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Global Asset Allocation: The View From Europe

February 2022

1 Market Perspective

- Global economic growth expected to moderate through the year, but remains above trend. Elevated inflation remains a headwind, but expected to recede over the course of the year amidst central bank tightening and supply chain improvement.
- Developed market central banks advancing tighter policies, with the US Federal Reserve continuing to reduce its balance sheet and expected to raise rates in March, the Bank of England raising rates for the second consecutive time in February, European Central Bank curbing asset purchases, while the Bank of Japan remains on hold. Emerging market central banks may be nearing peak tightening, while China policy moving in opposite direction, with a series of easier policy moves.
- Short-term rates biased higher with central banks tightening, while long-term rates balance impacts of slowing growth and stickiness of inflation.
- Key risks to global markets include central bank missteps, persistent inflation, increasing geopolitical concerns, emergence of coronavirus variants and China growth trajectory.

2 Portfolio Positioning

As of 31 January 2022

- We remain underweight equities as valuations—although off recent highs—remain extended. Elevated inflation and rising wages are likely to weigh on corporate margins and earnings growth.
- 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.
- Broadly across our fixed income allocation, we continue to favour shorter-duration and higher-yielding sectors through overweights to inflation protected securities, emerging market debt and high yield bonds supported by our still-constructive outlook on fundamentals.

3 Market Themes

Gimme Five, Powell!

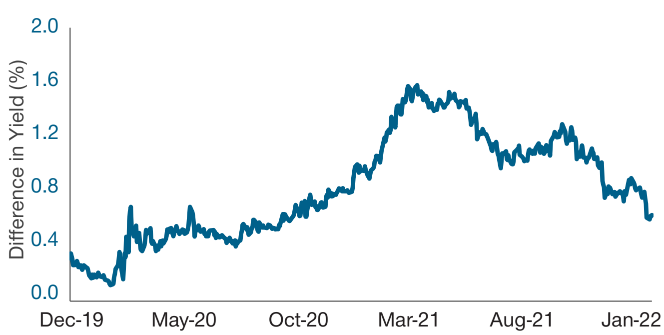
Equity markets are off to their worst start of the year since 2009 as they continue to price in the Federal Reserve's hawkish pivot and the probability of over five rate hikes this year. The drawdown in equities has been led by high-growth-oriented companies, notably in the technology and discretionary sectors, many of which rose to high valuations last year having benefitted from changes in consumer behaviour related to the coronavirus pandemic. Undaunted by the recent market weakness, Chairman Jerome Powell, at the Fed's meeting last month, reiterated their intentions to aggressively remove policy accommodation, citing strong labour markets and high inflation. With 10-year US Treasury yields already jumping over 40 basis points this year and mortgage rates following suit with a near 50-basis-point jump, the impacts are flowing through to the real economy. While the Fed seems set on its aggressive path forward, the flattening yield curve seems more worried about its potential impacts on growth and is questioning if we'll get the high-five from Powell this year.

Pulling Out All the Stops

After a rocky 2021, investors were hopeful for a rebound in China amidst signs of easier policy support and slowing regulatory reform; however, the year has started with continued signs of slowing growth, much of which has been attributed to strict zero-tolerance policies around COVID-19. Investor confidence is waning as equity markets have slumped nearly 8% to start the year and creditors are still waiting to find a bottom in prices for much of China's real estate-related debt sector. In response, China's policymakers have taken early steps to ease policy, including cutting lending rates, lowering reserve requirements and flipping course on the property sector by freeing up home loans to stabilise prices, and more support is likely on the way. With China hosting the Winter Olympics and President Xi Jinping looking to extend his leadership to an unprecedented third term, policymakers are especially eager to pull out all the stops to avoid an economic crisis this year.

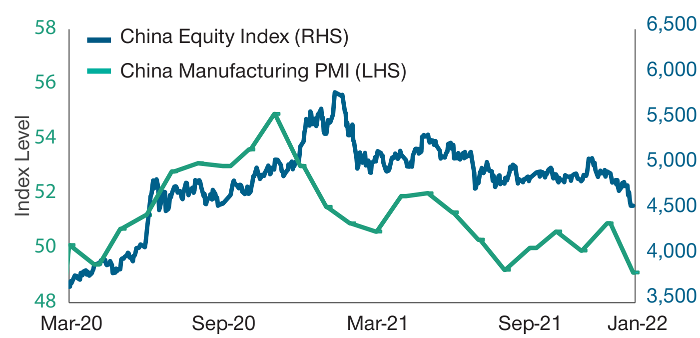
Difference in US 10-Y and 2-Y US Treasury Yield

As of 31 January 2022



China Equity Index and Manufacturing PMI

As of 31 January 2022



Past performance is not a reliable indicator of future performance.

China Equity Index represented by the Shanghai Shenzhen CSI 300 Index. China Manufacturing Purchasing Managers' Index (PMI) represented by Caixin China Manufacturing PMI Index.

Source: Bloomberg Finance L.P. (see Additional Disclosure).

REGIONAL BACKDROP

	Positives	Negatives
Europe	▪ Improving economic outlook ▪ Fiscal stimulus increasing ▪ Monetary policy remains accommodative ▪ Equity valuations attractive relative to the US	▪ Potential impacts of Ukraine conflict on energy and inflation ▪ Demand from China is fading both cyclically and structurally ▪ Limited long-term catalysts for earnings growth ▪ US dollar strength likely to remain a headwind
United Kingdom	▪ UK economy significantly stronger than expected before omicron ▪ Most economic indicators show expansion despite supply chain problems ▪ The labour market is historically very strong ▪ Rapid opening up will support economic bounceback	▪ Bank of England will hike multiple times in 2022 on the back of strong wage and price inflation ▪ Demand weakness from lower household disposable income due to higher energy prices ▪ Very tight labour market means higher wage growth and stronger inflationary pressure ▪ Demand risks remain from a delayed, but likely large, fiscal consolidation in two to three years
United States	▪ Strong corporate and consumer balance sheets ▪ Pent-up demand for services and capex ▪ Moderating, but still above-trend growth	▪ Anticipated pace of Fed tightening ▪ Elevated stock and bond valuations ▪ Supply chain issues limiting economic activity ▪ Significantly elevated inflation

	Positives	Negatives
Japan	▪ Local stock markets continue to be attractive due to favourable relative valuation and positive earnings trends ▪ Domestic fiscal support and easy monetary policy should prolong the economic recovery ▪ A weak Japanese yen boosts competitiveness	▪ Amidst the omicron variant uncertainty globally, Japanese companies are the most exposed due to their high sensitivities to global economic momentum ▪ Unexpected political risks resume as Prime Minister Fumio Kishida pushes for a less market-friendly agenda than his predecessors ▪ The rise in break-even inflation suggests inflationary pressures are also building in Japan
Asia Pacific ex-Japan	▪ China's policymakers are easing regulatory and credit conditions with a greater focus on economic growth ▪ Strong Australian labour market supports the ongoing recovery of consumer spending ▪ Economic activity in China is holding up better than expected and is likely to reaccelerate from here ▪ Low inventory levels and upgraded capex plans confirm the upward trend in Australian economic activity	▪ A strong Chinese yuan backed by large foreign inflows is tightening domestic financial conditions ▪ Housing market in Australia may become a headwind after a strong 2021 ▪ Until problems in the Chinese real estate sector are resolved, market participants are likely to stay on the sideline ▪ Australian mining investments remain low, as does the Australian dollar; bearish views on commodity prices are keeping businesses and investors cautious, while earnings growth is expected to be weak in 2022
Emerging Markets	▪ China easing regulatory and credit conditions ▪ Equity valuations attractive relative to the US ▪ COVID-19 vaccination rate is rapidly increasing	▪ Bottlenecks continue to impact global trade ▪ US dollar strength likely to remain a headwind ▪ Emerging market central banks (ex-China) tightening policy

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EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 January 2022

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.

	Change	Underweight	Underweight	Neutral	Overweight	Overweight	
ASSET CLASSES	Equities		■				Valuations off recent peaks but remain vulnerable to further rerating amidst Fed tightening policy. Earnings growth to remain positive but moderating, with potential headwinds from rising wage and input costs. Waning of omicron impacts and inventory rebuild to meet demand could be supportive.
ASSET CLASSES	Fixed Income				■		Tighter global central bank policies and elevated inflation pressuring yields higher, supportive of short duration posture. Credit sector fundamentals remain favourable; yield advantage should remain supportive, although limited upside to valuations.
	Region						
EQUITIES	US		■				Elevated valuations are being challenged by Fed tightening, persistent inflation, waning fiscal stimulus and decelerating earnings growth. Growth orientation of US market makes it more susceptible to rising rates.
EQUITIES	Europe ex-UK		■				Cyclical orientation and reasonable valuations attractive as omicron risk fades, but uncertainty surrounding Ukraine/Russia is a risk and could push energy prices even higher in the region.
EQUITIES	UK			■			Brexit adjustments probably exacerbate the effects of supply shortages and the rise in energy prices.
EQUITIES	Japan				■		Attractive valuations, recent fiscal stimulus, rebound in global trade outlook and improving corporate governance should provide tailwinds.
EQUITIES	Developed Asia ex-Japan*			■			Valuations are attractive relative to the US. Chinese stimulus and successful containment of the coronavirus are supportive. Export- and commodity-driven economies face challenges.
EQUITIES	Emerging Markets (EM)				■		Valuations are very attractive, and Chinese growth appears to have stabilised. Global trade should improve in 2022 as supply chain concerns ease and vaccination levels continue to improve; however, risk-off sentiment could remain a headwind.
	Style and Market Capitalisation						
EQUITIES	Global Growth vs. Value[1]		■				Value's cyclical orientation should benefit from pent-up consumer demand, elevated savings and economic strength. Meanwhile, elevated valuations of growth stocks are challenged by higher rates.
EQUITIES	Global Small-Cap vs. Large-Cap[1]				■		Small-caps should be supported by economic growth, attractive relative valuations and strong earnings outlook. However, elevated input costs, wage pressures and heightened market volatility could challenge performance. Higher quality bias is warranted.

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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 January 2022

▼ or ▲ Month-Over-Month Change

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		Change	Underweight		Neutral	Overweight		
FIXED INCOME	Euro Government Bonds		■					Europe is turning the coronavirus corner. Manufacturing purchasing managers' indexes are at record highs, inflation is elevated and services activity is likely to pick up as European countries gradually open up.
	Euro Inflation Linked					■		Inflation may be more persistent than expected and higher than market expectations, leading to outperformance of inflation-linked bonds.
	Euro Investment-Grade (IG) Corporates	▼		■				The balance of risks has turned in favour of spread-widening.
	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					■		Credit fundamentals remain strong, and default risk remains low. However, further upside is limited due to tight spreads and slowing growth.
	EM Dollar Sovereigns				■			Attractive valuations in a low rate environment; however, emerging markets remain at risk to Fed tightening, fiscal pressures, coronavirus concerns and China-related uncertainty.
	EM Local Currency					■		Yields remain modestly attractive as many emerging market central banks have recently raised rates. However, risks related to China, central bank tightening, US dollar strength and persistent inflation are near-term 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	EUR vs. USD	▲				■		We hold an increasingly positive view on the euro against the US dollar amidst a receding omicron wave, the European Central Bank pivoting to be more hawkish and resilient European economic data.
	EUR vs. JPY			■				The yen remains a safe-haven currency. The valuation of the yen is at an attractive level after its recent sell-off.

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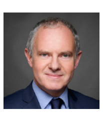
EUROPEAN INVESTMENT COMMITTEE



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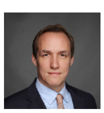

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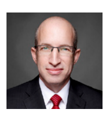

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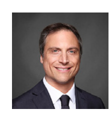

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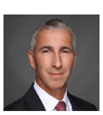

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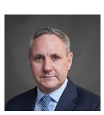

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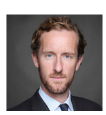

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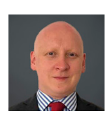

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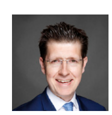

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