

Global Investment Views

Mixed economic outlook - pace of recovery likely to ease



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Overview

- ▶ From a macroeconomic perspective, there is further evidence of recovery across a number of countries, primarily in emerging market economies, which are likely to continue to lead the global turnaround. However, there are signs that leading economic indicators have now peaked in most markets, thus raising doubts on how long the recovery will last.
- ▶ Furthermore, rising public debt in developed economies, with Greece dominating the news flow over the month, may weigh on the outlook for economic growth, as government may need to curb public spending to maintain their credit quality. These concerns, combined with the potential acceleration of monetary tightening in China and India, adds to the challenges that still face a sustainable robust recovery.
- ▶ As a result of valuation and growth concerns, we maintained our preference for defensive sectors, such as healthcare and telecommunication services, over financials and cyclical stocks.
- ▶ Among emerging markets, we continue to see potential in Turkish equities. Turkey has been experiencing significant volatility as a result of, among other things; political turmoil around revelations planned military coup in 2003. However, the risks seem to be largely priced in, making valuations highly attractive, as Turkey has underperformed emerging markets overall. Furthermore, regarding Latin American equity markets, we maintain our positive stance versus Emerging Asian
- ▶ Within fixed income, we maintain our neutral position in government bonds over cash, as valuations for the former reflect the risks of higher issuance and normalisation of monetary policy. From a shorter-term perspective, regarding sovereign debt, while there is concern Greece's credit rating could be downgraded if the government fails to contain Greece's debt, the risks appear to be adequately priced in.
- ▶ For some time, we have held a positive view on corporate bonds, both on investment grade and high-yield debt. The strong performance of these asset classes over the course of 2009 has left valuation levels less appealing. But the current yield spread levels are still attractive relative to history and relative to the very low levels of yields offered by government bonds.
- ▶ We continue to have some conviction on longer term strengthening of the EUR against the GBP. However, we have a neutral near term position on the GBP versus the EUR as Greece's fiscal difficulties create uncertainty for the EUR.

News Release

The Global Investment Views represent the market view of HSBC Global Asset Management. This document offers our view and outlook on stocks, fixed income and currencies.



Stock Markets

US

Mixed Economic Outlook, Easing Pace Of Recovery And Risk Of Negative Earnings Surprises Prompt Cautious View

- ▶ The US outlook remains mixed. There is clear evidence of faster economic growth, but little progress has been made in reducing the deficit and unemployment levels.
- ▶ Also, US leading indicators appear to have peaked, indicating a possible slowdown in the pace of recovery.
- ▶ Turning to corporate news, there was further improvement in the already optimistic earnings growth estimates for 2010. This is also a concern, as it generally increases the chances for negative surprises.
- ▶ On a more positive note, the US Federal Reserve's chairman reiterated that monetary policy will remain accommodative "for an extended period" given the risks to growth.
- ▶ Overall, we retain our moderately cautious view on equities for the US and elsewhere, and maintain our preference for defensive sectors versus cyclical stocks.

Japan

Weak Spending And High Unemployment Mean A Sustainable Recovery May Be Difficult To Achieve

- ▶ The improvement in recent manufacturing and trade activity have been positive, but not sufficient to support a self-sustaining recovery.
- ▶ Consumer spending remains weak and unemployment is still high, adding to the deflation problem in Japan.
- ▶ That said, interest rates have been kept at 0.1% and the government has reiterated its commitment to provide economic support throughout 2010. Therefore, liquidity levels are likely to remain a positive factor in 2010.
- ▶ We maintain a moderately cautious view on the asset class and expect Japan to perform in line with other developed markets. Overall, we recommend an underweight position versus cash.

Europe

Record Unemployment And Weak Consumption Support View Of Anaemic Growth For 2010

- ▶ Elevated levels of unemployment and weak consumption continued to support our view of anaemic Eurozone growth in 2010.
- ▶ In addition, we remain concerned that current valuations reflect an overly optimistic level of economic and earnings growth for 2010.
- ▶ That said, at the recent European Central Bank meeting, interest rates were left unchanged in March at 1% for a ninth month, with comments suggesting they could remain at this level for some time, which is likely to provide liquidity to equity markets.
- ▶ Therefore, given the support from the high level of market liquidity, we recommend only a moderately cautious stance on European equities and maintain our moderate underweight versus cash.

Emerging Markets

Maintain Preference For Latin American And Turkish Equities On Valuation Grounds

- ▶ From a macroeconomic perspective, emerging markets are likely to continue to lead the recovery. That said, regional divergences are apparent.
- ▶ Earnings estimates for 2010 for emerging markets remained optimistic and were revised up further, and now over 30% growth is expected for 2010.
- ▶ Furthermore, emerging market equities are now trading at a 12-month forward PE ratio of 11.6, which is well above the bargain levels seen in early 2009.
- ▶ Therefore, we maintain our moderately cautious view on emerging equities relative to cash, and we expect them to perform in line with their developed peers.
- ▶ At the regional level, we maintain our preference for Latin American equities over emerging Asia. In addition, we continue to like Turkish equity on valuation grounds, while we acknowledge that local political tension is likely to remain a source of volatility.

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Asia ex Japan

Optimistic Earnings Growth Projections And Concern Of Acceleration in Monetary Tightening Represent Risk For Disappointment

- ▶ The outlook for Asia-ex Japan remains positive, with the Consensus Economics 2010 GDP growth forecast standing at 7.9% in February.
- ▶ However, concerns about any acceleration in monetary tightening could rein in the enthusiasm about the current pace of the recovery.
- ▶ The consensus 2010 company earnings growth forecasts rose further, and are now at a particularly optimistic rate of almost 32% y-o-y. Given the risks to global economic growth and consumption, we believe the risk for disappointment persists.
- ▶ Therefore, we maintain a moderately underweight allocation to Asia ex-Japan relative to cash. Even so, liquidity remains highly supportive for equity markets as central banks globally are likely to keep interest rates low for some time.

Eurozone

Retain Preference For Corporate Debt On Valuation Grounds

- ▶ We retain our neutral allocation in Eurozone government bonds relative to cash.
- ▶ Elevated unemployment is keeping a lid on consumption. The February Consensus Economics 2010 forecast for consumption growth in the Eurozone remained weak at 0.2%.
- ▶ Supply concerns could place pressure on Eurozone bond prices, as governments continue to issue record amounts of debt to support their economies. However, these concerns already seem to be largely reflected in bond prices.
- ▶ The market has reacted strongly to the fiscal situation in Portugal, Italy, Greece, Ireland and Spain. Whilst Greece's financial turmoil is likely to generate volatility in markets, currently the concerns appear to be well-reflected in market prices.
- ▶ Overall, within fixed income, given the exceptionally low yields offered by government bonds, our preference remains for corporate debt on valuation grounds.

Interest Rate/Fixed Income

US

Continue To Recommend A Neutral Position In US Treasuries Vs Cash

- ▶ Despite heavy supply, macro-economic headwinds have kept the demand for US government bonds fairly buoyant.
- ▶ We do not expect any changes in the Federal funds rate over the next six months and possibly for longer. Market expectations continued to shift closer to our view.
- ▶ Conditions in the labour market are likely to play a major role in the path of monetary policy over the course of the year. The ongoing weakness is a primary concern and a reason for the Federal Reserve to keep interest rates low.
- ▶ Overall, we continue to recommend a neutral position in US Treasuries relative to cash. However, within fixed-income assets, we prefer to own corporate debt, where we see greater value opportunities.

Investment Grade

Underlying Conditions And The Demand For Yield Remain Supportive For This Asset Class

- ▶ The sovereign risk surrounding Greece and other peripheral Eurozone countries facing fiscal challenges is likely to fuel additional market volatility.
- ▶ However, we do not expect significant contagion to credit spreads as issuers in the periphery of Europe only account for a modest fraction of the total corporate bond market, and are concentrated in the highly-rated utilities and telecom sectors.
- ▶ Furthermore, the major economies' commitment to low and stable interest rates has continued to send capital in search of growth and yield.
- ▶ Overall, valuations are historically attractive, company fundamentals are improving and technical factors should stay supportive of investment grade bonds. Therefore, we maintain our positive view on the asset class.

Interest Rate/Fixed Income

High Yield

Risk-Adjusted Returns Continue To Look Appealing

- ▶ With yields remaining attractive and the risk of a financial system collapse largely in the past, we believe that investors can capture attractive yields in the high yield market with relatively contained default risk.
- ▶ Credit spreads have widened slightly, on a year-to-date basis, by 0.25%. That said, high yield bonds have returned 2.1% since the start of the year “over the same period”. This compares with a fall of 1.7% for global equities. Given the volatility in other riskier asset classes, risk-adjusted returns in high yield bonds continue to look appealing.
- ▶ Besides attractive valuations, the ongoing search for yield by investors is favourable for credit.
- ▶ Overall, we reiterate our positive view on the asset class.

Emerging-Market Debt

Valuations Remain Less Attractive Than High Yield Corporate Bonds

- ▶ The month was characterised by improving macroeconomic news across the emerging-market region.
- ▶ However, rising inflation, especially in Latin America, and increasing concerns over the tightening of monetary policy are less positive elements.
- ▶ Overall, we have not seen major changes relative to the previous month and valuations of emerging-market debt continued to be less attractive than high yield corporate debt.
- ▶ We maintain our negative stance on USD-denominated emerging market debt relative to credit bonds.

Commodity

Oil

Subdued Demand Is Likely To Keep Oil Trading In A Target Range Of US\$65-85, Which We Have Revised Up from US\$60-80

- ▶ Supply and demand dynamics are slowly improving, as are global growth prospects.
- ▶ As such, we have raised our target range for oil from US\$60-80 per barrel to US\$65-85 due to cyclical improvements.
- ▶ Even so, the overall level of economic activity is likely to continue to keep oil demand at subdued levels.
- ▶ Key risks to our central view would include a fall in the USD or disruption to supply. In both cases, it would result in higher prices.

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Further Information

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