



Global Asset Allocation: The View From Europe

December 2021

1 Market Perspective



- Although expected to moderate from current levels, global growth and inflation remain above trend. New threats from coronavirus variants and continued supply chain disruptions and energy shortages could pose headwinds to growth, while placing upward pressure on inflation.
- Global monetary policy to continue path towards tightening with US Fed appearing more hawkish, while the European Central Bank and Bank of Japan maintain policy. Meanwhile, rate hikes continue to advance across emerging markets in response to higher inflation and to defend their currencies.
- Global short-term rates likely to trend higher with central bank tightening, while long-term rates react to lingering inflation pressures and renewed concerns about growth and policy missteps.
- Key risks to global markets include new variants, persistent inflation, supply chain disruption, energy shortages, central bank missteps, a downshift in China growth trajectory and increasing geopolitical concerns.

2 Portfolio Positioning

As of 30 November 2021



- We remain modestly underweight equities relative to bonds and cash given stocks' less compelling risk/reward profile, balancing elevated valuations against decent but moderating growth and potentially persistent inflation. Higher rates, rising input costs related to supply chain bottlenecks and fading monetary and fiscal policy could pose challenges to the near-term earnings outlook.
- Within equities, we continue to tilt towards cyclicality, maintaining overweights to value-oriented equities globally, US small-caps and emerging market stocks, where valuations are more reasonable and which should benefit from a continued path of recovery.
- We shifted a portion of our US value exposure into growth equities, where we find more companies with the potential to do well in a moderate growth environment and to moderately reduce the cyclicality of our positioning.
- Within fixed income, we continue to favour shorter-duration and higher-yielding sectors through overweights to high yield and emerging market debt supported by our constructive credit outlook.
- This month, we removed the partial hedge on the US dollar. The euro may weaken due to new pandemic-related restrictions in Europe, a more dovish European Central Bank compared to the US Fed and growth in Europe may slow at a faster pace compared to that in the US.

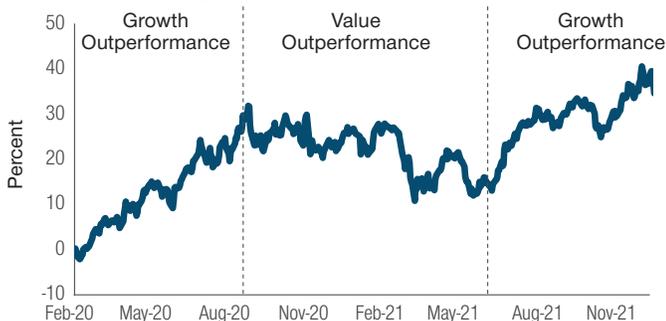
3 Market Themes

Not Too Hot, Not Too Cold

While stocks have broadly rallied nearly 80% off the lows of March 2020, leadership within has flip-flopped between expensive, defensive growth names to cheaper cyclicals and back again. The roller coaster ride has been driven by rotations from COVID-on to COVID-off, China regulatory fears and worries over Fed tapering. As we move into 2022, expectations are for moderating growth—yet still above potential—and easing inflationary pressures. Companies offering 'growth at a reasonable price' could be in vogue—where growth is not hot enough to drive the deepest cyclicals and not cold enough to need the defensiveness of high-flying growth companies. Reasonably priced, higher-quality companies that find themselves in the 'core' of the market are looking more attractive, particularly those paying dividends as forward return expectations are well below the more-than-15% annualised returns we've seen over the last decade.

Large-Cap Growth vs. Value Performance¹

As of 30 November 2021



Fed Up!

The Federal Reserve looks likely to accelerate its tapering of asset purchases when it meets later this month as it faces the risk that inflation does not recede as quickly as policymakers had hoped. With inflation at levels not seen in three decades, a tightening labour market and strong consumer spending, conditions seem to warrant tighter policy. Fed Chairman Jerome Powell and other committee members have increasingly hinted at accelerating the process, admitting that elevated inflation could persist longer than initially anticipated. Ending asset purchases earlier would give the Fed more flexibility to pull rate hikes forward, although Powell said the market should not link the two. While the Fed finally seems fed up with lingering inflation, the emergence of the omicron variant is a wild card that could weigh on growth, slow the nascent recovery in supply chains and add to inflation worries. Already a challenge unwinding policy at a pace not to destabilise growth, things have become a bit more tricky for the Fed.

Number of Rate Moves Priced In for December 2022²

As of 30 November 2021



Past performance is not a reliable indicator of future performance.

¹Large-Cap Growth vs. Value returns are represented by the Russell 1000 Growth and Russell 1000 Value Indices, respectively. Figures are shown in US dollars.

²Data represent the estimated number of Fed moves priced into the current forward-curve structure for December 2022. Actual outcomes may differ materially from estimates. Estimates are subject to change.

Source: Financial data and analytics provider FactSet. Copyright 2021 FactSet. All Rights Reserved. Bloomberg Finance L.P. (see Additional Disclosure).



REGIONAL BACKDROP

Positives

- Europe**
- Higher exposure to more cyclically oriented sectors that should benefit from economic recovery
 - Monetary policy remains accommodative
 - Fiscal stimulus likely to increase
 - Equity valuations remain attractive relative to the US

Negatives

- Elevated energy prices and supply chain issues are weighing on economic growth
- Rapidly rising COVID-19 concerns
- Limited long-term catalysts for growth
- Demand from China fading

United Kingdom

- Bank of England (BoE) December rate hike likely delayed due to omicron uncertainty
- Most economic indicators show expansion despite supply chain problems
- Labour market appears resilient to end of furlough
- Rapid booster campaign suggests greater resilience to omicron variant

- Omicron variant fear effect already seen in weaker UK services demand
- Demand weakness from lower household disposable income due to higher energy prices
- Steeper Phillips curve in the labour market means BoE will need to hike faster
- Demand risks from a delayed, but likely large, fiscal consolidation in two to three years remain

United States

- Healthy consumer balance sheets and high savings rate
- Strong earnings growth
- Infrastructure spending likely to increase

- Supply chain issues are weighing on economic growth
- Significantly elevated inflation
- Elevated stock and bond valuations
- Fed accommodation has peaked
- Fiscal stimulus has peaked

Positives

- Japan**
- Local stock markets continue to be attractive due to favorable relative valuation, light positioning and positive earnings trends
 - Thanks to very low infection rates, the reopening of the economy is broad-based. Consumption and manufacturing leading indicators are at a two-year high
 - Political risks are largely behind us. The upcoming fiscal stimulus is a tailwind for next year

Negatives

- Amidst the omicron uncertainty globally, Japanese companies are the most exposed due to their high sensitivities to global economic momentum
- Funding pressures of the stimulus programme could bring back the topic of tax increases
- The rise in break-even inflation suggests inflationary pressures are also building in Japan

Asia Pacific ex-Japan

- Sentiment is gradually turning towards Chinese stocks, with foreign flows being positive
- Australian domestic consumption indicators point towards a snap bounce back from lockdowns, while the summer weather dampens risks from the new variant
- Inflationary pressures in China are far more subdued than in the western world, giving policymakers room to ease from here
- A relatively cheap Australian dollar could see a rebound due to extreme speculative positioning, the repricing of yields and a normalisation of commodity prices

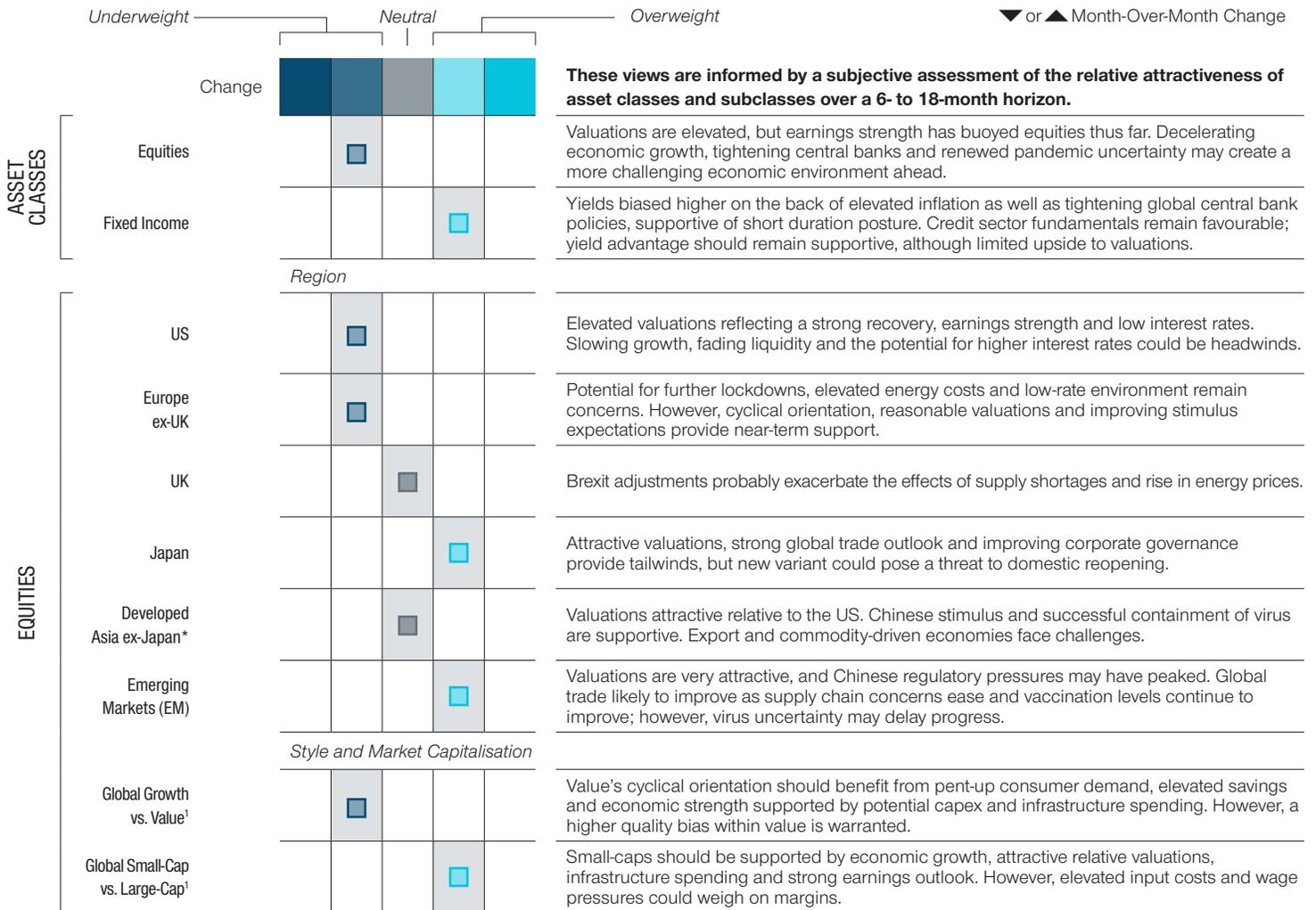
- China's heavyweight tech sector remains under scrutiny with clouds around the future of VIE, ADRs and dual listing
- Earning momentum in Australia is on a downward trajectory with the risk that dividend payouts got revised lower from this year's outsized figures
- Heightened political risks in China going into 2022 will create uncertainties and low incentives for local governments to step in if needed
- Australian inflation expectations are rising, which may lead to another surprise twist in The Reserve Bank of Australia's policy, with a rate hike earlier than communicated

Emerging Markets

- Attractive equity valuations
- Exposure to cyclical areas of economy should benefit from broad global recovery
- Chinese regulatory actions likely to have peaked
- Vaccination rates are improving

- New coronavirus variants remain a threat
- Heightened political and regulatory risk
- Accommodation from central banks is fading

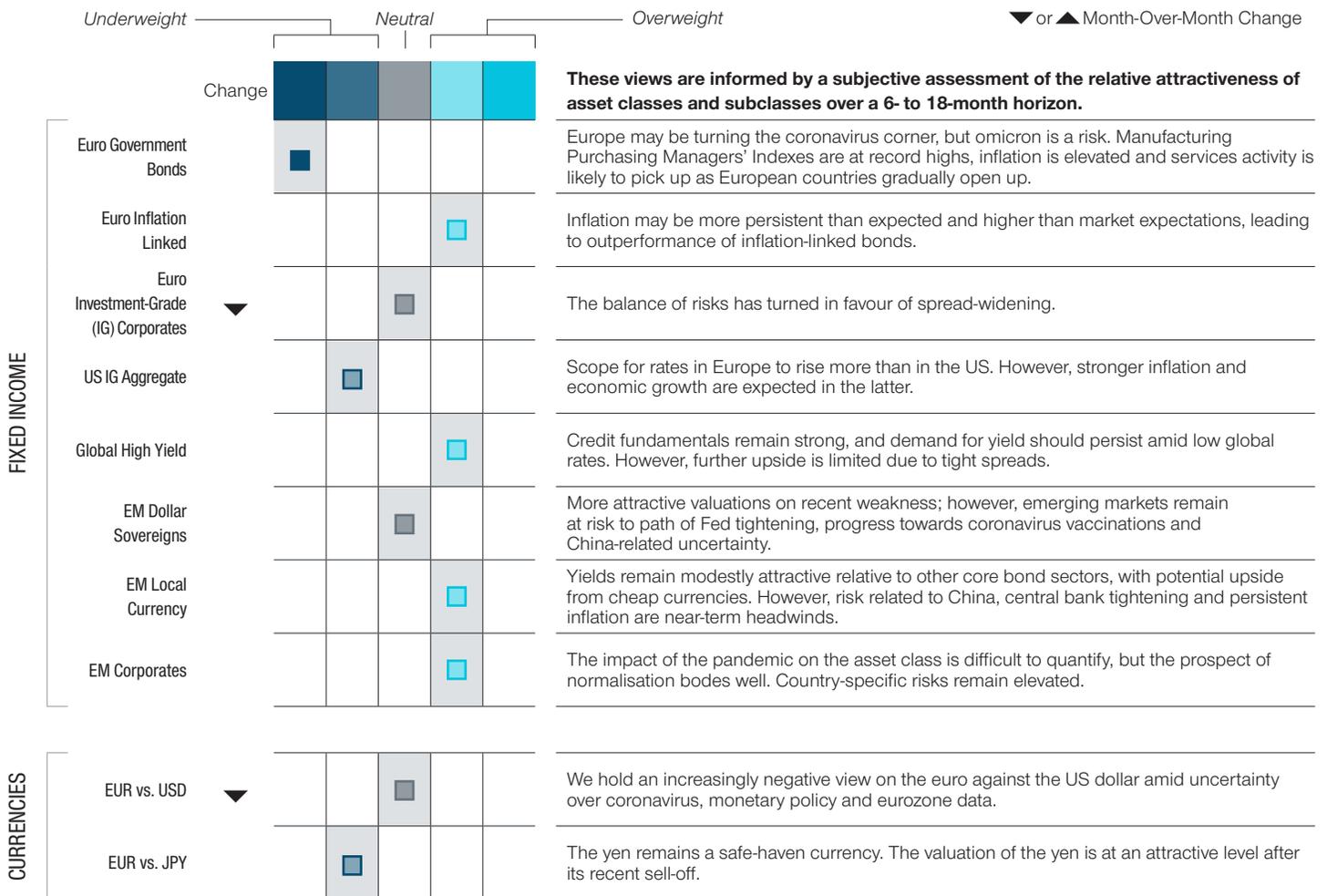
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*Includes Australia.

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.



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