2022 Investment Outlook

December 2021

The price of success

HSBC Asset Management

Opening up a world of opportunity

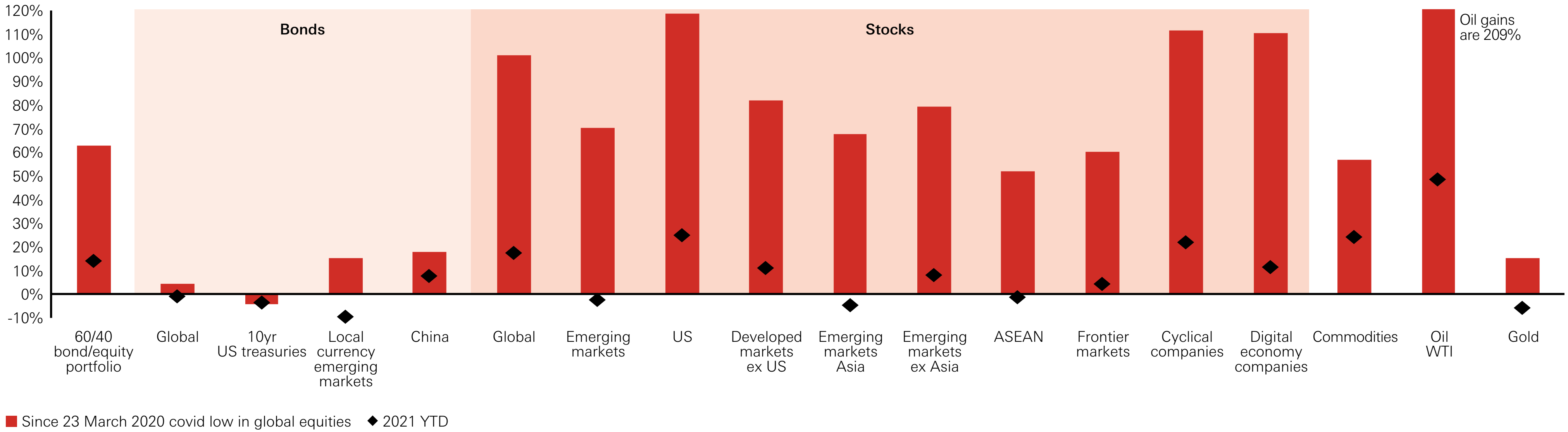
Three wins

Over the past 18 months the world has seen three important successes.

1. Government policy response has been effective in supporting economic growth, innovation of vaccines and new environmental initiatives
2. On the strength of this came the fastest economic recovery on record, with the world's largest economies on track to fully recover the pre-covid growth path by mid-2022
3. Investment markets recovered quickly to reach new highs

These wins are impressive, but come at a price. In 2022, investors face a pay-back period in terms of lower growth, higher inflation, greater uncertainties, more volatility, and reduced expected returns from here.

Market performance



Source: Bloomberg, HSBC Asset Management, December 2021.
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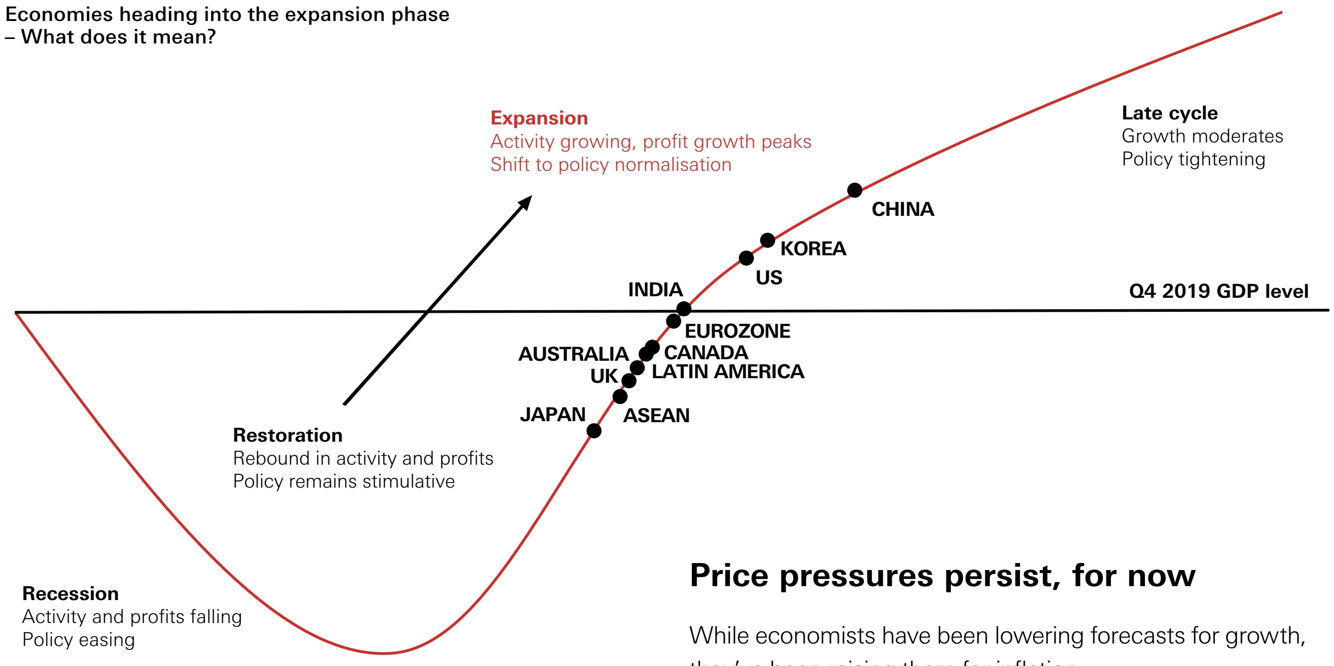
Economies heading into the expansion phase – What does it mean?



"One relative bright spot could be ASEAN, which should see a catch-up phase."

Price pressures persist, for now

While economists have been lowering forecasts for growth, they've been raising them for inflation.

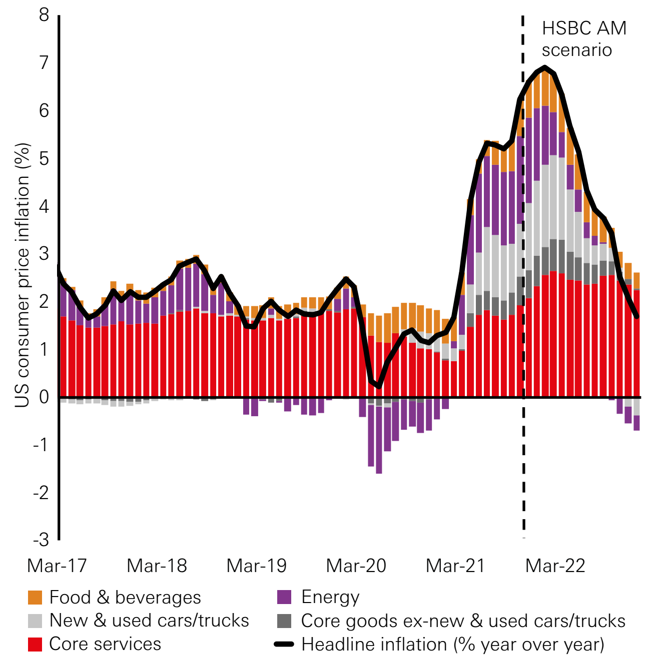
However, many of the temporary factors that are boosting inflation now (autos, energy, housing) should shortly peak, and be softening by the time we get to the middle of the year, with supply chains repaired.

Slower growth

The global economy is now in a phase we have labelled as 'the expansion economy'. Typically, that means we are past peak growth, inflation picks up, and policy support falls away.

One relative bright spot could be ASEAN, which has lagged badly but should see a catch-up phase as economic reopening progresses.

US price pressures have broadened, but are still narrow



Source: HSBC Asset Management, Bloomberg, Macrobond, November 2021.
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Central scenario and risks

	Stalling Growth	Expansion Economy CENTRAL SCENARIO	Sticky Inflation
Macro	**Demand** shocks (covid, policy, confidence) Economic growth trajectory stalls Eventual policy support, but limited in scope	Post-covid recovery continues Inflation shock transitory Gradual return to more normal policy / higher interest rates	**Supply-side** impairment Inflation is persistent and meaningful Faster policy normalisation
Market	Markets are broadly supported by government and central bank action Stock markets sensitive to the business cycle struggle US dollar rallies versus emerging market currencies	Stocks > bonds amid falling unemployment Catch-up potential for stock markets that have lagged Stronger emerging markets performance amid weaker US dollar	Inflation shock results in higher bond yields Equity valuations suffer Stocks with more durable earnings, or profitability resistant to inflation outperform

More uncertainty

The biggest challenge for investors will be navigating the many economic and market uncertainties. While our central scenario is reasonably positive, there are significant risks that something goes wrong on the demand or supply side.

In terms of demand, a negative shock could come from a resurgence of covid impacting consumer confidence and requiring new restrictions. Or, from the possibility of a harsher slowdown in China.

The second risk scenario is that something goes wrong on the supply side. Most saliently, supply chains could take a lot longer to rebuild than we currently assume. Another problem could be a bigger and more protracted impact from distortions in global labour markets.

Lower asset returns

Investors have enjoyed bumper returns over the last 18 months. But it's important to recognise that these returns are, in large part, borrowed from the future. Our measures of asset class expected returns are lower than they were.

That means uncertainty is exacerbated by higher valuations and lower margins-of-safety. We should expect more day-to-day fluctuations in markets. Stock market volatility remains low today, helped by recent good news on the strength of corporate profits. But volatility around assets most sensitive to interest rates is already heading higher and, in emerging markets, we see the highest dispersion of stock returns over the last decade.

What it means for portfolios

Continue to hold stocks

We see a solid investment case for global equities. Stocks typically beat bonds while labour markets are improving. And a mid-cycle market wobble requires a decisive softening of corporate profits, which hasn't happened yet as profit growth continues. Stock pickers can benefit from higher dispersion.

Look at emerging markets, especially for bonds

Parts of emerging markets appeal, especially bonds. The case for owning renminbi bonds over global bonds seems strong – both for superior yield and portfolio diversification. While there are prevalent risks today, the future return profile of Asian corporate bonds looks very attractive versus what we see in the US and Europe, which are more exposed to rising interest rates.

Protect against inflation

Real assets such as property make sense to offer some protection against inflation, as do commodities such as copper which will continue to see growing demand due to its use in clean energy infrastructure.

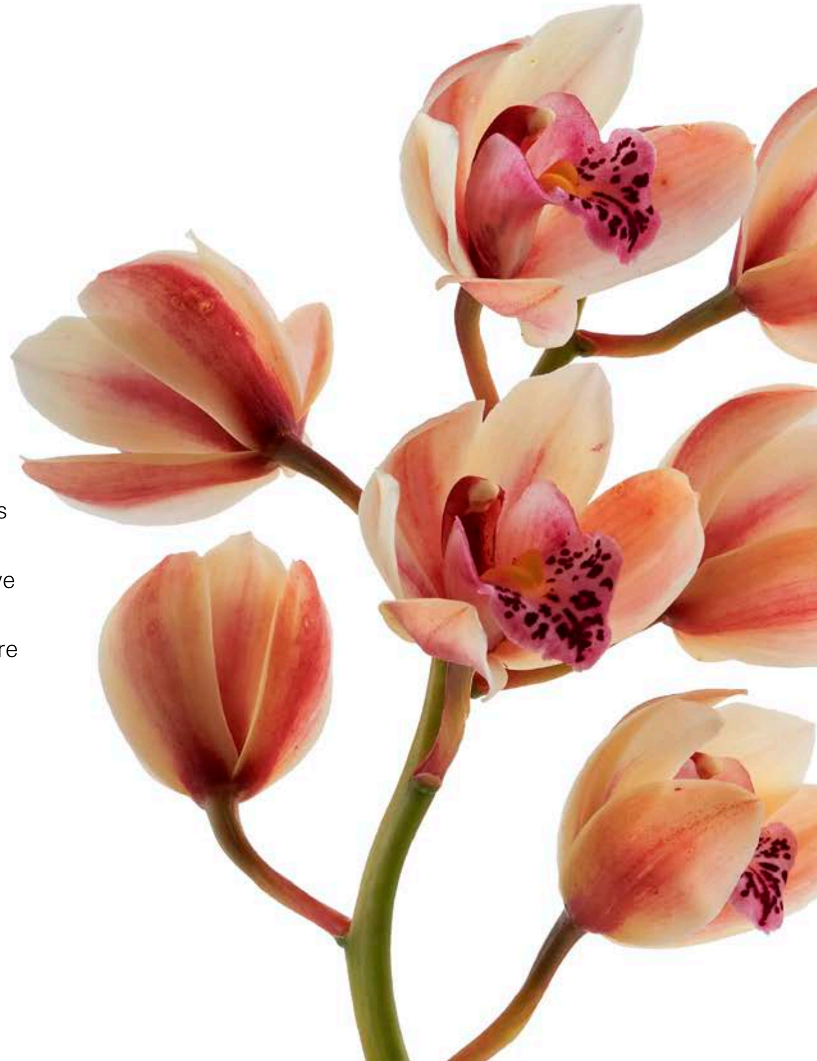
Explore alternative diversifiers

Investors have gotten used to a negative correlation between stocks and bonds – that is, the price of stocks and bonds have tended to move in opposite directions. However, higher inflation has historically caused stocks and bonds to be more correlated. Alternative diversifiers should be explored today.

Embrace sustainability

Companies with better sustainability practices tend to outperform the market over time. Particularly amidst the elevated uncertainty we face, investing in companies that have more sustainable business models and less exposure to risks should serve portfolios well.

> "It's important to have realistic expectations, but there are still a number of interesting opportunities."



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