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INVEST WITH CONFIDENCE

Global Asset Allocation: The View From Europe

January 2022

1 Market Perspective

- Despite the coronavirus omicron variant weighing in the near term, growth should remain above potential, with inflation likely to moderate this year amid central banks tightening and improvement in supply chains.
- Developed market central banks further advance tightening policy, with the Federal Reserve paring back quantitative easing and the Bank of England raising rates. Emerging market central banks may be nearing peak tightening, with China already taking steps towards easier policies.
- Yield curves likely to flatten as global short-term rates biased higher with central banks tightening, while long-term rates likely capped by easing inflation concerns and moderating liquidity.
- Key risks to global markets include the omicron variant, persistent inflation, supply chain disruption, central bank missteps, China growth trajectory and increasing geopolitical concerns.

2 Portfolio Positioning

As of 31 December 2021

- We underweight equities relative to bonds and cash given stocks' less compelling risk/reward profile, balancing elevated valuations against a backdrop of moderating growth and tightening central bank policies.
- Within equities, we underweight US growth stocks. 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.
- Within fixed income, we overweight inflation-linked securities and underweight government bonds as they provide ballast to the overall portfolio given a more cautious view on equity valuations and more hawkish major central banks that may limit further upside to interest rates.
- Broadly across our fixed income allocation, we continue to favour shorter-duration and higher-yielding sectors through overweights to emerging market debt and high yield bonds supported by our constructive credit outlook.

3 Market Themes

Holiday Rush

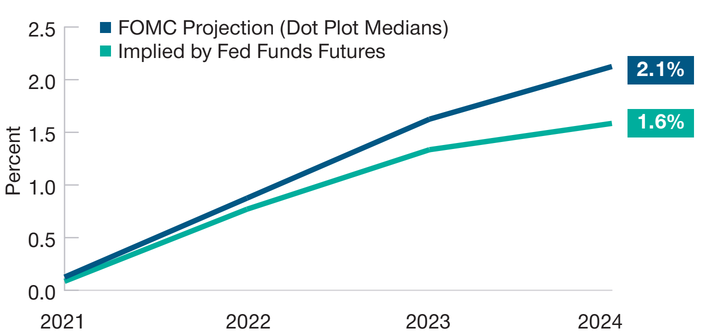
The Federal Reserve turned decisively more hawkish at its December meeting, announcing an acceleration of the pace of tapering, which will now end asset purchases by March, and guided towards a midyear start of rate normalisation. From a timing standpoint, these policies will be taking hold just as growth and inflation are expected to be moderating and amid a spike in the omicron variant across the globe. Given these factors, the market seems to be calling into question how far the Fed can tighten policy before being forced into retreat, looking for the fed funds rate to be 1.6% at the end of 2024, well below the Fed's target of 2.1%. With other developed market central banks on the move, such as the Bank of England's recent surprise rate hike, the Fed seems eager to join the holiday rush, perhaps worried that if they don't move fast enough while they can, they may be vulnerable to respond to the next economic downturn.

A New Year's Resolution

A confluence of events weighed on Chinese growth last year, including its crackdown on the massive property sector—making up nearly 25% of its economy, increased regulations particularly in the technology and education sectors and market disruption caused by shuttering coal production to meet its clean energy agenda. In response to the weakness, China is acting, having cut its reserve requirement ratio by 50bps, lowering its prime loan rate and accelerating loans for infrastructure projects. As China looks to balance its economy more towards consumption and to be less reliant on the speculative property sector, estimates are suggesting that growth targets for 2022 could be as low as 5.5% to 6%, down from 8% in 2021. Albeit lower, a more stable growth trajectory for China could be beneficial for investors and trading partners, who have had to navigate the recent volatility. But for now, China needs to focus on this year's resolution to engineer a soft landing in the property market to shore up the economy for years to come.

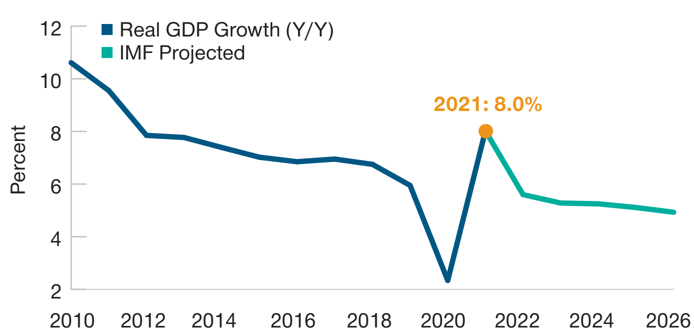
Fed Funds Rate Projections

As of 31 December 2021



China's Growth Slowdown

As of 31 December 2021



For illustrative purposes only. Actual future outcomes may differ materially.
Source: Bloomberg Finance L.P. (see Additional Disclosure).

REGIONAL BACKDROP

	Positives	Negatives
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	▪ Elevated energy prices and supply chain issues are weighing on economic growth ▪ Limited long-term catalysts for growth ▪ Demand from China fading ▪ US dollar strength likely to remain a headwind
United Kingdom	▪ Omicron variant wave will likely only have a short-lived effect on activity ▪ 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	▪ Bank of England (BoE) will hike multiple times in 2022 ▪ 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 ▪ US dollar likely to remain strong	▪ 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	Negatives
Japan	▪ Local stock markets continue to be attractive due to favourable relative valuation, light positioning and positive earnings trends ▪ While economic data are falling short of expectations, the service sector is rebounding sharply thanks to low COVID-19 cases. Capex is also expected to grow substantially on a year-on-year basis ▪ The fiscal stimulus is a tailwind for this year	▪ 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	▪ Chinese policymakers are easing regulatory and credit conditions with a greater focus on economic growth ▪ Indicators of domestic consumption in Australia point towards a snap bounce back from lockdowns ▪ Sentiment is gradually turning towards Chinese stocks, with foreign inflows being positive ▪ The Reserve Bank of Australia looks more dovish than what the market is currently pricing, and a slower hiking cycle might turn out to be a positive surprise for markets	▪ A strong Chinese yuan backed by large foreign inflows is tightening domestic financial conditions ▪ Funding costs in Australia are rising, pushing consumers to delay big-ticket item purchases ▪ Heightened political risks in China going into 2022 will create low incentives for local governments to step in if needed. Monetary easing might not be effective if credit appetite remains low ▪ Australian mining investments remain low, as is the Australian dollar. Bearish views on commodity prices are keeping businesses and investors cautious
Emerging Markets	▪ Attractive equity valuations ▪ Exposure to cyclical areas of the economy should benefit from broad global recovery ▪ Chinese regulatory actions have likely peaked ▪ Vaccination rates are improving	▪ Omicron variant remains a notable threat due to relatively low vaccination levels ▪ Heightened political and regulatory risk ▪ Accommodation from central banks is fading ▪ US dollar strength is likely to remain a headwind

Past performance is not a reliable indicator of future performance.

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.

		Underweight		Neutral	Overweight		
	Change						
ASSET CLASSES	Equities		■				Earnings comparisons will be more challenging in 2022 as decelerating economic growth, tightening central banks and renewed pandemic uncertainty may create a more difficult environment ahead. Elevated valuations and rising rates could pose additional headwinds.
ASSET CLASSES	Fixed Income				■		Tighter global central bank policies and elevated inflation are pressuring yields higher, supportive of short duration posture. Credit sector fundamentals remain favourable; yield advantage should remain supportive, although there is a limited upside to valuations.
	Region						
EQUITIES	US		■				Elevated valuations are likely to be challenged by Fed tightening, persistent inflation, waning fiscal stimulus and decelerating earnings growth. However, pent-up demand and elevated savings could continue to offer support.
EQUITIES	Europe ex-UK		■				Continued lockdowns, elevated energy costs, supply bottlenecks, weak demand from China and a low rate environment remain concerns. However, cyclical orientation, reasonable valuations and improving stimulus expectations provide near-term support.
EQUITIES	UK			■			Brexit adjustments probably exacerbate the effects of supply shortages and the rise in energy prices.
EQUITIES	Japan				■		Attractive valuations, recent fiscal stimulus, strong global trade outlook and improving corporate governance provide tailwinds, but the new variant could delay domestic reopening.
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, the coronavirus uncertainty is likely to delay progress over the near term.
	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 supported by potential capex and infrastructure spending. The upside in growth may be limited by valuations, and a higher-quality bias is warranted.
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 and wage pressures could weigh on margins, and a 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 December 2021

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

		Change	Underweight		Neutral	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.**
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.
	EM Dollar Sovereigns				■			Attractive carry 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 EM 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 negative view on the euro against the US dollar amid uncertainty over coronavirus, monetary policy and eurozone 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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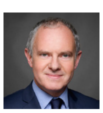
EUROPEAN INVESTMENT COMMITTEE



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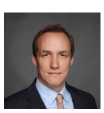

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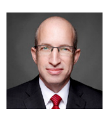

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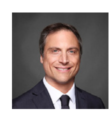

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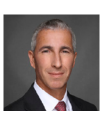

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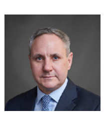

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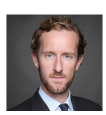

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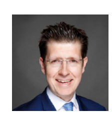

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