Special Coverage: What is causing the current market volatility and how far can it go?

Key takeaways

- While some investors have been worrying about the sharp rally in AI and tech stocks, the US announcement of an additional 100% tariff on Chinese goods and export controls on 'any and all critical software' from 1 November provided a good excuse for profit taking. The political uncertainty could extend the volatility in the coming weeks.
- We think the surprise effect is now much less than around Liberation Day – the market impact should therefore also be less pronounced (implied volatility is less than half the April level). Markets should be further supported by the US Q3 earnings season, where we expect to see positive surprises, and by the October Fed rate cut.
- In the short term, volatility needs to be managed and our overweight positions on gold and investment grade bonds should continue to benefit. Given our confidence in US economic growth, earnings expansion, AI innovation and Fed cuts, we remain overweight on US equities and would take any pronounced tactical market pullback as a longer-term buying opportunity.

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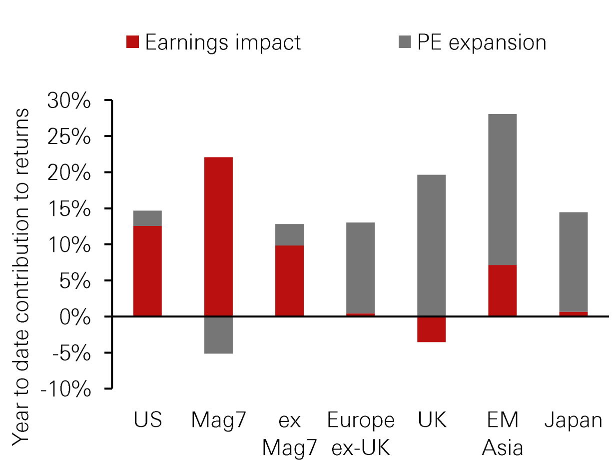
What happened?

- There has been much discussion about whether the AI rally is in a 'bubble', and this concern created the background for the current market volatility. But the 2025 rally of US equities, including Mag7 and Tech stocks, is almost entirely driven by earnings growth. This is much healthier than in many other parts of the world, where it is mostly an expansion of valuation multiples.
- On 10 October, the US announced an additional 100% tariff on Chinese goods and export controls on 'any and all critical software' from 1 November. The deadline indicated that the latest re-escalation of trade tensions could be negotiation tactics ahead of the potential Trump-Xi meeting during the APEC Summit on 31 October.

The US equity market rally has been mostly driven by earnings growth, not P/E multiple expansion.



Source: Bloomberg, HSBC Private Bank and Premier Wealth as at 12 October 2025.

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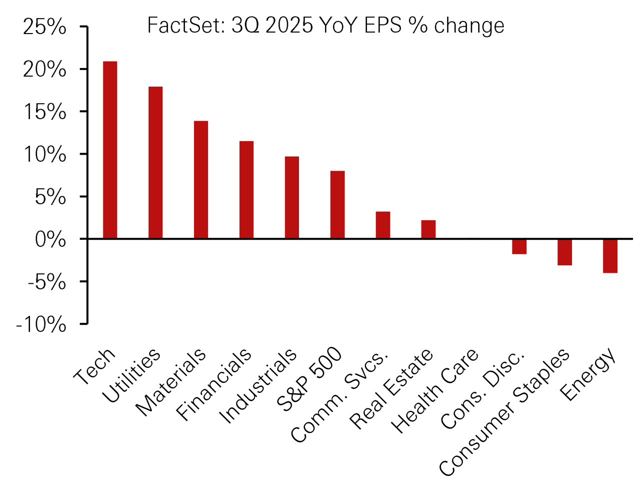
- While President Trump signalled his meeting with Chinese President Xi is still possible and China also reiterated its willingness to negotiate, the political uncertainty could extend the volatility in the coming weeks.
- However, we think the surprise effect is now much less than around Liberation Day – the market impact should therefore also be less pronounced (implied volatility is less than half the April level). Markets should be further supported by the US Q3 earnings season, where we expect to see positive surprises, and by the October Fed rate cut.

US 3Q earnings growth is healthy



Source: FactSet, HSBC Private Bank and Premier Wealth as at 12 October 2025.

Investment implications

- We stay overweight on the US stocks and expect the Q3 earnings season to reaffirm the market's positive fundamental outlook. We see the most scope for positive surprises in the Mag7 but also see positive earnings momentum broadening into other sectors. Many companies are expanding their margins despite cost pressures, which is another positive sign. We see US Financials and Industrials as attractive complements to the tech exposure.
- We expect China's upcoming Fourth Plenum on 20-23 October to provide greater clarity on growth-supportive structural reforms and policy stimulus, supporting our overweight on Chinese equities and expectations of earnings acceleration in 2026. Our Chinese equity strategy manages tariff risks by favouring the domestically focused technology leaders and quality companies that improve ROE through high dividends and share buybacks.
- Amid the volatility, gold and silver are clear beneficiaries of safe-haven flows. We reiterate our tactical overweight on gold to hedge against trade and political uncertainties. High quality bonds are attractive portfolio diversifiers amid the current equity market volatility, and we maintain our clear preference for investment grade over high yield bonds. We further mitigate portfolio drawdown risks through multi-asset strategies.

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