Video Transcript - HSBC Global Asset Management

Investment Outlook 2020: The age of uncertainty

Fixed Income Outlook

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After a challenging 2018, fixed income investments posted very solid performance in 2019. The pivot from Central Banks was the main driver pushing global bond yields even lower, especially in Europe where several sovereign curves showed negative yields. Corporate bonds performed even better, benefitting from a further boost generated by spread compression.

Looking ahead, we anticipate slight improvements in economic growth with a modest recovery in Europe, stability in Asia and emerging markets, and the U.S. lending around potential.

What does it mean for rates? Monetary policy will remain prudent and data-dependent, but in the absence of additional economic dislocation, further easing in developed markets is unlikely in our opinion.

As a result, most G7 curves may reconnect with a slightly higher trading range and the U.S.-Euro 10-year rate differential could continue to creep down, though at a slower pace. Worth noting that this scenario remains vulnerable to turbulences, and we will continue to track possible progress on lingering geopolitical risks such as trade tensions and Brexit.

On credit, we don’t expect the search for yield to be as easy as it was this year. We are more likely to see greater reducing credit stories, and as a result, default rates should increase from excessively low levels. Credit events, defaults, and downgrades will mainly result from excess leverage, and for corporate profits no longer boosted by lower interest rates or tax cuts.

We make a similar observation for emerging market debt, which has enjoyed significant yield compression in 2019. While we continue to value the benefit of diversification, future returns will depend a lot more on country selection in 2020. Within emerging market debt, we also think that currency will play a significant role and we favor local currencies against the U.S. dollar.

Important factors for valuations in 2020 are climate change and ESG considerations, with more exposed companies being stigmatized and more sectors impacted. An example is the auto industry where the transition to electric and hybrid engines is having significant effect. ESG analysis remains a question of risk primarily, but growing engagement should also trigger some opportunities over time.

In summary, in 2020, we are unlikely to enjoy the same largely indiscriminate positive performance in fixed income, and we will be more cautious and selective accordingly. Firstly, fundamentals will play a crucial role, especially in the lower credit quality segments. Secondly, we plan to be more tactical and exploit any spread widening as an opportunity to increase betas. In other words, for us and for asset allocators, fixed income portfolios will have to be more selectively built and managed with a view to return back to fundamentals.

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