global correction are not met, says HSBC Private Banking

10 October 2018, Geneva – Despite the volatility and partial reversal of asset price inflation that have marked 2018 so far, only two of four key conditions for the start of a large global correction are met, says HSBC Private Banking in its Investment Outlook for Q4. It says that opportunities remain within a well-diversified portfolio.

Willem Sels, Chief Market Strategist, HSBC Private Banking explains:

"The end of QE, the tightening of monetary policy and worries over the direction trade tariffs against China will take, are all valid investor concerns. At the start of the year they certainly caused us to predict the volatility we are continuing to see. But while markets are right to price in rate hikes and the end of QE in the US, they should not exaggerate other risks."

"The kind of contagion that could trigger a sustained sell-off has not happened: it has been largely limited to Emerging Markets, and within Emerging Markets we think it has been too indiscriminate."

"Moreover, there has been no negative feed-back loop between markets and the global economy. Weaker markets have not led to weaker growth. In our view, global growth remains resilient, and it is this, and what happens to China and its currency that are the crux."

"At this point, we continue to expect stable global growth in 2019. We expect only a mild slowdown in China; its largely domestic economy is supported by structural growth factors, and can be supported by monetary and fiscal stimulus if needed. In our view this justifies a small, selective overweight in equities as we do not believe that the equity bull market is finished yet."

Summary of our views: four market concerns

1. Lower global liquidity, higher US rates and stronger USD

Our view is that this is a valid concern, leading to market re-pricing of those assets most inflated by QE. But most US rate hikes are already priced in.

Investment implications: USD may appreciate further, but more slowly than before. We are underweight non-USD investment grade bonds and cut Emerging Markets bonds to neutral earlier this year. A selective approach is needed in Emerging Markets, with a focus on those markets which are fundamentally more resilient.

2. Uncertainty around trade tariffs and sanctions

Our view is that uncertainty is likely to remain.

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Investment implications: globally, market upside is limited, and we have reduced our exposure to market direction. We have increased relative positioning, and believe active management approaches should benefit from volatility, which may remain elevated.

3. Emerging Markets broad-based sell-off

Our view is that the sell-off is too indiscriminate, as the issues in most cases are idiosyncratic and not systemic.

Investment implications: we take a selective approach to Emerging Markets, based on our assessment of how sensitive each market is to the impact of trade restrictions and lower liquidity, favouring Chinese, Indian, Malaysian and Mexican stocks, as well as defensive bond markets (China, South Korea, GCC), especially for those who can stomach short term volatility. Chinese growth should continue and become an anchor for the region's Emerging Markets later in the year. We continue to see attractive long term opportunities in Emerging Markets.

4. Concern over economic growth

Our view is that although some data have slowed, growth prospects remain healthy, especially in the US. Earnings growth is supportive of global markets.

Investment implications: we maintain a small overweight to equities, and prefer it over credit, which is more impacted by liquidity-driven re-pricing. Uncertainty favours quality stocks, but as the cycle continues, we do not move to an outright defensive position. We favour the US over other regions, and our preferences include a few cyclical sectors, including financials and consumer discretionary in the US, and some structural themes, such as healthcare technology, fintech and the electric revolution.

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