January 2024

HSBC World Selection® Portfolios
Review and Outlook

Key takeaways

The dominant narrative from 2023 was the US economy's resilience, which was supported by high levels of consumer savings and strength in corporate profits in certain sectors.

In Canada, inflation also continued to move in the right direction. The implications of this suggest the Bank of Canada is close to the end of its tightening strategy as economic activity slows.

Investment outlook points to "a problem of interest," but a defensive stance may bode well for selective opportunities in 2024

Q4 2023 review

The dominant narrative from 2023 was the US economy's resilience, which was supported by high levels of consumer savings and strength of corporate profits in certain sectors. In Canada, inflation also continued to move in the right direction. The Consumer Price Index (CPI) rose 3.1% in October from a year earlier, down from 3.8% in September. Consider that roughly a year earlier, CPI growth was 8%. The implications of this suggest the Bank of Canada (BoC) is close to the end of its tightening strategy as economic activity slows.

Turning to Europe, the European Central Bank (ECB) is now at a point where it can pause and assess the impact of its tightening. It kept interest rates on hold last month, saying rates are now at a level that will help bring inflation back to the 2% target if maintained for long enough. The Bank of England (BoE) was the most hawkish on **inflation** of all the major central banks. This is consistent with the slower progress that the UK has seen on inflation and wage growth. While it left rates unchanged at its mid-December meeting, the governor of the BoE said it was too early to conclude that services price inflation and pay growth were on a firmly downward path.

China's economic recovery continues to face challenges amid declines in manufacturing activity, exports, and insufficient domestic demand. Efforts to stimulate demand in real estate by relaxing home buying restrictions (i.e. reducing down payment requirements) have been relatively unsuccessful and the property market remains sluggish. Overall economic challenges are likely to intensify pressures on Chinese policymakers.

Performance update

Despite volatility caused by inflationary pressures, rising interest rates, an unexpected regional banking crisis and rising geopolitical tensions around the world, Portfolios remained resilient and staying invested proved a sound strategy. Over the fourth quarter, WSP Portfolios posted returns between 7.07% and 9.05%. Year-to-date, the Portfolios are up between 8.73% and 15.82%.

Tactical asset allocation moves maintain defensive positioning

There was one tactical asset allocation move in the fourth quarter. On October 5, global high yield bonds were reduced given the risks that low-quality issuers faced with near-peak interest rates dominating financial news.

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China's economic recovery continues to face challenges amid declines in manufacturing activity, exports, and insufficient domestic demand.

In our view, a defensive asset allocation remains appropriate despite headline data holding up better than expected. Our portfolios maintain their overweight to cash and mortgages, while fixed income is underweight, and equities are neutral.

	Portfolio changes	
Date	**Reduced ▼**	**Proceeds allocated to ▲**
October 5, 2023	HSBC Global High Yield Bond Pooled Fund	HSBC Canadian Money Market Pooled Fund HSBC Mortgage Pooled Fund HSBC Canadian Bond Pooled Fund

Current asset class positioning

In our view, a defensive asset allocation remains appropriate despite headline data holding up better than expected. As result, overall asset mix is neutral. Using the WSP Balanced Portfolio as a proxy, we are cautiously positioned with total equity exposure now neutral to reflect reasonable valuations but also the risk of an economic slowdown. We retain a slight overweight to Canada and are neutral global equities, which takes advantage of the valuation gap between Canada and the rest of the developed world. Total fixed income is also neutral after Portfolios enacted several purchases of bonds in 2023. Despite the sharp rally in the bond market into year-end, valuations remain historically compelling. Within this asset class we have extended duration while continuing to focus on government and high-quality corporate issuers.

Asset class positioning				
	Underweight ▼	**Neutral ↔**	**Overweight ▲**	**Rationale**
Cash			Cash	
Fixed income	Global Inflation-Linked Bonds Emerging Market Debt Global High Yield	Canadian Bonds	Mortgages	Within this asset class we have extended duration while continuing 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.
Other		Global Real Estate Equities		Although valuations have improved, weaker global growth and high interest rates may dampen future rental and property values.

As of January 2, 2024.

Q1 2024 outlook

Equities and bonds still have the potential to offer decent returns

Monetary and credit conditions have tightened since the US Federal Reserve (Fed) began raising interest rates in March 2022, increasing the risk of lower growth or a hard economic landing over the next 12 months. The market appears to have concluded that US interest rates have peaked. This perspective requires a willingness to overlook some more nuanced comments from the Federal Open Market Committee that there is still a need to see further evidence that inflation will fall to 2% before interest rates are cut.

Although the world's major economies are making progress toward a soft landing, where the economy slows enough to cool inflation without choking off economic growth, our analysis suggests that there are risks to this scenario. Current market pricing continues to anticipate a soft-landing scenario overlooking an increased risk of recession. Hence, we are positioning for defensive growth with the view that both fixed income and equities have potential to offer decent returns in a slower growth environment.

Our base expectation is that inflation will fall back toward central bank inflation targets over 2024. We see the Fed making its first rate cut in the second quarter and then continuing to cut rates throughout the year. We expect the ECB to follow the Fed in lowering rates, with the BoC and the BoE also cutting rates in 2024. We believe further disinflation is likely to come at the price of rising unemployment, while depleting consumer savings, tighter credit conditions and weak labour market conditions could point to a possible recession in 2024. Ongoing geopolitical conflicts also have the potential to unsettle markets.

Words of advice: Taking advantage of select longer-term opportunities remains key as markets appear to discount a hard landing.

Given the risks and selective opportunities we have outlined, investors should navigate current conditions with an unwavering focus on long-term goals supported by proper diversification and intelligent asset allocation This approach recognizes that we could be in a new paradigm, with inflation and interest rates somewhat higher than we were used to during the 2010s.

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