



Global Asset Allocation: The View From the UK

October 2021

1 Market Perspective



- Global economic growth outlook remains favourable, albeit past peak levels, balanced by further progress toward global emergence from coronavirus shutdowns versus fading policy support and supply chain disruptions.
- Global monetary policy is expected to continue its path toward tightening, but central banks are on different trajectories, with some—particularly in emerging markets—having already acted in response to higher inflation while others continue to keep policy on hold awaiting stronger evidence of sustained growth.
- Long-term interest rates could trend higher amid the outlook for above-trend growth and inflation, but upside may be limited as growth and imbalances driving inflation moderate.
- Key risks to global markets include elevated inflation, central bank missteps, slowing China growth, supply chain disruption, increased regulatory pressures, higher taxes and increasing geopolitical concerns.

2 Portfolio Positioning

As of 30 September 2021



- We remain modestly underweight equities relative to bonds and cash as valuations look less compelling amid moderating growth and stimulus. Higher rates, rising input costs related to supply chain bottlenecks, rising energy prices and potential tax increases could pose challenges to the near-term earnings outlook.
- Within equities, we continue to favour value-oriented equities globally, US small-caps and emerging market stocks as we expect cyclically exposed companies to benefit from a supportive global growth profile, coupled with unleashed pent-up demand and inventory rebuilding as supply bottlenecks and coronavirus concerns abate.
- Within fixed income, we continue to favour shorter-duration and higher-yielding sectors through overweights to high yield bonds and emerging market debt given our constructive credit outlook.

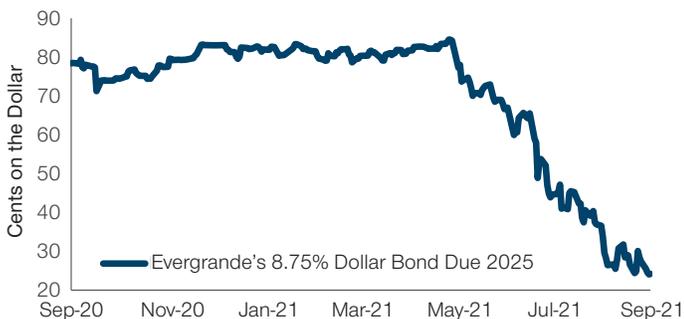
3 Market Themes

More Predictably Unpredictable

After a crackdown on internet technology and educational companies last month, risks continue to emerge out of China, including the potential fallout in its massive real estate sector following missed debt payments by Evergrande—one of the nation's largest property developers. The focused suite of regulatory actions out of Beijing are driven by efforts to balance wealth inequality and have had far-sweeping impacts on sectors such as technology, education, real estate and health care. At the same time, authorities have started to more aggressively pursue its five-year plan to reduce carbon emissions by limiting coal supply, resulting in power outages and shuttering factory activity leading to supply shortages. The degree of recent actions taken by the Chinese government combined with declining growth estimates is causing investors angst. Although unlikely to allow economic growth to fall significantly, China's actions may force foreign investors and trading partners to reassess the risks of investing in a place that has become more predictably unpredictable.

Evergrande's Debt Collapse¹

As of 30 September 2021



Past performance is not a reliable indicator of future performance.

¹Figures are shown in US dollars.

²Inflation is measured by consumer price index.

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Sources: Bloomberg Finance L.P. Financial data and analytics provider FactSet. Copyright 2021 FactSet. All Rights Reserved.

Actions Speak Louder Than Words

Inflation is proving to be a bit more persistent and higher than many expected, putting pressure on some central banks around the globe to act. Several emerging market central banks, such as Brazil and Mexico, began raising rates over the summer to fend off higher prices, and now, some developed market central banks are similarly looking to act. The Bank of England (BoE) has signalled that higher rates are coming soon as inflation is expected to get close to 4%—double its target. And while the US Federal Reserve is planning on tapering asset purchases, it remains committed to its current rate policy, reiterating that elevated inflation levels will be 'transitory'. The European Central Bank (ECB) similarly warned of not overreacting to current inflation levels, keeping current policy in place. Although most central banks believe inflation will prove temporary, prices could remain elevated for an extended period—perhaps too long for them to hold onto their words and not take action.

Global Inflation on the Rise^{1,2}

As of 31 August 2021





Positives

Negatives

United Kingdom

- Services activity has been resilient, despite shortages
- Investment tax super-deduction could support a strong recovery
- Most economic indicators show expansion, despite supply chain problems

- BoE to remain very hawkish in light of inflation surprises across a range of indicators
- Steeper Phillips curve in the labour market likely means BoE will need to hike faster
- Demand risks remain, stemming from a delayed—but likely large—fiscal consolidation in two to three years
- Overheating property market could pose future financial stability risk

Developed 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

- Limited long-term catalysts for growth
- Limited scope for ECB to stimulate further
- Demand from China fading
- Microchip shortage impacting auto production rebound

United States

- Healthy consumer balance sheets and high savings rate
- Exceptionally strong earnings growth
- Infrastructure spending likely to increase
- Delta variant spread appears to have peaked

- Elevated stock and bond valuations
- Elevated corporate and government debt levels
- Fed accommodation has peaked
- Fiscal stimulus has peaked
- Corporate taxes likely to rise

Positives

Negatives

- Japan**
- Local stock markets look attractive due to favourable relative valuation, light positioning and positive earnings trends
 - Policy setting remains extremely accommodative, with further boost coming from fiscal spending
 - Economic activity should benefit from a rebound in capex, inventory buildup and improvement in business confidence

- The slowdown in global economic data, especially in China, presents a headwind for Japanese companies
- Risk of a policy disappointment given elevated expectations
- Stagnant productivity remains a structural issue for margins in the face of a tight labour market

Asia Pacific ex-Japan

- The slowdown in Chinese economic activity may have increased the chances of policy easing to come
- Australian labour market and sentiment indicators have proved to be more resilient than expected in the face of current lockdowns
- Regulatory overhang in China has likely peaked
- High vaccination rates in Australia bode well for a strong economic reopening before the end of the year

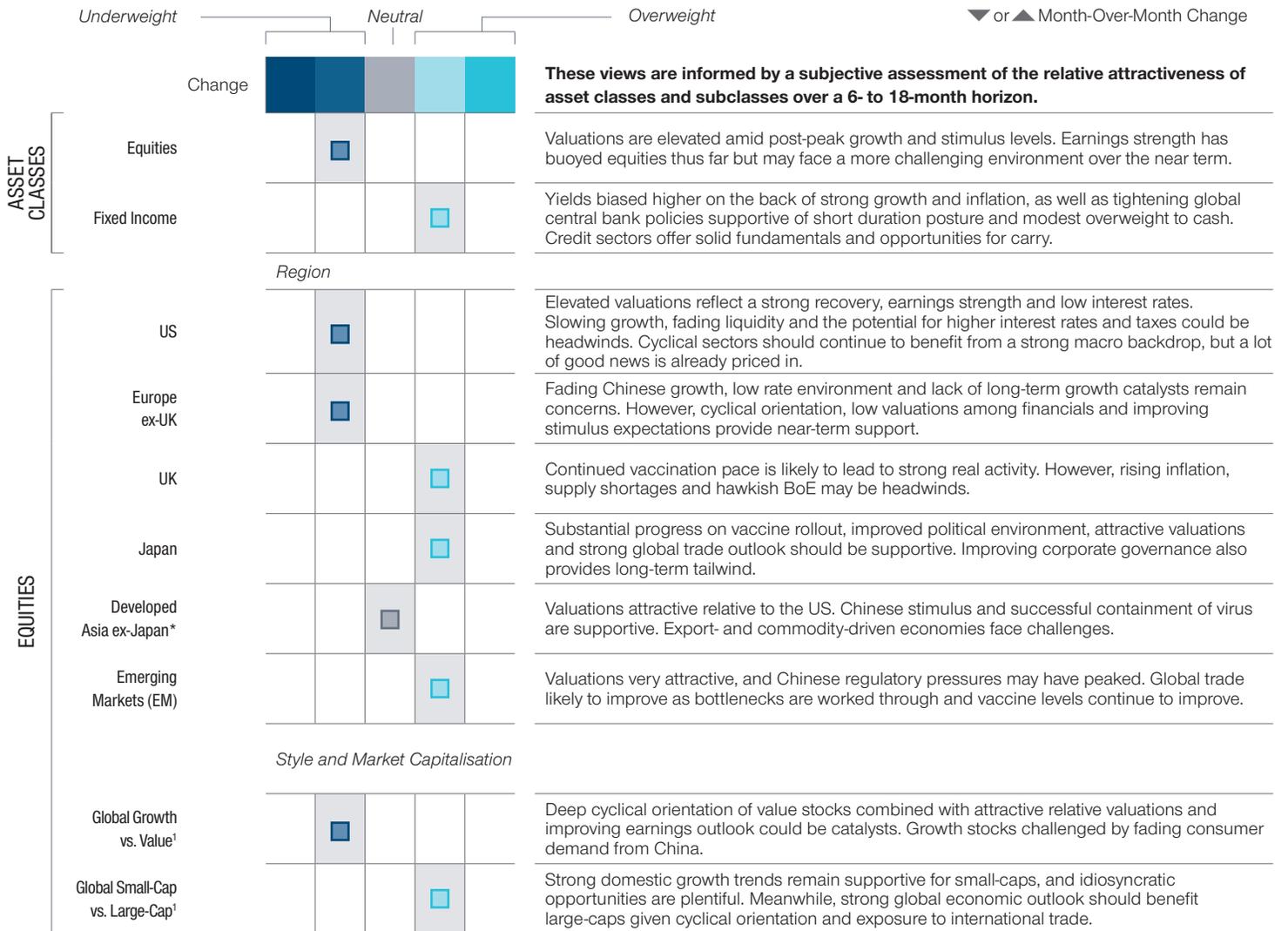
- Chinese consumer spending is still lagging the recovery and below expectations, with consumers acting cautiously in the face of uncertainties
- There is a contagion risk from the Chinese property sector, while power cuts add further uncertainty
- Earnings momentum in Australia is weak with more downgrades to come, reflecting impact of current lockdowns and the Chinese slowdown
- Australian valuations are not as favourable as they used to be

Emerging Markets

- Equity valuations attractive relative to developed markets
- Exposure to cyclical areas of economy should benefit from broad global recovery
- Chinese regulatory actions likely to have peaked
- Vaccination rates are improving

- Stimulus from China is fading
- Accommodation from central banks is fading
- New coronavirus variants remain a threat

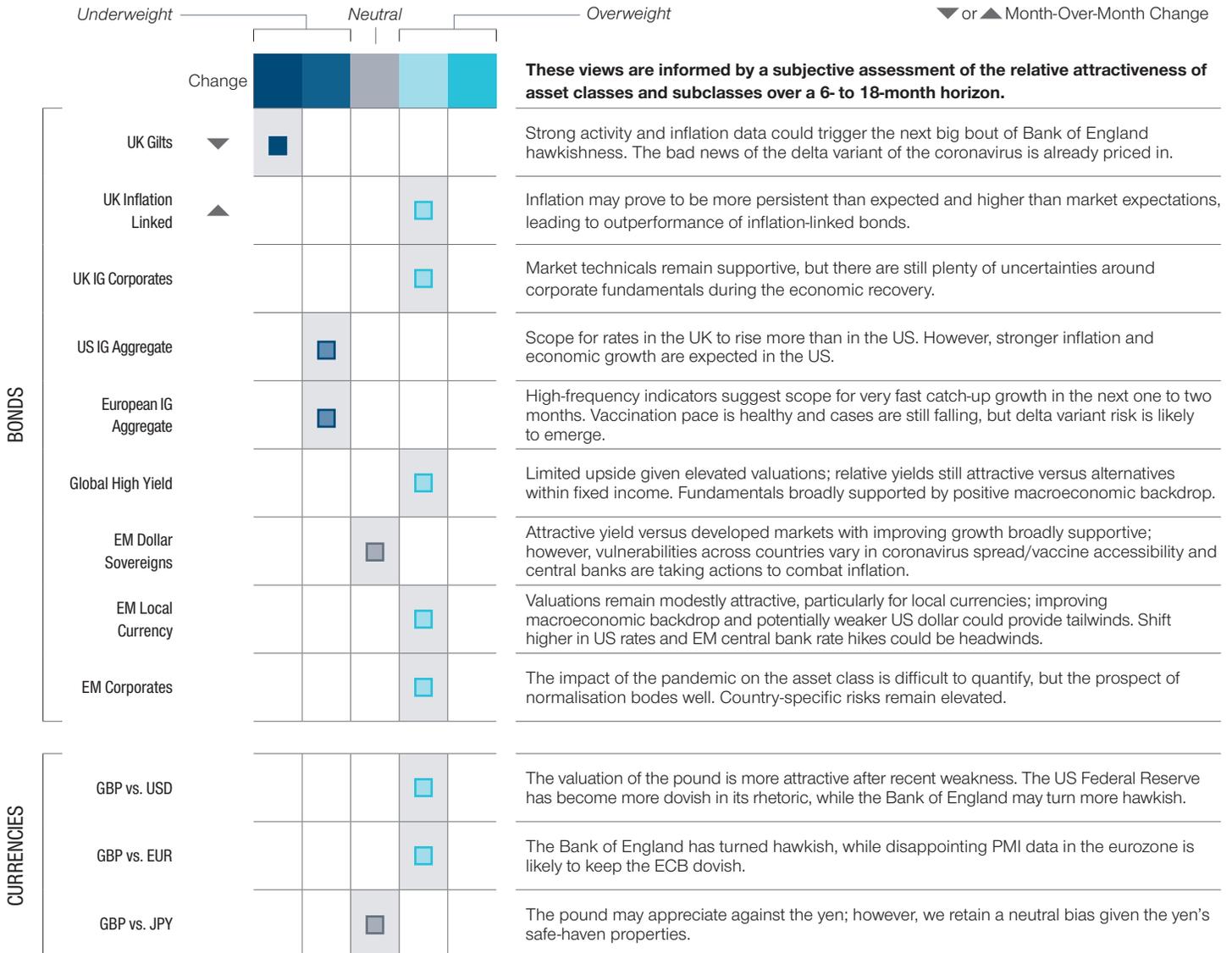
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*Includes Australia.

[†] 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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UK INVESTMENT COMMITTEE



Quentin Fitzsimmons
Senior Portfolio Manager,
Fixed Income Division



Andrew Keirle
Portfolio Manager, Emerging
Markets Local Currency Bonds



Yoram Lustig
Head of Multi-Asset
Solutions, EMEA



Ken Orchard
Senior Portfolio Manager,
Fixed Income Division



David Stanley
Portfolio Manager,
European Corporate Bonds



Toby Thompson
Portfolio Manager,
Multi-Asset Division



Mitchell Todd
Co-head of EMEA Equity



Michael Walsh
Solutions Strategist, EMEA



Tomasz Wieladek
International Economist

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