JULY 2021

GLOBAL ASSET ALLOCATION VIEWPOINTS AND INVESTMENT ENVIRONMENT

1 MARKET PERSPECTIVE As of 30 June 2021

- Global economic growth to remain strong through the back half of the year, albeit off peak levels, as monetary and fiscal policy support moderates from crisis-level highs.
- Longer-term interest rates likely challenged to move higher as growth moderates, inflation softens from recent peaks, and Federal Reserve moves closer to tapering asset purchases, while short-term rates could begin to price in tighter policy leading to a flattening yield curve.
- While still supportive, global monetary policy should continue to see a gradual trend toward tightening among central banks, notably within emerging markets (EM), facing rising inflation.
- Key risks to global markets include the path forward for the coronavirus, elevated inflation, central bank missteps, higher taxes, stricter regulatory environment, and increasing geopolitical concerns.

2 PORTFOLIO POSITIONING As of 30 June 2021

- 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 fading policy support, increased rate volatility, high inflation levels, and potential tax increases.
- Within equities, we continue to favor value-oriented equities globally, U.S. small-caps, and EM stocks as we expect cyclically exposed companies to continue to benefit from strong economic growth and global reopening.
- Within fixed income we continue to have a bias toward shorter duration, higher yielding, and inflation sensitive sectors through overweights to high yield bonds, floating rate loans, and to a lesser extent, short-term Treasury inflation protected securities, which we moderated over the month.

3 MARKET THEMES As of 30 June 2021

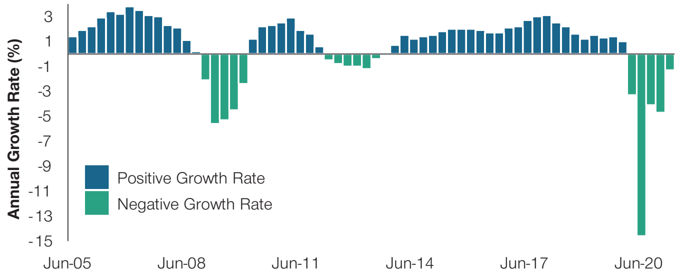
Easy on the Austerity

Following a shaky start to its vaccine rollout, Europe appears to be recovering as businesses are reopening and lockdowns continue to ease in some areas. As the European Central Bank debates the extension of its EUR 1.85 trillion asset purchase program, due to expire next March, additional fiscal stimulus is being rolled out through the unprecedented European Union recovery fund, worth up to EUR 800 billion. While the fund shows signs of growing unity among member nations, lines are being drawn once again as members take sides on scaling back monetary policies put in place amid the pandemic. Leaders such as Mario Draghi, Italy's prime minister, warn that shifting back to austerity too soon could ignite another decade-long recovery similar to the post-global financial crisis period. With Europe already lagging the U.S. and China, shifting back to austerity too soon could prevent the region from heading on a path towards more sustainable growth.

Curbing Our Enthusiasm

Global equity markets represented by MSCI All Country World Index have returned nearly 12% year-to-date in U.S. dollar terms amid signs that the worst of the pandemic may finally be behind us. But, as supportive trends that have fueled the global economic growth rebound start to fade, it's hard to envision equity markets expanding at the same record pace. In the back half of the year, we expect that growth will be off peak levels, monetary policy will continue to tighten, fiscal stimulus will be at lower levels, and higher taxes are likely. Adding to these headwinds, equity markets are sitting at elevated valuations supported by low interest rates, input costs are rising, and earnings growth is expected to moderate next year. Despite these trends, equities remain attractive as pent-up demand continues to be unleashed and while moderating, growth remains elevated. However, the ultra-easy environment is changing quickly and may lead to more volatility ahead, so investors may need to curb their enthusiasm for equity returns going forward.

Euro Area GDP
As of 30 June 2021



Global Equity Index Returns[1,2]
(Fig. 2) As of 30 June 2021

Past performance is not a reliable indicator of future performance.
Sources: Haver Analytics, Bureau of Labor Statistics, IMF.

[1] Global Equity Index is represented by MSCI All Country World Index. Total return in USD.
[2] Source: FactSet. Financial data and analytics provider FactSet. Copyright 2021 FactSet. All Rights Reserved.

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4 REGIONAL BACKDROP

As of 30 June 2021

United States

Positives

- Vaccinations widely distributed, case count near lows
- Infrastructure spending bill likely to be passed
- Healthy consumer balance sheets and high savings rate
- Strong earnings expectations

Negatives

- Elevated stock and bond valuations
- High corporate and government debt levels
- Fed dovishness has peaked
- Corporate taxes likely to rise

Europe

Positives

- Higher exposure to more cyclically oriented sectors that should benefit from economic recovery
- Pace of vaccinations has significantly improved
- Monetary and fiscal policy remain accommodative
- Equity valuations remain attractive relative to the US

Negatives

- Limited long-term catalysts for growth
- Limited scope for European Central Bank to stimulate further
- Brexit likely to negatively impact trade
- Potential for new coronavirus variants to cause continued outbreaks

China

Positives

- Economic growth remains solid but domestic drivers now need to contribute more. An impressive vaccination pace should remove uncertainties related to local outbreaks.
- Chinese equity consolidation looks overdone on the back of supportive flow dynamics and clarification on tech regulations.
- Micro fine tuning of monetary and fiscal policies removes the risk of a broad policy misstep.
- Chinese Yuan expected to weaken to remove pressure on the export sector

Negatives

- The leading economic indicators are starting to rollover following a fading monetary impulse.
- Consumer spending still lagging the recovery and below expectations. Local COVID outbreaks don't help sentiment.
- Inflationary pressures are mounting although they should likely prove transitory

Japan

Positives

- Economic data are slowly improving, especially in services and consumer related sectors.
- Domestic stocks are overdue to catch up with the global reflation play.
- Policy setting remains extremely accommodative with unspent fiscal spending expected to offer further boost to the economic recovery.
- Vaccination pace is accelerating

Negatives

- The pandemic is not yet under control with states of emergency being pushed back
- Valuation de-rating remains a headwind despite strong earnings growth.
- Capital spending outside of IT is disappointing and could be a risk for future earnings growth.

Australia

Positives

- Economic data continue to roar, boosted by strong commodity prices and construction related activities.
- Business capex expected to rebound to support future earnings growth.
- The Australian Dollar should likely catch a bid from higher commodity prices, rising long term yields and a policy shift from the RBA.

Negatives

- Early signs of inflationary pressures seen in the housing and construction markets. Mentions of a housing bubble in some reports.
- RBA might change its policy guidance abruptly as it upgrades the economic forecasts. Beware of a U-turn for financial conditions.
- COVID outbreaks slowing down the consumer recovery.
- Ongoing tensions with China in the background.

Emerging Markets

Positives

- Exposure to cyclical areas of economy should benefit from broad global recovery
- Commodity prices are elevated
- Chinese economy remains strong
- Equity valuations attractive relative to developed markets

Negatives

- COVID risk remains high in Central Asia and Latin America
- Vaccine supply and distribution infrastructure are well behind developed markets (excluding China)
- Stimulus from China is fading
- Limited ability to enact fiscal stimulus (excluding China)

ASSET ALLOCATION COMMITTEE POSITIONING

As of 30 June 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 CLASS	Equities			■				While peaking, growth remains supportive; however, elevated valuations leave little room for upside. Equities could also be vulnerable to fading policy support, coronavirus challenges, input cost inflation, tax increases, and higher rates.
ASSET CLASS	Bonds					■		Yields are rangebound as they face countervailing forces of higher inflation versus past peak growth and tightening global central bank policies. Solid fundamentals but upside limited for credit sectors.
EQUITIES	Regions							
EQUITIES	U.S.			■				Elevated valuations reflecting strong recovery and earnings rebound. Rising rates and taxes could be headwinds. Cyclical sectors should continue to benefit from strong macro backdrop, but a lot of good news is already priced in.
EQUITIES	Global Ex-U.S.					■		Procyclical sector profile, improving vaccination rate, and attractive relative valuation should prove beneficial amid strong global growth and higher rates. Aggressive stimulus measures and pent-up demand may provide further tailwinds.
EQUITIES	Europe			■				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	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	Emerging Markets (EM)					■		Exposure to global trade and elevated commodity prices offer strong tailwinds. However, fading Chinese stimulus, potential Fed tapering, and vaccine distribution challenges remain concerns.
EQUITIES	Style & Market Capitalization							
EQUITIES	U.S. Growth vs. Value[1]			■				Growth remains vulnerable to extended valuations and narrow leadership. Cyclical orientation of value could benefit from pent-up demand, economic strength, and infrastructure spending. Higher rates could also be supportive due to heavy financials exposure.
EQUITIES	Global Ex-U.S. Growth vs. Value[1]			■				Deep cyclical orientation of value stocks combined with attractive relative valuations and improving earnings outlook could be catalysts for further rotation out of growth. Vaccine progress may also provide a boost.
EQUITIES	U.S. Small vs. Large-Cap[1]					■		Small-caps should be supported by economic growth, infrastructure spending, pent-up demand, and strong earnings outlook. However, margins could suffer if input costs remain elevated.
EQUITIES	Global Ex-U.S. Small vs. Large-Cap[1]				■			Strong domestic growth remains supportive for small-caps, and idiosyncratic opportunities are plentiful. Meanwhile, steeper yield curves and strong global economic outlook should benefit large caps given cyclical orientation and exposure to international trade.
EQUITIES	Inflation-Sensitive							
EQUITIES	Real Assets Equities			■				Supply bottlenecks and elevated demand continue to buoy commodity prices. However, long-term outlook remains challenged by a supply/demand imbalance and a less accommodative Fed. Outlook and valuation for real estate attractive despite rising rates.
BONDS	U.S. Investment Grade (IG)			■				Peaking growth and inflation expectations could keep yields elevated, but could be capped as policy becomes less accommodative. IG corporate valuations less compelling as spreads near record lows.
BONDS	Developed Ex-U.S. IG (Hedged)					■		Major central banks' policies should keep short-end rates contained as policy changes unlikely through 2022, while higher inflation could bias longer yields higher. Hedged yield advantage less pronounced with narrower short-term interest rate differential.
BONDS	U.S. Treasury Long		■					Longer-duration bonds remain vulnerable to a further rise in yields as growth and inflation expectations remain elevated, but expectations for tighter policy could increase rate volatility.
BONDS	Inflation-Linked	▼				■		Inflationary pressures expected to remain high through year end, but mostly priced in. Likelihood of Fed letting economy run hot reduced following June meeting.
BONDS	Global High Yield					■		Limited upside from elevated valuations, relative yields still attractive versus alternatives within fixed income. Fundamentals and commodity rebound broadly supportive.
BONDS	Floating Rate Loans					■		Relative valuations and credit fundamentals remain favorable. Sector should benefit from higher standing in the capital structure and shorter-duration profile as rate hike expectations begin to be priced in.
BONDS	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.
BONDS	EM Local Currency					■		Valuations remain modestly attractive; improving macro backdrop and potentially weaker U.S. dollar could provide tailwinds. Shift higher in U.S. rates and EM central bank rate hikes could be a headwind.

[1] For pairwise decisions in style & market capitalization, positioning within boxes represent positioning in the fi rst mentioned asset class relative to the second asset class.

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ADDITIONAL DISCLOSURES

Certain numbers in this report may not equal stated totals due to rounding.

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