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INVESTMENT WEEK

HSBC: The ten biggest risks for 2015

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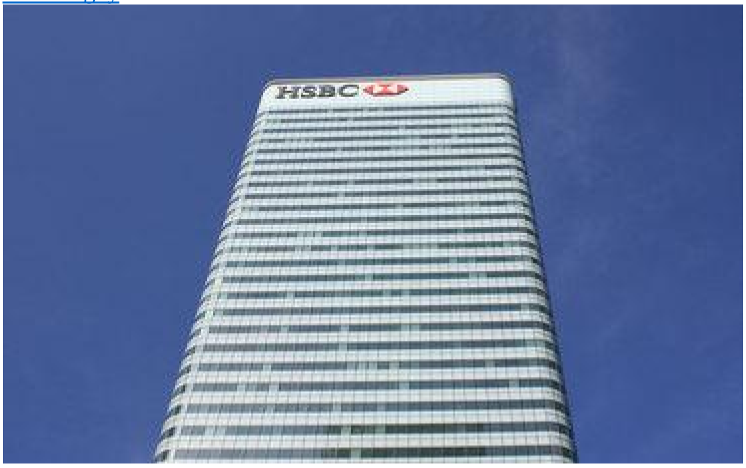

Acknowledging that the forecasting consensus has missed many of the big stories of recent years, analysts at HSBC have attempted to outline the biggest potential risks for investors in 2015.

Outlining their top ten risks, the team stressed that forecasts have been notoriously unreliable since the crash, particularly concerning regional growth.

Nonetheless, they argue that downside growth risk and central bank policy risk, alongside the strong dollar and general illiquidity, could present real challenges for markets and investors in 2015.

Their top ten risks are:

1. Global recession

Highlighting the vulnerability of China, the eurozone and central banks' "bloated" balance sheets, they analysts say that the impact of a slowdown in growth could be particularly damaging given the still-fragile state of the global economy.

Expanding that analysis into investment implications, they say that the likely impact of a slowdown would be widening credit spreads, a flattening US treasury yield curve and a "widespread US dollar rally".

2. Peripheral eurozone weakness spreading to the core

While Germany did well in the early post-crisis years, the analysts highlight that much of its export market relied on strength in emerging markets, notably Russia and China. Now that is no longer guaranteed, they say Germany could slip into recession, with the silver lining being a policy rethink.

The investment implications are a further drop in bund yields, prompting periphery spreads to widen, underperformance in European equities and a euro sell-off.

3. A sharp fall in Chinese growth

The HSBC analysts note China has already seen a dramatic fall in growth, a reduction in its balance of payments surplus and a fall in exports. They argue that conditions in the Chinese economy lead to a further growth slump, similar to Japan's three decades ago.

That could cause East Asian equities to fall, commodity markets to continue to sell off and several local currencies, including the Australian dollar, to weaken, causing serious problems for regional investors.

4. Structural reforms improve emerging markets' growth prospects

As emerging markets have lost their appeal for international investors over the last two years, many countries' economies have been seriously affected. with those such as Brazil facing ratings downgrades as a result. The governments of those countries have begun looking at structural reforms to bolster growth.

The analysts say that this presents a real investment opportunity, should reforms deliver real growth - though investors remain unconvinced in Brazil's case.

They caution that other factors could play a part in dampening that story, but the real risk in the above scenario is that investors miss out on an EM rally.

5. US tightens prematurely

Highlighting several central banks that have raised rates prematurely, including the Bank of Japan in 2000 and the European Central Bank in 2011, the analysts say that post-crash economies often perform differently to pre-crash economies and are therefore hard to judge.

Premature tightening can bring recoveries driven by low rates to an end, and, with US wage growth not yet rebounding strongly, HSBC said there are signs a rate rise may yet prove unhealthy.

Such a hike, they said, could prompt a US equities drop and volatility in the US treasury yield curve.

6. ECB does not deliver full quantitative easing

Discussing the circumstances within which the ECB would not deliver full QE, the analysts highlight that the real issue is convincing the central bank's governing council that government bond purchases are the right solution, particularly given the "political and possible legal sensitivities."

The analysts split the investment risk of no action into two. In a worst case scenario, talk of a eurozone collapse could resurface. Otherwise it could simply put pressure on European equities and the euro.

7. Experimental Japanese easing unhinges inflation

The launch of Japanese "helicopters", used to finance a tax cut or bolster investment in response to continued low growth, could result in the Japanese economy moving from deflation to hyperinflation, according to the analysts.

That could cause an aggressive rally in Japanese equities - followed by a collapse - and could also prompt a dramatic weakening of the yen. However, the analysts also say this would prompt a gold rally so would not be devastating for all investors.

8. Excessive US dollar strength

A rapidly rising dollar is more likely to be prompted by a collapse in confidence in other monetary systems rather than US actions, according to HSBC.

Nonetheless, its impact would be felt by investors. The analysts believe that the US treasury curve would likely flatten and that commodity prices would collapse [further], with a deflationary impact as a result.

9. An oil price spike

HSBC said the supply/demand curve for oil now looks to be rebalancing following the plunge in crude oil prices, albeit the timeline remains unclear. The impact of the potential upside prices is also unclear, but it is possible that such a move would surprise markets.

The investment impact could be a degree of emerging market recovery. However, it is likely that equity markets would fall globally, albeit with energy stocks outperforming, the team said.

10. Liquidity black holes

The analysts suggest this October's 'flash crash' could be a sign of more to come next year. As central banks start to normalise policy, there is a risk of spikes in the liquidity premium across asset classes, according to HSBC.

In that scenario, they suggest, limiting drawdown will become a priority for investors. They acknowledge the potential failsafe of owning volatility across equities, rates and currencies would be "costly", but flag credit as being particularly vulunerable given central banks' relative inability to supply a backstop here.

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