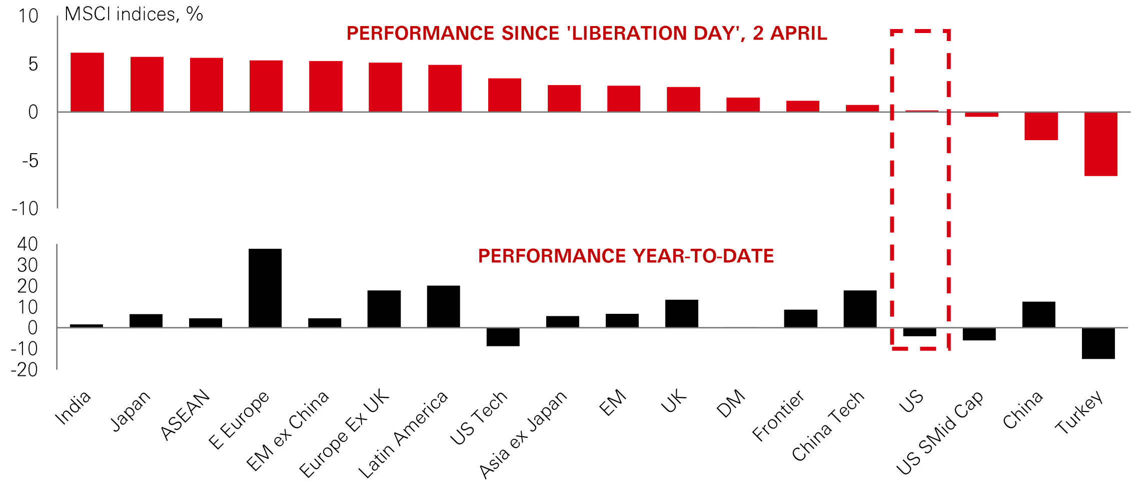
HSBC

Investment Weekly

12 May 2025

Chart of the week – Stocks since 'Liberation Day'



It took five weeks, but US stocks have finally recovered from the global market sell-off sparked by the 'Liberation Day' tariff proposals in early April. The relief rally has played out amid falling volatility, still-high valuations and profits expectations, tighter credit spreads, and a sense of calm in Treasury bonds. Put together, it suggests that recession isn't priced anywhere in investment markets right now. **But policy uncertainty remains ultra-high, and the July deadline to restore reciprocal tariffs still looms. So, what has driven this rebound?**

For a start, US economic momentum at the beginning of the year was strong. Facts about the labour market and profits – including a solid Q1 earnings season – remain good. There's been some growth cooling, but nothing more than that – at its May meeting, the Fed concluded "economic activity has continued to expand at a solid pace". Meanwhile, there's a sense on global trade that we're moving from 'tariff escalation' to negotiation. A more dovish tone from US leaders has helped, and constructive talks between China and the US could be a further boost for markets. Last week saw US-UK and UK-India trade agreements, and there have been accelerated talks between China, Japan, and South Korea.

But despite signs of progress on trade, there is still cause for concern. In the soft data, US consumer and business confidence has fallen sharply in the face of uncertainty. And it could be that lagging hard data will eventually "catch down" with weak survey data in the coming months. While markets have rebounded, the underperformance of the US versus EAFE regions in Asia (particularly India and Japan), Europe, and Emerging Markets, reflects **a 'wait-and-see' stance by investors and the ongoing risk that policy uncertainty could provoke further volatility**.

Market Spotlight

An investment (h)edge

Amid the recent pick-up in market volatility, traditional diversification strategies have not proved reliable, with stock-bond correlations going haywire at times. But one asset class proving resilient is hedge funds. A recent review by some alternatives specialists shows that typical balanced hedge fund portfolios have insulated against as much as 90% of recent market weakness.

As expected, some hedge fund strategies have been well-suited to the conditions. Equity market neutral strategies in particular, tend to benefit from volatility, and they have performed well. Macro fund managers have also enjoyed some success, especially in trading rates and commodity markets. But net-long and long/short equity market strategies have faced a tougher test given the weakness in US stocks, and their performance has retraced sharply.

Given that recent volatility has been partly driven by policy uncertainty, some investment specialists expect further volatility to come. Indeed, **allocators may need to lean ever more heavily on their hedge fund portfolios in the coming years to maximise returns**. For Q2, the environment remains tricky for many strategies, but some specialists are most positive on 'equity market neutral long/short' and 'multi-strategy multi-portfolio manager' funds.

Asia FX →

Exploring recent moves in Asian currency markets

Mexico Outlook →

Mexico's growth outlook amid trade policy uncertainty

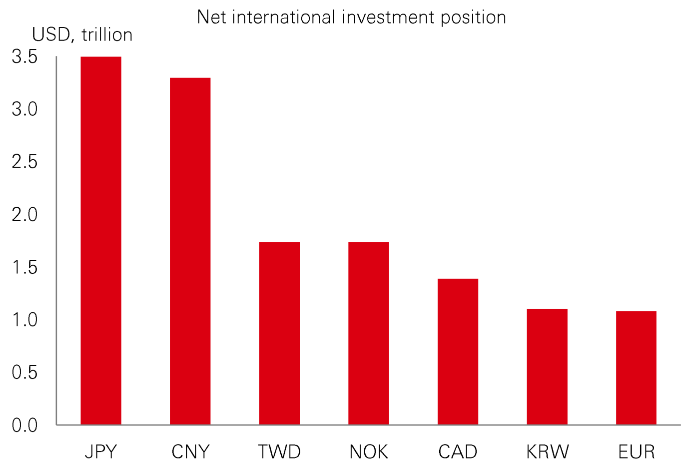
Japan Stocks →

Higher yields and falling debt in Japanese equities

Plaza 2.0 by stealth

Recent weakness in the US dollar has been down to worries over US growth, high deficits, and an end of US exceptionalism. But it's no secret that the US is keen on a weaker USD to improve trade competitiveness. Back in the 1980s, it did it with the 'Plaza accord', a multilateral deal to weaken its currency. While a similar 'Mar-a-Lago accord' might not be achievable now, countries with large external surpluses might let their FX rates strengthen against the USD to smooth the way for new trade deals.

Persistent surpluses lead to what's known as large positive net international investment positions (NIIP) – a measure of an economy's net external wealth. And Asian majors like Japan, mainland China, Taiwan, and South Korea have outsized NIIPs, which over time should put upward pressure on their currencies. But many Asian currencies have actually been weakening in recent years. The largest ever single-day gain in the Taiwanese dollar earlier last week may not be a policy-driven move. But the timing and the size of it have led to speculation about what it might mean more broadly for other external-surplus currencies. **Could significant appreciation in the likes of JPY and KRW be the next big moves in FX?**

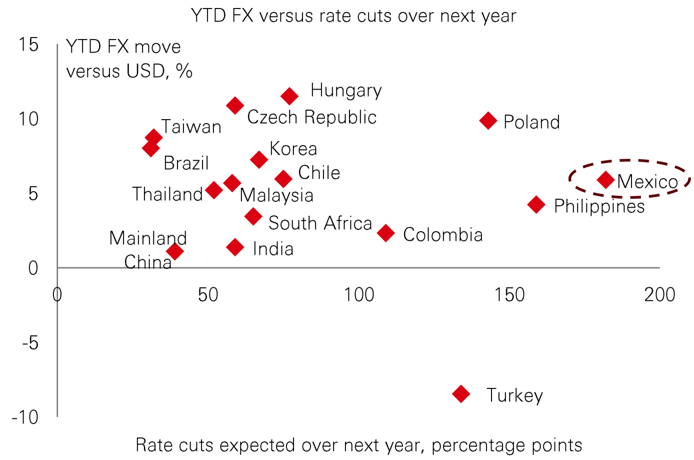


Mexico as a safe harbour?

Mexico's growth engine is stuttering amid high policy uncertainty, with a slowing US economy adding to headwinds. The previous week's Q1 GDP data just eked out positive growth, after a big contraction in the prior quarter.

But the good news is that these growth risks, combined with inflation consolidating below 4%, mean Banxico looks set to maintain its easing stance. The market is pricing in over 1.75% of cuts over the next year. Despite this, the Mexican peso has done relatively well against the US dollar this year, helping to cap inflation. This reflects Mexico's robust macro fundamentals – including healthy fiscal and external balances, and FDI inflows amid nearshoring (which may speed up as firms leave China).

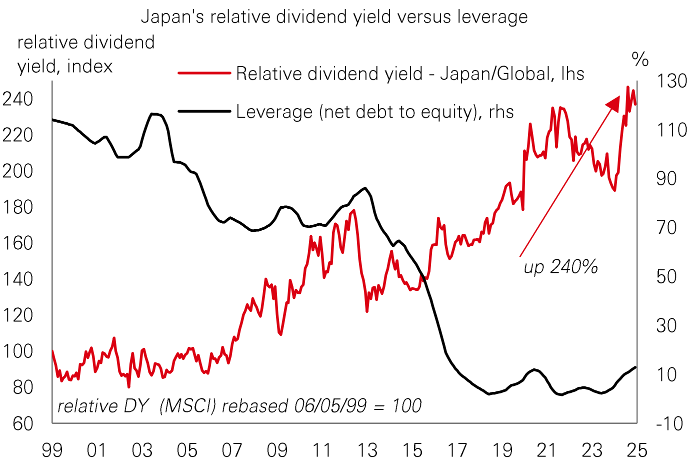
And for those worried about tariffs, it should be remembered a big component of Mexico's exports to the US are covered by the USMCA treaty, with negotiations underway to reduce the 25% rate for non-USCMA compliant goods. Some Mexico City-based analysts think the combination of a **limited tariff impact, high real yields, significant rate cuts, and a widening domestic investor base set the stage for further strong performance of local currency government bonds**.



Still a Buffet favourite

Japanese equities have beaten global markets by 5 percentage points in USD terms year-to-date, but they've lagged by 30 percentage points over the past decade (MSCI Japan vs ACWI). Nonetheless, at Warren Buffet's 60th and final Berkshire Hathaway AGM as CEO, he reiterated how much he likes them. The appeal lies in their attractive valuations and shareholder-friendly policies that have boosted dividends and buy-backs.

Buffet is renowned for scouring corporate balance sheets for weakness – which explains why he skipped on Japan after the 1989 crash. Back then leverage skyrocketed, averaging 100% from 1989 to 2010. With persistent deflation, Japanese companies were stuck in a debt trap. It was only last year that the Bank of Japan finally reversed course on ultra-loose policy in response to a pick-up in inflation and growth. Meanwhile, corporate leverage has fallen to 10%, and new rules are encouraging firms to hand back cash or invest. That has lifted return-on-equity to around 10% (versus a 4-5% average pre-Abenomics that began in 2012). But valuations still look low, with an MSCI price-to-book of 1.4x, which is less than half global peers, at 3.1x. Meanwhile, the average dividend yield now stands at 2.5%. **It's no surprise that Buffett likes what he sees**.



Key Events and Data Releases

Last week

Date	Country	Indicator	Data as of	Actual	Prior
Mon. 05 May	US	ISM Services Index	Apr	51.6	50.8
Wed. 07 May	CN	7-day Reverse Repo Rate	May	1.40%	1.50%
Wed. 07 May	US	Fed Funds Rate (upper bound)	May	4.50%	4.50%
	BR	Banco de Brazil SELIC Target Rate	May	14.75%	14.25%
Thu. 08 May	UK	BoE MPC Base Rate	May	4.25%	4.50%
	NW	Norges Bank Sight Deposit Rate	May	4.50%	4.50%
	SW	Riksbank Policy Rate	May	2.25%	2.25%
Fri. 09 May	CN	Trade Balance (USD)	Apr	96.2bn	102.6bn
Sat. 10 May	CN	CPI (yoy)	Apr	-	-0.1%
	US	US-China Trade Negotiations			

US - United States, CN - China, BR - Brazil, UK - United Kingdom, NW - Norway, SW - Sweden

This week

Date	Country	Indicator	Data as of	Survey	Prior
Mon. 12 May	US	Earnings	Q1		
	IN	CPI (yoy)	Apr	3.2%	3.3%
Tue. 13 May	US	CPI (yoy)	Apr	2.4%	2.4%
Thu. 15 May	US	PPI (mom)	Apr	0.2%	-0.4%
	US	Retail Sales (mom)	Apr	0.0%	1.5%
	JP	GDP (qoq)	Q1	-0.1%	0.6%
	MX	Banxico de Mexico, Overnight Lending Rate	May	8.50%	9.00%
	US	Industrial Production (mom)	Apr	0.2%	-0.3%
	EZ	GDP, Flash (qoq)	Q1	-	0.4%
Fri. 16 May	US	Univ. of Michigan Sentiment Index (Prelim)	May	53.0	52.2

US - United States, IN - India, JP - Japan, MX - Mexico, EZ - Eurozone

Market review

Risk appetite improved amid rising optimism for a de-escalation in global trade tensions. The US dollar was stable against a basket of major currencies. US Treasury yields rose modestly after some solid economic data, including ISM services and jobless claims figures. The Fed left rates unchanged, with Chair Powell emphasising that policy remains well positioned to respond when there is further clarity how the economy evolves, while noting risks of higher unemployment and inflation. Meanwhile, the Bank of England lowered rates by 0.25%. In equity markets, US stocks traded sideways following rallies in the prior two weeks. The Euro Stoxx 50 was largely unchanged amid mixed Q1 earnings, while Japan's Nikkei 225 gained in a holiday shortened week. Other Asian markets were broadly higher, with a new round of Chinese policy stimulus bolstering the Shanghai Composite and Hang Seng, whereas India's Sensex softened on geopolitical uncertainties. In commodities, oil prices rebounded, and gold posted decent gains in a volatile week.

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