HSBC Private Banking

US Perspectives

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Growth driving the economy and markets

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Key Highlights

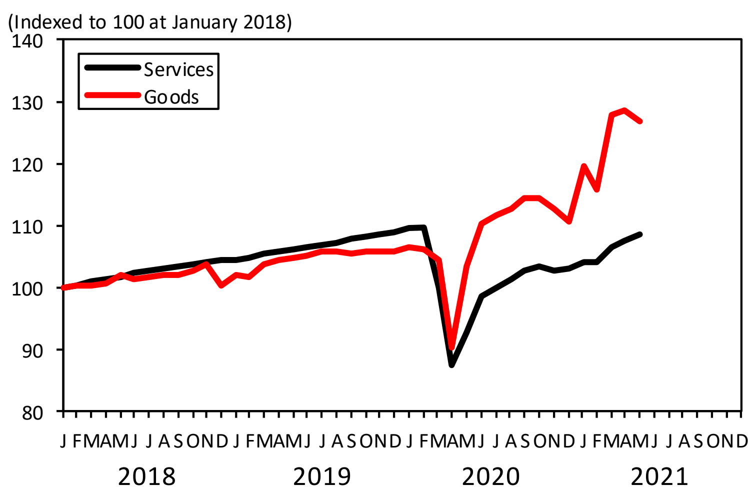
- For the first six months of 2021, US equities have outperformed most major market indices and the MSCI world index. Looking ahead to the second half of the year we expect that outperformance to continue but we also know that volatility should pick up given certain potential headwinds.
- US demand should remain strong as the economy continues to reopen, this will be felt more significantly in the services industries. Consumers have excess savings and should continue to spend especially in industries like cruise lines, hotels, restaurants, theme parks, movie theaters, vacation resorts, and a host of other service industries.
- While we remain cyclical in orientation in our US equity overweight, we continue to focus on quality value opportunities.
- In terms of investment spending, as the Biden Administration pushes its social agenda, the threat of higher individual, corporate, and capital gains taxes loom. This could result in a lift in investment spending towards the end of the year as companies bring forward investment plans to use a tax regime they are comfortable with.
- As a result of this favorable economic backdrop, we remain constructive on US equities with our overweight position firmly in place. Over the long term, we continue to focus on the multi-year rollout of emerging technologies beginning with 5G, which suggests an overweight to technology and communication services continues to make sense as well.

Potential headwinds

US equities continue to struggle with several issues. First, inflation has been more persistent than most forecast, including the Fed. Unfortunately, given the pervasive supply shortages and the surge in demand, this inflationary backdrop may stay in place for longer than most anticipated. While the rise in inflation remains problematic, it is important to remember that top line revenue growth, or GDP, is surging faster. Especially in the sectors hurt most by Covid, revenues are expected to rebound dramatically. Second, the threat of higher taxes looms as the Biden administration looks to increase spending on social issues. Higher individual tax rates could affect consumer spending, but strong labor markets should more than offset that issue. On the corporate side of the equation, most forecasters estimate that at most higher tax rates could take 3-5% off the future growth in earnings, not including the generous investment offsets President Biden has proposed. Finally, the issue of the Fed tapering its quantitative easing programs will probably become a major issue in the fall. The reduction of asset purchases by the Fed could result in a backup in treasury yields. From a global perspective, any increase in US treasury yields would probably be well received by markets given the lack of viable options in other sovereign markets. This probably implies that there is still some upper constraint to US government bond yields, which would be supportive for US equities.

Goods consumption has soared
while services have just begun to rise

PCEs: Goods vs. Services



Source: Bloomberg, HSBC Private Banking as of 7/16/2021. Past performance is not a reliable indicator of future performance.

Pent-up demand pushing growth

Consumer spending has been strong and is set to rise close to 10% in the second quarter. While that spending has benefited from the injection of stimulus checks, the consumer savings rate remains abnormally high at almost 13%. Looking ahead, as the unemployment rate continues to drift lower, look for more sustainable consumer spending to continue to lift economic activity. The June retail sales report was almost 1% stronger than the consensus forecast and core retail sales (excluding autos, building materials, and gasoline) rose 1.3%, the third increase in spending in the last four months. Consumer spending is shifting, as in June, spending at restaurants rose 2.3% and spending at clothing stores rose 2.6%, perhaps reflecting the need to freshen up wardrobes as consumers begin to return to work and socialize. The excess level of savings, combined with tremendous pent-up demand suggests that consumer stocks should benefit from the continued expansion in consumer spending on services and technology

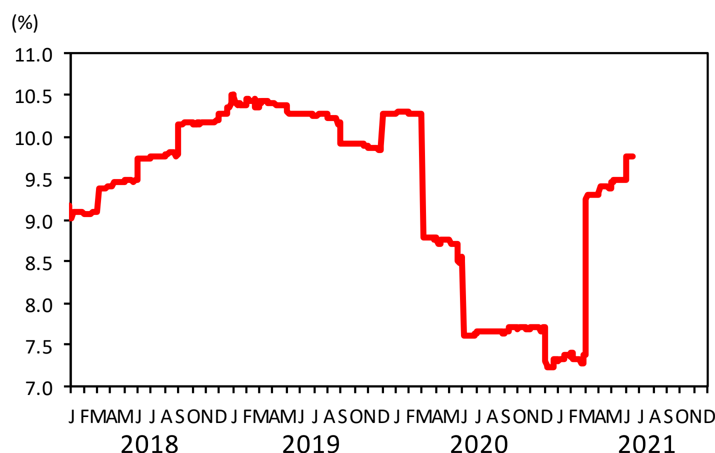
Inflation rising for now

Inflation is still strong in the US, at both the producer and consumer levels. Consumer prices surged 0.9% in June, rising more than expected for the third consecutive month. The overall CPI rose 5.4% on a year-on-year basis, which represents the sharpest 12-month advance in inflation since June 2008. The economy's reopening has led consumers to increasingly travel, dine out and shop after avoiding crowds for a year. That burst of spending has forced up prices for restaurant meals, clothes, and airplane tickets. A shortage of semiconductors has made new and used cars much more expensive, and rental car prices have soared.

Over the last three months, new and used car prices have been responsible for about half of the increase in the monthly gain in consumer prices. As car and truck production picks up that should reverse. Economists estimate a high percentage of the gains in inflation are due to supply shortages and pent-up demand fueled by excess savings. Price surges in goods as varied as car and truck prices, energy, and food were responsible for most of the gains in CPI last month. In fact, if those outsized price gains are eliminated Bloomberg estimates the CPI would have risen a more reasonable 0.2% on the month.

In the US corporate margins remain healthy

S&P 500 profit margin



Source: Bloomberg, HSBC Private Banking as of 7/16/2021. Past performance is not a reliable indicator of future performance.

Earnings & Margins outlook

US corporate earnings have exceeded expectations for a year now. We expect the same results in the second half of the year as top line growth should continue to expand faster than inflation resulting in continued strong profits gains. Significantly, Bloomberg consensus forecast for US corporate

profits is for growth of 10% per year for the next two years. In any inflationary environment, a key question in monitoring the potential trajectory for corporate profits is corporate margins. Earnings remain strong in part because the strength in demand has allowed companies to pass on the higher costs to consumers. As a result, margins have stayed strong even in the face of rising prices.

Investment Summary

US equity markets have performed well this year and we expect them to continue to do so. Above-trend economic growth, combined with healthy margins, suggests earnings should remain healthy for the foreseeable future. A combination of strong consumer demand and the expectation that investment spending should pick up suggests US equity markets should remain well bid. In addition, with cash at high levels, companies will probably look to expand dividend policies and re-purchase stock. Both of those should also be supportive for US equities. Finally, in advance of potentially higher corporate taxes look for investment spending and M&A to pick up before year-end as companies bring forward spending plans in a tax regime they are comfortable with. While issues remain for US equity investors they should not derail the current bull market. That said, a repricing of equities due to changing fundamentals is always in the cards but the longer-term outlook remains positive for US equities.

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