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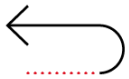
# Playing the Yield



Mid Year Global  
Investment Outlook

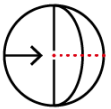
# Bond yields hovering around their highest levels in over 15 years present a unique opportunity to 'play the yield'.

After a rally in risk assets in the first half, we remain cautiously optimistic but think 'playing the yield' is the right strategy now. We prefer a 'defensive growth' stance and focus on these key themes:



## **The return of fixed income**

High yields and potential capital appreciation amid rate cuts and disinflation point to better fixed income returns in the second half. Furthermore, should economic growth disappoint, this should boost bond returns, which could prove important for portfolio resilience.



## **Emerging market leadership**

Valuation discounts and broadening global growth create an opportunity for emerging markets to lead. Individual drivers of economic growth and market returns also mean emerging and frontier markets can provide diversification benefits.



## **Real role for real assets**

Economic shifts and increased geopolitical tensions create a more volatile inflation environment in the medium term. This has profound implications for stock/bond correlations. Real assets can deliver returns and resilience should market volatility re-emerge.

Source: HSBC Asset Management, July 2024. Any views expressed were held at the time of preparation and are subject to change without notice. Diversification does not ensure a profit or protect against loss. This information shouldn't be considered as a recommendation to invest in any of the sectors shown.

**The level of yield is not guaranteed and may rise or fall in the future.**



# What's happened so far this year

We've had negative returns from core fixed income markets due to a reset in interest rate expectations.

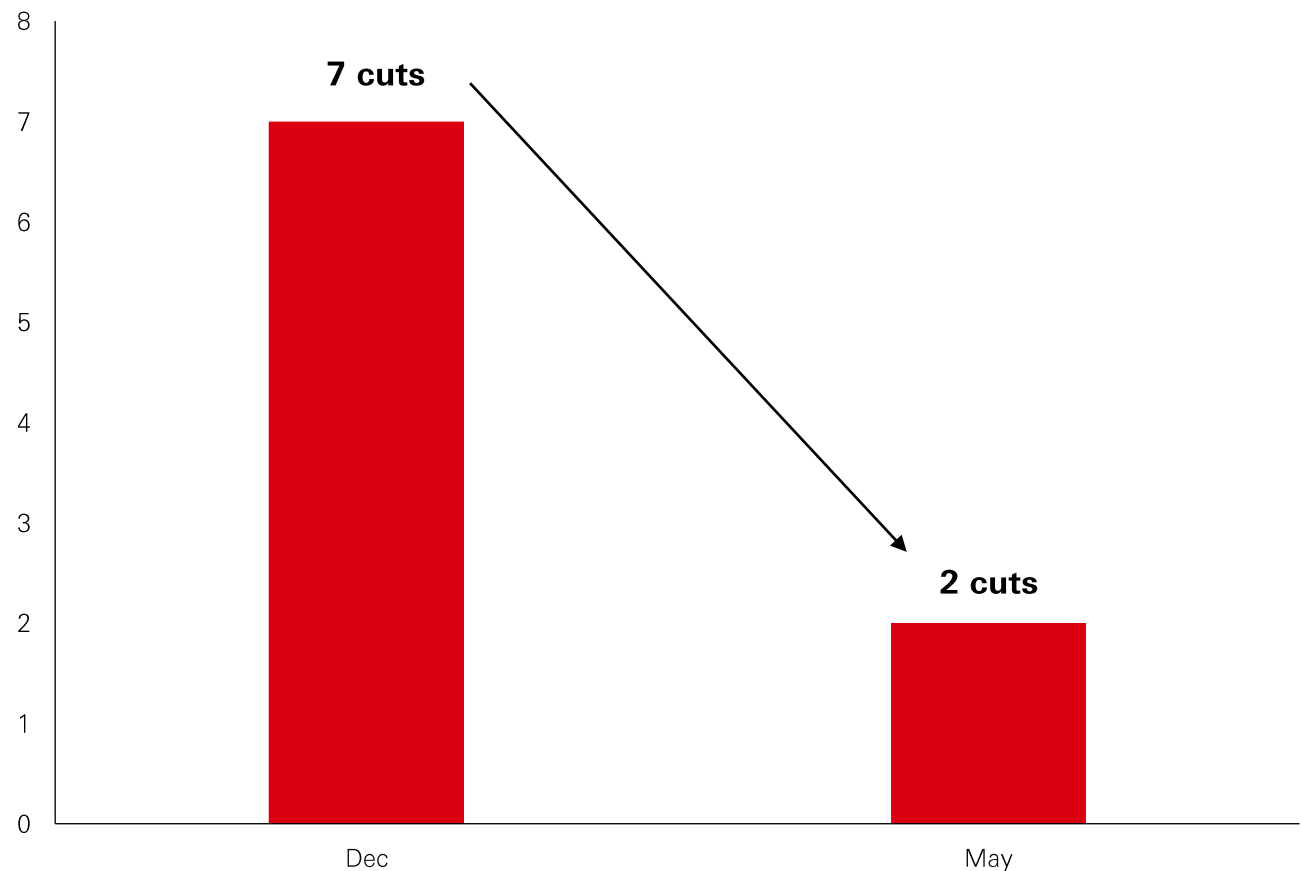
Expected rate cuts in the US, along with Europe and the UK, are now less than a third of what were they were at the end of last year. This has had a big effect on returns for US Treasury bonds and high-quality corporate bonds – given that bond prices rise when interest rates fall, and vice versa.

Global stocks on the other hand, have been driven more by megatrends, such as AI and technology. We've also seen some broadening out, as growth and corporate profits have proven to be resilient following the fastest interest rate hiking cycle since the 1980s.

In emerging markets, we've seen a bit of a reversal – especially since the start of the second quarter. China has rebounded, outperforming India, and Asia has been the strongest region, with Latin America lagging.

The direction of the US dollar will be an important factor for emerging markets assets ahead, with any weakening a potential tailwind. While dollar strength has continued, it's now off of its highs, which may have been a peak if rate cuts from the Federal Reserve materialise.

**Market pricing/expectations of interest rate cuts by the US Federal Reserve, European Central Bank and the Bank of England**



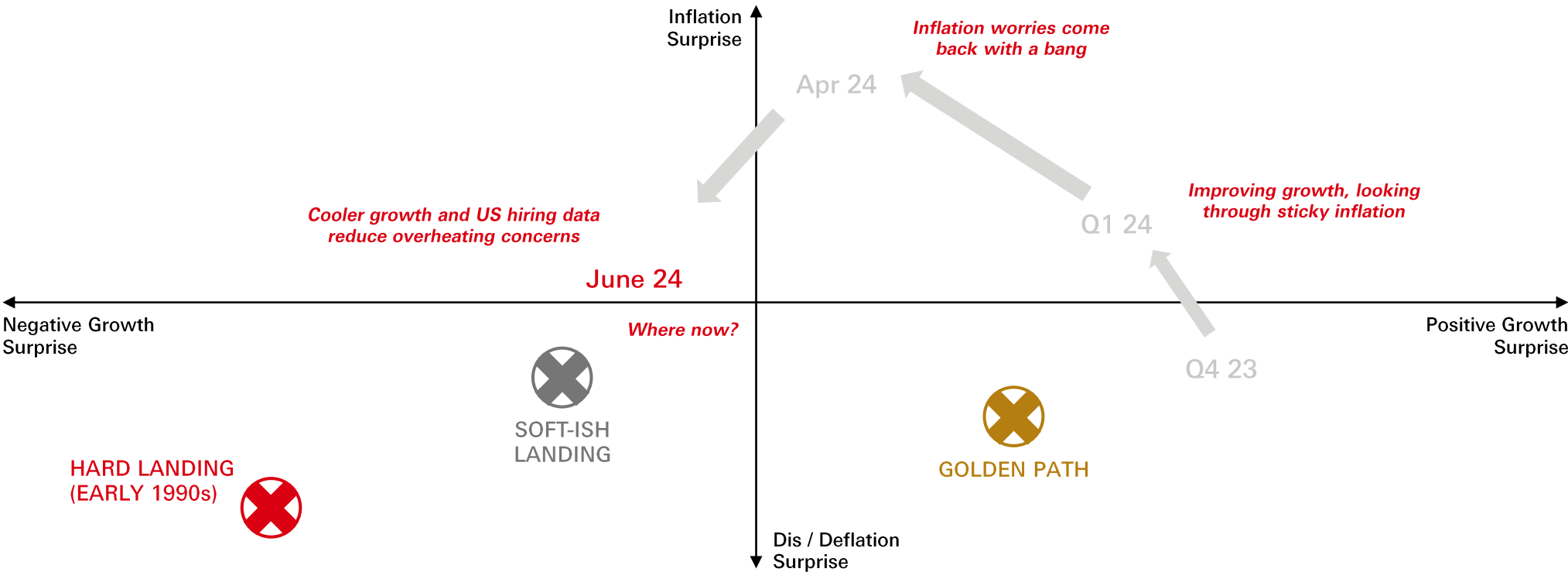
Source: HSBC Asset Management, June 2024. Any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Asset Management accepts no liability for any failure to meet such forecast, projection or target.

# What's next for the economy

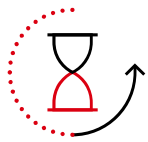
Sticky inflation was a problem for western economies early in the year, sparking the reset in interest rate expectations. However, we see growing evidence that inflation is gradually unsticking itself.

**Our baseline scenario ahead is for a ‘soft-ish’ landing:**

- ◆ Gradual weakening of growth and labour markets, easing inflation
- ◆ Fed to cut rates twice this year, with a severe recession or ‘hard landing’ avoided
- ◆ Not quite as positive an outcome as the golden path, which aligns with current market pricing and relies on factors such as AI boosting productivity



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# Why emerging markets can assume leadership

A soft-ish landing should support further broadening out of market performance. In this scenario, less expensive international stocks can take up leadership from the US. We think emerging markets, where growth has been a bright spot, can perform well.

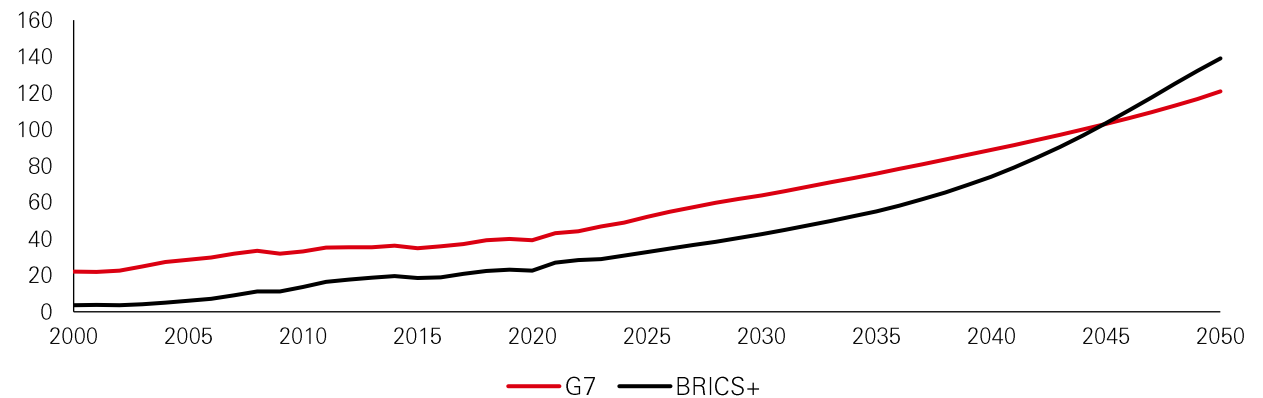
The economic power shift towards Asia and emerging markets is becoming more pronounced. India, for instance, remains the fastest growing major economy in the world. A good mix of growth and disinflation, strong profits, a young and growing population, plus megatrends around the digital economy and infrastructure bode well for longer-term performance.

Separately, there are clear challenges to growth in developed markets. A reliance on inexpensive labour and raw materials was helped by the trend of globalisation over past decades. Although not completely reversing, this trend has stalled into what can now be described as 'slowbalisation'.

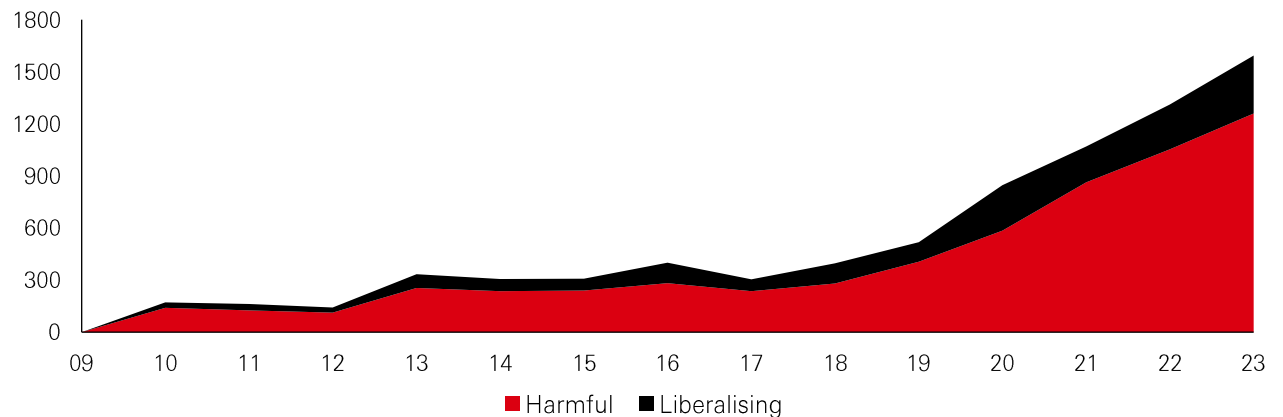
Supply limitations could result in higher inflation and lower potential output in the years ahead. As protectionist measures rise, investors must recalibrate their strategies to account for heightened volatility and divergent country dynamics. This is a key part of our defensive growth positioning, in which real assets and total returns from bonds play an important role.

## Rising global weight of emerging economies

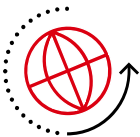
Nominal GDP; USD trillion



## Trade interventions per year



Source: HSBC Asset Management, EIU data, Global Trade Alert database, May 2024.



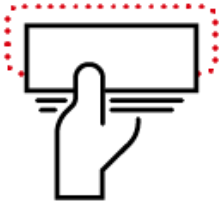
# Pursuing ‘defensive growth’

Even with a soft-ish landing, the combination of cooling demand, weaker profits and modest rate cuts could be a tricky situation for risk markets to navigate.

Although the extent of the rate-cutting path through to the end of the year is uncertain – and will be more modest than expected at the start of the year – the procession of rate cuts that has already started in several markets will gain steam.

This means that interest gained on cash is set to diminish. Bonds, on the other hand, will benefit from capital appreciation as interest rates decline. Locking in the high yields on offer with potential capital appreciation ahead presents a compelling option for putting cash to work, while maintaining some protection should economies and risk assets stumble.

We emphasize putting cash to work in fixed income



Estimated 12m total return under different US government bond yield changes

	300bps	100bps	50bps	-50bps	-100bps	-300bps
2yr	-0.3%	3.1%	4.0%	5.8%	6.7%	10.4%
5yr	-7.3%	0.3%	2.4%	6.6%	8.8%	18.3%
10yr	-15.5%	-3.0%	0.6%	8.3%	12.4%	30.9%
20yr	-23.3%	-6.9%	-1.5%	11.1%	18.2%	52.2%
30yr	-25.6%	-9.4%	-2.9%	12.8%	22.1%	68.9%

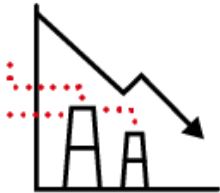


Return potential is asymmetric – rate cuts should generate larger gains than estimated losses from any further rise in rates.

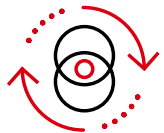
Looking longer term, geopolitical factors look set to increasingly influence market dynamics. We’ve recently seen volatility flare up after elections in both developed and emerging markets. The upcoming US election could bring more, while a new multi-polar world – one in which global powers increasingly jockey for control – has meant less global cooperation, with negative implications for supply chains and growth dynamics.

This signals a shift to an era with more volatile inflation, lower potential growth and inconsistent stock/bond correlations. Real assets, such as those tied to infrastructure or nature, can offer defensive qualities and stable returns amid fluctuating bond yields. Growing development needs, particularly in fast-growing Asia and also connected to the net-zero transition, mean massive infrastructure investment is needed. This heightens the value and importance of infrastructure assets.

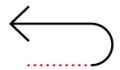
Real assets support portfolio defence and can benefit from the net-zero transition



Source: Bloomberg, HSBC Asset Management, May 2024. Any forecast, projection or target where provided is indicative only and not guaranteed in any way. HSBC Asset Management accepts no liability for any failure to meet such forecast, projection or target. The level of yield is not guaranteed and may rise or fall in the future. Past performance does not predict future returns.



# Portfolios taking shape



## Return of fixed income

US treasuries and UK gilts look appealing, and should grow deteriorate and result in a more aggressive pivot by central banks, impressive returns could be realised. Yields and total return potential is also relatively high in investment grade and high-yield bonds, while resilient growth and corporate balance sheets are keeping default projections contained.

Emerging markets bonds have shown impressive resilience in the face of higher-for-longer interest rates, China growth challenges and a stronger dollar. We expect emerging market central banks in Latin America and Europe to continue leading the global easing cycle, supporting our positive view. However, divergence in central bank policies means assessment of currency risks and rate differentials is important.

We expect modest dollar depreciation in the second half of the year, which is broadly supportive for emerging market assets, and Asia in particular. Asian high yield is a sub-segment we remain positive on after its turnaround this year amid China policy support and strong regional growth prospects.

### Past performance is no guarantee of future returns.

Returns are for market indices and do not reflect any fees or currency considerations. Source: Macrobond, Bloomberg, HSBC Asset Management, June 2024.

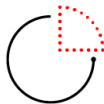


## Divergence in equities

US outperformance has led to high valuations, with a scenario better than a soft landing priced in. Today's opportunity looks to be more in international stocks.

We continue to like the low valuations, economic recovery story and long run corporate reform theme in Japanese stocks, for example. Separately, profits growth expectations look beatable in Europe, where stocks are trading at a price-to-earnings discount more than twice the historic norm.

In emerging markets, we emphasise Asia with its encouraging growth outlook. Importantly, given the potential for increasing economic divergence that we have highlighted, emerging market stocks also offer diversification benefits to portfolios.



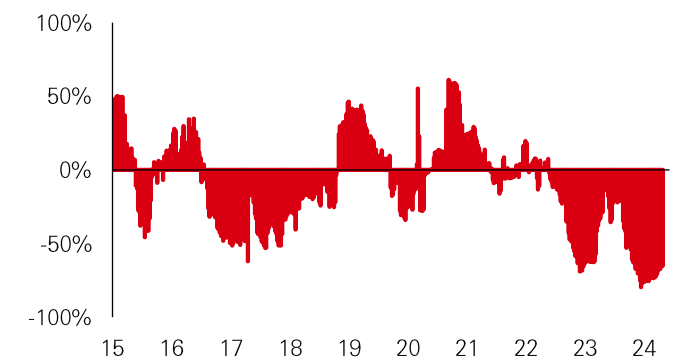
## Real assets for resilience

Given the new geopolitical and economic regime, we don't expect a return to reliably negative stock/bond correlations. This new regime unfortunately points to higher portfolio volatility and lower longer-term return

potential. To improve portfolio outcomes, we suggest prioritising allocations to alternative diversifiers, which can reduce volatility while enhancing returns.

Infrastructure equities offer an example and currently trade at an unusual discount to global stocks. They have historically delivered positive returns across inflation regimes, with good reason. Infrastructure assets, which include railroads, airports and water treatment facilities, to name a few, play a vital role in economies and generate cashflows independent of economic cycles.

### Unlike broader stocks, infrastructure equity has negative correlation with US government bonds



■ 26-week rolling correlation Dow Jones Brookfield Global Infrastructure Total Return Index versus US 10-year Treasuries



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