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Global Asset Allocation: The View From Europe

June 2021

1 Market Perspective

As of 31 May 2021

- Global economic growth to remain above trend this year but nearing peak levels as major economies make progress on vaccinations and reopen over the summer.
- Global monetary policy outlook broadly supportive with most major central banks expected to remain on hold well into next year, although beginning to see a gradual trend toward tightening by some central banks, notably within emerging markets (EM), facing rising inflation.
- Asian and European economies that have trailed in pace of vaccinations should see improved growth trajectory over coming quarters as they advance reopening and benefit from their more cyclically oriented economies.
- Key risks to global markets include the path forward for the coronavirus, rising inflation, higher taxes, central bank missteps and increasing geopolitical concerns.

2 Portfolio Positioning

- No changes in positioning over the period.
- We remain modestly underweight equities relative to bonds and cash as the risk/reward profile looks less compelling for equities and could be vulnerable to potential setbacks in the recovery, fading policy support, rising inflation and higher taxes.
- Within equities, we favour value-oriented equities globally, small-caps and EM stocks as we expect cyclically exposed companies to continue to benefit from the improvement in growth throughout the year.
- Within fixed income, we continue to have a bias toward lowering duration risk and overweighting credit and inflation sensitive sectors such as high yield bonds, emerging markets debt local currency and inflation-linked government bonds.

3 Market Themes

Just Passing Through?

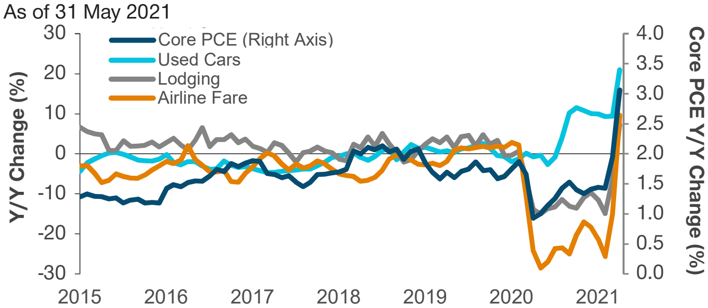
The Federal Reserve has been consistent in its messaging that a near-term spike in inflation pressures will be transitory and recede once COVID-related impacts fade. The latest inflation print showed that prices, as measured by core personal consumption expenditures (PCE), jumped 3.1% year over year, the highest level in three decades, due to supply chain and labour shortages, unleashed pent-up demand and base effects. While the data showed that consumers are facing steep price increases across a range of areas, including used cars, hotel prices and air fare, these are expected to fade as pent-up demand subsides. So far, the bond market seems to believe the Fed's transitory view; however, the risk may be that the transition takes a bit longer than markets anticipate. Labour shortages and unconstrained fiscal spending in the US could keep inflation elevated for longer, forcing the Fed and bond market to react faster than anticipated.

Easy Come, Easy Go

Global central banks were quick to act last year in response to the coronavirus pandemic, unleashing ultra-easy monetary policies, helping countries weather the economic impacts and aiding in the current growth rebound. Now on the back of more stable growth, some central banks have more recently announced plans to start pulling back on policy, including Canada and South Korea. Meanwhile, some EM central banks have already started raising rates this year, such as Russia, Turkey and Brazil; however, the motivation has been more to fend off rising inflation compounded by COVID-related shortages. While the trend in global easing appears to be behind us, the major central banks are still pledging to maintain current support well beyond next year. Despite their intentions, markets have pulled forward expectations of when they'll act on recent data showing higher inflation. The months ahead could see more volatility as investors reevaluate how fast 'easy' may go.

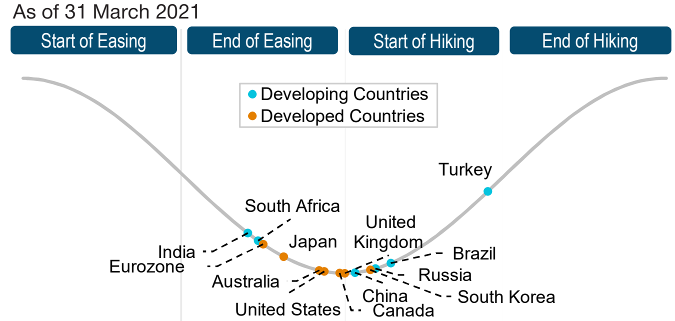
Inflation Spiking Across Various Segments[1]

As of 31 May 2021



Divergence in Monetary Policies Across the Globe[2]

As of 31 March 2021



Past performance is not a reliable indicator of future performance.

[1] Used cars, lodging and airline fare represented by the consumer price index. All rights reserved.
[2] Country classifications in the chart are in line with IMF groupings as of reporting date.
Sources: Haver Analytics, Bureau of Labor Statistics, and IMF.

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	Positives	Negatives
Europe	▪ Higher exposure to more cyclically oriented sectors that should benefit from economic recovery ▪ Pace of vaccinations has significantly improved ▪ Monetary and fiscal policy remains accommodative ▪ Equity valuations remain attractive relative to the US ▪ Stronger long-term euro outlook	▪ Spread of new variants leading to continued outbreaks ▪ Limited long-term catalysts for growth ▪ Limited scope for European Central Bank to stimulate further ▪ Brexit likely to negatively impact trade
United Kingdom	▪ Large share of population had at least one dose, and vaccine hesitancy remains low ▪ Fiscal furlough extension and investment tax super-deduction to support strong recovery ▪ A Brexit deal has been achieved	▪ The rise of the delta variant in the UK could delay further opening by up to several weeks ▪ Demand risks from a delayed, but likely very large, fiscal consolidation in two to three years remain ▪ The Bank of England remains very hawkish in light of strong real economy data ▪ Overheating housing market could pose future financial stability risk
United States	▪ Vaccinations widely distributed, case count near lows ▪ Monetary policy remains very accommodative ▪ More fiscal support on the way ▪ Healthy consumer balance sheets and high savings rate	▪ Elevated stock and bond valuations ▪ High corporate and government debt levels ▪ Corporate taxes likely to rise ▪ Unemployment remains elevated

	Positives	Negatives
Japan	▪ Economic data are finally surprising on the upside ▪ Domestic stocks are a global reflation play, with positive correlations to global Purchasing Managers' Indices and bond yields ▪ Light positioning, oversold conditions and earning optimism are all supportive for stocks in the short term	▪ The pandemic is not yet under control, with states of emergency being pushed back and slow vaccine rollout ▪ Valuation derating remains a headwind despite strong earnings growth ▪ Uncertainty regarding the leadership of Prime Minister Yoshihide Suga with elections set for the autumn
Asia Pacific ex-Japan	▪ Chinese economic growth remains solid, exceeding pre-COVID levels on many fronts ▪ Micro fine-tuning of Chinese monetary and fiscal policies removes the risk of a broad policy misstep ▪ Economic data in Australia continues to be promising, boosted by strong commodity prices ▪ The Reserve Bank of Australia remains extremely dovish, indicating any policy organisation may be a long way off	▪ Supply bottlenecks and rising input prices are concerning for future Chinese manufacturing activities. Economic momentum may have already peaked ▪ Chinese consumer spending is still lagging the recovery, with local COVID-19 outbreaks not helping sentiment ▪ The Reserve Bank of Australia may change its policy guidance abruptly as it upgrades the economic forecasts, which could see a U-turn for financial conditions ▪ Early signs of inflationary pressures seen in Australian housing and construction markets
Emerging Markets	▪ Exposure to cyclical areas of economy should benefit from broad global recovery ▪ Commodity prices rising ▪ Chinese economy remains strong ▪ Equity valuations attractive relative to developed markets	▪ COVID-19 risk remains high in Central Asia and Latin America ▪ Vaccine supply and distribution infrastructure are well behind developed markets ▪ Stimulus from China is fading ▪ Limited ability to enact fiscal stimulus (excluding China)

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EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 May 2021

Underweight — *Neutral* — *Overweight*

▼ or ▲ Month-Over-Month Change

		Underweight		Neutral	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		■				Strong growth continues to be supportive. Elevated valuations leave little room for upside and could be vulnerable to fading policy support, tax increases and higher rates and inflation expectations.
ASSET CLASSES	Bonds				■		Yields to remain biased higher on elevated inflation expectations and growth trajectory but could experience heightened volatility as central banks' policies diverge over coming months. Solid fundamentals but upside limited for credit sectors.
	Region						
EQUITIES	US		■				Elevated valuations reflecting strong recovery and earnings rebound. Rising rates and taxes could be headwinds. Defensive, growth-oriented profile less supportive as cyclical sectors should benefit from improving macro backdrop.
EQUITIES	Europe ex-UK		■				Cyclically oriented sector profile, low valuations among financials, fiscal support and improving vaccination rate supportive. However, long-term catalysts for sustained growth are scarce.
EQUITIES	UK				■		Continued vaccination pace is likely to lead to easing lockdown and strong real activity.
EQUITIES	Japan				■		Despite year-to-date weakness and challenges in vaccine rollout, cyclical exposure should be supportive along with attractive valuations and improving global trade outlook.
EQUITIES	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.
EQUITIES	Emerging Markets				■		Exposure to global trade and rising commodity prices offer strong tailwinds. However, fading Chinese stimulus and vaccine distribution challenges remain concerns.
	Style and Market Capitalisation						
EQUITIES	Global Growth vs. Value[1]		■				Deep cyclical orientation of value stocks combined with attractive relative valuations and rising rates could be catalysts for further rotation out of growth. Vaccine supply constraints and outbreak in India are sources of uncertainty.
EQUITIES	Global Small- vs. Large-Cap[1]				■		Early-cycle exposure remains supportive for small-caps and idiosyncratic opportunities are plentiful. Meanwhile, steeper yield curve and improving global economic outlook should benefit large-caps given cyclical orientation and exposure to international trade.

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*Includes Australia.

[1] For pairwise decisions in style and market capitalisation, positioning within boxes represents positioning in the first-mentioned asset class relative to the second asset class.

EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 May 2021

Underweight — *Neutral* — *Overweight*

▼ or ▲ Month-Over-Month Change

		Change	Underweight		Neutral	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.
FIXED INCOME	Euro Government Bonds		■					Europe is turning the coronavirus corner. Manufacturing PMIs are at record highs, and services activity is likely to pick up as European countries gradually open up.
	Euro Inflation Linked					■		While inflation expectations are on the rise, actual inflation can surprise on the upside.
	Euro IG Corporates					■		Technicals remain supportive, but there are still plenty of uncertainties around corporate fundamentals during the recovery. Little value at current spreads, though European Central Bank buying remains supportive.
	US IG Aggregate			■				Scope for rates in Europe to rise more than in the US. However, stronger inflation and economic growth are expected in the latter.
	Global High Yield					■		Limited upside from elevated valuations, relative yields still attractive versus alternatives within fixed income. Fundamentals and commodity rebound broadly supportive.
	EM Dollar Sovereigns				■			Sector offers attractive yield versus developed markets with improving growth broadly supportive; however, vulnerabilities across countries vary in coronavirus spread, rising inflation and susceptibility to rising rates.
	EM Local Currency					■		Valuations remain modestly attractive; improving macro backdrop and weaker US dollar could provide tailwinds. Higher US rates and EM central bank rate hikes could be a headwind.
	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					■		Recent dollar weakening should continue as the US policy stance is very loose and the European reopening accelerates in the spring. Europe is also a major beneficiary of the current global manufacturing boom.
	EUR vs. JPY			■				The yen remains a safe-haven currency.

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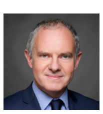
EUROPEAN INVESTMENT COMMITTEE



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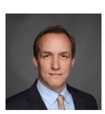

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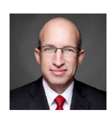

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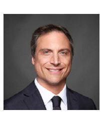

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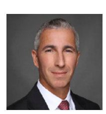

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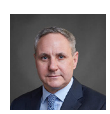

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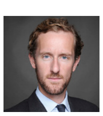

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