Top Trends and
High Conviction Themes
Q1 2025

A Compass for the Future: Mapping Investment Trends and Themes

HSBC

Global Private Banking

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Welcome

Dear clients,
Some of you may be half expecting a publication about investment trends and themes to have been written by generative AI (Artificial Intelligence). After all, AI-led innovation has been the number one discussion topic in 2024 – especially for people who wanted to steer clear from election debates. And it's not just with the GenZ crowd: this year's Noble Prizes for both physics and chemistry were for research enabled by (and enabling) AI and advanced computing.

We can assure you that the authors of this publication are yours truly and the investment team. One reason we are still writing is that we are not ready to give up, in spite of the IMF ranking economists among the jobs most vulnerable to AI displacement. We like to think that economics and investing is not just about data but also about market psychology, where human investment teams should still have an edge for some time.

More importantly, we believe that writing and thinking about big trends helps us understand the world better, benefiting our investment strategy. For example, several investors we spoke to who correctly predicted that Mr Trump was going to return to the White House based that prediction at least in part on big trends, including demographic and social shifts, immigration, inflation and the challenges of our multi-polar world.

Targeting long-term trends can give direction to portfolios. For example, it is clear that our Evolving Society presents shifts in how people live and what they consume, leading new business models to prosper while outdated businesses die. It is also clear that our clever human species, with the help of AI, will continue to invent a lot of new Disruptive Technologies, which will trigger applications across industries. This should lead to interesting investments in both the tech enablers and the adopters. Lastly, we believe Climate Action will continue, in spite of the quite mixed outcome of COP29. Our view is not just based on the imperative to act as climate change continues, but also because this is a growth industry in which countries will want to gain market share. Similarly, we think investors will want to make sure that their portfolios are reflecting these big structural shifts.

Regular readers will know that we complement these structural themes with Asian and cyclical themes. In Asia, we think markets will favour domestically-oriented companies, given the threat of US tariffs, or companies that are focused on boosting shareholder value. Meanwhile, our cyclical themes in the West reflect our preference for the US stock market, and our tactical approach in the bond market.

Our themes should be considered as a menu and we hope that something catches your interest. We suggest to combine a few different options, because the danger with thematic investing is that it can have a bias towards technology and growth-style stocks. Combining them with a well-diversified core portfolio is the best way to go, in our view.

Willem Sels,
Global Chief
Investment Officer
December 2024

Investing with a Thematic Lens

When Mario Draghi, the former head of the European Central Bank, was asked to propose a strategy to boost Europe's competitiveness, he painted a clear picture with strong thematic trends. Europe is part of a very competitive world that is more multi-polar and much less multi-lateral than before. It has a big innovation gap in a world that is full of digital disruption. With a shrinking population, it needs to make the best use of its skills to adapt to automation and AI to maintain social inclusion. And amid rapid climate change, Mr Draghi sees decarbonisation as both an imperative and an opportunity for Europe.

These trends overlap perfectly with our structural trends, including Disruptive Technologies, Evolving Society and Climate Action. And while politicians in the EU, the US, China and other countries are formulating an industrial strategy to respond to these trends, investors should respond too by incorporating thematic thinking in portfolio construction.

What makes these trends durable is not just the scientific evidence behind global ageing and climate change. It is also because the three trends reinforce each other.

For example, Climate Action is accelerating because technological innovation improves the performance of solar and wind solutions, while economies of scale reduce their cost. Conversely, the AI revolution is very energy intensive and requires a huge amount of additional electricity installations. The Environmental Impact Assessment (EIA) believes almost the entirety of the net new installations will consist of clean energy and nuclear. It should not come as a surprise that the very big tech companies are investing heavily in clean energy technologies – not just for sustainability reasons but also to ensure energy access and security.

Disruptive Technologies also interact with the Evolving Society trend, as younger generations want to consume differently. Older generations need new solutions too and healthcare innovation is a big topic here, as many innovations are being sped up by AI.

And lastly, we see many interactions between climate change and the Evolving Society. Young generations have increasingly demanding requirements from companies, as they require more recycling and better respect of biodiversity. And climate change has social

implications, often hitting poorer communities and the elderly more than others. This last point was illustrated by the victory of a group of Swiss elderly women in a court case that argued that because of their age, the women were more vulnerable to climate change induced heatwaves, forcing their government to take more action.

Much of the world's attention may well be on the US in coming months, as the new administration formulates its policies and may break with many conventions. The US also remains at the forefront of many innovations.

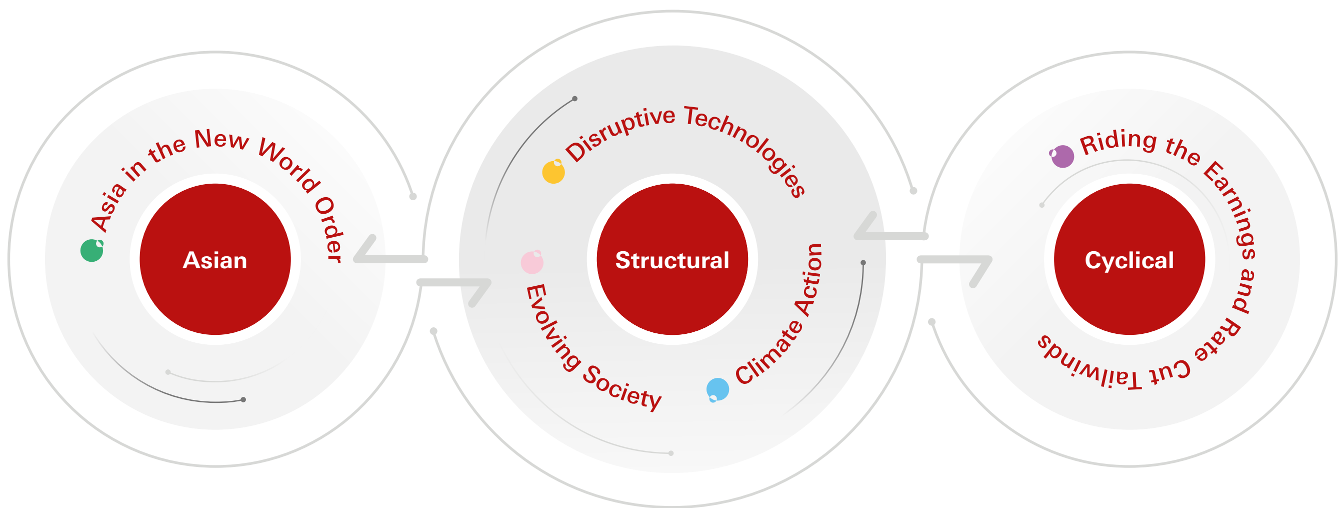
But Asia is also key in the new world order. For a start, Asia is home to 59% of the world's population, and while China and Japan are shrinking, India should continue to grow till 2060, according to the UN. Asia is also competitive in a growing number of industries, with China expected to lead in a range of areas such as semiconductor packaging, unmanned aerial vehicles, LNG carriers, high-speed rail, electric vehicles, lithium batteries, solar panels and graphene by 2030, according to Bloomberg Intelligence. Japan is an established player in tech and advanced manufacturing, and India has ambitious plans to grow its share of manufacturing in GDP. That said, the Chinese government is looking at domestic consumption as the key lever for growth as US tariffs will likely hamper exports. As a result, our Asian themes focus on domestic leaders and companies focusing on boosting shareholder returns.

As usual, we complete our menu of thematic investment opportunities with some shorter-term cyclical ideas. We continue to see the US as the most attractive equity market, thanks to its resilient growth and the potential for tax breaks and deregulation. We think the re-industrialisation is ongoing, and America's corporate vitality is also visible in areas such as financials and consumer demand. We have included a theme on 'Income Through Active Credit

Selection' as we don't want to miss the opportunities in fixed income. But given the tight credit spreads, and the likelihood of changeable rate expectations, we think an active approach is needed here.

We hope that our menu of themes includes some areas of interest. At the very least, the discussion of specific opportunities can help inform your sector or market views. In fact, equity analysts and strategists increasingly think thematically and less along relatively arbitrary sector or geographical buckets. After all, many telecom companies resemble tech companies, and many of the largest Swiss, Spanish or South Korean companies do little business locally. Thinking across borders in a thematic way can be eye-opening and help uncover many opportunities.

Our Top Trends and High Conviction Themes



Global High Conviction Themes

Asian	Structural			Cyclical
Asia in the New World Order	Disruptive Technologies	Climate Action	Evolving Society	Riding the Earnings and Rate Cut Tailwinds
• Asia's Domestic Leaders • Power Up Asian Shareholder Returns • Rise of India and ASEAN • High Quality Asian Credit	• Aerospace & Security • Digital Infrastructure • Intelligent Automation & AI • NextGen Medicines	• Energy Transition • Biodiversity and Circular Economy	• Social Empowerment and Well-being • Silver Economy & Demographics	• American Vitality • North American Re-Industrialisation • Income Through Active Credit Selection

Top Trend

Asia in the New World Order

Navigating the fast-evolving geopolitical landscape after the US elections, Asia is expected to sustain solid economic growth in 2025 with support of robust domestic growth drivers in India and ASEAN, together with China's broadening policy stimulus. We forecast Asia ex-Japan GDP growth to remain resilient at 4.4% in 2025, well above the global average growth of 2.6% (As at 13 December 2024). Increasing trade uncertainty under the new US administration will likely trigger more policy stimulus from China in 2025 to mitigate the external headwinds.

Our four high conviction themes

1. Asia's Domestic Leaders
2. Power Up Asian Shareholder Returns
3. Rise of India and ASEAN
4. High Quality Asian Credit

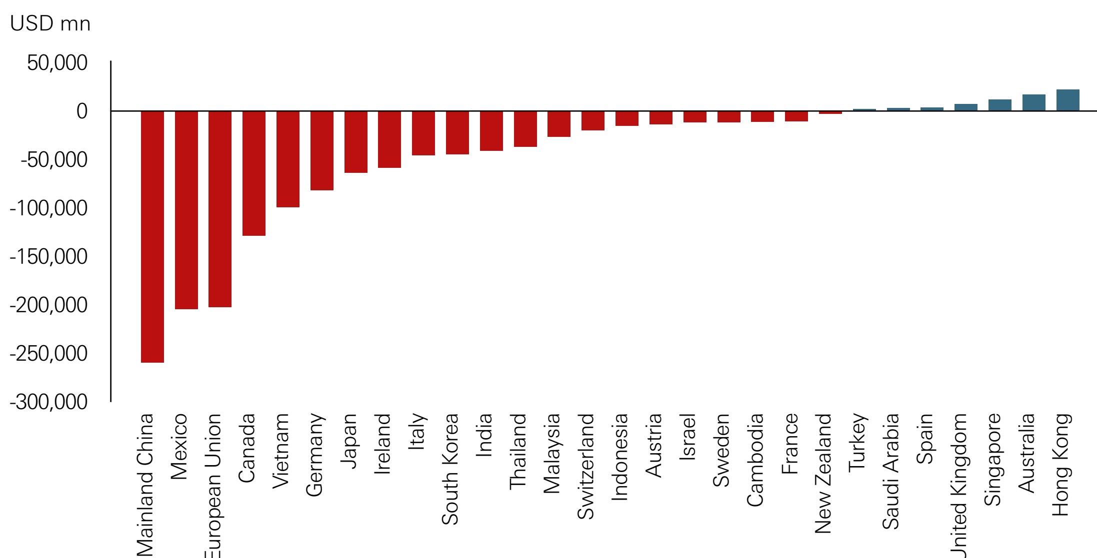
India and ASEAN continue to benefit from structural tailwinds of young demographics, rising middle-class consumers, strong foreign and domestic investment flows, and technology boom.

We anticipate the tariff overhang may bring greater impact on risk sentiment towards Chinese and Asian assets than on the actual earnings. Except the technology-heavy and export-oriented markets in South Korea and Taiwan, the export sector is generally underrepresented in most Asian equity markets which are predominantly dominated by domestic earnings. In mainland China, export revenues only account for around 10% of the onshore A-share market's total revenues. Our research studies show that every 10% hike in US tariffs on Chinese imports would reduce CSI300 net profit by only 0.5ppt due to limited export revenues of China A-share companies (As at 13 December 2024).

More importantly, China and other Asian countries have taken proactive policy responses to mitigate the impact of US tariff hikes after the US-China trade conflict escalated in 2018 during the first presidential term of Mr Trump. Since 2018, many Chinese companies have built overseas manufacturing plants in Vietnam, Malaysia, Indonesia, and Thailand as they diversified their supply chains across Asia to circumvent higher tariffs, reduce labour costs, and strengthen supply chain security. Beijing has reduced its trade dependency on the US market, which currently accounts for only 15% of China's total exports, down from 19% in 2018. China's share of total US imports has declined to the current 13.9% from the peak of 21.6% in 2017 (Source: HSBC Global Private Banking as at 13 December 2024).

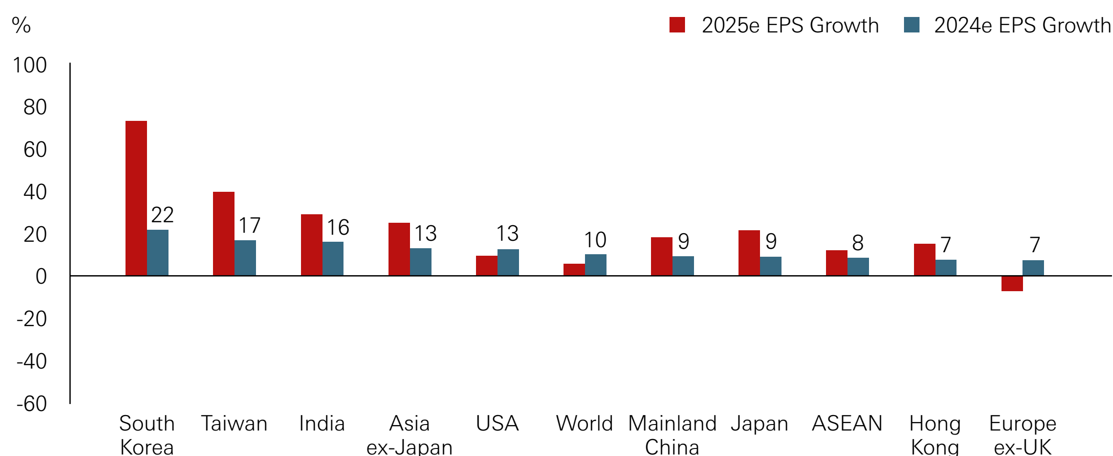
According to the Peterson Institute for International Economics, the average US tariff rate on Chinese goods was 19.3% as at end-2023, well above

The US records substantial trade deficits with Mainland China, Mexico, the EU, and Canada, but has trade surpluses with Hong Kong and Singapore



Source: Bloomberg, LSEG Datastream, HSBC Global Private Banking as at 13 December 2024.

2025 Asian earnings growth stays ahead of global peers



Source: Bloomberg, HSBC Global Private Banking as at 13 December 2024. Past performance is not a reliable indicator of future performance.

3.1% in early 2018 before escalation of US-China trade tensions. During Trump 1.0, the US imposed additional tariffs on roughly USD350bn of Chinese imports and China also retaliated by increasing tariffs on USD100bn of US imports. It remains highly uncertain if US President-elect Mr Trump will fully implement his proposed 60% tariff on all Chinese products as he had pledged during the election campaigns. Based on experience of the tariff hikes implemented during Trump 1.0, we believe the upcoming US tariff hikes will likely be targeted against the countries which have the largest trade surpluses with the US, including China, Mexico, the EU, and Canada. Considering widespread concerns about the impact of higher tariffs on inflation and consumer spending, we believe the new US administration will likely implement the new tariffs in an incremental, phased, and targeted approach rather than a drastic universal tariff hike.

At the same time, we expect China will likely ramp up policy stimulus to bolster domestic demand to mitigate the external headwinds, particularly through expanded fiscal stimulus to boost domestic consumption. We believe additional US tariffs and restrictions on technology exports will act as an external catalyst for accelerating technology self-sufficiency in China. We expect the Chinese and Asian policymakers will be better prepared to respond to the trade uncertainty and tariffs with more effective policy responses by supporting domestic demand growth.

Positioning for greater uncertainty surrounding US trade policy and tariffs, we have launched a new High Conviction Theme on **Asia's Domestic Leaders** that focuses on the domestic industry champions which are well positioned to withstand the tariff risks with support of resilient domestic growth drivers and limited trade exposure to the US. In our overweight equity markets in Japan, India, and Singapore, we find attractive alpha generation opportunities from the domestic growth leaders, which are captured by the theme on the **Rise of India and ASEAN** which attaches stronger focus on domestic consumption. The recent pullback in Indian equities presents an attractive opportunity to add exposure, as the market remains well supported by 16% 2025e earnings growth, high ROE, and strong inflows from domestic investors (As at 13 December 2024).

Within ASEAN, we prefer Singapore equities as the country has a modest trade deficit against the US, making it a defensive play under tariff risks as compared to other regional peers, especially with support of its compelling dividend yield of over 4%. In Japan, the sustained reflation trend and bumper wage hike bodes well for domestic consumption companies. These resilient Asian domestic leaders should act as relative safe havens to withstand tariff risks, and they are expected to outperform trade-dependent exporters that rely on the US market.

We believe the tariff overhang will add momentum to Asia's intra-regional trade and investments, offering growth opportunities to high-end manufacturing leaders with global competitiveness. Asian companies with high exposure to intra-regional trade and cross-border investments are better positioned to mitigate trade uncertainty in the months ahead. In mainland China, Hong Kong, and Japan, we find attractive opportunities from the domestic leaders with strong competitive position and above sector average earnings potential.

Looking ahead into 2025, we favour quality Asian companies that improve ROE by paying high dividends and increasing share buybacks. Our new theme on **Power Up Asian Shareholder Returns** seeks for resilient and defensive equity returns by positioning in quality companies which enhance ROE by paying high dividends and increasing share buybacks.

Dividend yields in Singapore and Indonesia at 4.2%; Hong Kong and Malaysia at 3.9% look really compelling versus 1.8% of MSCI World. Consensus estimates forecast Asia ex-Japan ROE will rise from 11.5% this year to 12% in 2025 (As at 13 December 2024)

While we hold a neutral position in China equities, we identify beneficiaries from Beijing's widening policy stimulus. We like Chinese internet stocks, quality SOEs paying high dividends, select domestic travel plays, and resilient consumer leaders which can benefit from policy support to boost domestic consumption.

Finally, more Fed rate cuts should create more room for Asian central banks to lower rates that should bode well for quality bonds in the region. To capture the best quality Asian credit opportunities, our theme on **High Quality Asian Credit** stays focused on Asian USD investment grade corporate bonds, Asian financials, Indian and Indonesian local currency bonds, Indonesian high quality quasi-sovereign investment grade bonds in USD, select Macau gaming bonds and Chinese TMT issuers.

1 Asia's Domestic Leaders

Overview

- Following the decisive victory of Mr Trump, we think domestic leaders in Asia as well as those that focusing on intra-regional trades are better positioned to navigate the potential trade uncertainty ahead.

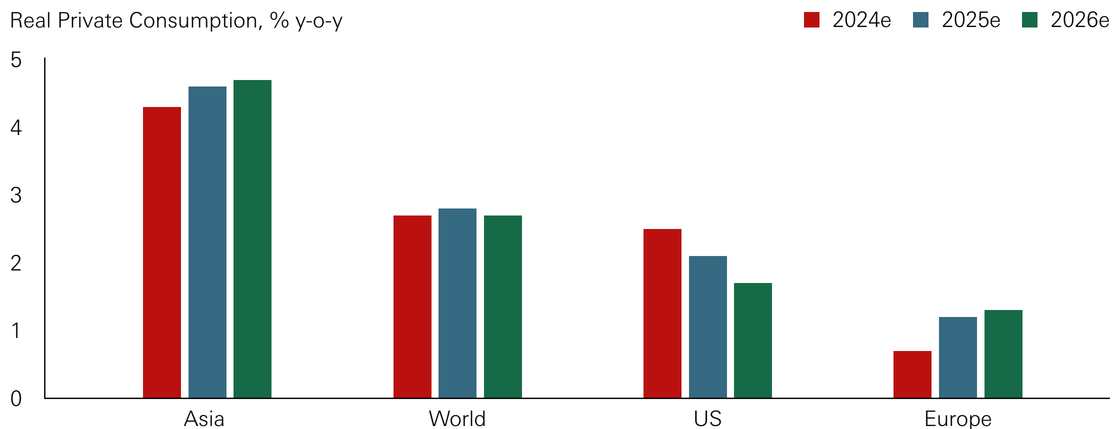
- We find attractive alpha generation opportunities from the domestic growth leaders in mainland China, Hong Kong, and Japan which are expected to outperform exporters that focus on the US market as the former should act as safe havens to withstand trade uncertainty. Companies with high exposure to intra-regional trades are also better positioned amid the regional integration in Asia.

- The identified companies are leaders in their respective domestic sectors and/or non-US export markets, which enjoy competitive advantages and should have the pricing power to pass on at least a part of tariff burden to consumers, thus better protecting their profit margins.

The Opportunity

- In Asia, we favour resilient domestic leaders which are expected to outperform exporters that focus on the US market. These companies should act as safe havens to withstand trade uncertainty and tariff risks under the Trump administration.

Domestic consumer spending in Asia is expected to accelerate at a rate much faster than its global peers



Source: HSBC Global Private Banking as at 13 December 2024. Forecasts are subject to change.

- In mainland China and Hong Kong, we favour quality industry leaders which are expected to benefit from further policy stimulus to boost consumption, including quality internet stocks, select domestic travel plays, and domestic consumer leaders.

- In Japan, some consumer goods giants enjoy a relatively large revenue exposure to the domestic market as well as other Asian markets. They are thus less affected by the potential US trade tariffs.

- The tariff overhang should add momentum to Asia's intra-regional trade and investments, offering growth opportunities to companies with a meaningful exposure to the regional integration in Asia.

Why now?

- Trade uncertainty arising from the Trump administration should bode well for domestic leaders in Asia as they are expected to outperform exporters that focus on the US market.

- Chinese internet and consumer leaders can benefit from further policy stimulus from the Chinese government to reboot domestic growth.

2 Power Up Asian Shareholder Returns

Overview

- Improving shareholder returns have become one of the hot topics in Asia. This is often rewarded by investors and we are seeing more companies in the region paying more dividends and conducting share buybacks.

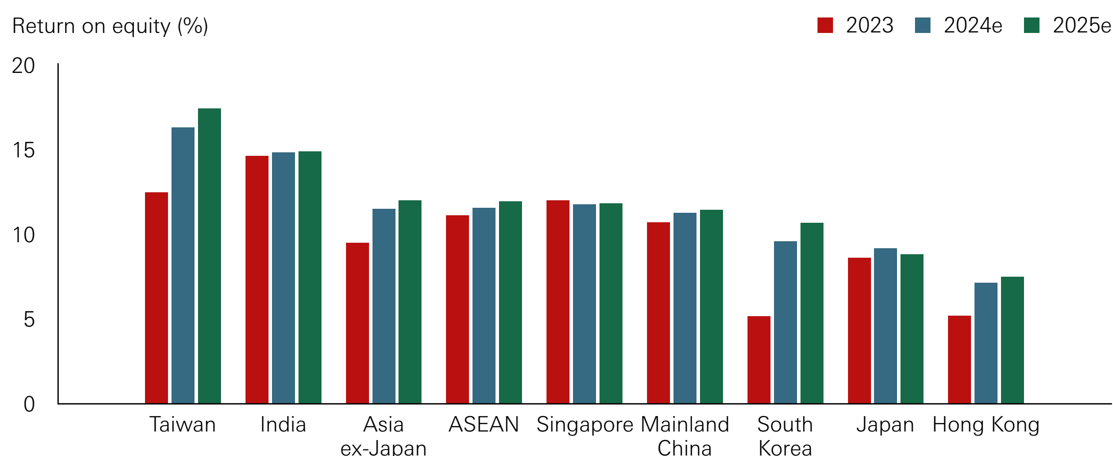
- Asian markets are expected to see improvements in Return on Equity (ROE) in 2025, led by Taiwan at 17%, following by India at 15%, ASEAN at 12%, and mainland China at 11%.

- Amid the global rate cutting cycle, companies which pay higher dividends than peers with the ability to pay even more in the future should be rewarded by investors.

The Opportunity

- As regional real GDP growth rate is expected to stay at around 4.4% in 2025 and 2026, we focus on markets and companies that can deliver strong dividend growth. Taiwan is expected to deliver 11.8% dividend growth in 2025, followed by Japan at 8.8%. At the Asia ex-Japan level,

Asian markets including Japan are projected to see ROE improvements in 2024 & 2025



Source: Bloomberg, HSBC Global Private Banking as at 13 December 2024. Forecasts are subject to change.

dividend is also expected to grow at 7.3% next year (Source: HSBC Global Private Banking as at 13 December 2024).

- A number of Asia Pacific equity markets offer attractive dividend yield – Indonesia and Singapore at ~4.2%, Malaysia and Hong Kong at ~3.9%, Australia at ~3.8% – which compare favourably to MSCI AC World of 1.8% (Source: HSBC Global Private Banking as at 13 December 2024).

- Share buybacks are growing at a record pace, particularly in Japan, mainland China and Hong Kong markets. More Japanese companies are using capital more efficiently while Hong Kong companies that are undervalued are buying back shares. In mainland China, the PBoC has started a specialised re-lending facility for commercial banks to facilitate share buybacks by listed companies and major shareholders. Corporate governance reform is also in play to improve shareholders' returns.

- Over the longer term, dividend income is an important contributor to total returns – roughly half of the total return in the MSCI Asia Pacific ex-Japan index is coming from dividends over the past two decades.

- Investment Opportunities: corporate governance reform names in Japan, South Korea and quality Chinese SOEs, undervalued high dividend stocks in Hong Kong market, high dividend plays in ASEAN and Australia, as well as those that have the dry powder to conduct more share buybacks.

Why now?

- Asian central banks are set to cut rates further in the coming months, including mainland China, India, South Korea, Hong Kong, Indonesia, and the Philippines (the only exception is Japan), thus increasing the attractiveness of dividends as the gap between dividend yield and bond yield is expected to widen.

- In times of uncertainty, investor interest tends to be higher towards companies with higher dividends as they seek stable income returns.

3 Rise of India and ASEAN

Overview

- The rise of India and ASEAN is supported by structural tailwinds from young demographics, rising middle-class consumers, strong foreign and domestic private investments, and technology boom. This bodes well for a number of sectors including financials, consumers, real estate, infrastructure and communication services.

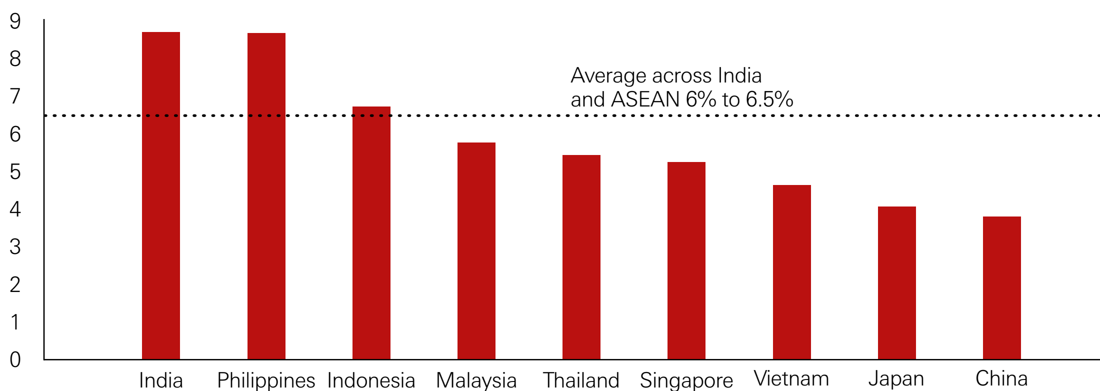
- Indian and ASEAN economies are expected to deliver robust growth the coming years. In 2025, we forecast the Indian economy to grow by 6.7% while ASEAN-6 is expected to deliver average GDP growth of 4.8% – above the global growth of 2.6% (Source: HSBC Global Private Banking as at 13 December 2024).

- While the region could face headwinds should president-elect Mr Trump choose to impose trade tariffs, we currently ascribe low probability to such an event and believe that the more domestically oriented and defensive countries can still do well.

The Opportunity

- India's economic growth is supported by public infrastructure investment and an uptick in household investments. The manufacturing sector remains the bright spot, coupled with a resilient services sector. For Indian equities, its long-term trend is underpinned by solid fundamentals and favourable policy backdrop. We prefer large over small/mid caps, preferring financials, consumer discretionary and industrials sectors.

India and ASEAN economies are projected to see around 6.5% average growth in per-capita GDP over 2023 – 2026



Source: CEIC, HSBC Global Private Banking as at 13 December 2024. Forecasts are subject to change.

- In Fixed Income, we like Indian local currency bonds which continue to see strong index inclusion inflows with lower supply, supported by prospect of RBI rate cuts. As we expect the Bank Indonesia (BI) to continue its easing cycle, we prefer Indonesian local currency bonds and high quality quasi-sovereign bonds.

- In ASEAN, countries with strong linkages to AI-related tech exports (i.e., Singapore, Malaysia) should enjoy the ongoing tech upcycle. In Singapore, we think the market can outperform its regional peers on the back of lower interest rates, reasonable valuations and attractive dividend yields.

- We like the long term Indian and ASEAN consumption outlook. Robust personal income growth, rise in middle-class population and moderating inflation points towards greater spending power for consumers in India and ASEAN.

Why now?

- The recent pullback in Indian equities presents an attractive window to add exposure as the market remains supported by high-teens earnings growth, high ROEs and strong inflows from domestic investors.

- Amid potential market volatility triggered by higher US tariffs, we prefer Singapore equities as the country has a trade deficit against the US and should thus behave more defensively compared to peers.

4 High Quality Asian Credit

Overview

- Asian bonds are supported by a favourable macro backdrop, ongoing policy support from mainland China as well as global monetary easing cycle. We expect long-term US Treasury yields to have room to fall in 2025 which should support bond returns.

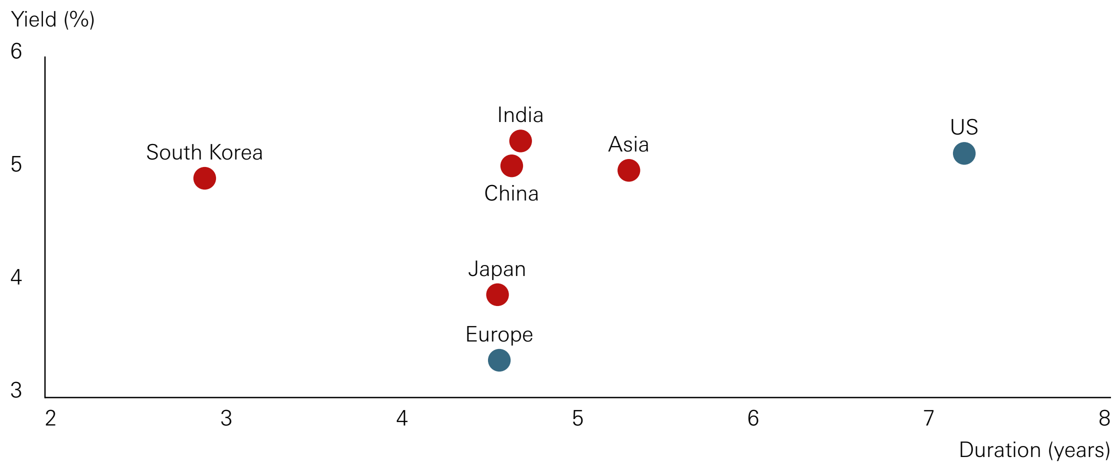
- Asian fixed income has a track record of generating higher returns with lower volatility compared to other fixed income instruments. Credit spreads remain resilient during recent market sell-off. Investors can benefit from the exposure to Asian bonds to achieve diversification benefits.

The Opportunity

- Asian credit investors prefer Japan Investment Grades (IG) credits for diversification as the country has finally moved away from zero interest rates, along with improving economic conditions and better corporate culture. We prefer select Japanese IG corporate and financial bonds.

- We like Australian IG bonds issued by high quality companies with medium duration. The market is tilted towards high quality issuers with established commodities producers, services businesses as well as well-capitalised banks.

Asian IG credits offer more attractive yield/duration profiles relative to global peers



Source: Bloomberg, HSBC Global Private Banking as at 13 December 2024.
Note: Bloomberg Barclays' IG-rated indices for respective markets are used in the above chart for illustrative purpose.

- While investors' sentiment has improved following China's policy pivot, we remain selective and focus on high-quality Chinese issuers. Macau gaming sector is backed by strong fundamentals of casino operators while Chinese TMT companies have strong balance sheets with solid cash flows. As we believe more supportive measures are needed to stabilise the sector, we stay cautious on Chinese property names.

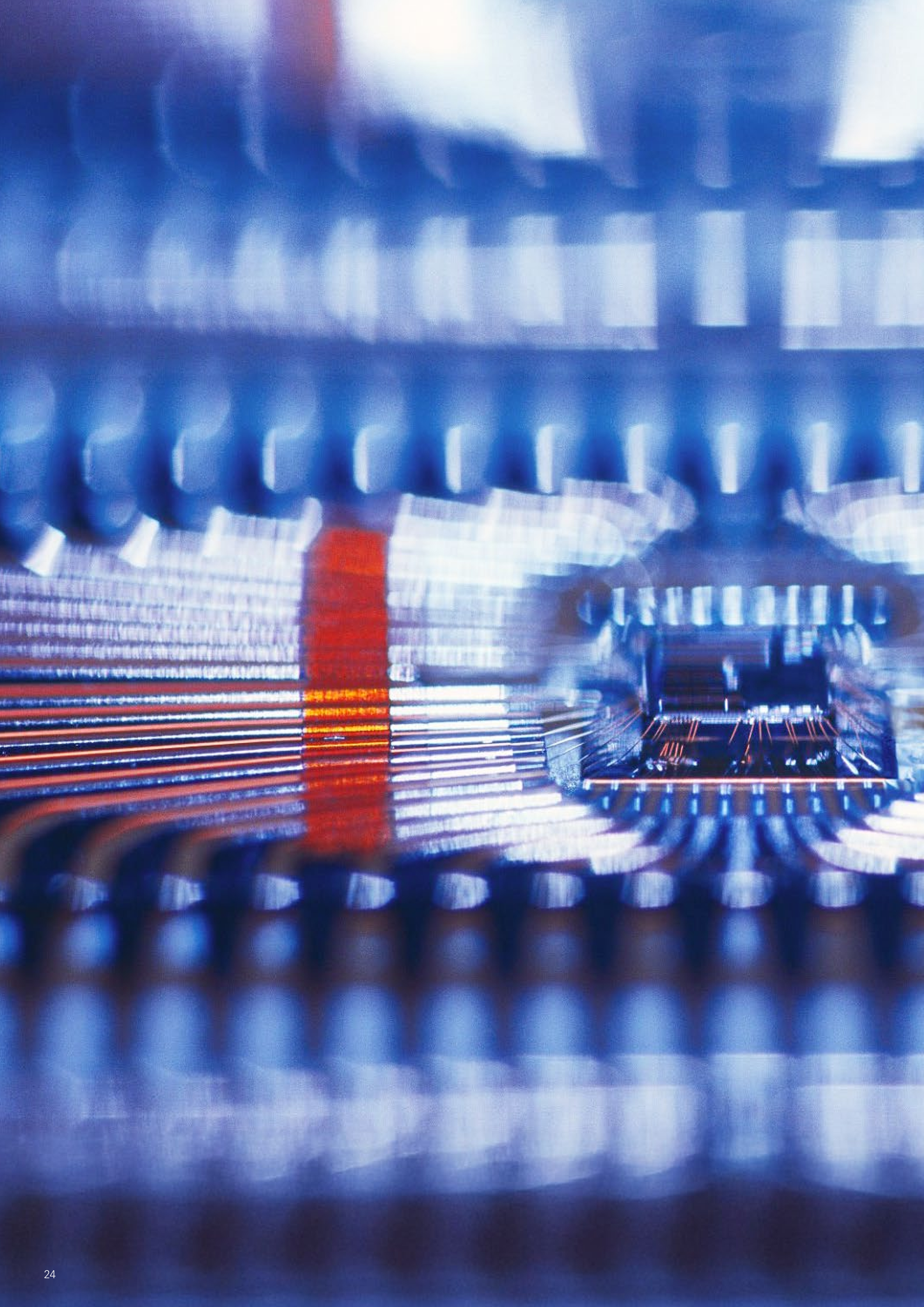
- We like Asian financial credit. Apart from those in Japan, we like bank papers in Australia, Singapore and Thailand as the macro backdrop remains favourable with banks maintaining robust capital adequacy ratios across markets.

- We are overweight on Indian and Indonesian local currency debt. In Southeast Asia, we prefer Indonesian quasi-sovereign IGs in USD as they enjoy the tailwind of the country's strong economic growth with decent yield pickup.

Why now?

- Asia-Pacific central banks are on the course to ease policy following the Fed pivot (e.g. Australia and South Korea). We expect the PBoC to cut policy rates further. It is time to put cash to work towards quality Asian bonds to lock in the all-in yields which are still at attractive levels.

- Cyclical growth momentum in Asia remains solid and we are seeing improving momentum in China where the PMIs have recently returned to the expansion territory.



Top Trend
Disruptive Technologies

Virtually all processes and systems have elements of unpredictability or uncertainty, even where the potential outcomes are governed by well-understood rules or laws and the risks have been somewhat mitigated. The Chaos theory centres on apparently random or unpredictable behaviour in systems governed by deterministic laws. Its origins were in mathematics and mechanics, but it is now finding wider applications in everything from gaming to weather to planetary movements. Chaos theory is routed in the butterfly effect, rather than the black swan event, with apparently small insignificant events having a disproportional impact.

Our four high conviction themes

1. Aerospace & Security
2. Digital Infrastructure
3. Intelligent Automation & AI
4. NextGen Medicines

What does this have to do with disruptive technologies?

Often, major disruptions occur as the result of small, seemingly inconsequential events, often referred to as the butterfly effect. Many of us experience this with public transport systems on our daily commute. We will highlight several examples where this has happened in the last decade and the impact they are now having.

Our first example was the simple observation that diabetics being treated with a new class of medicines called GLP-1 agonist seemed to have lower BMIs relative to patients receiving other medications. Further investigations confirmed the medicines seemed to reduce patients' sense of desire for food. Pharmaceutical companies producing the medicine turned this into a hugely success commercial opportunity after securing an obesity treatment indication from the licencing authorities. The World Healthcare Organisation (WHO) estimates that there are 2.5bn overweight people in the world of those 850mn or 1 in 8 people are classified as obese. A simple observation has the potential to change hundreds of millions of lives for the better.

Moving away from healthcare to the brave new world of technology that is slowly edging towards the utopian vision of Fritz Lang's film Metropolis, albeit less dystopian in reality than portrayed in the movie. Advances in sensors, materials and software have increased the adoption of automation in all manner of products and services over the last decade. Things are about to get even more interesting with AI software being deployed in a transformational wave that bring promise of productivity gains, autonomy and much, much more. Why the sudden excitement as AI capabilities have been around for years. The introduction of advance software in the form of large language models (LLMs) provided a step change in capabilities that have far wider potential applications than all previous AI iterations. The speed of developments is breathtaking.

In McKinsey latest Global Survey on AI (as at May 2024), they reported "65% of respondents report that their organizations are regularly using gen AI, nearly double the percentage from our previous survey just ten months ago".

Enhanced products and services are already entering the market as the AI software is integrated into a wide array of services from internet search engines, chatbots, to online LLMs that offer to write a presentation or assemble facts. Integrating AI capabilities into more complex situations is where more significant benefits are likely to be recognised, especially as AI software expands to potential for more autonomous products and services. Robots already roam freely in some factories and monitor safety and environmental standards moving along walkways, mounting stairs and reaching less accessible spaces.

AI software has shown great potential in pattern recognition often discovering links in data or images or information that was overlooked or not seen by humans. Well documents research has shown AI software models have higher success at detecting some cancers and pre-cancerous tissue in patients than the human eye. Similar technologies are being applied to all manor of information sources in the hope of unlocking new discoveries from prospective new medicine candidates to weather patterns to random events in financial markets.

Giving machines an AI-powered 'brain', albeit a rather simplistic in its abilities, gives machines some freedom to act independently with a degree of intelligence. The aerospace industry has always been quick to identify the potential of new technologies including autopilot, flight simulators, fly-by-wire, remote systems monitoring; these technologies improve safety, enhance product features, reduce cost and/or open up new commercial opportunities. Therefore, it is no surprise that the industry is at the vanguard of new developments such a re-usable launch vehicles, materials and coatings developments, fully autonomous flight vehicles; hypersonic engines; space travel. The industry is benefitting from a wave of innovation that promises to bring new commercial opportunities from satellite sensor monitoring crops, weather, maritime activity, etc., to drones delivering medicines and post to remote islands. The trade and geopolitical uncertainties have heightened awareness of vulnerabilities of global supply chains and the need to develop local technology capabilities and manufacturing capacity in critical industries to protect regional and national interest. Few would doubt that a strong aerospace industry is strategically important and unsurprisingly investment is again booming.

But it is the less glamorous areas that sometimes steal the limelight and unfortunately for all the wrong reasons. All the mentioned technological advances have a common weak spot or 'Achilles heel' namely the software that powers, instructs and controls their activities. This inherent vulnerability if detected by malefactors can be ruthlessly exploited either for ransom, extortion, data theft; disruption or to inflict seriously damage. Cybercrime takes many forms and fulfils many purposes from simply blocking computers until a ransom is paid to stealing person or commercial data to damaging digital and physical infrastructure in a foes' country. Software providers try to combat malware, spyware, computer viruses and many other cyber threats though regular software updates that aim to patch identified vulnerabilities. A parallel industry has evolved focused purely on supplying dedicated software tools to combat this threat which is only likely to grow as the world increasingly becomes digitalised.

Innovation is creating an evermore digitally connected world where AI software uses an array of sensors to monitor and control activities. This is not a dystopian vision, but rather a growing reality that should bring many benefits and opportunities as traditional industries evolve in new and emerging industries.

1 Aerospace & Security

Overview

- Aerospace companies have seen the demand for airplanes, associated products and services continue to rise, with large orders extending the manufacturing backlogs.

- Recent achievements by private companies in delivering private citizens to space, and in landing reusable space crafts have crafted new and exciting opportunities in the space economy.

- Aerospace, as an industry, is underpinned by stable government contracts, which have been increasing annually across the major countries.

- Rising demand for data and interconnectivity is providing a key support to the growth of the small satellite industry.

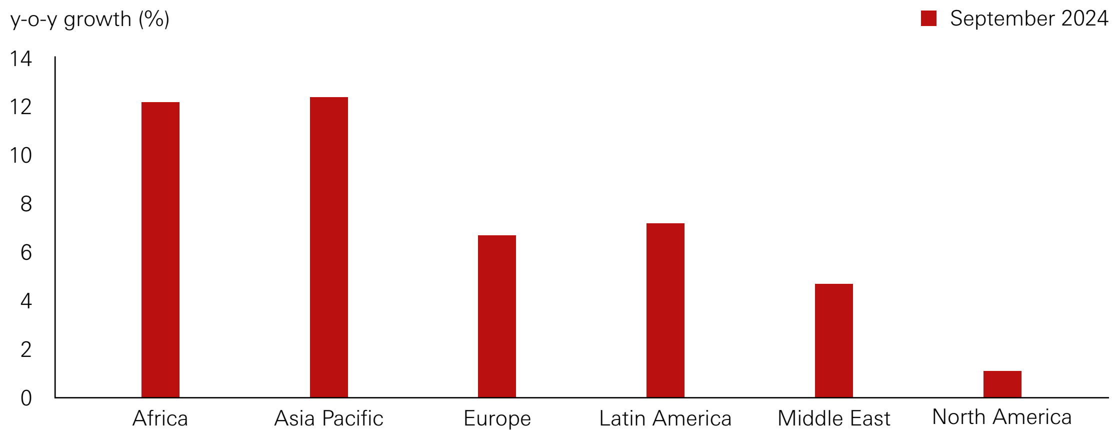
- Aerospace companies play a central role in securing sovereign interests from the rising concern of geopolitical cyber attacks.

The Opportunity

- We see opportunities in companies that manufacture aircrafts, spacecrafts, satellites, aerospace services and cyber defense, as there has been growing demand across the industry.

- The demand for airplanes has been growing, as the number of flights continues to grow with global Revenue Passenger-Kilometers (RPK) rising 7.1% y-o-y in September 2024, which is now ahead of pre-pandemic levels, according to the International Air Transport Association (IATA) data.

Revenue passenger-kilometers on the rise



Source: IATA, HSBC Global Private Banking as at 13 December 2024.

- In 2023, small satellites represented 97% of all spacecrafts launched. Small satellite launches are up 7X in the last 6 years (Source: Bryce Tech small satellites report, 2024).
- Aerospace companies also benefit from a stable, secure and growing income stream of governments and their agencies, with a rising share coming for cyber defense.
- Companies which are heavily reliant on larger, faster and lower latency data are also expected to benefit from this trend.

Why now?

- Recent progress in aerospace technology has driven a resurgence of interest in the space economy with private company space flights growing rapidly.
- Rising demand for flights and air travel has seen delivery numbers and order books at aerospace manufacturers swell and the resulting backlog can take many years to reduce.
- The rising demand for data from an ever-increasing number of connected devices from all corners of the globe has raised the competition among entrepreneurs to try and meet that demand via private low-earth orbit satellite solutions.

2 Digital Infrastructure

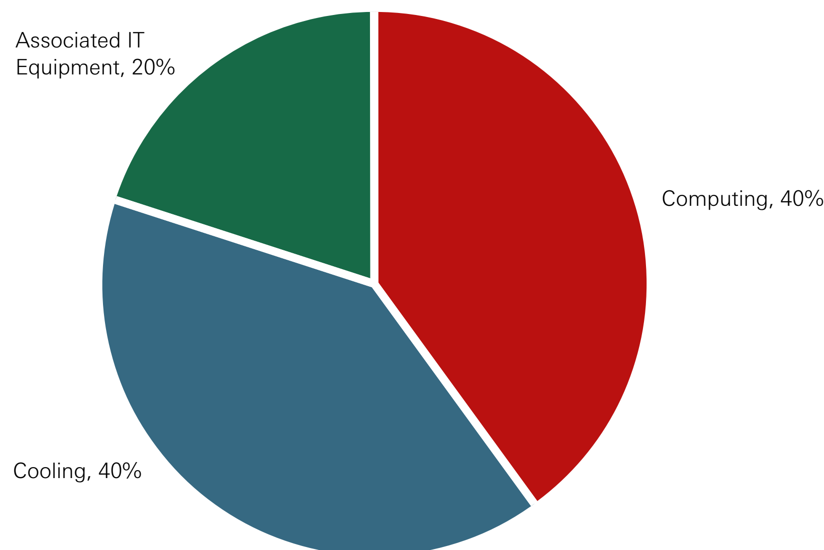
Overview

- Datacenters, cloud demand, cyber security and cooling systems are all set to see expanded demand as corporate capex budgets rise on the back of improving outlooks and demand for resource hungry AI surges.
- According to a report from P&S Intelligence, the datacenter market is expected to grow from c.USD302bn in 2023 to c.USD622bn in 2030, a CAGR of over 10.5%.
- Demand for AI will have a major impact on datacenters, cloud and related services, as AI needs vastly more energy and computing power to run on.

The Opportunity

- The demand for both traditional cloud offerings and AI-related cloud services is on the rise, following a period of higher fiscal caution among corporates.
- Manufacturers of cloud servers and related hardware should see a rise in demand from both traditional cloud needs and AI-related demand, with the increasing data consumption.
- Datacenters are growing rapidly in less developed regions too. In ASEAN, we estimate demand for IDC will grow to 6.5GW by 2030e, up from 1.3GW currently.

Datacenters' costs breakdown



Source: International Energy Agency, HSBC Global Private Banking data as at 2023.

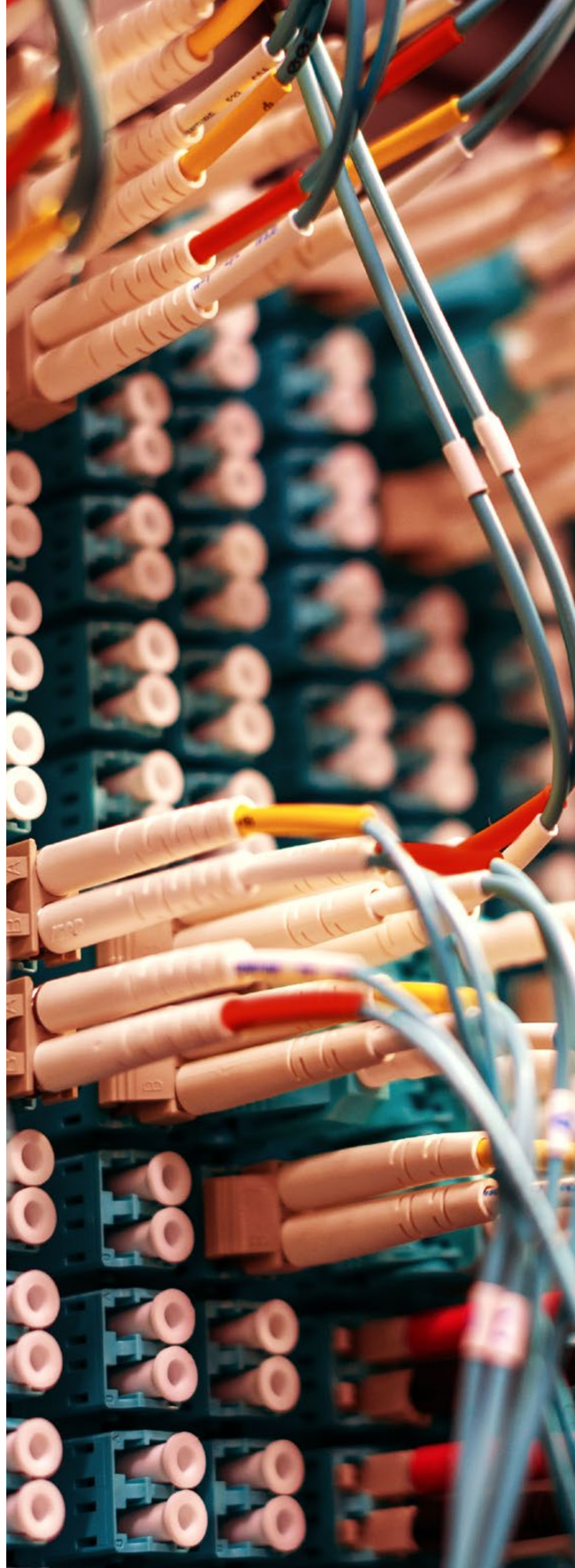
- Cooling is a major component of digital architecture, already making up to 40% of the datacenter costs. With increasing energy usage and as server rack density is expanding too, so more and better cooling will be needed.

Why now?

- Companies are seeing their economic outlook improving, earnings expectations rising and, following the recent US election, likely tax cuts and less anti-trust regulation which will add to this, leading to expansion of digital capex spends across industries.

- The arrival of AI has created a flurry of demand for AI capabilities across all sectors and industries. Companies that embrace this new tool are more likely to succeed in the future and this can be seen in the huge multi-billion-dollar outlays for AI capex that companies have outlined in the recent months.

- More powerful AI tools enhance both good faith and bad faith actors and as a result, organisations will need to expand their cybersecurity spending too and they will need to adapt it to the changing landscape of cyber attacks.



3 Intelligent Automation & AI

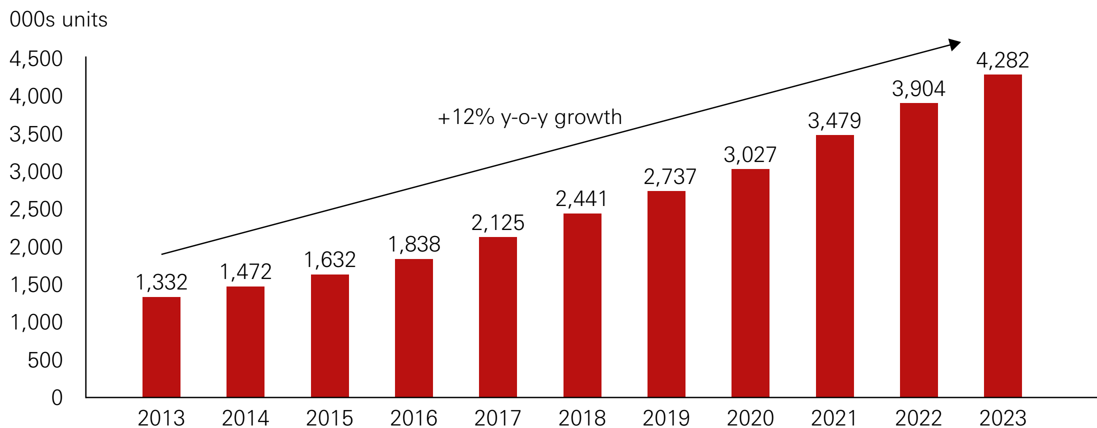
Overview

- Over the last two years, there has been a dramatic evolution of AI software to the point where it is being increasingly used in commercial applications.
- Skilled labour shortages; productivity gains; service expansion (24/7) and new commercial opportunities are driving AI adoption.
- Products and services are being enhanced by the increasingly intelligent machines that are capable of more complex tasks.
- In 2023, 541,000 new industrial robots were installed bringing the total number of operational industrial robots nearly 4.3mn units (Source: The International Federation of Robotics (IFR) , 2024).
- Fully autonomous machines offer the greatest potential.

The Opportunity

- Full factory automation has been limited by the cost and capabilities of the machines, but recent improvements in software and hardware is making this feasible.

Worldwide operational stock of industrial robots



Source: IFR World Robotics 2024, HSBC Global Private Banking as at 13 December 2024.

- Automated products and services offer consistent, seamless service without disruption, boosting productivity, quality and reliability.

- Healthcare sector is already benefitting in several areas including as surgical robots, high-throughput screening, scan analysis; but AI could used to improve diagnostic analysis physician support, disease monitoring and tracking.

- Financial services are deploying AI software in a number of areas including sophisticated chatbots; identification verification; insurance risk assessments; bank account and credit card applications; and transaction monitoring.

- Agriculture is being automated in many developed markets, from GPS controlled tractors and harvesters, to soil and crop management using satellite data, drones and AI.

Why now?

- Integrating the latest generation of AI software and related hardware is markedly enhancing products and services.

- Labour shortages and rising costs are driving a fresh wave of investment in automation, as potential investment returns become increasingly attractive.

- The roll-out of 5G, cable and low-earth orbit satellite networks have significantly expanded data capacity and while reducing the latency.

4 NextGen Medicines

Overview

- Global biopharma sales are forecast to be USD1.2trn (as at 2024), with biotechnology companies are often the primary innovators of new medicines.

- Targeted therapies or personalised medicines offer better outcomes, fewer side effects, and often at a lower cost.

- New generation of biopharmaceuticals are addressing unmet clinical conditions such as obesity, hepatitis, haemophilia, and cancer sometimes offering a cure for the disease.

- The USD350bn Consumer Health market should benefit from several important structural growth drivers.

The Opportunity

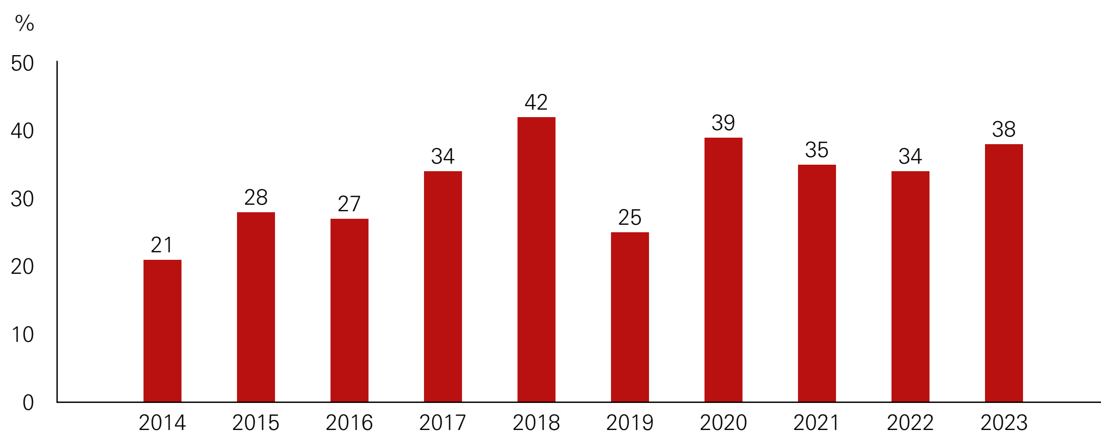
- Highly-targeted medicines including stem cell and monoclonal antibody therapies offer far better patient outcomes, fewer side-effects and often lower lifetime treatment cost.

- Cutting-edge technologies are reaching the market including mRNA cancer vaccines, cell, gene and stem cell therapies.

- Personalised medicines were 38% of FDA approved new molecular entities last year and growing (Source: Statista as at 2024).

- Sophisticated software, high-throughput screening and testing are accelerating the testing and development.

Personalised medicines as a percentage of FDA approved new molecular entities

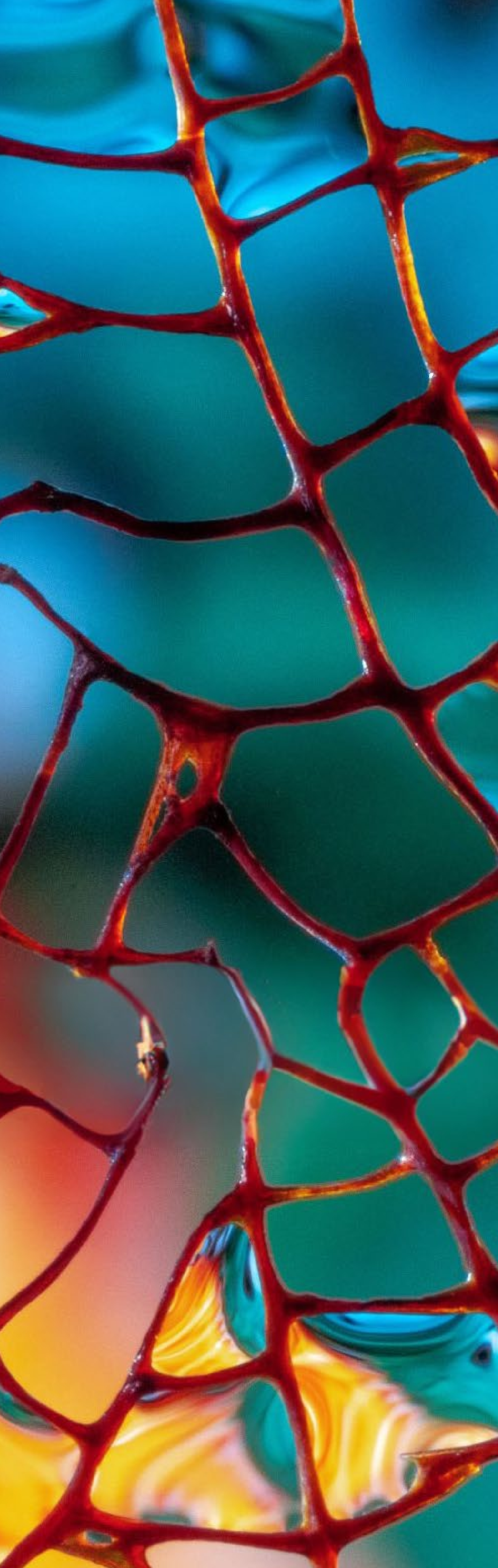


Source: Statista, HSBC Global Private Banking as at 13 December 2024.

- Orphan drug status provides additional commercial benefits for some medicines helping to mitigate development risks.
- Licensing and M&A activity is picking-up as companies restructure and look to bolster their product pipelines.

Why now?

- Spiraling healthcare costs due aging demographics and societal trends, favour cost effective treatments.
- Gene editing, CAR-T therapies, mRNA vaccines are among the new technologies being entering the market with significant commercial potential.
- AI initiatives (e.g. AlphaFold, image screening) are identifying millions of potential new medicines and treatment targets, plus identifying healthcare trends in large, complex data.
- Expanded testing and screening facilities (from pandemic) is leading to the early detection and treatment of diseases that lead to better patient outcomes and lower costs.
- Increase patient awareness and new category product launches are expanding the demand for healthcare products and services.



Top Trend
Climate Action

The demand momentum for sustainable or zero carbon products and services continues to present investment opportunities for investors with the opportunity set growing every day. For example, recent announcements of nuclear energy deals for energy hungry AI companies shows that sustainability is a key driving force in corporate spend. Behind that spend is a clear demand from customers for sustainable products and services.

Our two high conviction themes

1 Energy Transition
2 Biodiversity and Circular Economy

The case for sustainability is a relative clear one when it comes to both the need and the want for solutions. The planet and the climate are witnessing new levels of extreme weather every day. Anecdotally we see and feel that weather patterns and with them, the natural order is changing. The evidence is in front of us in the headlines almost weekly. We witnessed incredible flooding in Europe, particularly in Spain recently, while Storm Bert flooded major parts of England, this summer was the hottest on record globally, hurricanes Milton and Helene devastated parts of the US southeast and California experienced storm rain and snow that cost lives. The need is clear.

The desire is there too and it is rising. We are seeing an expanding "want" for sustainable solutions. The arrival of AI this year was a landmark moment for humanity offering a step change in human development and productivity in our future but it also brings with it a huge appetite for energy and the companies consuming this energy are looking, in the first instance, to zero emission solutions to provide it – with nuclear getting particular interest. Nuclear energy has grabbed the headlines in recent months as major AI and cloud companies announced partnerships with nuclear energy providers as part of their strategy to obtain carbon free energy to meet their AI energy demand. Old reactors are being considered for reignition and small modular reactor technologies have become a widely discussed topic. This energy is available from non-sustainable sources such as oil, gas and other fossil fuels but the desire and the momentum of these major companies is for long term sustainable solutions, because their customers demand it. Global investments in the low-carbon energy transformation have been rising across the board and topped USD1.8trn in 2023 (Source: HSBC Global Private Banking as at 13 December 2024). Still, much more investment is needed. The reinvigoration of Nuclear as an option in a sustainable future has opened a path for some major energy consumers to expand investment in this area to add to the energy mix.

Renewable energy adoption has seen a steep rise over the past couple of decades, thanks to rising awareness and policy push but if we were to remove the policy support now, renewable energy would still be on course to represent 50% of electricity generation by 2030 according to Bloomberg New Energy Finance. The acceleration of adoption has a compounding effect on technological progress too which can be seen across the space and needs to be accounted for when forecasting the future. The hurdles for a sustainable future are high but they are coming down with every technological step. Lithium Ion batteries for example, integral to mobile phones, laptops, electric vehicles and grid storage fell 90% in cost per kilowatt hour between 2010 and 2023 and they halved in price since 2017, according to BloombergNEF.

Small modular nuclear reactors are another technology being developed that could significantly advance the sustainability agenda. They are designed to be cost effective, portable, easier to manage and quicker to launch. They present an attractive solution for energy hungry industry that wants zero carbon emissions and can't wait for a full-scale nuclear plant. Some of the designs being touted also have hydrogen as an offshoot of the process. Energy grids will need to be adapted to a future of more sustainably sourced energy where the sources of that energy are more disparate and need to be connected.

Energy takes the lion's share of headlines and investor focus when it comes to sustainability but biodiversity is an area that is rapidly rising in investor interest.

Biodiversity funds have seen their inflows grow over 5X in the last 4 years according to a recent Morningstar report and yet, it is still only early days for the sector. The climate fund market, by comparison, is c.USD530bn on a global basis.

Interestingly, the report highlights three types of funds: ones with companies focused on reducing the risk of biodiversity loss, funds seeking companies that provide solutions to biodiversity loss and funds that are a mix of the two. It is the solution-focused funds that are growing fastest which may be a healthy sign that people want solutions when it comes to biodiversity.

Similar to climate, biodiversity is an area that has been hugely impacted and damaged by human activity. The Living Planet Index report was recently updated and it makes for grim reading with an estimated 73% average decline in wildlife populations since 1970. This is often linked to the destruction of habitats where waste from a linear economy is a major culprit. Circular solutions are needed but we also need to be able to attach a value to nature. The World Economic Forum has estimated that 50% of global GDP is connected to natural capital but because nature has always been free and its use has not been managed it has led to issues such as overfishing, or river pollution, damaging its value for future generations. The Taskforce on Nature-related Financial Disclosures developed a set of disclosure recommendations for companies to assess, report and act on their nature-related dependencies, impacts, risks and opportunities. The number of adopters is rising quickly, and this disclosure of companies' biodiversity exposure is another area within sustainability that presents opportunities for investors.

1 Energy Transition

Overview

- Energy transition refers to the global shift from depletable energy resources to cleaner and renewable resources that leave a smaller environmental impact and offer higher efficiency.

- Beyond the renewable energy sources such as solar, wind and biofuels, the transition encompasses other forms of cleaner energy generation such as hydrogen, nuclear power and the broader electrification.

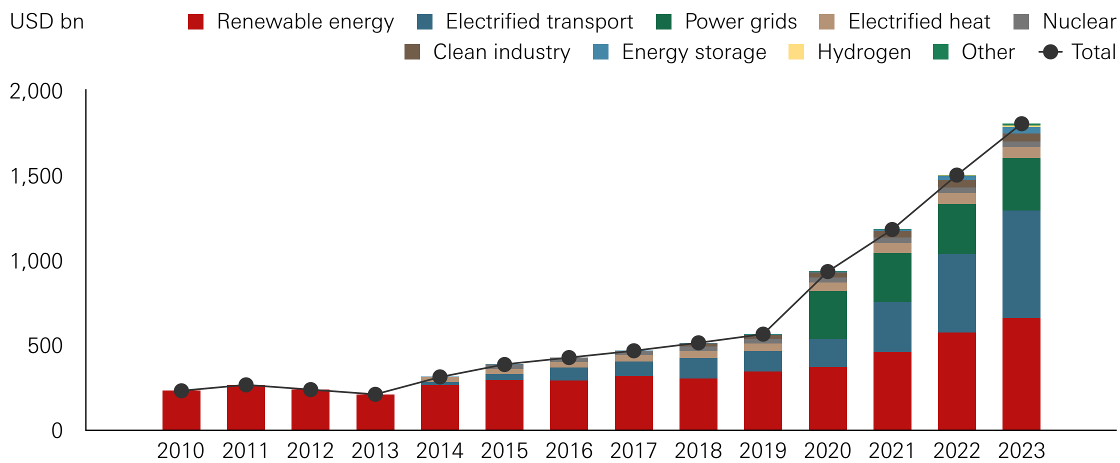
- As countries and corporates pursue their net-zero strategies the transition is accelerating, driving technological advancements, promoting energy security and creating new business models in the energy sector.

The Opportunity

- Keeping the world in a net-zero trajectory by 2050 requires substantial investments in infrastructure, and new technology development on both the demand- and supply-side of energy. Governments have taken a leading role in setting policy frameworks and incentivizing energy solutions creating investment opportunities for private capital flows as well.

- Just last year, global investments in low-carbon technologies and supply chains reached USD1.8trn making double-digit annual growth, while it is estimated that investments in the next six years need to almost triple (average USD4.8trn) to keep the world on track for the 2050 targets (Source: BloombergNEF as at January 2024).

Despite headwinds from higher interest rates in the past years, investments in the energy transition have continued at pace globally



Source: BloombergNEF, Energy Transition Investment Trends 2024 as at 30 January 2024, HSBC Global Private Banking as at 13 December 2024.

- At the same time, demand for electrified transport and related infrastructure expanded by 36% y-o-y, and the growing adoption of AI technologies requires vast amounts of power beyond current systems' capacity (Source: BloombergNEF as at January 2024).

Why now?

- The urgency of the energy transition has never been greater. With global temperatures rising off-track for the 1.5°C target of the Paris Agreement, the transition to a low-carbon economy is recognised as both an environmental and economic necessity. With energy demand expected to rise in tandem with global growth, governments and businesses accelerate efforts to shift to cleaner energy sources.
- Technological innovation is not only facilitating this transition but also creating new needs. In the COP29 summit, the US unveiled a roadmap to triple its nuclear power capacity by 2050.
- While investments in renewable energy projects reached USD623bn in 2023, renewable power capacity needs to nearly triple and energy efficiency double by 2030 to meet the climate targets.

2 Biodiversity and Circular Economy

Overview

- Earth's biodiversity is imperative for human existence. Our societies, livelihoods and economies depend on nature for the natural regulation of weather patterns and provision of basic materials like food and wood.

- The linear 'Make – Take – Use – Waste' economic model is damaging the biodiversity and natural habitats. Conservation efforts alone are insufficient to halt biodiversity loss. Adoption of a circular economic model should help minimise waste of essential resources and help in stemming biodiversity loss.

The Opportunity

- As per the World Economic Forum, half of global GDP – USD44trn – is dependent on nature to some extent. Biodiversity loss and ecosystem collapse are cited by the WEF Global Risks Report 2024 as one of the top three risks over the next decade. This therefore creates an opportunity to act. New business models and solutions that transition business from a Linear to a Circular economic model of 'Reduce – Repair – Reuse – Recycle and Re-design' provide new investment opportunities.

- While the business world has paid great attention to climate change, the issue of biodiversity has largely gone unnoticed until recently. But the good news is that the transition to a circular economy is already in motion due to increased regulation, market, consumer and investor forces. Companies that harness and preserve biodiversity could offer investors the potential to access growth, provide relative outperformance and support long-term change.

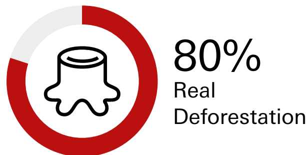
Why now?

- According to the World Economic Forum, failure to address nature risks could result in an estimated loss in global GDP of USD2.7trn by 2030. Given the economic risk, businesses need to adapt their operations to mitigate the impact on the nature and simultaneously, the consequences of biodiversity loss on their business.

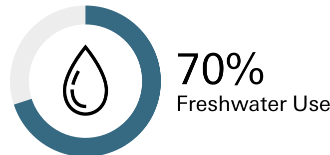
- UN member states agreed on terms of the High Seas Treaty in March 2023, aiming to oversee and protect seas outside areas of exclusive economic zones. This will have a direct monetary impact in food, pharmaceutical and cosmetics industries.

The environmental impacts of food production

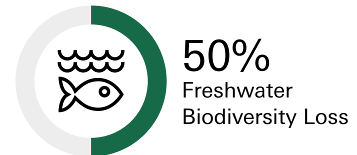
Agriculture is responsible for 80% of global deforestation



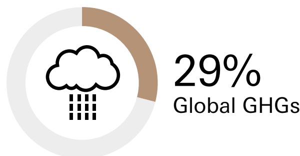
Agriculture accounts for 70% of freshwater use



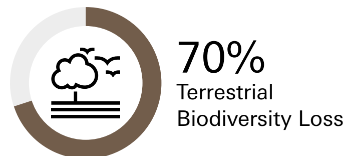
Drivers linked to food production cause 50% of freshwater biodiversity loss



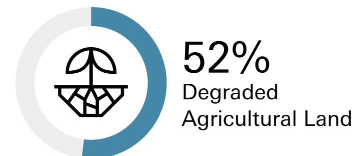
Food systems release 29% of global GHGs



Drivers linked to food production cause 70% of terrestrial biodiversity loss



52% of agricultural production leads to land degradation



Source: WWF Living Planet Report 2020, The Convention on Biological Diversity (CBD), The Global Sustainable Development Report (GSDR), The Economics of Land Degradation (ELD) Initiative, HSBC Global Private Banking as at 13 December 2024.

Top Trend

Evolving Society

Society is seeing several major fundamental trends converging at once where the long term impacts will be felt on markets, the economy and life for decades. These trends are happening across three core strands, age, diversity and technology.

Our two high conviction themes

1 Social Empowerment and Well-being
2 Silver Economy & Demographics

The demographics of age of most societies have been changing for years as birth rates have been falling, while at the same time, people are living longer. Although this change is well known, it is happening at a relatively rapid pace compared to history. It is unclear how much investors have positioned for it as many view it as too far away to be meaningful. It is also not clear what the full ramifications on society and its economics will be but they are expected to be deep and wide. Older people are the richest people in society in aggregate, but they have very different savings and consumption patterns then younger, working people. Heath and assisted living are priority sectors for the over 60's but with the advances in lifestyles, medical treatments and medicines, older people are more active, more mobile and more willing to spend.

Our theme of **Silver Economy & Demographics** is designed to capture the best opportunities resulting from an aging, wealthy, population with much different saving and spending habits than younger working people. Opportunities in this space are likely to present themselves in a variety of ways. The over 60's also have the highest average net worth in society having spent a lifetime building up wealth, typically in their home equity which is often downsized, releasing capital. Retirees then have more time to spend and will typically do so with experiences, travel, leisure, hospitality. Modern retirement lifestyles of fitter, more able and keen to travel retirees, supported by a high purchasing power, are fuelling the Silver Economy. The typical industries we think of, such as pharmaceuticals; healthcare, assisted living and mobility equipment should also have hotels, cruise liners, airlines, consumer goods and specialist financials considered alongside them.

Technology also has a major role to play and older societies such as Japan are already using robotics and technology to service older consumers. The capabilities of these robots are also advancing at pace and the incorporation of AI into robotics software is already demonstrating that it can learn and develop tasks previously that were too difficult for computer programmers. Autos are also an area that are likely to transform older living. There are already a range of autonomous vehicle companies in operation across pockets of the US and the space is somewhat advanced but getting closer to complete autonomy with each fully autonomous mile. This is a global trend that is set to persist for the very long term and society is still adjusting to meet the demands revealing itself.

Society is also changing at the fundamental level of work. Technology and the COVID-19 pandemic have moved a large portion of office work to be remote or partially remote. This change has shifted consumption patterns, commuting for example has changed with the bulk of activity now occurring mid-week, in turn driving consumption in cities to those days. This has major knock-on effects for commercial real estate and this sector is still trying to adjust to the new reality.

Society is also driving for workplaces that are more diverse and better representations of all ethnicities. Progress is slow but evident and some research suggests that more diverse organisations are more robust to the challenges of business. There are several reasons why a business would be more robust when it has a more diverse employee base; different perspectives drive greater creativity and innovation; relevant market and cultural knowledge and insight is crucial across different segments of society; and, casting a wider net for talent gets you better talent.

Empowering diversity and inclusion in organisations is an important trend for society but it should also be a consideration for investors looking for resilience in their portfolios. Shifts in the demographics of major corporations bringing better balance to gender representation and to ethnicity representation are creating opportunities with research showing that it may be linked to corporate profitability.

The universities of Leicester and Glasgow showed that companies with more than 30% female executives tend to outperform. Similarly, McKinsey calculates that companies in the top quartile for gender diversity on executive teams are 18% more likely to be more profitable than the bottom quartile set of companies. Top quartile companies for ethnic diversity have a 27% greater chance of outperforming companies in the bottom quartile. Companies in the bottom quartile for executives on both gender and ethnic representation are 66% less likely to outperform top quartile companies.

What's more, unsurprisingly, research suggests that workplaces with senior management and executive teams that are more diverse across gender and ethnicity are more likely to have workforces that have better diversity which in turn leads to more robust decision making and financial outcomes.

1 Social Empowerment and Well-being

Overview

- The cost-of-living crisis, geopolitical tensions and rising impact of climate change has caused a widening in disparities between, and within nations. Food insecurity and access to basic fundamental rights have come into focus as investors look also at the "S" – social component in ESG (Environmental, Social and Governance) and seek to contribute to a more sustainable and inclusive world.

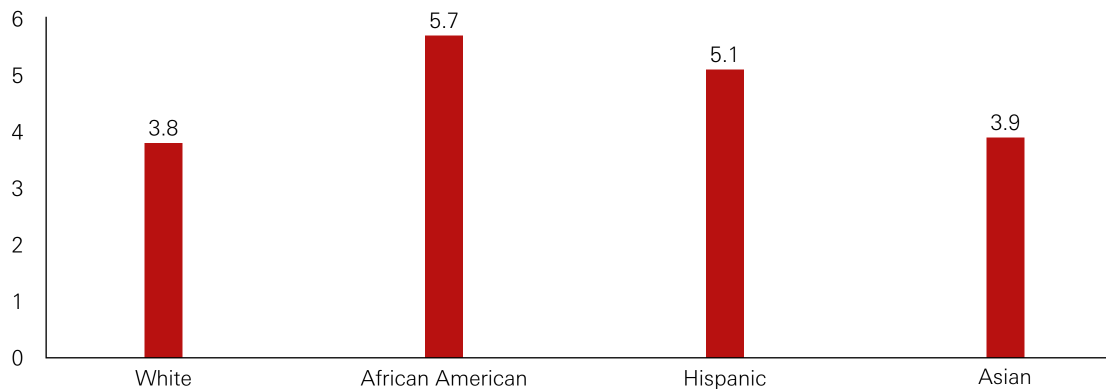
- Growing awareness and initiatives such as the UN Sustainable Development Goals increases the pressure on businesses to address the social and environmental challenges alongside delivering on their financial metrics.

The Opportunity

- Amid the unraveling of structural forces such as demographic shifts, climate change and technological revolution, companies are increasingly adopting business strategies that offer innovative products and services which incorporate solutions to long-term challenges, while also delivering sustainable shareholder value.

- Thanks to innovative products and services, companies will be able to access underserved markets and generate new revenue streams and business growth and build greater economic inclusion. Investors will be able to participate in the growth of currently untapped markets and opportunities around clean water, financial inclusion and healthcare access.

Inequality in unemployment and wages can limit an economy to reach full potential



Sources: US Bureau of Labor Statistics, Bloomberg, HSBC Global Private Banking as at 13 December 2024.

- Several governments and regulators are increasingly implementing policies for the public and private sector to encourage social inclusion and practices to address social issues, such as nutrition, clean water and access to education. Investors could position in areas that are supported by policy incentives, whilst also contributing to the transition towards a more sustainable world. Although investors should primarily focus on the financial and investment considerations, ESG factors are also important. Please refer to our ESG disclosures.

Why now?

- With more than half of the world's population having voted in some election in 2024, the political and economic outlook is notably shifting. Policy implications could vary from trade protectionism to immigration policy, and amid the ripple effects of economic and geopolitical conditions, there is a greater need for private capital flows to address the ongoing social topics.

- We believe businesses that address social (and environmental) challenges tend to have more forward-thinking strategies in their stakeholder interactions and achieve stronger business resilience during structural shifts in global dynamics.

2 Silver Economy & Demographics

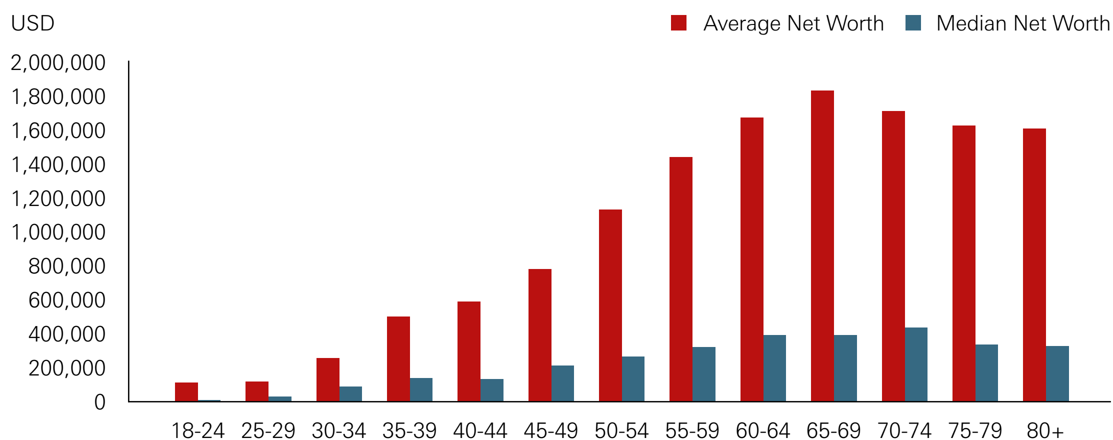
Overview

- People are living longer due to advances in healthcare, medical treatments, knowledge of lifestyles, technology and historically high levels of wealth in society.
- In most large economies, the cohort of the population that make up the over 60s is the wealthiest cohort having built up a lifetime of savings and wealth gained in property.
- The over 60s are much fitter, healthier and mobile than previous generations and they have much different spending habits than their younger counterparts.

The Opportunity

- Opportunities in this space are likely to present themselves in a variety of places. New retirement lifestyles of fitter, more able and keen to travel retirees, supported by a high purchasing power, are fuelling the Silver Economy.
- The typical industries we think of, such as pharmaceuticals; healthcare, assisted living and mobility equipment will be core holdings in a portfolio of exposures to the Silver Economy but there are other industries that are becoming more prevalent with the current generation.
- With higher levels of mobility and healthiness, the over 60s are travelling more and engaging in more experiences. So, opportunities around hotels, cruise liners, airlines, consumer goods such as golf or exercise providers and specialist financials should be considered alongside the core exposures.

Average and median wealth levels in the US by age groups



Source: Federal Reserve Survey of consumer Finances 2022, HSBC Global Private Banking as at 13 December 2024.

Why now?

- Demographics is not a new trend, but it has now reached a point where wealth is being used by the over 60s in a much broader way, across the typical industries for this generation but also in experiences, sports and travel.

- The number of companies who are now focusing on the Silver Economy opportunity is rising and with technology the products and services available to the over 60s is expanding.

- Falling birth rates which has been a trend running in parallel and contributing to the rise in older populations means there is less support within societies to care for the older generation and they are turning more and more to dedicated companies with products and services to accommodate their needs.

Top Trend

Riding the Earnings and Rate Cut Tailwinds

So far, we have discussed three structural trends and the evolving role of Asia in the New World Order. To complete our set of themes, we look at shorter-term or cyclical trends, which we discuss in this final chapter. The cyclical environment is supportive for risk assets, thanks to resilient earnings generation and falling interest rates. But it is also diverse, with the outlook for equities being much more constructive in the US than in the Eurozone or China.

Our three high conviction themes

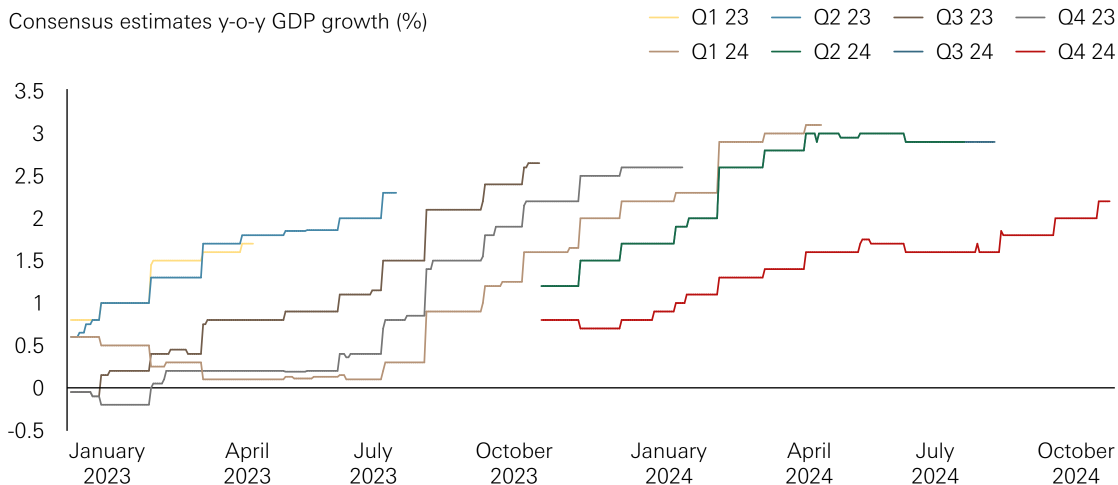
1. American Vitality
2. North American Re-Industrialisation
3. Income Through Active Credit Selection

The US economy resembles a super-tanker that is difficult to blow off course. That's been shown in the past two years, where economic growth consistently surprised to the upside, forcing economists to upgrade their initial growth estimates, quarter after quarter (see graph). The main explanations for this are that companies have benefited more from innovation than is often appreciated, helping them maintain and even grow their near-record margins. They also suffered far less from the high interest rates than expected, as many had locked in low rates before these started to rise. As for US households, they have benefited from falling inflation, while unemployment remains low, resulting in a low reading of the 'misery index' (the sum of inflation and unemployment). And even though voters did not seem very pleased with the state of the economy during the latest elections, consumer confidence has nevertheless been rising ever since mid-2022.

The fall in inflation is allowing the Fed to cut rates, which means that borrowing costs for both companies and households are coming down. Some companies postponed investments ahead of the elections, but the increased clarity we now have – together with the falling borrowing costs – should lead to a pickup in investment activity in our view.

So, US investment fundamentals are favourable as we move into 2025. All eyes will now be on the measures taken by the new US administration. While there is considerable uncertainty about their specific

Economists have time and again been forced to upgrade their US growth forecasts as data continue to be better-than-expected



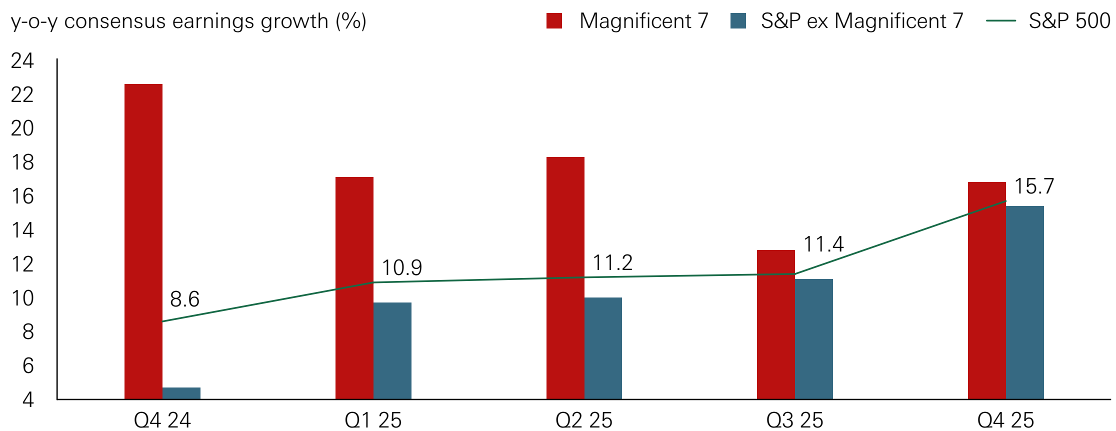
Source: Bloomberg, HSBC Global Private Banking as at 13 December 2024. Forecasts are subject to change.

nature, the direction of travel is towards tax cuts and deregulation, which have the potential to boost earnings growth above the current 15% consensus expectations (see graph).

It is in the US bond market that there is more uncertainty: tariffs and changes to the immigration policy could lead to higher inflation expectations and slow down Fed rate cuts, while concerns over rising deficits and stronger growth could lead to upward pressure on Treasury yields. That means that bonds need an active approach, where investors move up or down the credit rating scale and the duration spectrum as market assumptions on growth, inflation, rates and global risk appetite change over time. That said, with real yields at elevated levels and the need for diversification, there are still good reasons to have sizable allocation to bonds.

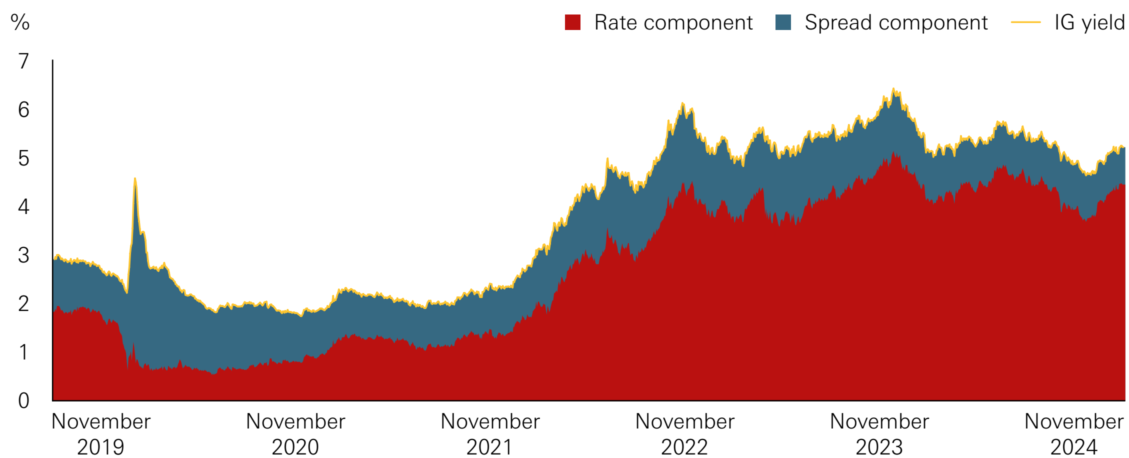
Of course, bond volatility can be an obstacle for equity performance, but unless 10-year Treasury yields move significantly and durably above 4.5% (which is seen as a critical level), we think US stocks are unlikely to start trending down. Instead of being overly concerned about stocks' rate sensitivity, we focus on stocks and themes that benefit most from innovation, government deregulation and structural trends. In fact, earnings growth is broadening, well beyond the Magnificent-7 that have been driving much of the earnings growth and stock market performance in the past year. As our chart shows, earnings of the 'forgotten 493' (those stocks in the

Earnings growth is expected to accelerate and spread well beyond the Magnificent 7



Source: Bloomberg, I/B/E/S, HSBC Global Private Banking as at 13 December 2024. Forecasts are subject to change.

In credit markets, spreads are not overly generous, and most of the value comes from the rate component.



Source: Bloomberg, HSBC Global Private Banking as at 13 December 2024. Past performance is not a reliable indicator of future performance.

S&P500 not part of the Mag-7) are accelerating rapidly. This is at least in part because productivity gains linked to technology are benefiting other sectors too, while lower borrowing costs and easing wage pressures also support margins across sectors. We note that these consensus estimates could see a substantial uplift if corporate tax cuts materialise or fiscal largesse boosts growth (though tariffs could raise input costs and offset part of these benefits).

So in our selection of cyclical themes, we have not retained any European themes, but focused instead on the US. And of course, the best Asian opportunities are already covered under our Asian trend. Among the sectors we currently like in the US, we already include IT, Communications and Healthcare ideas under our Disruptive Technologies trend. So we focus here on Financials and Industrials, which we represent under our **American Vitality** and **North American Re-Industrialisation** themes.

1 American Vitality

Overview

- Anticipated corporate tax cuts, tax credits and incentives aim to boost US manufacturing, enhancing resilience and independence in critical sectors like energy and technology. This initiative seeks to reduce reliance on foreign supply chains and bring production back to the US.

- Proposed middle-class tax relief measures, including expanded deductions and potential child tax credits, are expected to increase disposable income, benefiting consumer staples and discretionary spending, and strengthening the foundation for sustainable growth.

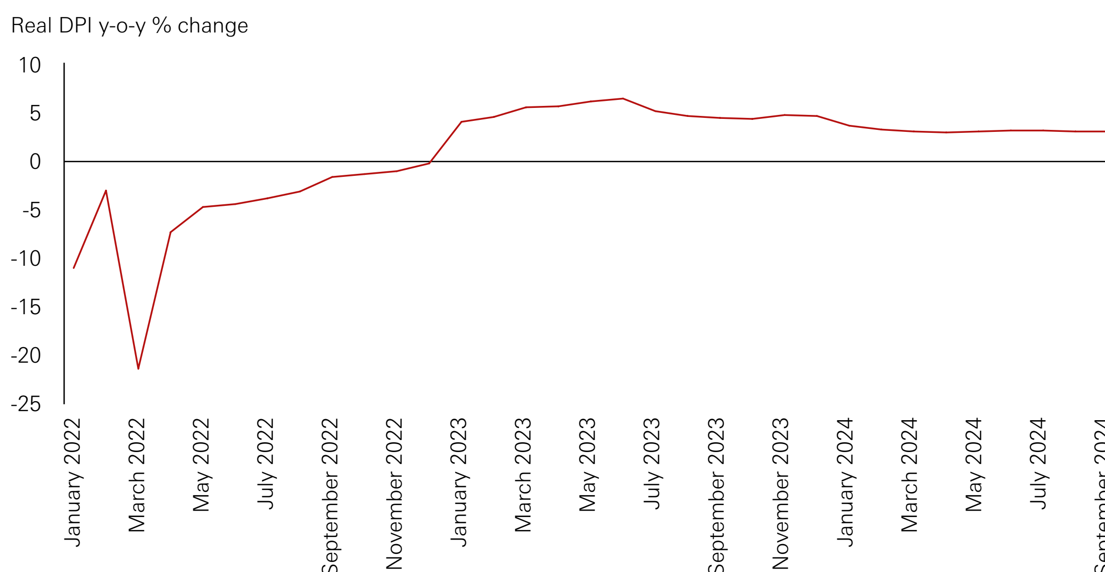
The Opportunity

- New tax cuts, credits, and incentives are expected to strengthen US manufacturing and repatriate production, enhancing resilience in vital sectors like energy and tech.

- Deregulation efforts, especially in energy, finance, healthcare, and technology, aim to reduce operational costs and encourage innovation, supporting business growth and market flexibility.

- Additionally, a focus on streamlining infrastructure hurdles could stimulate growth in construction and related sectors, driving job creation and bolstering US competitiveness. Together, these initiatives position the US for long-term growth, fostering a self-sustainable and resilient economy.

The consumer remains supported by steady growth in real disposable income



Source: Bloomberg, HSBC Global Private Banking as at 13 December 2024.

- The integration of advanced manufacturing technologies, such as AI, robotics, and automation, is transforming production efficiency, reducing costs, and accelerating output, making new US factories competitive globally.
- Investment in a skilled labour force to operate these technologies supports high-quality job creation and productivity gains, making domestic manufacturing more competitive in key industries.
- The unemployment rate is low, real disposable income is positive, potential tax cuts and lower interest rates suggest consumer spending could remain healthy.

Why now?

- With Republicans now controlling both the executive and legislative branches, new initiatives could pass with a simple majority.
- This unified government creates a rare opportunity for swift action on deregulatory measures, tax cuts, and business incentives designed to fuel economic growth and stimulate "animal spirits" in the US.
- These efforts aim to boost consumer spending and encourage business investment in R&D, equipment, and U.S.-based manufacturing. This alignment of policy and economic incentives, driven by a unified government, presents a timely and unique opportunity to enact transformative growth-focused legislation.

2 North American Re-Industrialisation

Overview

- The US is prioritising secure, resilient supply chains for intermediate and finished goods, especially in critical industries.

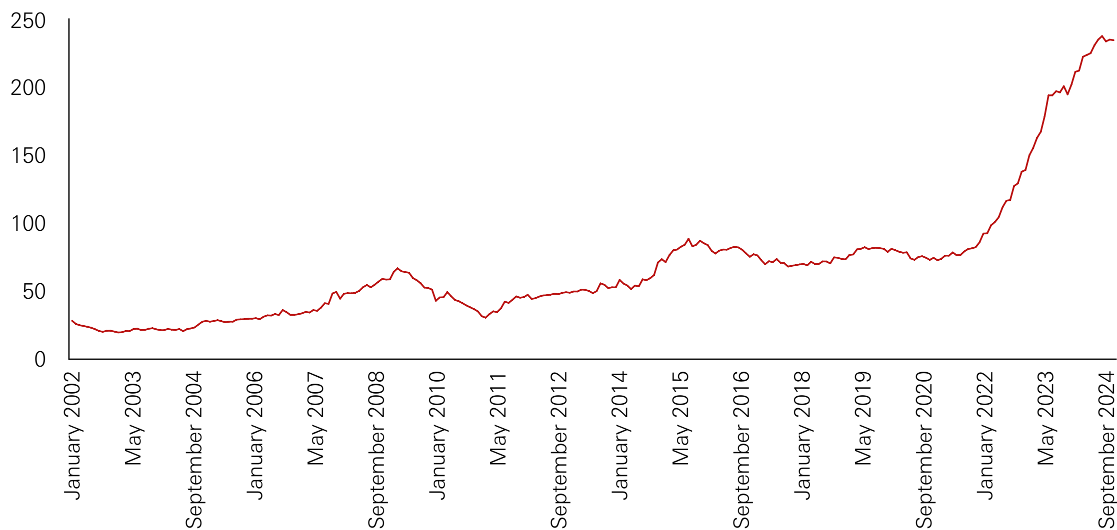
- In a volatile global environment, re-industrialisation ensures economic independence and supply chain security. Federal, state, and local governments are leveraging advanced technologies, strategic spending, and tax incentives to reduce manufacturing costs and boost domestic employment.

- This combined approach has strengthened the US as a competitive player in global manufacturing, making domestic production economically viable and strategically essential in the face of global disruptions.

The Opportunity

- Re-industrialisation is driving job growth across the US, as federal initiatives fund and incentivise new manufacturing facilities, particularly in sectors like semiconductors, electric vehicles, and solar facilities.

Spending on manufacturing remains strong



Source: Bloomberg, HSBC Global Private Banking as at 13 December 2024.

- The construction of these facilities boosts employment and contributes to wealth creation, while also increasing demand for industrial companies and demand for energy.

- Manufacturing employment has grown by 12.7% since April 2020, underscoring this trend. Supporting infrastructure, like logistics and local services, must evolve to meet heightened activity levels. In the past six months, construction spending on new manufacturing facilities has risen by 20% year-over-year (Source: FRED as at September 2024).

- Re-shoring efforts and a technological revolution featuring robotics, automation, AI, and 3D printing are enhancing productivity, making domestic manufacturing more sustainable.

- Both major US political parties continue to champion these initiatives, recognising re-industrialisation as essential for economic security and regional competitiveness.

Why now?

- The new US administration will likely prioritise job creation, with bipartisan support for expanding US manufacturing as a key driver of economic growth.

- Heightened geopolitical instability has accelerated efforts to re-shore production, as companies aim to secure supply chains for basic, intermediate, and finished goods.

- Emerging technologies like robotics, AI, automation, and 3D printing are lowering costs and driving efficiency.

- With the Federal Reserve on the path of monetary easing, the financing of new facilities is becoming increasingly affordable. This shift aligns with global trends, as companies diversify production toward politically stable regions closer to end markets.

- These new highly automative facilities laying the groundwork for long-term economic resilience and enhanced North American competitiveness in global markets.

3 Income Through Active Credit Selection

Overview

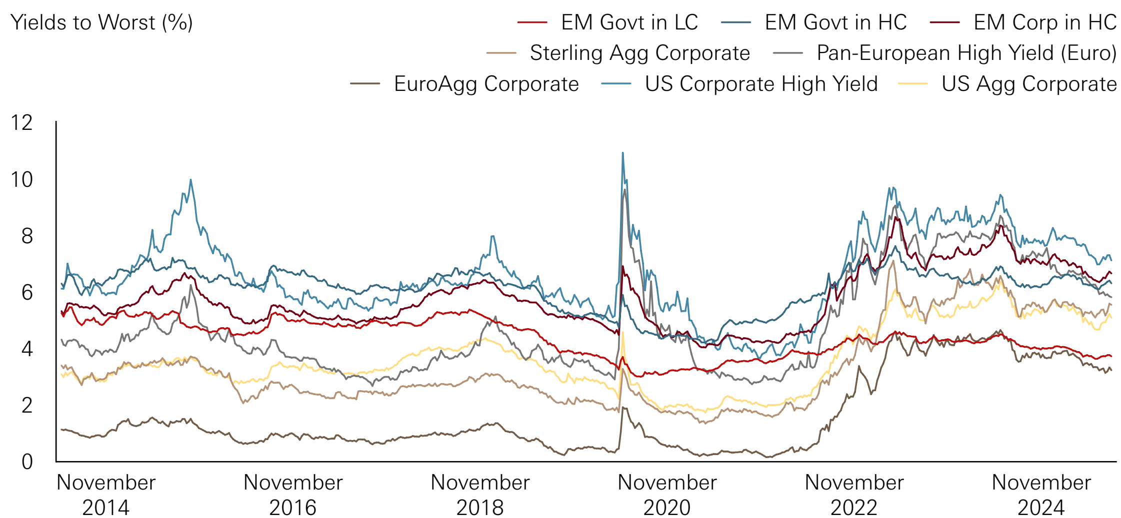
- We have broadened our investment opportunity set to include High Yield (HY) and IG markets from DM and EM, following the swift outcome of the US Elections and rally in risk assets. However, credit selection becomes even more relevant considering the uncertainty around the US administration's policy measures.

- Many central banks, including the US Federal Reserve, may carry on with their monetary policy easing in 2025, amid declining inflation and moderating global economic growth. This should remain supportive for bonds. We continue to see corporate credit as a good way of diversifying multi-asset portfolios and generating income by locking in elevated yields

The Opportunity

- Active credit selection becomes even more relevant considering the uncertainty around fiscal stimulus and geopolitical risks. Some companies may be better positioned to navigate any potential tariff escalation and their resulting impact on the economy. We believe that Financials, especially Banks, could fare relatively well in a deregulatory environment.

Investing in credit markets can generate income by locking in elevated yields



Source: Bloomberg, HSBC Global Private Banking as at 13 December 2024. Past performance is not a reliable indicator of future performance.

- We are conscious however, that current credit spreads in general do not fully compensate for default risk. As a result, we focus on companies prioritising bondholder-friendly policies, with sound leverage ratios and low short-term refinancing needs, but also with robust supply chains and no geographic mismatches, which would make them less vulnerable to US tariffs. This is valid for DM but also for EM companies, and across the IG and HY ratings spectrum.

- Considering elevated volatility across US Treasuries, we keep our focus on the belly of the curve for Global IG (5 – 7 years on average) and slightly shorter for Global HY and EM Hard Currency debt (3 – 5 years on average), where we limit spread duration exposure.

Why now?

- US Treasuries are pricing in a generous risk premium for investor concerns around fiscal deficits and potentially elevated debt supply. We look for opportunities in selective credits which can be a source of additional carry above sovereign rates.

- Fundamentals remain robust across IG companies and DM HY companies have on average refinanced the maturity wall expected for 2025/26. In addition, quality EM bonds provide a strong carry opportunity, while giving diversification across ratings, sectors and nations.

- Bonds and equities have recently moved back to an environment of negative correlation. Therefore, a well-diversified portfolio across asset classes should be able to thrive during "risk-on/risk-off" periods.

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Risk Disclosures

Risks of investment in fixed income

There are several key issues that one should consider before making an investment into fixed income. The risk specific to this type of invest-ment may include, but are not limited to:

Credit risk

Investor is subject to the credit risk of the issuer. Investor is also sub-ject to the credit risk of the government and/or the appointed trustee for debts that are guaranteed by the government.

Risks associated with high yield fixed income instruments

High yield fixed income instruments are typically rated below invest-ment grade or are unrated and as such are often subject to a higher risk of issuer default. The net asset value of a high-yield bond fund may decline or be negatively affected if there is a default of any of the high yield bonds that it invests in or if interest rates change. The spe-cial features and risks of high-yield bond funds may also include the following:

- Capital growth risk – some high-yield bond funds may have fees and/ or dividends paid out of capital. As a result, the capital that the fund has available for investment in the future and capital growth may be reduced; and
- Dividend distributions – some high-yield bond funds may not distribute dividends, but instead reinvest the dividends into the fund or alternatively, the investment manager may have discretion on whether or not to make any distribution out of income and/or capital of the fund. Also, a high distribution yield does not imply a positive or high return on the total investment.
- Vulnerability to economic cycles – during economic downturns such instruments may typically fall more in value than investment grade bonds as (i) investors become more risk averse and (ii) de-fault risk rises.

Risks associated with subordinated debentures, perpetual debentures, and contingent convertible or bail-in debentures

- Subordinated debentures – subordinated debentures will bear higher risks than holders of senior debentures of the issuer due to a lower priority of claim in the event of the issuer's liquidation.
- Perpetual debentures – perpetual debentures often are callable, do not have maturity dates and are subordinated. Investors may in-cur reinvestment and subordination risks. Investors may lose all their invested principal in certain circumstances. Interest pay-ments may be variable, deferred or cancelled. Investors may face uncertainties over when and how much they can receive such payments.
- Contingent convertible or bail-in debentures – Contingent con-vertible and bail-in debentures are hybrid debt-equity instruments that may be written off or converted to common stock on the oc-currence of a trigger event. Contingent convertible debentures re-fer to debentures that contain a clause requiring them to be writ-ten off or converted to common stock on the occurrence of a trigger event. These debentures generally absorb losses while the issuer remains a going concern (i.e. in advance of the point of non-viability). "Bail-in" generally refers to (a) contractual mecha-nisms (i.e. cotractual bail-in) under which debentures contain a clause requiring them to be written off or converted to common stock on the occurrence of a trigger event, or (b) statutory mech-anisms (i.e. statutory bail-in) whereby a national resolution authority writes down or converts debentures under specified con-ditions to common stock. Bail-in debentures generally absorb losses at the point of non viability. These features can introduce notable risks to investors who may lose all their invested princi-pal.

Contingent convertible securities (CoCos) or bail-in debentures are highly complex, high risk hybrid capital instruments with unusual loss-absorbency features written into their contractual terms.

Investors should note that their capital is at risk and they may lose some or all of their capital.

Changes in legislation and/or regulation

Changes in legislation and/or regulation could affect the performance, prices and mark-to-market valuation on the investment.

Nationalisation risk

The uncertainty as to the coupons and principal will be paid on sched-ule and/or that the risk on the ranking of the bond seniority would be compromised following nationalisation.

Reinvestment risk

A decline in interest rate would affect investors as coupons received and any return of principal may be reinvested at a lower rate. Changes in interest rate, volatility, credit spread, rating agencies actions, liquidi-ty and market conditions may have a negative effect on the prices, mark-to-market valuations and your overall investment.

Risk disclosure on Dim Sum Bonds

Although sovereign bonds may be guaranteed by the China Central Government, investors should note that unless otherwise specified, other renminbi bonds will not be guaranteed by the China Central Government.

Renminbi bonds are settled in renminbi, changes in exchange rates may have an adverse effect on the value of that investment. You may not get back the same amount of Hong Kong Dollars upon maturity of the bond.

There may not be active secondary market available even if a renminbi bond is listed. Therefore, you need to face a certain degree of liquidity risk.

Renminbi is subject to foreign exchange control. Renminbi is not freely convertible in Hong Kong. Should the China Central Government tighten the control, the liquidity of renminbi or even renminbi bonds in Hong Kong will be affected and you may be exposed to higher liquidity risks. Investors should be prepared that you may need to hold a renminbi bond until maturity.

Alternative Investments

Hedge Fund – Please note Hedge Funds often engage in leveraging and other speculative investment practices that may increase the risk of investment loss. They can also be highly illiquid, are not required to provide periodic pricing or valuation information to investors, and may involve complex tax structures and delays in distributing important information. Alternative investments are often not subject to the same regulatory requirements as, say, mutual funds, and often charge high fees that may potentially offset trading profits when they occur. **Private Equity** – Please note Private Equity is generally illiquid, involving long term investments that do not display the liquid or transparency characteristics often found in other investments (e.g. Listed securities). It can take time for money to be invested (cash drag) and for invest-ments to produce returns after initial losses.

Risk disclosure on Emerging Markets

Investment in emerging markets may involve certain, additional risks which may not be typically associated with investing in more estab-lished economies and/or securities markets. Such risks include (a) the risk of nationalisation or expropriation of assets; (b) economic and political uncertainty; (c) less liquidity in so far of securities markets; (d) fluctuations in currency exchange rate; (e) higher rates of inflation; (f) less oversight by a regulator of local securities market; (g) longer set-tlement periods in so far as securities transactions and (h) less strin-gent laws in so far the duties of company officers and protection of Investors.

Risk disclosure on FX Margin

The price fluctuation of FX could be substantial under certain market conditions and/or occurrence of certain events, news or developments and this could pose significant risk to the Customer.

Leveraged FX trading carry a high degree of risk and the Customer may suffer losses exceeding their initial margin funds. Market conditions may make it impossible to square/close-out FX contracts/options. Customers could face substantial margin calls and therefore liquidity problems if the relevant price of the currency goes against them.

The leverage of a product can work against you and losses can exceed those of a direct investment. If the market value of a portfolio falls by a certain amount, this could result in a situation where the value of collateral no longer covers all outstanding loan amounts. This means that investors might have to respond promptly to margin calls. If a portfolio's return is lower than its financing cost then leverage would reduce a portfolio's overall performance and even generate a negative return.

Currency risk – where product relates to other currencies

When an investment is denominated in a currency other than your local or reporting currency, changes in exchange rates may have a negative effect on your investment.

Chinese Yuan ("CNY") risks

There is a liquidity risk associated with CNY products, especially if such investments do not have an active secondary market and their prices have large bid/ offer spreads.

CNY is currently not freely convertible and conversion of CNY through banks in Hong Kong and Singapore is subject to certain restrictions. CNY products are denominated and settled in CNY deliverable in Hong Kong and Singapore, which

represents a market which is different from that of CNY deliverable in Mainland China.

There is a possibility of not receiving the full amount in CNY upon settlement, if the Bank is not able to obtain sufficient amount of CNY in a timely manner due to the exchange controls and restrictions applicable to the currency.

Illiquid markets/products

In the case of investments for which there is no recognised market, it may be difficult for investors to sell their investments or to obtain reliable information about their value or the extent of the risk to which they are exposed.

Environmental, Social and Governance ("ESG") Customer Disclosure

In broad terms "ESG and sustainable investing" products include investment approaches or instruments which consider environmental, social, governance and/or other sustainability factors to varying de-grees. Certain instruments we classify as ESG or sustainable investing products may be in the process of changing to deliver sustainability outcomes. There is no guarantee that ESG and Sustainable investing products will produce returns similar to those which don't have any ESG or sustainable characteristics. ESG and Sustainable investing products may diverge from traditional market benchmarks. In addition, there is no standard definition of, or measurement criteria for, ESG and Sustainable investing or the effect of ESG and Sustainable investing products. ESG and Sustainable investing and related measurement criteria are (a) highly subjective and (b) may vary significantly across and within sectors.

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An investment which is considered to fulfil sustainable criteria today may not meet those criteria at some point in the future. When we allocate an HSBC ESG and Sustainable Investing (SI) classification: HSBC ESG Enhanced, HSBC Thematic or HSBC Impact (this is known as HSBC Purpose in the UK) to an investment product, this does not mean that all individual underlying holdings in the investment product or portfolio individually qualify for the classification. Similarly, when we classify an equity or fixed income under an HSBC ESG Enhanced, HSBC Thematic or HSBC Impact (this is known as HSBC Purpose in the UK) category, this does not mean that the underlying issuer's activities are fully aligned with the relevant ESG or sustainable characteristics attributable to the classification. Not all investments, portfolios or services are eligible to be classified under our ESG and SI classifica-tions. This may be because there is insufficient information available or because a particular investment product does not meet HSBC's SI classifications criteria.

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