

HSBC World Selection® Portfolios

Review and Outlook

Key takeaways

Both the Canadian and US equity markets finished the third quarter slightly lower.

The inflation picture is continuing to improve in developed markets, but sticky core inflation raises the probability of small additional rate hikes.

The phrase “higher for longer” has emerged as the dominant view when it comes to describing the interest rate outlook in most markets.

Maintaining positive outlook, but choppy global waters encourage our defensive stance

Q3 2023 review

Both the Canadian and US equity markets finished the third quarter slightly lower, after rising and falling over the last three months. Fears of higher interest rates acting as a drag on future economic growth were the primary driver.

The inflation picture is continuing to improve in developed markets, but sticky core inflation raises the probability of small additional rate hikes. The phrase “higher for longer” has emerged as the dominant view when it comes to describing the interest rate outlook in most markets. This means that interest rates won’t come down as fast as the market was expecting and will remain at higher levels for a longer period.

China’s economy struggled further in Q3 despite attempts by policymakers to stimulate growth. Industrial production faced downward pressure from weakening external demand and a struggling property sector. Tighter credit conditions will continue to weigh on global activity and as consumers spend more on services, this may cause further weakness in exports for the months ahead.

Despite Q3 being challenging for most asset classes, equity markets have generally performed well over the past 12 months.

Performance update and portfolio changes

Over the third quarter, World Selection Portfolios posted returns between -2.12% and -1.94%. Year-to-date, the Portfolios are up between 1.56% and 6.21%.

There were four tactical asset allocation moves in the third quarter to ensure the Portfolios were properly positioned in current global market conditions.

On July 17 and August 23, US equities were reduced to realize profits from high US equity valuations. Proceeds from the sale were redeployed to Canadian bonds which were attractive for their higher yields, lower prices and their defensive characteristics.

On August 1, holdings in global high yield bonds were trimmed and reallocated to Canadian bonds to reduce exposure to risky fixed income asset classes across portfolios as economic indicators and earnings deteriorate.

On September 20, holdings in seven funds were reduced and reallocated to Canadian bonds and mortgages. The sale proceeds were invested in Canadian, US, international and emerging market equities along with global real estate.



	Portfolio changes	
Date	Reduced ▼	Proceeds allocated to ▲
July 17, 2023	HSBC U.S. Equity Pooled Fund HSBC U.S. Equity Index Fund	HSBC Canadian Bond Pooled Fund
August 1, 2023	HSBC Global High Yield Bond Pooled Fund	HSBC Canadian Bond Pooled Fund
August 23, 2023	HSBC U.S. Equity Pooled Fund HSBC U.S. Equity Index Fund	HSBC Canadian Bond Pooled Fund
September 20, 2023	HSBC Canadian Equity Pooled Fund HSBC U.S. Equity Pooled Fund HSBC U.S. Equity Index Fund HSBC International Equity Index Fund HSBC Emerging Markets Pooled Fund HSBC Emerging Markets Equity Index Fund HSBC Global Real Estate Equity Pooled Fund	HSBC Mortgage Pooled Fund HSBC Canadian Bond Pooled Fund

Current asset class positioning

In this economic and market environment, our portfolio strategy has not changed from the last quarter, and we remain defensive in our asset mix. Some riskier asset classes such as equities and higher-yielding fixed income continue to suggest they are pricing in a soft economic landing. This is inconsistent with our central global scenario of an economic recession.

Our overweight position in cash and mortgages aims to protect capital in potential downside scenarios while providing flexibility to take advantage of opportunities as they arise. We prefer high-quality fixed income assets, especially core domestic and government bonds, which will act as solid diversifiers for portfolios in the coming quarters and have the potential to outperform in the event of recession. In addition, the lower valuations and cyclical exposure of Canadian equities should help our portfolios keep up with markets if upside scenarios payout.

Asset class positioning				
	Underweight ▼	Neutral ↔	Overweight ▲	Rationale
Cash			Cash	
Fixed income	Global Inflation-Linked Bonds Emerging Market Debt Global High Yield	Canadian Bonds	Mortgages	We remain defensive within fixed income, preferring short duration fixed income such as mortgages and cash. Within our Canadian bond allocation, we continue to focus on Government and high-quality corporate issuers.
Equities	Emerging Market Equities	International Equities US Equities	Canadian Equities	Our defensive positioning in equities reflects the backdrop of decelerating economic growth, weakening profitability, and impacts to labour markets. We believe the Canadian market continues to offer good return potential on the back of attractive valuations, supported by strong balance sheets and cash flows, which translate to attractive dividend yields. For this reason, we maintain a modest overweight to Canadian equities.
Other	Global Real Estate Equities			We are underweight global real estate equities as weaker global growth and higher interest rates may dampen future rental and property values.

We maintain our forecast of recession in developed markets, with Canada facing the prospects of perhaps a milder recession than what is forecast in some other economies.

Q4 2023 outlook

Investors should expect a choppy environment

Investors should continue to expect a choppy environment over the coming six-to-12 months with data-dependent monetary policy, political uncertainty and fluctuating oil prices. Our central scenario assumes that near-peak monetary policy in North America and Europe, driven by inflationary concerns and tight labour markets, continue throughout 2023 and into first half of 2024.

In Canada, elevated mortgage rates and a higher cost of living will continue to put pressure on household and business spending. Recent GDP data reinforces that the economy is contracting as the Bank of Canada is near the end of its rate-hiking campaign. In the US, while economic growth has shown resilience, consumer savings have declined, and inflation pressures have eased more significantly in recent months. The US Federal Reserve will continue to be data-dependent in its monetary policy decisions. Outside of North America, weak economic activity in the eurozone is likely to continue given the near-peak European Central Bank policy rates and export challenges. Further monetary easing cannot be ruled out in China, while more fiscal support is needed to sustain a recovery. We maintain our forecast of recession in developed markets, with Canada facing the prospects of perhaps a milder recession than what is forecast in some other economies.

According to the OECD, interest rate hikes are working their way through the global economy and are projected to slow the pace of global expansion from 3% this year to 2.7% in 2024.

Overall, we continue to expect tighter financial conditions, inducing recession in the global economy over the year ahead. As economic indicators and earnings deteriorate (the desired outcome of tightening monetary policy) we expect a more favorable environment for North American government, corporate and investment grade bonds. Compared to the previous quarter, global equity valuations are no longer unreasonable. However, as economies continue to show signs of contraction, the earnings outlook should continue to become vulnerable.

Words of advice: Cautiously positioned and fully focused on quality opportunities for capital appreciation

On balance, we believe the way to navigate uncertain markets is by being fully focused on quality in ways that encourage long-term capital appreciation while retaining the ability to act decisively when conditions warrant. We also retain our ongoing commitment to building diversification and resilience into our portfolios in order to encourage investors to remain confidently invested for the long term.

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