HSBC IO 2021 Second Quarter – Willem Sels Video

In our Quarterly Investment Outlook, we examine what the market is telling us about the world, and in this video we look at four of those market views and see whether we agree with them.

And the first thing we can deduct from the equity market rally and the outperformance of cyclical stocks is that the market is looking for a sharp economic recovery.

And we agree with that.

We believe that economic growth is supported by ongoing construction activity, a healthy global manufacturing sector, and it should get a further lift from discretionary consumer spending as economies reopen.

So our forecasts for GDP growth, which you can see here, are up sharply in 2021 and across the world.

And what it means for our positioning is that it supports our equity market overweight, our cyclical stance in sectors such as industrials and materials, but also our preference for countries like China, where growth is healthy,

and in the US and the UK, where the vaccine rollout is well advanced. We have also selectively added some exposure to small and mid-caps as those stocks tend to benefit from the local recovery.

Now, this economic recovery is also leading markets to fear a pickup in inflation, and they have pushed up bond yields.

And what is odd here is that it's not just today's inflation that they worry about, but they also think that inflation could go up between five and 10 years from now.

Now, we agree that it is a short term risk to inflation due to oil prices and supply bottlenecks.

But we don't think that the US fiscal package will lead to long term inflation, in part because the labour markets have become even more global and competitive as we move online and therefore wage inflation will remain low.

So what does it mean for our positioning?

Well, we think that bond markets may remain volatile for now, but a move in bond yields should largely be behind us.

So we look for a yield pick-up in investment grade, high yield in emerging markets.

We look for income in dividend stocks and we manage this volatility that we may still see by being diversified and by keeping duration in check.

Now, the third thing that you can see when you look at markets is that they are clearly getting more worried about high valuations.

And indeed, price earnings ratios have drifted up around the world in the past few years.

But how high are equity market valuations actually? When you compare them to BBB bond yields, they are very much in line with this and global liquidity continues to be generous.

In fact, the central banks around the world, have told us that they will probably not react to this temporary inflation spike because their economies are not yet ready for a tightening of financial conditions.

So in our view, equity market valuations on the whole are not under an immediate threat.

But nevertheless, we look at the relative value and we point out that within each sector there are expensive and cheap stocks which hedge funds can exploit, for example.

We also point out that the UK is one of the cheaper markets, hence our overweight.

But what we don't do is simply go into value stocks and look for the cheapest stocks because some of those may be value traps if the company is not adapted to the world that we live in.

It's worth looking at the similarities and links between technology and sustainability. Of course, both are two of our big trends for 2021.

Technology often enables advances in sustainability.

And the correction in March was largely related to the valuation concerns in those two areas.

But we think the correction was largely a bond market movement and a movement in growth stocks, which should now be behind us.

The earnings potential of sustainability is really quite structural in nature and long term because we need to make huge investments in that area of activity.

And lastly, the valuation concern is largely focused on large cap US tech stocks and pure play sustainability stocks.

We have for a long time pointed out that beyond the US tech names, there are opportunities in small caps in Asia and in technology-related fields such as 5G.

As for sustainability, we think that beyond the pure plays, there are many companies that now have a small but growing exposure to sustainable activities.

And by inserting those in the core portfolio, it quickly adds up in terms of exposure.

It may provide you with diversification, and it may provide you also with a cheaper way to access the sustainability theme.