



Global Asset Allocation: The View From the UK

March 2022

1 Market Perspective



- Global economic growth is expected to moderate over the course of the year but remains above trend. Expectations for a moderation in inflation over the year may be stalled by inflationary pressures resulting from the conflict in Ukraine.
- Despite rising geopolitical risk impacting growth, developed market central banks are advancing toward tighter policies, the US Federal Reserve is expected to raise rates in March, the Bank of England is expected to continue hiking rates, the European Central Bank is curbing asset purchases and the Bank of Japan remains on hold. Emerging market central banks may need to raise interest rates to defend currencies against a stronger US dollar and to contain inflation.
- Short-term rates are biased higher with central banks tightening, while long-term rates balance concerns of slowing growth, the trajectory of inflation and risk-off sentiment.
- Key risks to global markets include the conflict in Ukraine, accelerating inflation off already high levels, central bank missteps, emergence of COVID-19 variants and China's growth trajectory.

2 Portfolio Positioning

As of 28 February 2022



- While valuations are off recent peaks, we remain underweight equities given moderating growth and earnings outlook amidst an active Fed and inflation concerns. Within fixed income, we remain overweight cash as longer rates remain biased higher.
- Within equities, we trimmed our overweight to US value stocks and into growth equities to take profits following a period of strong outperformance by value stocks and reduced the overweight to Japanese equity to further de-risk our positioning.
- Within our fixed income allocation, we continue to favour inflation-linked securities and shorter-duration and higher-yielding sectors through overweights to emerging market debt and high yield bonds, supported by our still-constructive outlook on fundamentals, while keeping a cautious eye on liquidity amidst higher volatility.

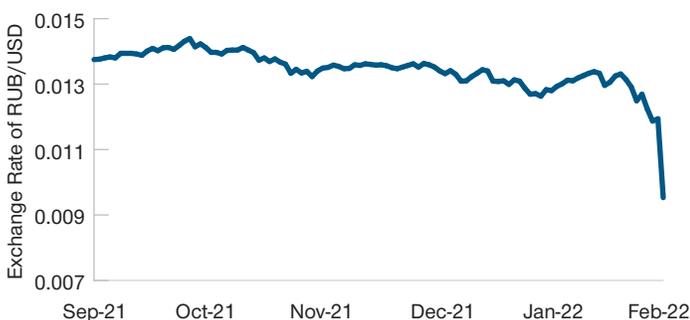
3 Market Themes

Chaos and Consequences

Russia's invasion of Ukraine has shocked the world, and while the immediate concerns are the human toll on the Ukrainian people, the implications and aftermath will be felt far beyond the region. With the European continent being thrown into chaos not seen since World War II, it's no surprise to see markets unsettled as they try to comprehend the impacts. In response to the aggression, the West has successfully collaborated by implementing several punishing sanctions targeting Russian banks, the Russian central bank and Russian sovereign debt, which have sent the ruble on a downward spiral and could devastate Russia's economy. However, so far, the sanctions have stopped short of penalising Russian energy companies, given Europe's, and especially Germany's, heavy reliance on Russian energy supply and the potential negative inflationary impacts of an energy price shock on already high prices related to the pandemic. As this situation continues to unfold, the consequences could be far-reaching, weighing on global growth and further accelerating inflation—especially given the area of conflict's notable contributions in energy and food to the rest of the world.

Russian Ruble Relative to the US Dollar

As of 28 February 2022



Past performance is not a reliable indicator of future performance.

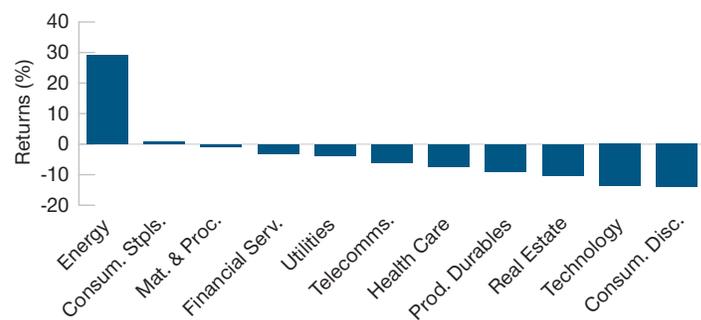
¹ References the Russell 1000 Index. Source: London Stock Exchange Group plc and its group undertakings (collectively, the "LSE Group") (see Additional Disclosure). Sources: Bloomberg Finance L.P., financial data and analytics provider FactSet. Copyright 2022 FactSet. All Rights Reserved.

In and Out of Style

Equity markets' rough start to the year facing high inflation and a more aggressive Fed has only gotten worse amidst rising geopolitical issues in Ukraine, with the S&P 500 Index down roughly 8% year-to-date. Notable as the sell-off has deepened is that growth stocks have continued to underperform, where they are typically seen as more defensive in risk-off environments. Year-to-date, Russell 1000 Value Index stocks are down as well, but just 3%, while the Russell 1000 Growth Index has fallen over 14%, largely due to fears that already high inflation could worsen and lead the Fed on a more aggressive tightening trajectory. Although more cyclically oriented, value stocks have held up relatively well; nearly all of the positive contribution came from energy, which makes up 15% of the Russell 1000 Value Index and is up over 30% year-to-date. With the conflict continuing to unfold in Ukraine, as investors and central banks evaluate the balance of rising inflation pressures and slowing growth with the possibility of stagflation, growth and value stocks may be out of style.

Year-to-Date Equity Sector Returns¹

As of 28 February 2022





REGIONAL BACKDROP

Positives

Negatives

United Kingdom

- Most economic indicators show expansion despite supply chain problems
- The labour market is historically very strong
- Rapid opening up will support economic bounceback
- Majority of UK gas from outside Russia

- Bank of England will hike multiple times in 2022 on the back of strong wage and price inflation
- Despite little direct exposure, UK still likely to be affected by much higher gas prices
- Demand weakness from lower household disposable income due to higher energy prices as a result of Russia-Ukraine conflict may lead to small technical recession at the end of the year
- Very tight labour market means higher wage growth and stronger inflationary pressure

Developed Europe

- Fiscal stimulus increasing
- Monetary policy remains accommodative
- Equity valuations attractive relative to the US

- Ukraine conflict likely to continue to exacerbate energy shortages
- Industrial production dampened by supply chain challenges
- Limited long-term catalysts for earnings growth
- US dollar strength likely to remain a headwind

United States

- Strong corporate and consumer balance sheets
- Pent-up demand for services and capex

- Fed tightening expected at a rapid pace
- Elevated stock and bond valuations
- Supply chain issues limiting economic activity
- Significantly elevated inflation
- Fiscal stimulus has peaked

Positives

- Japan**
- Local stock markets continue to be attractive due to favourable relative valuation and healthy earning expectations
 - Domestic fiscal support and easy monetary policy should prolong the economic recovery
 - Despite the risk-off environment, the Japanese yen remains cheap and still boosts competitiveness

Asia Pacific ex-Japan

- Loosening financial conditions in China starting to flow into the system, albeit at a reasonable pace
- A tight Australian labour market supports the ongoing recovery in consumer spending, with wages accelerating at a pace close to the targets of the Reserve Bank of Australia (RBA)
- Chinese economic activity is likely to reaccelerate from here after a short soft patch due to the Olympics, COVID-19 outbreaks and property concerns
- Australian assets proved to be more resilient to current geopolitical risks than the rest of the world, benefitting from higher commodity prices

Emerging Markets

- Chinese authorities are easing regulatory and credit conditions
- Equity valuations attractive relative to the US
- COVID-19 vaccination rate is rapidly increasing

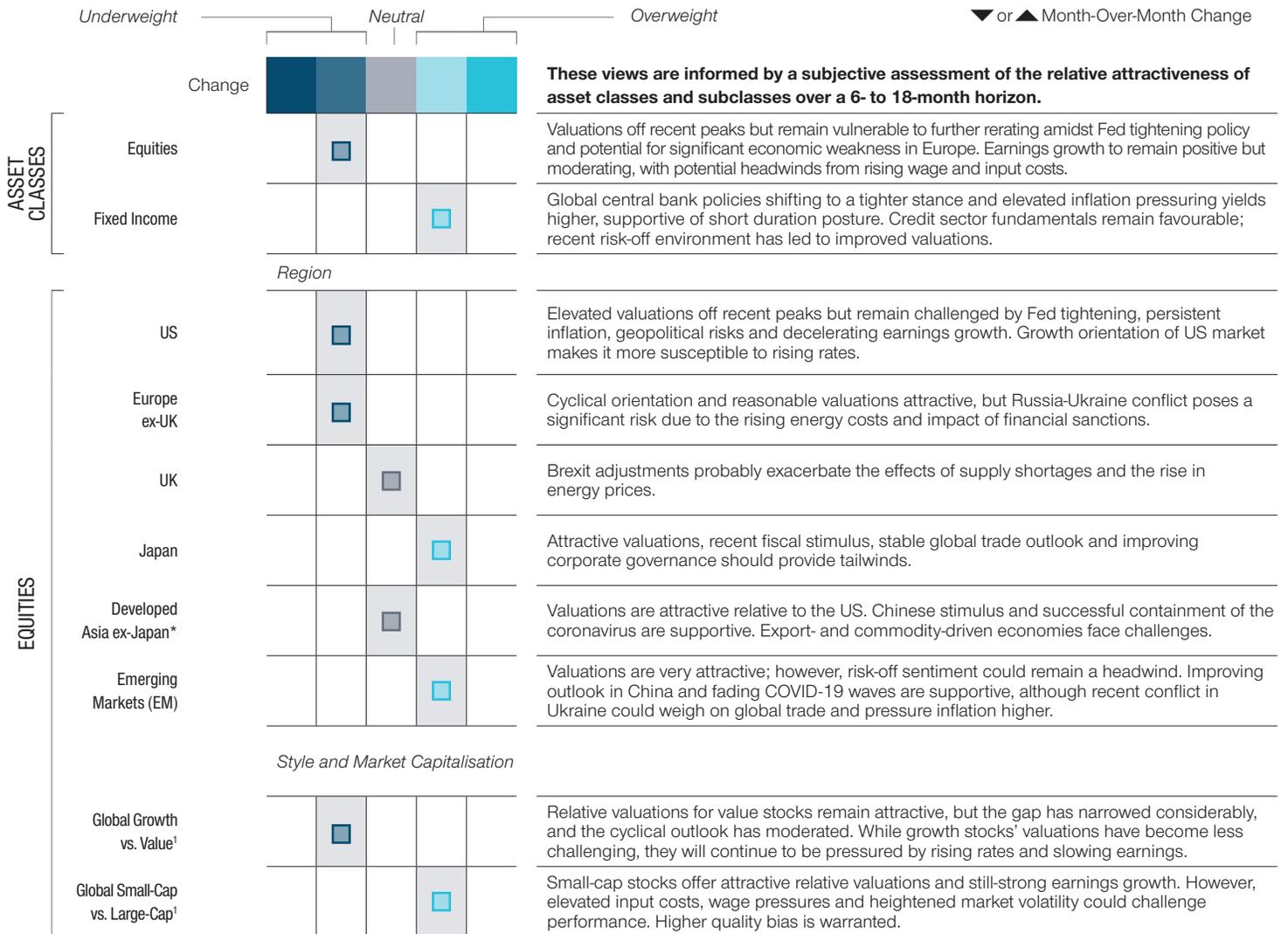
Negatives

- Leading economic indicators are weakening on the back of the omicron wave, supply shortages and rising input prices. Hopefully, this will prove to be transitory
- Unexpected political risks resume as Prime Minister Fumio Kishida pushes for a less market-friendly agenda than his predecessors
- Inflationary pressures may be underappreciated due to rising commodity prices, communication costs increases and hopeful wage negotiations

- Until problems in the Chinese real estate sector are resolved, risk appetite will remain weak
- The RBA's dovish stance looks unsustainable and might create volatility when it catches up to market expectations
- A strong Chinese yuan, backed by a solid current account surplus, is tightening financial conditions
- Rising yields on the horizon raise concerns over a hot Australian property market

- Global trade remains impacted by supply chain issues, geopolitical uncertainty and COVID-19 restrictions
- US dollar strength likely to remain a headwind
- Central bank accommodation is fading

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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.



UK INVESTMENT COMMITTEE POSITIONING

As of 28 February 2022



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UK INVESTMENT COMMITTEE



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