HSBC World Selection Portfolios (AC)

Fund update

31 Oct 2023

Latest developments

- Global Equities fell in October, as rising bond yields and geopolitical uncertainty weighed on investor sentiment. Developed market equities outperformed emerging markets over the period. Across developed markets, US equities outperformed, driven by another wave of strong economic data. Eurozone and UK saw the biggest falls, as the macroeconomic outlook weakened, as credit conditions tightened and business and consumer confidence declined. Within emerging markets, weak economic data from China continued to drag performance.
- Global Government bonds fell over the month as US economic data showed persistent resilience and worries of 'higher for longer' interest rates continue. Japanese bond markets also sold off as the Bank of Japan further loosened Yield Curve Control. The Eurozone, was an outlier, with bonds posting small positive returns, on soft economic data and a softer-than-expected inflation print.
- The US Dollar continued its gains in October, on the back of US Treasury yields raising further, resilient US data, and softening global risk sentiment. The Euro was flat over the month on the back of softer inflation and GDP numbers. Sterling fell against the US Dollar given stronger US momentum.

Impacts on the portfolios

- Equity and bond markets fell in October. This resulted in negative returns across the World Selection range, with lower risk profile funds outperforming higher risk profile funds.
- The World Selection portfolios are actively positioned against a long-term strategic asset allocation. During October, the cautious positioning of the portfolios added value. Notably, our tilts away from Equity, High Yield bonds, Emerging Market Debt in Hard Currency, and Property all added value.
- Our holding in Gold, preference for the IT sector within the US, and preference for Brazil within emerging markets, also added value. By contrast, our positions in US Consumer Staples and Korean equity detracted.

Any performance information shown refers to the past and should not be seen as an indication of future returns.

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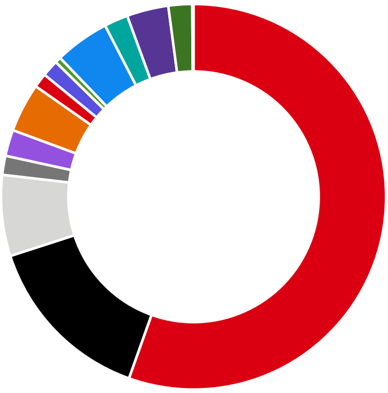
Asset class weightings % (HSBC World Selection 3)



There are three key themes in markets that we are positioned to capture within the World Selection portfolios.

1. Slowing Growth in Developed Markets

- We are conscious of the fragility of the global economy, resulting from high interest rates and tight financial conditions. As a result, we continue to tilt away from higher beta and more cyclical areas of the market.
- We have a preference for Investment Grade versus High Yield bonds on concerns around potential corporate defaults. We are tilted away from Property on higher financing costs and falling return on equity. Finally, we hold a US curve steepening position; as the Fed approaches peak rates, we expect shorter dated bond yields to fall.

2. Bumpy Disinflation

- While inflation has begun to fall, we expect price pressure to remain elevated over the next 6 months, and are therefore overweight inflation sensitive areas of the market e.g. Quality equities. Our expectation is that the pricing power wielded by these companies will ensure profits remain resilient even as inflation increases their costs. We hold an allocation to Gold given strong momentum, the heightened level of market risk, and sticky core inflation.
- During October, we rotated out of US Healthcare and Consumer Staples, in preference for broad US Quality companies. We introduced a preference for European Healthcare over broad European equity given its high quality, and tendency to outperform towards the end of the rate hiking cycle.
- We remain selective within our bond holdings, and currently have a preference towards Treasuries, given the US's positive progress towards controlling inflation and in anticipation of a cut in the Fed funds rate next year. We also hold an overweight to UK Gilts, given the highly attractive carry available from the bonds.
- We are underweight the US dollar on the currency's high valuations as well as an expectation of narrowing spreads between US and DM ex-US interest rates. We hold a preference for Swiss Franc, Euro and Sterling given their attractive valuations and strong momentum.
- We hold an overweight to the Krone versus Euro, as Norwegian inflation remains stickier than in Europe and we expected further rate hikes in the region. Additionally, the Krone is attractively valued.

3. Divergence Between East and West

- While Western economies face slowing GDP growth and sticky inflation, the economic backdrop in Eastern markets such as India, Japan, and South Korea is stronger. Additionally, more accommodative monetary policy settings and room for fiscal support in the East, make these markets more appealing for investors over the medium term.
- As a result, we are overweight Emerging Market equity versus Developed Market equity. We also hold a number of granular equity positions, to gain access to the specific opportunities we see in Eastern markets

Source: HSBC Asset Management, as at 31 October 2023.
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What's next?

- Disinflation continues in the West, but some components of core inflation remain sticky, raising the probability of higher-for-longer rates. Eastern economies face a more benign growth and inflation picture, with pockets of strength across Latin America and Asia, despite China's slower economic recovery.

- Growth in the US continues, as economic activity and labour markets have proven resilient. However, we anticipate a slowdown in 2024 as consumer savings dwindle and higher interest rates continue to impact the real economy. The Fed is now likely at peak hawkishness, we expect policy cuts from Q2 2024.

- Sluggish Eurozone economic data and softer-than-expected inflation prints limit the risk of further ECB policy tightening. Given our view that a Eurozone recession is likely, we see rates falling faster in 2024, compared to the US.

- In the East, inflation is less of a concern, and areas of supportive policy can help maintain growth. China's economy continues to face a challenging property market and weaker consumer confidence, but further monetary easing is possible, with more fiscal support required to sustain a recovery. In Japan we expect a gradual normalisation of the yield curve.

- Our central scenario is consistent with "choppy waters" for risk assets over the next 12 months. We therefore maintain a cautious stance in portfolios: within developed markets we maintain a bias towards companies with earnings resilience, favouring quality. We believe fixed income is the "natural asset class" at this juncture and we maintain a high quality bias within corporate debt. We hold gold given its safe heaven properties and as an inflation hedge. Our portfolios are tilted towards Eastern markets, where we see selective opportunities in Asia, including Japan and India.

Key risks

The value of an investment in the portfolios and any income from them can go down as well as up and as with any investment you may not receive back the amount originally invested.

- **Counterparty Risk**: The possibility that the counterparty to a transaction may be unwilling or unable to meet its obligations.
- **Credit Risk**: A bond or money market security could lose value if the issuer's financial health deteriorates.
- **Default Risk**: The issuers of certain bonds could become unwilling or unable to make payments on their bonds.
- **Derivatives Risk**: Derivatives can behave unexpectedly. The pricing and volatility of many derivatives may diverge from strictly reflecting the pricing or volatility of their underlying reference(s), instrument or asset.
- **Emerging Markets Risk**: Emerging markets are less established, and often more volatile, than developed markets and involve higher risks, particularly market, liquidity and currency risks.
- **Exchange Rate Risk**: Changes in currency exchange rates could reduce or increase investment gains or investment losses, in some cases significantly.
- **Interest Rate Risk**: When interest rates rise, bond values generally fall. This risk is generally greater the longer the maturity of a bond investment and the higher its credit quality.
- **Investment fund risk**: Investing in other funds involves certain risks an investor would not face if investing in markets directly. Governance of underlying assets can be the responsibility of third-party managers.
- **Investment Leverage Risk**: Investment Leverage occurs when the economic exposure is greater than the amount invested, such as when derivatives are used. A Fund that employs leverage may experience greater gains and/or losses due to the amplification effect from a movement in the price of the reference source.
- **Liquidity Risk**: Liquidity Risk is the risk that a Fund may encounter difficulties meeting its obligations in respect of financial liabilities that are settled by delivering cash or other financial assets, thereby compromising existing or remaining investors.
- **Operational Risk**: Operational risks may subject the Fund to errors affecting transactions, valuation, accounting, and financial reporting, among other things.

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Important information

For Retail Clients

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