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Global Asset Allocation: The View From the UK

August 2021

1 Market Perspective

As of 31 July 2021

- Global economic growth remains strong but varied across regions, balancing progress on vaccination distribution with setbacks from growing delta variant cases.
- While still supportive, global monetary policy is expected to continue a gradual trend toward tightening as central banks weigh moderating growth and increased coronavirus risk against more persistent inflation.
- While global fiscal impulse continues to fade from crisis level highs, the European Union (EU) recovery fund and potential US infrastructure spending, along with China's efforts to stabilise growth, could offset the pullback.
- Longer-term interest rates could trend higher on the growth and inflation outlook, but upside may be limited as both factors move past peak levels. Short-term rates could begin to price in tighter central bank policy, leading to flatter yield curves.
- Key risks to global markets include: the path forward for the coronavirus, elevated inflation, central bank missteps, higher taxes, a stricter regulatory environment and increasing geopolitical concerns.

2 Portfolio Positioning

- 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, higher rates, elevated inflation and potential tax increases.
- Within equities, we continue to favour value-oriented equities globally, US small-caps and emerging markets (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 and higher-yielding sectors through overweights to high yield bonds, emerging market debt and cash.

3 Market Themes

Balancing Act

At the same time that China has taken steps to stabilise its slowing economy with measures such as a surprise reserve requirement ratio cut and pledge to increase fiscal support, policymakers continued to advance social policies through increased regulation, the latest of which rattled markets. These new regulations are tied to specific priorities around ensuring data security, improving the quality and sustainability of economic growth, reducing the wealth gap and protecting the environment. Some of the enforcement measures, such as forcing education companies to transition to not-for-profit, were seen as severe and prompted concerns that additional stringent measures for other industries may be forthcoming. Recent comments from government officials seem to indicate that this is unlikely but were sufficient enough to worry investors. As China moves forward, stabilising its economy while pursuing its social agenda could prove to be a tricky balancing act.

Double Reversal

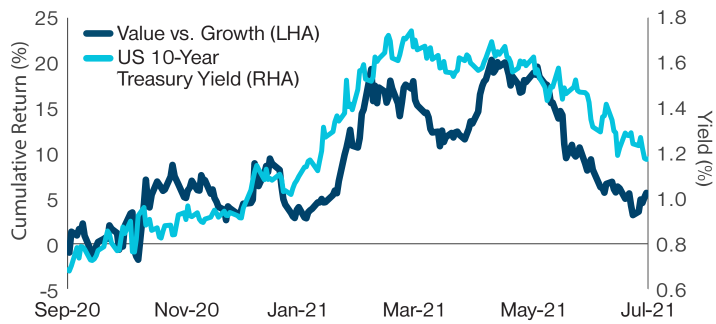
After lagging growth stocks for over 15 years, value was finally positioned to outperform growth last fall on expectations of sharply rebounding economic growth, higher inflation and the unleashing of pent-up demand as lockdowns eased. That was just how the story played out until late March when markets quickly reversed and rates moved lower as the narrative changed to 'peaking' growth and inflation and concerns surrounding potential Fed tapering as well as increases in delta variant cases led to a more defensive tone across markets. However, the story for value may not be over just yet, as recent underperformance has led to more attractive relative valuations, global growth remains above trend and supply/demand imbalances continue to keep inflation stubbornly high. With the hopeful containment of the delta variant and increasing regulatory pressure on growth stocks, investors may start betting on value pulling off a double reversal this cycle.

EM Ex-China vs. China Equity Index Returns[1]

As of 31 July 2021

Value vs. Growth and US 10-Year Treasury Yield[2]

As of 31 July 2021



Past performance is not a reliable indicator of future performance.

[1] Emerging markets ex-China and China equity returns are represented by the MSCI Emerging Markets Ex-China and MSCI China Indices respectively. Total return in USD.
[2] Value vs. growth returns are represented by the Russell 1000 Value and Russell 1000 Growth Indices, respectively.
Source: FactSet. Financial data and analytics provider FactSet. Copyright 2021 FactSet. All Rights Reserved.

	Positives	Negatives
United Kingdom	▪ Large share of population has had at least one dose, and vaccine hesitancy remains low ▪ Investment tax super-deduction could support strong real activity ▪ Many key economic indicators are either at or close to record highs	▪ The Bank of England remains very hawkish in light of strong real economic data ▪ Demand risks from delayed, but likely large, fiscal consolidation in two to three years remain ▪ Overheating housing market could pose future financial stability risk ▪ Unwinding of furlough scheme could lead to a short-term rise in unemployment
Developed Europe	▪ Higher exposure to more cyclically oriented sectors that should benefit from economic recovery ▪ Vaccination rates improving rapidly ▪ Monetary and fiscal policy remain accommodative ▪ Equity valuations remain attractive relative to the US	▪ Limited long-term catalysts for growth ▪ Limited scope for European Central Bank to stimulate further ▪ Brexit likely to negatively impact trade ▪ Demand from China fading ▪ Microchip shortage impacting manufacturing
United States	▪ Vaccinations widely distributed ▪ Infrastructure spending bill likely to be passed ▪ Healthy consumer balance sheets and high savings rate ▪ Strong earnings expectations	▪ Elevated stock and bond valuations ▪ High corporate and government debt levels ▪ Fed dovishness has peaked ▪ Corporate taxes likely to rise

	Positives	Negatives
Japan	▪ Economic data are slowly improving, especially in services and consumer-related sectors ▪ Domestic stocks are overdue to catch up with the expected recovery in capex ▪ Policy setting remains extremely accommodative with unspent fiscal spending expected to offer further boost to the economic recovery	▪ 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 information technology is disappointing and could be a risk for future earnings growth
Asia Pacific ex-Japan	▪ Chinese economic activity should rebound in the second half on the back of monetary support and a high level of vaccination ▪ Micro fine-tuning of monetary and fiscal policies removes the risk of a broad policy misstep ▪ Australian business capex expected to rebound to support future earnings growth, assuming the coronavirus outlook clears out	▪ Chinese consumer spending is still lagging the recovery, with local coronavirus outbreaks not helping sentiment ▪ Earnings outlooks in Australia could be revised lower due to renewed lockdowns ▪ Uncertainties over Australia's coronavirus exit strategy could prove to be a serious headwind in the future
Emerging Markets	▪ Exposure to cyclical areas of the economy should benefit from a broad global recovery ▪ Commodity prices are elevated ▪ Equity valuations attractive relative to developed markets	▪ 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)

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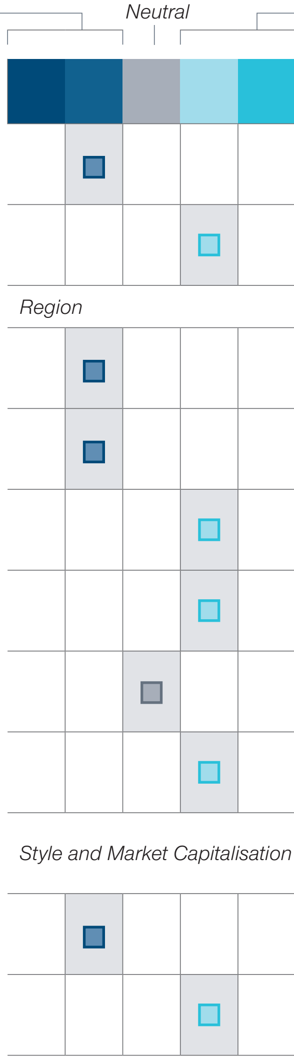
UK INVESTMENT COMMITTEE POSITIONING

As of 31 July 2021

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



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	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.
	Bonds	Yields biased modestly higher on the back of strong, yet peaking growth and inflation but could be offset by tightening global central bank policies. Solid fundamentals but upside limited for credit sectors.
EQUITIES	*Region*	
	US	Elevated valuations reflecting strong recovery, earnings rebound and low interest rates. Slowing growth, delta variant challenges 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.
	Europe ex-UK	Cyclically oriented sector profile, low valuations among financials and improving vaccination rate supportive. Continued monetary policy support and recent launch of the EU recovery fund should provide additional tailwinds.
	UK	Vaccination pace is likely to lead to easing lockdown and strong real activity.
	Japan	Despite challenges in vaccine rollout and the disappointment of empty Olympic venues, attractive valuations and improving global trade outlook should be supportive. Improving corporate governance also provides a long-term tailwind.
	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, attractive valuations and potential currency upside are supportive. However, weakness in China, potential Fed tapering, inflation and vaccine/delta variant challenges remain concerns.
	Style and Market Capitalisation	
	Global Growth vs. Value[1]	Deep cyclical orientation of value stocks combined with attractive relative valuations and improving earnings outlook could be catalysts. Vaccine progress, a rebound in manufacturing, and easing of supply bottlenecks could also provide a boost.
	Global Small-Cap vs. Large-Cap[1]	Strong domestic growth trends remain supportive for small-caps, and idiosyncratic opportunities are plentiful. Meanwhile, strong 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.

UK INVESTMENT COMMITTEE POSITIONING

As of 31 July 2021

▼ or ▲ Month-Over-Month Change

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		Underweight	Underweight	Neutral	Overweight	Overweight	Change
BONDS	UK Gilts		■				Strong activity and inflation data could trigger the next big bout of Bank of England hawkishness. The bad news of the delta variant of the coronavirus is already priced in.
	UK Inflation Linked				■		While inflation expectations are on the rise, actual inflation can surprise on the upside.
	UK IG Corporates				■		Market technicals remain supportive, but there are still plenty of uncertainties around corporate fundamentals during the economic recovery.
	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 US.
	European IG Aggregate		■				High-frequency indicators suggest scope for very fast catch-up growth in the next one to two months. Vaccination pace is healthy and cases are still falling, but delta variant risk is likely to emerge.
	Global High Yield				■		Limited upside given elevated valuations; relative yields still attractive versus alternatives within fixed income. Fundamentals broadly supported by positive macroeconomic backdrop.
	EM Dollar Sovereigns			■			Sector offers attractive yield versus developed markets with improving growth broadly supportive; however, vulnerabilities across countries vary in coronavirus spread/vaccine accessibility, rising inflation and susceptibility to rising rates.
	EM Local Currency				■		Valuations remain modestly attractive; improving macroeconomic backdrop and potentially weaker US dollar could provide tailwinds. Shift higher in US rates and EM central bank rate hikes could be headwinds.
	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	GBP vs. USD				■		The valuation of the pound is more attractive after recent weakness. The US Federal Reserve has become more dovish in its rhetoric, while the Bank of England may turn more hawkish.
	GBP vs. EUR				■		We expect a stronger economic recovery in the UK than in the eurozone and that the pound will continue its positive momentum against the euro. One risk to our view is the spread of the delta variant.
	GBP vs. JPY			■			The pound may appreciate against the yen; however, we retain a neutral bias given the yen's safe-haven properties.

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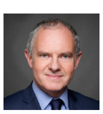
UK INVESTMENT COMMITTEE



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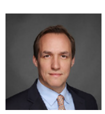

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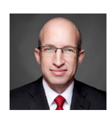

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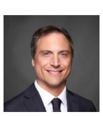

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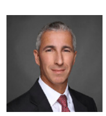

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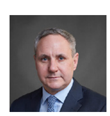

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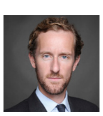

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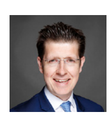

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