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GLOBAL ASSET ALLOCATION: THE VIEW FROM EUROPE

February 2021

MARKET INSIGHTS

As of 31 January 2021

Mutating Expectations

Optimism surrounding the global economic recovery is beginning to change as potentially deadlier variants of the coronavirus found in the UK, Brazil and South Africa are spreading just as vaccine rollout efforts have gotten underway. The potentially more transmittable and harmful mutations have led to renewed lockdowns, particularly in the UK and eurozone, and are threatening to push some regions into double-dip recessions. Current vaccines such as the one produced by Moderna are reported to still be effective against the new variants, but the pressure is on nations around the world to advance vaccinations to control the virus as it has shown the ability to aggressively mutate. The concerning mutations come as many regions are facing vaccine shortages and challenges surrounding vaccine storage and distribution. The next few months will be a critical race against the virus, as the longer it takes to control, the more damage it will have on lives and expectations for a global recovery.

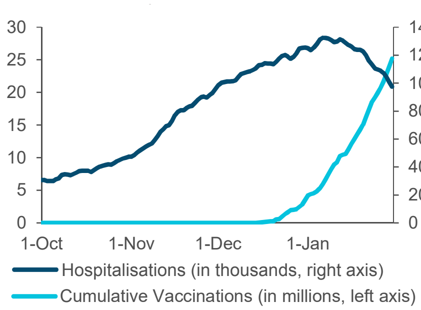
Leaping Ahead

As the rest of the world struggles to get back on its feet, China reported that its economy grew 2.3% last year, making it the only major economy to report positive growth in 2020. After posting a strong 6.5% year-over-year growth rate in the fourth quarter, supported by investment spending and export growth, China's economy leapt back to pre-pandemic levels and made strides toward becoming the world's largest economy. China's V-shaped recovery can be attributed to the early, stringent lockdown measures put in place to control the spread of the virus and the deployment of significant fiscal and monetary stimulus. A focus on infrastructure and a surge in pandemic-related demand—from masks to home office equipment—helped propel export demand, while domestic consumption contracted by 3.9% as retail sales remain one of the hardest-hit sectors amid the pandemic. China has worked for years to reduce its dependence on trade and grow domestic consumption, so the setback is likely to be temporary.

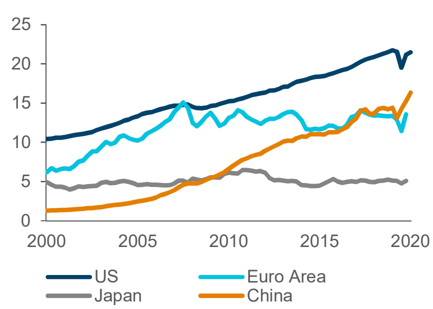
Off to a Quick Start

While the Biden administration put eradicating the coronavirus at the top of its agenda, taking action on regulations with executive orders has also been a top priority. Deregulation was a defining focus of the prior administration, notably within the energy sector; however, Biden has rapidly revisited a wide range of regulations emphasising climate change and green energy, as well as equality. On his first day, Biden temporarily suspended new permits for oil and gas leases on US properties, shut down the Keystone XL pipeline, and rejoined the Paris Climate Agreement. Democrats in Congress have also been swift to act on their agenda, pushing an additional USD 1.9 trillion stimulus package, on top of last year's USD 4 trillion, and may look to use reconciliation, allowing for a simple majority in the Senate, to avoid requirements for a 60-vote threshold. While still early in the new government, Democrats are acting quickly and independently on advancing their agenda—perhaps more than the market may have anticipated when it expected a divided government.

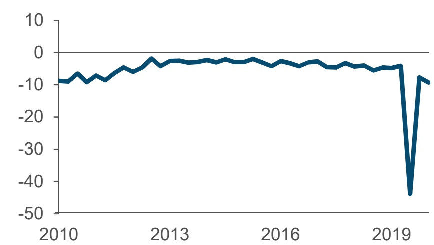
US Hospitalisations and Cumulative Vaccinations
As of 31 January 2021



Nominal GDP by Country (in trillions)[1]
As of 31 December 2020



US Federal Government Budget Surplus/Deficit (as % of GDP)
As of 31 December 2020



[1] These figures are in USD and annualised.
Sources: CDC, Covid Tracking Project (covidtracking.com), Bureau of Economic Analysis/Haver Analytics, US Treasury/Haver Analytics.

	Positives	Negatives
Europe	▪ Higher exposure to more cyclically oriented sectors that should benefit from economic recovery ▪ Monetary and fiscal policy remain accommodative ▪ Equity valuations remain attractive ▪ Stronger long-term euro outlook	▪ New lockdowns amid second wave of virus ▪ Vaccination effort facing supply shortages ▪ Brexit likely to negatively impact trade ▪ Limited scope for European Central Bank (ECB) to stimulate further ▪ Limited long-term catalysts for growth
United Kingdom	▪ Rapid vaccination means that the economy could return closer to normal by the autumn, potentially three or four months ahead of eurozone countries ▪ Fiscal support for firms and workers continues to be extended during the second wave ▪ The prospect of negative rates has been pushed back by at least six months ▪ A Brexit deal has been achieved	▪ New coronavirus variant means a tougher national lockdown in January and February ▪ Brexit transition and third lockdown could mean the second quarterly gross domestic product (GDP) contraction in a row ▪ Demand risks from housing market weakness and large fiscal consolidation remain ▪ Bank of England's forecasts suggest optimism and less easing, but given large risks to demand, negative risks may still materialise within the next year
United States	▪ Stronger probability for more fiscal support ▪ Vaccination rollout underway ▪ Monetary policy remains very accommodative ▪ Healthy consumer balance sheets and high savings rate	▪ Elevated stock and bond valuations ▪ Corporate and government debt at high levels ▪ US dollar weakness continues ▪ Unemployment remains elevated

	Positives	Negatives
Japan	▪ The economy continues to heal at a slow pace with an accommodative policy backdrop ▪ Domestic stocks are a global reflation play, with positive correlations to Purchasing Managers' Indices and bond yields ▪ While current recovery will be centered on traditional industries like automakers, Japan Inc. is changing with a push toward digitalisation and governance	▪ Economic momentum remains fragile with manufacturing indicators still below pre-pandemic levels ▪ The pandemic is not yet under control during this winter season and vaccine rollout not expected until late February ▪ Market indicators signal a stronger yen, which would reduce companies' competitiveness and profitability
Asia Pacific ex-Japan	▪ Chinese economic growth is solid, supported by strong exports and the potential for domestic consumption to follow through ▪ Demand for Chinese assets is expected to attract significant inflows, adding pressure to the yuan and bond yields ▪ Strong consumer spending in Australia should continue, based on pent-up demand, an improving job market and extra savings ▪ The Australian economy surprise index is at record-high levels, boding well for near-term momentum	▪ Chinese economic momentum seems to be peaking while a tightening of policies is possible in the second half ▪ Tech dominance in the Chinese equity markets may be a headwind in the face of new regulations and high valuations ▪ Risk exists that Australian support measures could be wound down too quickly, creating a hangover effect if the fiscal tap is turned off ▪ A strong Australian dollar might be the target of future measures from the central bank
Emerging Markets	▪ Exposure to cyclical areas of the economy should benefit from broad global recovery ▪ Chinese economy remains strong ▪ US dollar weakness continues ▪ Equity valuations attractive relative to developed markets	▪ Stimulus from China likely to fade going forward ▪ Limited ability to enact fiscal stimulus (excluding China) ▪ Vaccine supply and distribution infrastructure are well behind developed markets

EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 January 2021

Underweight — *Neutral* — *Overweight* ▼ or ▲ Month-Over-Month Change

		Change	Underweight	Underweight	Neutral	Overweight	Overweight	**These views are informed by a subjective assessment of the relative attractiveness of asset classes and subclasses over a 6- to 18-month horizon.**
ASSET CLASSES	Equities				■			Recovery in earnings supportive, but extended valuations are vulnerable to recent delays in vaccine distribution and impacts of virus mutations.
	Bonds				■			Short-term sovereign yields remain anchored by central bank policies. Longer rates biased higher on improving growth and hints of inflation. Select opportunities remain in credit.
EQUITIES	*Region*							
	US			■				Defensive profile less supportive as cyclical sectors should benefit from improving 2021 outlook. US dollar weakness could be an additional headwind. Stimulus still providing a backstop.
	Europe ex-UK			■				Cyclically oriented sector profile and low valuations among financials are supportive. However, long-term catalysts are scarce, and coronavirus outbreaks remain problematic.
	UK				■			After underperforming other equity markets in 2020, price level is compelling. Bank of England and fiscal stimulus are supportive, as well as the rollout of vaccines.
	Japan					■		Improving global trade outlook is a key driver. Refocus on reform efforts remains an important catalyst for improving productivity and attracting foreign capital.
	Developed Asia ex-Japan*				■			Valuations attractive relative to the US. Chinese stimulus and successful containment of virus are supportive. Export and commodity-driven economies face challenges.
	Emerging Markets					■		Exposure to global trade and favourable currency trends offer strong tailwinds. However, fading Chinese stimulus and limited vaccine supply and distribution pose challenges.
	Style							
	Global Equity Growth			■				Vulnerable to extended valuations, narrow leadership, tech scrutiny and continued rotation toward cyclicals. However, longer-term secular trends remain favourable.
	Global Equity Value					■		Cyclical orientation could benefit from pent-up demand, economic improvement, higher rates and further fiscal stimulus. Valuations have increased but remain attractive on a relative basis.
	Capitalisation							
	Global Equity Large-Cap			■				Larger companies face challenging valuations, particularly in tech, and could lag as recovery advances. Second-half earnings comparisons will be challenging.
	Global Equity Small-Cap					■		Smaller companies should benefit most from unleashed pent-up demand and fiscal stimulus. Valuations less challenging than large-caps and offer upside potential amid economic recovery.

Past performance is not a reliable indicator of future performance.

* Includes Australia.

EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 January 2021

Underweight — *Neutral* — *Overweight*

▼ or ▲ Month-Over-Month Change

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		Change	Underweight	Underweight	Neutral	Overweight	Overweight	
FIXED INCOME	Euro Government Bonds			■				Yields remain near record lows as the ECB is willing to further support the eurozone's recovery, but they are vulnerable to steepening at the long end should growth expectations improve.
	Euro Inflation Linked				■			Inflation expectations remain low amid slightly improving growth outlook. The European Central Bank remains supportive.
	Euro IG Corporates				■			Supportive technicals and digestible supply, alongside positive vaccine news, have allowed the market to look through weak fundamentals and squeeze valuations.
	US IG Aggregate			■				Nominal Treasury yields remain at low levels; potential for improving growth and additional fiscal stimulus could place upward pressure on yields.
	Global High Yield					■		Spreads near long-term averages and remain attractive versus IG bonds. Fundamentals broadly supportive, but resurgence in virus could reignite downgrade and default concerns.
	EM Dollar Sovereigns				■			Sector offers attractive yield versus developed markets, but less compelling after rally. Concerns around capacity for additional fiscal support and vaccine distribution remain.
	EM Local Currency					■		Attractive sector with continued supportive monetary policy and potential tailwind from a weaker US dollar. Uncertainty from virus resurgence and vaccine distribution.
	EM Corporates				■			The impact of the pandemic on the asset class is difficult to quantify, but the prospect of normalisation bodes well. Country-specific risks remain elevated.
CURRENCIES	EUR vs. USD				■			The euro could be weighed down by growth weakness in first quarter, amid slow coronavirus vaccination progress. However, we retain a bias to the euro's upside over the medium term.
	EUR vs. JPY			■				Wide interest rate differentials and a positive outlook should support yen appreciation over the medium term.

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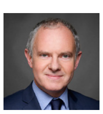
EUROPEAN INVESTMENT COMMITTEE



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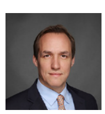

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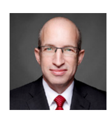

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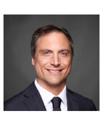

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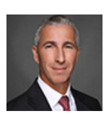

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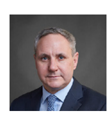

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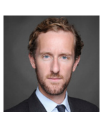

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