17 September 2020

Investment Event

The Fed strikes a dovish tone

At the September meeting, the Federal Reserve (Fed) maintained the Fed funds rate target range at 0.00-0.25%

Policy unchanged and set to remain highly accommodative

At its September meeting, the Federal Open Market Committee (FOMC) of the US Federal Reserve (Fed) left the target range for the Fed funds rate at 0.00-0.25%, in line with market expectations. The Fed also maintained its guidance on asset purchases, namely that "over coming months the Federal Reserve will increase its holdings of Treasury securities and agency mortgage-backed securities at least at the current pace."

The Fed's projections show the funds rate target range remaining at current levels until at least 2023

Average inflation targeting = lower-for-even-longer rates

The main news from the meeting was the changes to the statement and projections to bring them into line with the Fed's move to an Average Inflation Target (AIT) framework, which was announced in late August. The Fed now expects to maintain the Fed funds rate at 0.00-0.25% until:

- Labour market conditions are consistent with full employment
- Core Personal Consumption Expenditures (PCE) reaches 2.0%
- Core PCE is "on track to moderately exceed 2 percent for some time"

According to the revised economic projections, the FOMC believes the conditions to raise rates will not be in place until beyond its current forecast horizon; the median forecast sees the funds rate remaining at current levels until at least 2023 (Table 1).

The statement marks a change in behaviour, with policy only being tightened once inflation is at target and expected to rise above target

While one FOMC member sees scope for a rate hike in 2022 and four members see the potential for higher rates in 2023, in his press conference Chair Jerome Powell emphasised that the revised guidance was a "powerful" signal that policy settings would remain at least as accommodative as at present for a sustained period.

The commitment to keeping rates lower-for-even-longer comes despite the economy recovering more quickly than the Fed had expected; the 2020 projection for growth was revised up meaningfully. Consistent with this, the unemployment rate was revised down and core inflation revised up, although neither meet the Fed's objectives until 2023.

Table 1: FOMC median economic projections

FOMC median economic projections	2020	2021	2022	2023	Longer run
GDP (% yoy)	**-3.7**	**4.0**	**3.0**	**2.5**	**1.9**
June Fed projection	*-6.5*	*5.0*	*3.5*	*-*	*1.8*
Unemployment rate (%)	**7.6**	**5.5**	**4.6**	**4.0**	**4.1**
June Fed projection	*9.3*	*6.5*	*5.5*	*-*	*4.1*
Core PCE inflation (%)	**1.5**	**1.7**	**1.8**	**2.0**	**2.0***
June Fed projection	*1.0*	*1.5*	*1.7*	*-*	*2.0**
Fed funds rate (%)	**0.1**	**0.1**	**0.1**	**0.1**	**2.5**
June Fed projection	*0.1*	*0.1*	*0.1*	*-*	*2.5*

*Source: US Federal Reserve * Longer run figure is headline PCE inflation rather than core PCE*

Our views

A lower-for-even-longer Fed interest rate policy supports our overweight stance on US and global equities

Meanwhile, the Fed's greater tolerance of higher inflation suggests a possible downside scenario for government bond prices

The Fed's statement and projections mark a departure from previous behaviour. Rather than raising the policy rate in anticipation of inflation moving up to target, the Fed will maintain current, or looser, policy settings until inflation has reached target. By contrast, when the Fed started raising rates in late 2015, core PCE inflation was only 1.2% and didn't reach 2.0% until early 2018. Ultimately, the move to an AIT framework means the Fed is aiming to push inflation moderately above target, "so that inflation averages 2 percent over time".

Investment implications

Overall, the September FOMC meeting has produced a clear commitment to "lower-for-even-longer" rates. In turn, this implies a low discount rate for future equity dividends, an important factor in our overweight strategic view on US and global equities.

Meanwhile, the Fed's tolerance of moderately above-target inflation suggests some upside risks to US inflation in the longer-term as the economy recovers. This implies a possible downside scenario to government bond prices, where we maintain a strategic underweight view. Nevertheless, we should also bear in mind that a prolonged period of asset purchases by the Fed can provide support for global bond markets.

HSBC

Important Information

This document has been prepared by HSBC Global Asset Management Limited (AMG) and is distributed by and/or made available to clients of HSBC Investment Funds (Canada) Inc. (HIFC), HSBC Private Wealth Services (Canada) Inc. (HPWS) and the HSBC InvestDirect division within HSBC Securities (Canada) Inc. (HIDC) ("we" refers to AMG, HIFC, HPWS, and HIDC collectively).

The contents of this document may not be reproduced or further distributed to any person or entity, whether in whole or in part, for any purpose or otherwise, without the prior written permission of AMG. All non-authorised reproduction or use of this document will be the responsibility of the user and may lead to legal proceedings.

The material contained in this document is for general information purposes only and does not constitute advice or a recommendation to buy or sell investments. Some of the statements contained in this document may be considered forward-looking statements which provide current expectations or forecasts of future events. Such forward-looking statements are not guarantees of future performance or events and involve risks and uncertainties. Actual results may differ materially from those described in such forward-looking statements as a result of various factors. We do not undertake any obligation to update the forward-looking statements contained herein, or to update the reasons why actual results could differ from those projected in the forward-looking statements. This document has no contractual value and is not by any means intended as a solicitation, nor a recommendation for the purchase or sale of any financial instrument in any jurisdiction in which such an offer is not lawful. The views and opinions expressed herein are those of AMG at the time of preparation, and are subject to change at any time. These views may not necessarily indicate current portfolios' composition. Individual portfolios managed by AMG or HSBC Global Asset Management (Canada) Limited (AMCA) primarily reflect individual clients' objectives, risk preferences, time horizon, and market liquidity.

The value of investments and the income from them can go down as well as up and investors may not get back the amount originally invested. Past performance contained in this document is not a reliable indicator of future performance whilst any forecasts, projections and simulations contained herein should not be relied upon as an indication of future results. Where overseas investments are held, the rate of currency exchange may cause the value of such investments to go down as well as up. Investments in emerging markets are by their nature higher risk and potentially more volatile than those inherent in some established markets. Economies in emerging markets generally are heavily dependent upon international trade and, accordingly, have been and may continue to be affected adversely by trade barriers, exchange controls, managed adjustments in relative currency values and other protectionist measures imposed or negotiated by the countries with which they trade. These economies also have been and may continue to be affected adversely by economic conditions in the countries in which they trade.

We accept no responsibility for the accuracy and/or completeness of any third party information obtained from sources we believe to be reliable but which have not been independently verified.

This information has been prepared for informational purposes only, and is not intended to provide and should not be relied on for accounting, legal or tax advice. You are advised to obtain appropriate professional advice where necessary.

All products and services of HIFC, AMCA, HIDC and HPWS are only available for sale to residents of Canada, unless the laws of a foreign jurisdiction permit sales to its residents. Please contact an HSBC Mutual Fund Advisor or HPWS Investment Counsellor for more details. The contents of this report should not be considered an offer to sell or a solicitation to buy products or services to any person in a jurisdiction where such offer or solicitation is considered unlawful.

Important Information about HSBC Global Asset Management (Canada) Limited (AMCA)

HSBC Global Asset Management is a group of companies in many countries and territories throughout the world including AMCA that are engaged in investment advisory and fund management activities, which are ultimately owned by HSBC Holdings plc. AMCA is a wholly owned subsidiary of, but separate entity from, HSBC Bank Canada.

Important Information about HSBC Investment Funds (Canada) Inc. (HIFC)

HIFC is the principal distributor of the HSBC Mutual Funds and offers the HSBC Pooled Funds through the HSBC World Selection Portfolio service. HIFC is a subsidiary of AMCA, and indirect subsidiary of HSBC Bank Canada, and provides its products and services in all provinces of Canada except Prince Edward Island. Mutual fund investments are subject to risks. Please read the Fund Facts before investing.

Important Information about HSBC Private Wealth Services (Canada) Inc. (HPWS)

HPWS is a direct subsidiary of HSBC Bank Canada and provides services in all provinces of Canada except Prince Edward Island. The Private Investment Management service is a discretionary portfolio management service offered by HPWS. Under this discretionary service, assets of participating clients will be invested by HPWS or its delegated portfolio manager in securities, including but not limited to, stocks, bonds, pooled funds, mutual funds and derivatives. The value of an investment in or purchased as part of the Private Investment Management service may change frequently and past performance may not be repeated.

Important Information about HSBC InvestDirect (HIDC)

HIDC is a division of HSBC Securities (Canada) Inc., a direct subsidiary of, but separate entity from, HSBC Bank Canada. HIDC is an order execution only service. HIDC will not conduct suitability assessments of client account holdings or of the orders submitted by clients or from anyone authorized to trade on the client's behalf. Clients have the sole responsibility for their investment decisions and securities transactions.

Expiry: 17 March 2021

DK2000424A / H202009025 / P2009004 / HD200918