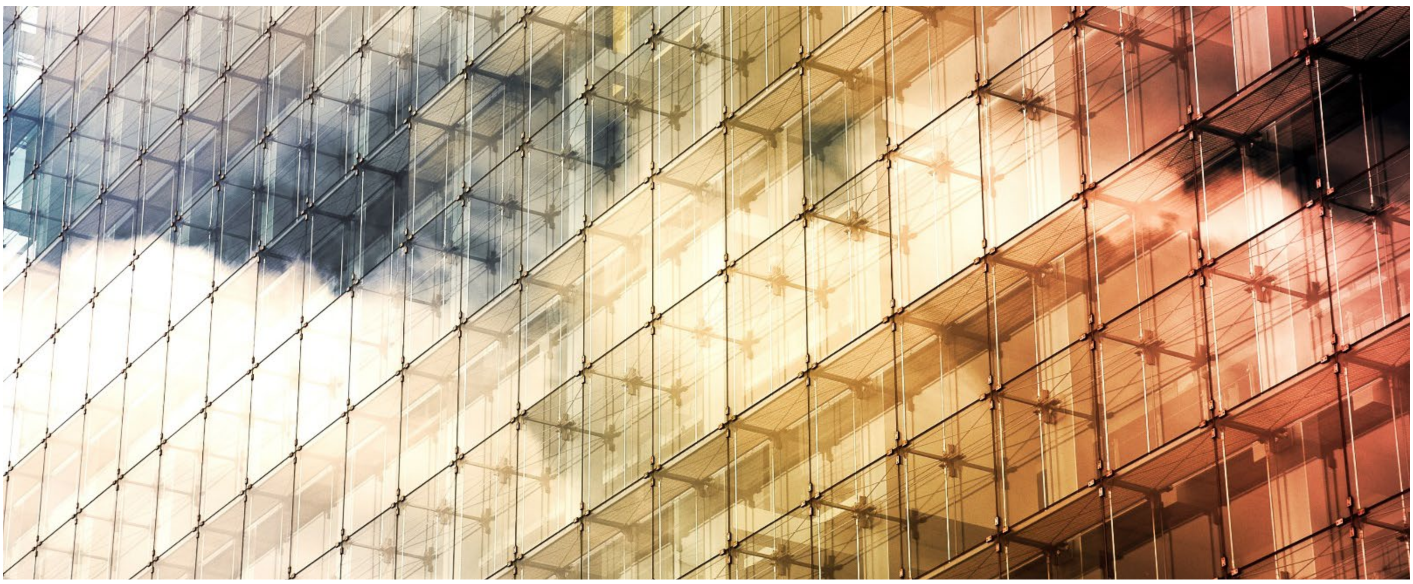
Three Good Reasons

Why the US equity correction may now be in overshooting territory

12 March 2025



Contributors

Willem Sels
Global CIO, HSBC Global Private Banking and Wealth

Highlights

US stock markets have been underperforming year to date, first because of increased opportunities elsewhere in the world, but more recently also because of investors' fears of weaker US growth. While uncertainty can weigh both on activity and on valuations, both factors are already starting to be reflected in current market levels. Markets are starting to price in elevated recession risks, and a buffer for uncertainty is now 'in the price'. We continue to diversify geographically as US equities could see further two-way volatility in the short term, but structural opportunities remain in the US and there is good upside with a 6-month horizon.

- The Mag7 have been at the forefront of the correction after their sharp rally in the past years. Their valuation multiples are now more than one standard deviation below the 10-year average. The fall may have been exacerbated by investor sentiment, which according to some surveys is now so low that it triggers a contrarian bullish signal.

- The relative performance of stocks vs Treasuries is reflective of a recessionary environment. This contrasts with the consensus calling for 2.3% GDP growth and with constructive business surveys (PMI, ISM, Small business confidence).

- The underperformance of cyclicals vs defensives seems quite pronounced in light of positive earnings surprises in Q4 – especially for cyclicals - and the Fed being on a rate cut path.

- We acknowledge that policy uncertainty is at the highest level since 2020 but we do not think markets should be pricing in a recession or stagflation scenario. Structural trends including AI innovation and onshoring should help keep the US economy out of recession, and the today's CPI figure – albeit ahead of the new tariffs - is benign.

- We believe that investors will start looking for solid companies that have sold off but are supported by lasting trends and themes. In our view, this should be complemented by tail risk hedges and diversifiers, including gold, hedge funds and long-dated quality bonds, as well as global diversification.

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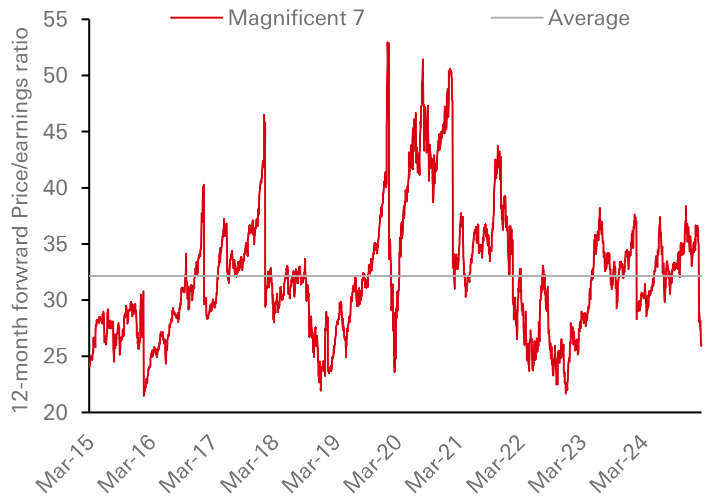
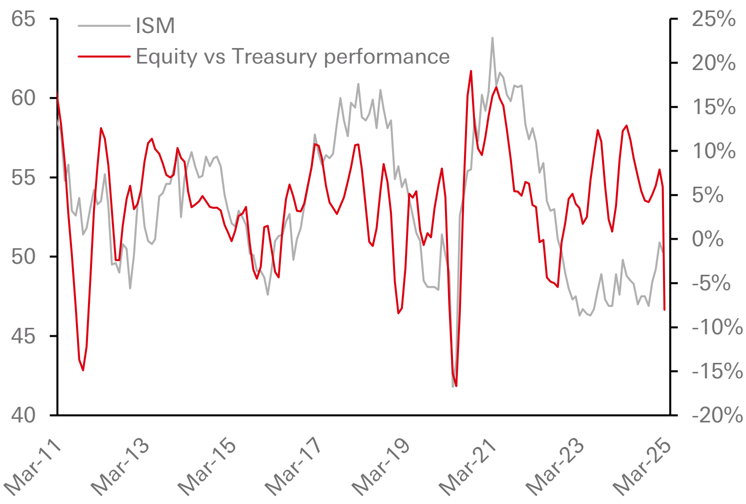
- P/E valuation multiples for the Magnificent 7 have now dropped more than one standard deviation below their 10-year average.
- The moves for the Magnificent 7 may have been particularly pronounced because they are widely held with retail investors and a consensus overweight.
- Retail sentiment is particularly negative, with the AAII survey showing 37% more bears than bulls. Such a negative reading has only been seen in 4 weeks since 2008 and is often a bullish contrarian indicator.
- We continue to diversify our exposure beyond the Magnificent 7 into communication, industrials, financials and healthcare but do not flee from IT.



Source: I/B/E/S, HSBC Global Private Banking, March 2025. Past performance is not a reliable indicator of future performance

2

- The relative performance of Treasuries (seen as safe havens) and equities is closely linked to investors' risk appetite and their view of the economic outlook. The recent rally of Treasuries combined with the sell-off in equities is typical of an economy in recession (or for an ISM reading of about 47 vs the current actual reading of 50.3).
- We think the equity market may be too negative on the economic cycle. Equity analysts are projecting negative earnings growth for Q1 2025 compared to Q4 2024, which seems conservative.
- Recent business surveys remain constructive, with a composite PMI at 51.6 and small business confidence at the 62nd percentile, clearly out of recession territory.



Source: Bloomberg, HSBC Global Private Banking, March 2025. Past performance is not a reliable indicator of future performance.

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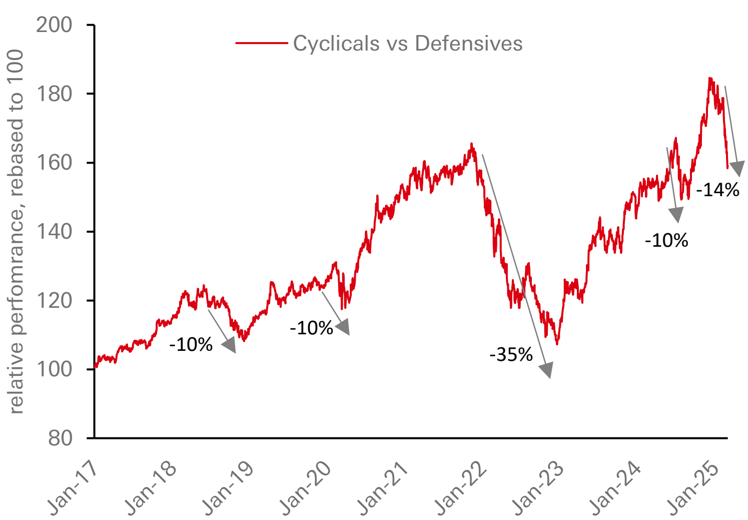
- Cyclicals have underperformed defensives recently by around 14%. In past episodes of market turmoil, that underperformance was usually limited to 10%, even during COVID.
- The exception is 2022, when the 35% underperformance was linked to rate hikes. The Fed is on an easing path now, and today's lower-than-expected CPI figure solidifies the case for rate cuts.
- Some investors were spooked by the Atlanta Fed GDPNow indicator which suggests 1Q GDP could be as low as -2.4%. But the breakdown clarifies that 3.8% of the drop is due to US firms boosting imports ahead of tariffs. Underlying domestic demand is thus much more resilient than this GDPNow indicator suggests.



Source: Bloomberg, HSBC Global Private Banking, March 2025. Past performance is not a reliable indicator of future performance.

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 investment may include, but are not limited to:

Credit risk

Investor is subject to the credit risk of the issuer. Investor is also subject 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 investment 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 special 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) default 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 incur reinvestment and subordination risks. Investors may lose all their invested principal in certain circumstances. Interest payments 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 convertible and bail-in debentures are hybrid debt-equity instruments that may be written off or converted to common stock on the occurrence of a trigger event. Contingent convertible debentures refer to debentures that contain a clause requiring them to be written 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 mechanisms (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 mechanisms (i.e. statutory bail-in) whereby a national resolution authority writes down or converts debentures under specified conditions 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 principal.

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 schedule 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, liquidity 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 investments 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 established 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; (c) higher rates of inflation; (f) less oversight by a regulator of local securities market; (g) longer settlement periods in so far as securities transactions and (h) less stringent 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

Risk Disclosures

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 degrees. 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 classifications. 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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• Deposits are not covered by the financial claims scheme and are not guaranteed by the Australian Government.

• Deposits do not receive priority ahead of amounts owed to other creditors. This means that if a foreign ADI was unable to meet its obligations or otherwise is in financial difficulties and ceases to make payments, its depositors in Australia would not receive priority for repayment of their deposits from the foreign ADI's assets in Australia.

A foreign ADI is not required to hold assets in Australia to cover its deposit liabilities in Australia. This means that if the foreign ADI were unable to meet its obligations or otherwise is in financial difficulties and ceases to make payments, it is uncertain whether depositors would be able to access the full amount of their deposit.

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For SAA/TAA

This is an illustrative approach of a globally diversified portfolio allocation strategy across asset classes; the strategy and the underlying fulfilment options are not applicable to India customers.

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