IM Investment Monthly

02 June 2017

US Treasury yields dip amid soft inflation data

Key takeaways

- We have upgraded our US and UK equity view to neutral. We remain neutral global equities, although now with a positive bias. Meanwhile, we also retain our underweight stance on developed market (DM) government bonds
- Global equities rose for a seventh straight month in May, supported by continuing robust economic data releases and generally upbeat earnings reports
- The May Federal Open Market Committee (FOMC) meeting minutes suggested the Fed is confident enough to raise interest rates again at its June meeting
- Strong eurozone data amid the victory of Emmanuel Macron in the French elections paves the way for the European Central Bank (ECB) to reduce its asset purchases in 2018
- April Chinese data showed softer growth momentum following Q1's strength with activity likely to moderate further this year due to the lagged impact of tightening measures
- EM assets still look attractive to us, although strong performance in EM equities this year has resulted in valuations that no longer look anomalously cheap

We upgrade our US and UK equity view to neutral

Consistent with reduced expectations of a US fiscal stimulus package and easing global macro momentum, markets have recently moved to price a softer outlook for global inflation. The cooling of this "reflation trade" has resulted in slightly lower US Treasury yields, boosting the relative attractiveness of US equities. Amid a positive US Q1 earnings season, we now advocate a neutral stance in this asset class. Similarly, we also move to neutral on UK equities as lower gilt yields have improved the relative reward to bearing UK equity risk. Overall, the global implied equity premium – the excess return over bonds – remains little changed. With few signs of a meaningful deterioration in macro fundamentals, we retain our neutral view on global equities, albeit now with a positive bias.

The prevailing economic environment remains bond unfriendly. We are past the peak of loose global monetary policy, whilst the era of fiscal austerity has ended. Also, recent softness in inflation data is unlikely to persist, in our view. Therefore, we retain our underweight positioning in DM government bonds, which we still believe are overvalued. We also maintain our overweight stance on EM assets. However, for EM equities, the investment case has become more about economic and price momentum, alongside the upside offered by cheap currencies.

Equities			Government bonds			Corporate bonds & other			Asian assets		
Asset Class	View	View Movement	Asset Class	View	View Movement	Asset Class	View	View Movement	Asset Class	View	View Movement
Global	**Neutral**	–	**Developed Market (DM)**	**Underweight**	**–**	**Global investment grade (IG)**	**Neutral**	**–**	EM Asian fixed income	Underweight	–
US	Neutral	↑	US	Underweight	–	USD IG	Neutral	–	Asia ex-Japan equities	Overweight	–
UK	Neutral	↑	UK	Underweight	–	EUR and GBP IG	Neutral	–	China	Overweight	–
Eurozone	Overweight	–	Eurozone	Underweight	–	**Global high-yield**	**Neutral**	**–**	India	Overweight	–
Japan	Overweight	–	Japan	Underweight	–	**Gold**	**Neutral**	**–**	Hong Kong	Neutral	–
Emerging Markets (EM)	Overweight	–	**EM (local currency)**	**Overweight**	**–**	**Other commodities**	**Neutral**	**–**	Singapore	Overweight	↑
CEE & Latam	Neutral	–				**Real estate**	**Neutral**	**–**	South Korea	Overweight	–
									Taiwan	Neutral	–

HSBC

Long-term asset class positioning (>12 months)

Basis of Views and Definitions of 'Long term Asset class positioning' table

Views are based on regional HSBC Global Asset Management Asset Allocation meetings held throughout May 2017, HSBC Global Asset Management's long-term expected return forecasts which were generated as at 28 April 2017, our portfolio optimisation process and actual portfolio positions.

Icons: ↑ View on this asset class has been upgraded — No change ↓ View on this asset class has been downgraded

Underweight, overweight and neutral classifications are the high-level asset allocations tilts applied in diversified, typically multi-asset portfolios, which reflect a combination of our long-term valuation signals, our shorter-term cyclical views and actual positioning in portfolios. The views are expressed with reference to global portfolios. However, individual portfolio positions may vary according to mandate, benchmark, risk profile and the availability and riskiness of individual asset classes in different regions.

"Overweight" implies that, within the context of a well-diversified typically multi-asset portfolio, and relative to relevant internal or external benchmarks, HSBC Global Asset Management has (or would have) a positive tilt towards the asset class.

"Underweight" implies that, within the context of a well-diversified typically multi-asset portfolio, and relative to relevant internal or external benchmarks, HSBC Global Asset Management has (or would) have a negative tilt towards the asset class.

"Neutral" implies that, within the context of a well-diversified typically multi-asset portfolio, and relative to relevant internal or external benchmarks HSBC Global Asset Management has (or would have) neither a particularly negative or positive tilt towards the asset class

For global investment-grade corporate bonds, the underweight, overweight and neutral categories for the asset class at the aggregate level are also based on high-level asset allocation considerations applied in diversified, typically multi-asset portfolios. However, USD investment-grade corporate bonds and EUR and GBP investment-grade corporate bonds are determined relative to the global investment-grade corporate bond universe.

For Asia ex Japan equities, the underweight, overweight and neutral categories for the region at the aggregate level are also based on high-level asset allocation considerations applied in diversified, typically multi-asset portfolios. However, individual country views are determined relative to the Asia ex Japan equities universe as of 31 May 2017.

Similarly, for EM government bonds, the underweight, overweight and neutral categories for the asset class at the aggregate level are also based on high-level asset allocation considerations applied in diversified, typically multi-asset portfolios. However, EM Asian Fixed income views are determined relative to the EM government bonds (hard currency) universe as of 31 May 2017.

Equities

Asset class	View	Movement	Rationale
Global	**Neutral**	—	**Positive factors:** Global economic growth momentum remains solid, driving global equity markets to deliver positive returns over the long term. Overall, support from accommodative monetary policy and an increased willingness for looser fiscal policy will, in the medium and longer term, likely outweigh any headwinds from more modest Chinese growth, tighter US monetary policy, and political uncertainty in many regions. **Risks to consider:** The recent compression of implied equity premia (excess returns over bonds) limits the ability of the market to absorb bad news. Episodic volatility may be triggered by concerns surrounding Chinese growth, US economic policy, and/or a potentially more rapid than expected Fed tightening cycle, coupled with political risks. A notable and persistent deterioration of the global economic outlook could also dampen our view.
US	Neutral	↑	**Rationale of view change:** Lower yields on US Treasuries make US equities a comparatively more attractive investment, in our view. Meanwhile, the Q1 earnings season has done well, and profits data has shown improvement. Overall, despite record highs in US equities, this suggests a more neutral stance. **Positive factors:** Corporate tax reform, looser regulation and fiscal stimulus under the Trump administration present an upside risk to earnings. **Risks to consider:** Relatively high current valuations lead to an implied risk premium that is lower than in many other developed markets. The policy outlook under the Trump administration remains highly uncertain.
UK	Neutral	↑	**Rationale of view change:** Lower yields on UK gilts have improved the relative reward to bearing UK equity risk. Positive global economic momentum also supports the UK earnings outlook given a large dependency on foreign earnings. **Positive factors:** Further sterling weakness would likely prove supportive given a relative dependence on foreign earnings. Gains in commodity prices would also be a positive. **Risks to consider:** We believe the prospective reward to bearing equity risk in the UK is relatively low. The UK economy could slow amid sterling-induced inflationary pressures and Brexit related uncertainty.

Eurozone	Overweight	—	**Rationale of overweight views:** We favour eurozone equities due to their higher implied risk premia and scope for better earnings news given the region's earlier point in the activity cycle. Furthermore, the monetary backdrop remains supportive, with ultra-low interest rates likely to persist until the end of the decade. **Risks to consider:** According to recent polls, the upcoming Italian elections should see the eurosceptic 5-star movement perform well. Also, the outcome of Brexit negotiations is highly uncertain. Brexit-related trade disruptions and/or slower UK GDP growth will likely hit eurozone exports. ECB monetary policy may also be less accommodative than expected.
Japan	Overweight	—	**Rationale of overweight views:** Relative valuations and risk premia are attractive, in our view, whilst the Bank of Japan's (BoJ) extremely loose monetary policy and the government's recent fiscal stimulus package may boost earnings. Large corporate cash reserves provide Japanese firms with the scope to boost dividends or engage in stock repurchases. Earnings momentum is showing signs of picking up. **Risks to consider:** Domestic economic fundamentals are relatively sluggish, with an absence of momentum in wage growth, despite tight labour market conditions.
Emerging Markets (EM)	Overweight	—	**Rationale of overweight views:** We believe EM equities remain attractive for western-based investors (USD, GBP or EUR based) given our expectation of longer-term currency appreciation. However, we continue to be selective, focusing on countries with strong underlying macro fundamentals, and positive price momentum. **Risks to consider:** Aggregate EM equity valuations no longer look anomalously cheap. There could be some near-term volatility as worries persist around the uncertain path for future Fed tightening, the potential for increased trade protectionism, economic transition in China, and the robustness of the global economy as a whole. Geopolitical uncertainty also poses risks.
CEE & Latam	Neutral	—	**Positive factors:** Brazil is set to exit recession in Q1 and is embarking on an ambitious reform agenda, whilst Mexico's economy is resilient. Countries, such as Poland, have low levels of US dollar-denominated debt, and along with Russia and Hungary offer attractive risk premia. **Risks to consider:** Geopolitical tensions are also high and unpredictable. High local cash rates and sovereign yields in many countries diminish the case for bearing equity risk.

Government bonds

Asset Class	View	Movement	Rationale
Developed Markets (DM)	**Underweight**	—	**Rationale of underweight views:** Prospective returns still look low relative to competing asset classes. In a bond-unfriendly environment (strong global activity, the prospect of fiscal easing), global bond yields could move higher still. **Positive factors:** Government bonds still provide diversification benefits and reduce volatility within multi-asset portfolios. Meanwhile, "secular stagnation" forces are powerful (ageing populations, low productivity and investment), and the global pool of safety assets is limited. Therefore, the "normalisation" of bond yields could take several years.
US	Underweight	—	**Rationale of underweight views:** The US labour market is at (or close to) full employment so underlying inflationary pressures are likely to build, especially if fiscal stimulus materialises. In addition, prospective returns still look low relative to competing asset classes. **Positive factors:** We think there is a strong diversification case for owning Treasuries as insurance in case of a worsening global growth picture or the re-emergence of deflationary pressures. Investors also seem to be pricing a significant level of US stimulus.
UK	Underweight	—	**Rationale of underweight views:** Prospective UK gilt returns remain very low. Although the UK economy could slow, any support in this respect may be offset by inflationary pressures. **Positive factors:** Amid downside risks to growth, UK monetary policy is likely to stay accommodative for a longer period.
Eurozone	Underweight	—	**Rationale of underweight views:** Similarly, core European bonds are overvalued, in our view. A key risk is the likelihood of further tapering of the ECB APP after December 2017. **Positive factors:** Core inflationary pressures in the region remain subdued, which should keep accommodative monetary policy in place for an extended period of time.
Japan	Underweight	—	**Rationale of underweight views**: Japanese government bonds are overvalued, in our view, whilst the BoJ's commitment to peg 10-year yields close to zero could be re-evaluated. **Positive factors:** The "Yield Curve Control" framework should limit volatility and reduce the risk of higher yields in the near-term. Meanwhile, BoJ Governor Kuroda has indicated that cutting policy rates could play a central role in future policy decisions.
Emerging markets (EM)	**Overweight**	—	**Rationale of overweight views:** The yield available on EM sovereign bonds makes them attractive relative to DM government debt, in our view. Furthermore, our estimate of the sustainable return on EM currencies reinforces our choice to hold this position unhedged. **Risks to consider:** Spreads in the EM debt universe are at risk of widening as US policy tightens.

Corporate bonds

Asset Class	View	Movement	Rationale
Global investment grade (IG)	**Neutral**	—	**Positive factors:** The prevailing macro environment remains supportive for credits. Implied recession probabilities are near zero – the default outlook appears benign. **Risks to consider:** Valuations do not appear anomalously cheap, with low implied credit premia meaning that the margin of safety is now very thin against any negative shocks (such as tighter than expected US monetary policy).
– USD investment grade	Neutral	—	**Positive factors:** US investment grade debt looks more attractive relative to European credit. Carefully-selected US credit may outperform. **Risks to consider:** Lower relative valuations for USD-denominated credit is offset in the nearer term by the risk of a more aggressive pace of Fed tightening. The US credit cycle is more mature than that in Europe which remains nascent.
– EUR and GBP investment grade	Neutral	—	**Positive factors:** The ECB's corporate bond-buying programme remains supportive. Meanwhile, in the eurozone, the latest survey data suggests a gradual improvement in credit conditions, and default rates remain low. Valuations are still around neutral levels. **Risks to consider:** UK credits are vulnerable given the recent completion of the BoE corporate bond buying programme amid downside risks to the UK economic outlook. European credits could be hit as the ECB tapers its APP.
Global high-yield	**Neutral**	—	**Positive factors:** Corporate fundamentals are improving following a pick-up in the global activity cycle. Defaults remain comparatively low and are likely to be contained to commodity-related sectors. **Risks to consider:** Further credit spread compression leaves a thin margin of safety. We are neutral with a negative bias

Other

Asset Class	View	Movement	Rationale
Gold	**Neutral**	—	**Positive factors:** Fed hikes are likely to remain historically gradual, limiting the opportunity-cost of holding the non-yield generating asset. Rising inflationary pressures could boost hedging demand, whilst high political risks/uncertainty could also be supportive. **Risks to consider:** A stronger-than-expected Fed hiking cycle may push the USD higher.
Other commodities	**Neutral**	—	**Positive factors:** With oil demand growth remaining robust there is scope for the market to continue to rebalance, particularly following OPEC's November output cut deal (extended to March 2018) **Risks to consider:** Oil markets could remain oversupplied, especially if US production remains resilient. Industrial metals remain exposed to the pace of China's economic rebalancing and global growth.
Real estate	**Neutral**	—	**Positive factors:** Based on our dividend growth assumptions and current yields, which offer a premium of around 1.3% points above the dividend yield from wider equities, we believe real estate equities are priced to deliver reasonably attractive long-run returns compared to developed-marked government bonds. In the long run, rents are positively related to wider economic growth and offer a partial inflation hedge. **Risks to consider:** The US has underperformed other listed property equity markets since the start of the year. Concerns over the health of some retailers has dragged down retail-oriented Real Estate Investment Trusts. In this environment, we believe higher quality malls and shopping centres are likely to outperform stocks with weaker portfolios. The UK's decision to leave the EU has reduced rental growth prospects, especially in central London, and increased uncertainty around future occupier demand.

Asian assets

Asset Class	View	Movement	Rationale
EM Asian Fixed Income	Underweight	—	**Rationale of underweight views:** From a near-term perspective, this asset class is sensitive to US monetary policy. Whilst a gradual interest rate hike cycle in the US is positive for the asset class, Asian bond spreads look tighter (169bp for the EMBI Global Asia as at 31 May) than in other regions of the EM space (426bp for the EMBI Global Latin America for example), which reduces their relative attractiveness in the near to medium term. **Positive factors to consider:** From a long-term perspective, return signals are still positive, backed by relatively sound economic fundamentals, stable inflation and credit quality.
Asia ex-Japan Equities	Overweight	—	**Rationale of overweight views:** Improving earnings and profitability and more efficient use of cash levels on balance sheets support rising returns on equity, amid an export recovery, better domestic growth, and supportive global and regional monetary policy. Structural reforms and shareholder-return policies are potential catalysts in some markets. Valuations look reasonable. **Risks to consider:** A sharp rise in Treasury yields is a key risk. Fed balance sheet reduction and ECB tapering could raise uncertainty. US protectionist policies remain a major risk. Other risks include geopolitical events; commodity-price volatility; fragile or faltering global growth recovery; and renewed concerns about China's growth and financial risks.

– China	Overweight	—	**Rationale of overweight views:** Earnings growth has seen a solid recovery on the back of better top/bottom-line growth and higher margin and helped by the commodity and fast-growing sectors such as the Internet (MSCI China). Financial deleveraging and regulatory tightening is a long-term positive for the financial sector and real economy, despite some short-term pressure on liquidity and sentiment. SOE reform, MSCI's A-share inclusion, rising market participation from domestic pension funds and any positive development in Sino-US relations are potential long-term positives. **Risks to consider:** Economic growth continues to rely on credit and policy stimulus rather than productivity improvements, amid structural headwinds (e.g. high leverage, inefficient SOEs and capital allocation). Financial deleveraging, shadow banking credit tightening, and higher funding costs pose growth and liquidity/default risks. Other risks include a significant growth slowdown; a setback in supply-side reform; property bubbles & burst, and global growth and policy uncertainties.
– India	Overweight	—	**Rationale of overweight views:** A revival in earnings growth later this year off a low base is likely aided by lower domestic rates on improved banking system liquidity; fiscal support for infrastructure and (affordable) housing; the 7th Pay Commission boost to (urban) consumption; and stable global growth environment, as the impact of de-monetisation fades. The GST rollout and bank NPA resolution look on track. Credible reforms, macro stability and structural tailwinds add to a cyclical recovery amid remonetisation. India is relatively less vulnerable to any rise in global protectionism. **Risks to consider:** The year-to-date rally has compressed Indian equities' risk premium and led to elevated valuations relative to their history, limiting the scope for further valuation re-rating. Weak loan growth, public sector NPAs and sluggish private capex remain concerns. Farm loan waivers risk creating moral hazard and having negative fiscal implication. Other risks include faster pace of Fed/DM monetary policy normalisation; US protectionist policies; and a sharp rise in oil prices. The GST could cause some initial disruptions, despite its long-term economic benefits.
– Hong Kong	Neutral	—	**Positive factors:** Hong Kong equities have been underpinned by a cyclical recovery with the upturn in trade, improving retail sales thanks to a recovery in inbound tourism and solid domestic demand amid a stable labour market, a robust property market, and moderate fiscal stimulus. Integration with China could help raise productivity of Hong Kong's service economy in the longer term. Hong Kong maintains a significant liquidity buffer against potential deposit/capital outflows. **Risks to consider:** Hong Kong faces the risk of tightening of monetary conditions due to higher US interest rates/Fed balance sheet reduction and/or capital outflows. The falling Hibor, divergent from rising Libor, this year reflects ample HKD liquidity, but such divergence may not be sustainable and Hibor would eventually adjust. Further short-term property cooling measures are likely should signs of overheating persist, to buy time for increasing land/home supply. Other risks include US/global protectionism, China's financial contagion and growth slowdown, and global demand uncertainties.
– Singapore	Overweight	↑	**Rationale of view change:** This largely reflects somewhat reduced concerns about the two heavy-weight sectors of MSCI Singapore: financials (43.1%) and real estate (17.9%). Bank asset quality concerns have eased with oil & gas NPL formation likely having passed its peak. Earnings could benefit from US rate hikes with NIM uptick. The easing of property curbs and an improving macro outlook have improved home sales due to pent-up demand, better sentiment and low interest rates. **Rationale of overweight views:** Earnings and return on equity have recovered with a turnaround in Singapore's economy, amid a revival in global trade and manufacturing (tech cycle), a pickup in loan growth, continued public investment growth and modest fiscal stimulus. The government is pump priming the new digital age push. MSCI Singapore dividend yield remains one of the highest in Asia. **Risks to consider:** Singapore's economy and asset markets face the risk of rising US interest rates and US/global protectionism, and are sensitive to the USD trend. The country's transition from a labour-driven growth model to a productivity-driven one remains challenging, with productivity gains still negative. Structural shifts point to headwinds for domestic demand and labour market slack.
– South Korea	Overweight	—	**Rationale of overweight views:** Earnings momentum has been strong with improved breadth of EPS upgrades across more sectors in May. Expectations of increasing fiscal spending (to boost job creation) under the new government have improved domestic sentiment. Any improvement in China-Korea relations would be a major positive. Chaebol reform to improve corporate governance and strengthen minority shareholders' rights, as well as favourable shareholder return policy and group restructuring are long-term catalyst. The risk-return profile remains favourable at the current level. **Risks to consider:** There are concerns over the trend of EPS upgrades and ROE improvement not being sustained; corporate tax hike and pro-labour policies proposed by President Moon; tighter policy against chaebols (heavyweights of the index); and weaker semiconductor demand weighing on DRAM demand/prices. Geopolitical tensions (North Korea, China), US protectionist policies and global growth and policy outlook remain uncertainties. Currency is a wild card for exporter earnings.
– Taiwan	Neutral	—	**Positive factors:** We have seen solid earnings recovery this year, amid a tech-led export revival and the spillover to domestic demand, better commodity pricing, and more infrastructure spending. A new smartphone product cycle in H2 should support Taiwan's exports and industrial activities, after a soft Q2. We are fundamentally positive on the outlook for these tech sub-sectors benefiting from the trend for the industrial Internet of Things. MSCI Taiwan dividend yield is relatively high. **Risks to consider:** TWD strength is a major headwind for (tech) earnings and margins, although much of manufacturing is China-based. Consensus EPS estimates have been cut on weaker-than-expected Q1 results due to substantial FX losses. Taiwan's tech sector is facing challenges from slower global demand growth for its product mix and tougher competition from China in the supply chain. Deterioration in cross-strait relations and US protectionist trade policies are major risks.

US Treasury yields dip amid soft inflation data

Global equities edged up again in May; oil prices fell on OPEC disappointment; 10-year Treasuries gained

Global equities rose for a seventh straight month in May, supported by continuing robust economic data releases and generally upbeat earnings reports. The MSCI AC World index finished 1.3% higher over the month. In the US, the S&P 500 rose 1.2% with volatility driven by political turmoil in Washington that raised doubts about the administration's ability to implement pro-growth policies. This boosted 10-year **US Treasuries** (yields fell). In Europe, the Euro Stoxx 50 was roughly flat over the month, whilst the UK's FTSE 100 outperformed (+4.4%). The MSCI EM also rose (+2.3%), although the MSCI Russia and Brazil both fell sharply. The decline in Russian equities came as **oil prices** retreated in the wake of OPEC's meeting on 25 May which disappointed investors who had hoped for deeper or longer cuts to production. Meanwhile, volatility in Brazilian asset prices was predominantly driven by a political scandal engulfing reformist President Michel Temer. Finally, eurozone peripheral government bond spreads narrowed amid receding political risks in the region (all data above as of close of 31 May in local currency, price return, month-to-date terms).

US Q1 GDP print revised upwards with Fed signalling another rate hike in June

US data releases in May remained broadly upbeat. Positively, the second estimate of Q1 GDP was revised upwards, to +1.2% qoq annualised, on the back of a better than expected gain in personal consumption. With the Q1 GDP print likely depressed by temporary factors and seasonal adjustment issues, a rebound is likely in Q2. Crucially, the labour market remains strong, with the April employment report seeing a 211,000 rise in nonfarm payrolls, slightly above expectations, and the unemployment rate declining to 4.4%. However, wage pressures remain subdued, perhaps going some way in explaining recent soft inflation prints. Nevertheless, the May FOMC meeting minutes suggested the Fed is confident enough to raise interest rates again in June – assuming the data holds up – whilst also signalling a gradual unwinding of its balance sheet later this year. A fiscal stimulus package remains the largest upside risk to the economy, although the precise timing and size of this remain uncertain.

Eurozone activity data remains strong; Macron victory paves the way for reduction in ECB purchases in 2018

In the **eurozone**, Q1 GDP expanded by a solid 0.5% qoq in the second estimate. Confidence surveys remain high going into Q2, pointing to the potential for an acceleration in growth during the quarter. Importantly, household spending is likely to stay upbeat this year as employment gains remain positive (although higher inflation will weigh on real income growth). Elsewhere, net trade should find a boost from strong global demand conditions. Meanwhile, political uncertainty eased this month with the victory of market-friendly Emmanuel Macron in the French presidential elections, which should support confidence in the region. Combined with the strength of recent data, this also paves the way for the European Central Bank (ECB) to further reduce its asset purchases in 2018. However, interest rate increases remain a long way off given the lack of underlying inflationary pressures in the region.

Chinese growth moderates amid regulatory and credit tightening; Japan GDP accelerates in Q1

April **Chinese** data showed softer growth momentum following Q1's strength. Growth is likely to moderate further this year due to the lagged impact of liquidity and credit tightening, stricter enforcement of financial regulations, and intensified property tightening measures. However, we believe the government will proceed with financial de-leveraging and regulatory tightening at a measured and calibrated pace to avoid triggering a sharp economic slowdown or financial system instability. **Japan's real GDP** expanded by 2.2% qoq annualised (seasonally adjusted) in Q1, up from 1.4% in Q4. This marked the fifth consecutive quarter of positive growth, driven by both external and domestic demand, with firm consumer spending and housing investment. Looking ahead, a weaker yen and uptick in global trade should support exports, and fiscal policy will be supportive. Also, weak inflationary pressures (amid subdued wage growth) should see the Bank of Japan (BoJ) maintain its ultra-loose policy stance.

Economic performance is improving in many major EM countries; Brazilian politics remains volatile

In terms of economic developments during the month, **Brazilian** data releases continued to point towards a gradual recovery. However, a political scandal engulfing reformist President Michel Temer significantly raises downside risks to much needed reforms being implemented. More positively, however, easing inflationary pressures should allow the Central Bank of Brazil to remain on its easing path. In **Mexico**, the final release of Q1 GDP came in at 0.7% qoq seasonally adjusted, pushing the annual growth rate to 2.8% yoy (its highest since Q3 2015). Amid peso and fuel price-induced inflationary pressures, the Bank of Mexico remains on a tightening path, raising the overnight rate by another 25bps at its May meeting. In **India**, a growth recovery post-demonetisation remains on track, led by a revival in consumption, solid external demand, and better infrastructure sector output growth. Following recent downside surprises to inflation, the Reserve Bank of India (RBI) is expected to keep policy on hold at its June meeting.

A mix of synchronised growth and subdued inflation implies a market regime where equities continue to outperform bonds

The macro environment remains supportive for **global equities**, with the implied equity risk premium on offer still consistent with a neutral positioning. However, we move to a positive bias on this stance, as we have upgraded our US and UK equity view to neutral amid recent gains in US Treasuries and UK gilts which we think has increased the relative attractiveness of bearing equity risk in these two countries. We also maintain a relative preference for Japan and Europe where profits and valuations look relatively attractive. Elsewhere, our market-implied measure of the **credit** risk premium is still not particularly substantial. However, a mix of positive growth and low inflation should sustain low default and downgrade rates, therefore we remain neutral overall (with a negative bias for the riskier high-yield category). We remain underweight in **DM government bonds** which we continue to view as being overvalued. Upbeat global activity amid the prospect of fiscal easing and gradual Fed and ECB tightening should see higher yields over time. Nevertheless, Treasuries still have the scope to rally should bad news on growth or deflation materialise.

For emerging markets (EM) equities, strong performance this year has resulted in aggregate EM equity valuations that no longer look anomalously cheap. Therefore, the investment case has changed to be more about economic and price momentum, alongside the upside offered by cheap currencies. From the perspective of a dollar based investor, we think unhedged prospective returns look attractive across much of Asia and parts of EMEA. **EM local-currency debt** has not rallied as strongly as equities this year, and aggregate yields remain high, particularly relative to developed markets.

Market Data

Equity Indices	Close	MTD Change (%)	3M Change (%)	1-year Change (%)	YTD Change (%)	52-week High	52-week Low	Fwd P/E (X)
World								
MSCI AC World Index (USD)	464	1.9	4.3	15.2	9.9	465	379	16.7
North America								
US Dow Jones Industrial Average	21,009	0.3	0.9	18.1	6.3	21,169	17,063	17.3
US S&P 500 Index	2,412	1.2	2.0	15.0	7.7	2,419	1,992	18.6
US NASDAQ Composite Index	6,199	2.5	6.4	25.3	15.1	6,222	4,574	23.7
Canada S&P/TSX Composite Index	15,350	-1.5	-0.3	9.1	0.4	15,943	13,610	16.6
Europe								
MSCI AC Europe (USD)	457	3.9	11.0	13.8	14.1	460	354	15.4
Euro STOXX 50 Index	3,555	-0.1	7.1	16.0	8.0	3,667	2,678	15.2
UK FTSE 100 Index	7,520	4.4	3.5	20.7	5.3	7,586	5,789	15.2
Germany DAX Index*	12,615	1.4	6.6	22.9	9.9	12,842	9,214	13.9
France CAC-40 Index	5,284	0.3	8.7	17.3	8.7	5,442	3,956	15.7
Spain IBEX 35 Index	10,880	1.5	13.9	20.4	16.3	11,184	7,580	15.0
Asia Pacific								
MSCI AC Asia Pacific ex Japan (USD)	498	2.3	6.8	21.9	16.7	501	395	13.8
Japan Nikkei-225 Stock Average	19,651	2.4	2.8	14.0	2.8	19,998	14,864	17.4
Australian Stock Exchange 200	5,725	-3.4	0.2	6.4	1.0	5,957	5,051	15.9
Hong Kong Hang Seng Index	25,661	4.2	8.1	23.3	16.6	25,835	19,663	12.7
Shanghai Stock Exchange Composite Index	3,117	-1.2	-3.8	6.9	0.4	3,301	2,808	13.7
Hang Seng China Enterprises Index	10,603	3.7	3.0	21.8	12.9	10,705	8,275	8.5
Taiwan TAIEX Index	10,041	1.7	3.0	17.6	8.5	10,122	8,374	14.2
Korea KOSPI Index	2,347	6.4	12.2	18.4	15.8	2,372	1,893	10.2
India SENSEX 30 Index	31,146	4.1	8.4	16.8	17.0	31,255	25,718	18.9
Indonesia Jakarta Stock Price Index	5,738	0.9	6.5	19.6	8.3	5,874	4,754	16.1
Malaysia Kuala Lumpur Composite Index	1,766	-0.1	4.3	8.6	7.6	1,788	1,612	16.6
Philippines Stock Exchange PSE Index	7,837	2.3	8.7	5.9	14.6	8,118	6,499	19.2
Singapore FTSE Straits Times Index	3,211	1.1	3.7	15.0	11.5	3,275	2,703	14.7
Thailand SET Index	1,562	-0.3	0.1	9.6	1.2	1,601	1,343	15.2
Latam								
Argentina Merval Index	22,349	6.3	16.9	76.2	32.1	22,624	12,520	10.0
Brazil Bovespa Index*	62,711	-4.1	-5.9	29.4	4.1	69,488	48,067	11.8
Chile IPSA Index	4,856	1.3	11.4	23.4	17.0	4,911	3,847	17.8
Colombia COLCAP Index	1,439	5.0	8.5	11.4	6.5	1,461	1,271	13.8
Mexico Index	48,788	-1.0	4.1	7.3	6.9	50,154	43,902	17.9
EEMEA								
Russia MICEX Index	1,900	-5.8	-6.7	0.1	-14.9	2,294	1,842	6.1
South Africa JSE Index	53,563	-0.5	4.7	-0.6	5.7	54,717	48,936	14.7
Turkey ISE 100 Index*	97,542	3.0	11.5	25.4	24.8	98,795	70,426	9.4

*Indices expressed as total returns. All others are price returns.

Equity Indices - Total Return	3-month Change (%)	YTD Change (%)	1-year Change (%)	3-year Change (%)	5-year Change (%)
Global equities	5.1	11.0	17.5	16.8	72.4
US equities	2.4	8.6	16.9	30.6	97.8
Europe equities	12.6	16.2	17.0	-0.6	62.9
Asia Pacific ex Japan equities	7.5	17.6	25.3	11.1	46.1
Japan equities	3.7	8.8	15.0	22.4	64.2
Latam equities	-1.8	9.4	27.3	-15.8	-14.8
Emerging Markets equities	7.9	17.3	27.4	4.9	24.8

All total returns quoted in USD terms.
Data sourced from MSCI AC World Total Return Index, MSCI USA Total Return Index, MSCI AC Europe Total Return Index, MSCI AC Asia Pacific ex Japan Total Return Index, MSCI Japan Total Return Index, MSCI Latam Total Return Index and MSCI Emerging Markets Total Return Index.

Sources: Bloomberg, HSBC Global Asset Management. Data as at close of business 31 May 2017.
Past performance is not an indication of future returns.

Market Data (continued)

Bond indices - Total Return	Close	MTD Change (%)	3-month Change (%)	1-year Change (%)	YTD Change (%)
BarCap GlobalAgg (Hedged in USD)	508	0.6	1.2	1.8	1.7
JPM EMBI Global	787	0.8	2.8	9.7	6.5
BarCap US Corporate Index (USD)	2,822	1.1	2.0	4.3	3.5
BarCap Euro Corporate Index (Eur)	244	0.4	0.5	2.8	1.2
BarCap Global High Yield (USD)	455	0.8	2.2	13.3	5.3
Markit iBoxx Asia ex-Japan Bond Index (USD)	192	0.4	1.2	4.1	3.2
Markit iBoxx Asia ex-Japan High-Yield Bond Index (USD)	243	-0.8	0.3	9.1	3.5

Total return includes income from dividends and interest as well as appreciation or depreciation in the price of an asset over the given period

Bonds	Close	End of last mth.	3-mths Ago	1-year Ago	Year End 2016
US Treasury yields (%)					
3-Month	0.97	0.79	0.60	0.28	0.50
2-Year	1.28	1.26	1.26	0.88	1.19
5-Year	1.75	1.81	1.93	1.37	1.93
10-Year	2.20	2.28	2.39	1.85	2.44
30-Year	2.86	2.95	3.00	2.65	3.07
Developed market 10-year bond yields (%)					
Japan	0.04	0.01	0.05	-0.12	0.04
UK	1.05	1.08	1.15	1.43	1.24
Germany	0.30	0.32	0.21	0.14	0.20
France	0.73	0.83	0.89	0.48	0.68
Italy	2.19	2.28	2.08	1.35	1.81
Spain	1.54	1.64	1.64	1.47	1.38

Currencies (vs USD)	Latest	End of last mth.	3-mths Ago	1-year Ago	Year End 2016	52-week High	52-week Low
Developed markets							
EUR/USD	1.12	1.09	1.06	1.11	1.05	1.14	1.03
GBP/USD	1.29	1.30	1.24	1.45	1.23	1.50	1.18
CHF/USD	1.03	1.01	0.99	1.01	0.98	1.05	0.97
CAD	1.35	1.37	1.33	1.31	1.34	1.38	1.27
JPY	110.8	111.5	112.8	110.7	117.0	118.7	99.0
AUD	1.35	1.34	1.31	1.38	1.39	1.40	1.29
NZD	1.41	1.46	1.39	1.48	1.44	1.48	1.34
Asia							
HKD	7.79	7.78	7.76	7.77	7.76	7.80	7.75
CNY	6.82	6.89	6.87	6.59	6.95	6.96	6.55
INR	64.51	64.25	66.69	67.26	67.92	68.86	63.93
MYR	4.28	4.34	4.44	4.13	4.49	4.50	3.93
KRW	1,120	1,138	1,130	1,192	1,206	1,212	1,090
TWD	30.12	30.21	30.68	32.62	32.33	32.62	29.93
Latam							
BRL	3.23	3.18	3.11	3.61	3.26	3.61	3.04
COP	2,916	2,943	2,926	3,090	3,002	3,208	2,822
MXN	18.62	18.82	20.11	18.47	20.73	22.04	17.90
EEMEA							
RUB	56.62	56.93	58.38	66.72	61.54	67.70	55.70
ZAR	13.12	13.37	13.13	15.71	13.74	15.68	12.31
TRY	3.53	3.55	3.65	2.95	3.52	3.94	2.84

Commodities	Latest	MTD Change (%)	3-month Change (%)	1-year Change (%)	YTD Change (%)	52-week High	52-week Low
Gold	1,269	0.1	1.7	4.4	10.1	1,375	1,121
Brent Oil	50.3	-2.7	-9.5	1.2	-11.5	58	42
WTI Crude Oil	48.3	-2.0	-10.5	-1.6	-10.1	55	39
R/J CRB Futures Index	180	-1.1	-5.7	-3.4	-6.6	196	177
LME Copper	5,682	-0.9	-4.9	21.6	2.6	6,204	4,484

Sources: Bloomberg, HSBC Global Asset Management. Data as at close of business 31 May 2017.
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