



Global Asset Allocation: The View From Europe

June 2022

1 Market Perspective



- While global growth is trending lower, recent economic data, especially pertaining to the labour market, have shown resilience amid geopolitical challenges, supply disruption and reduction of liquidity.
- The US Federal Reserve remains committed to its tightening policy, hinting at a front-loaded path of rate hikes. The European Central Bank (ECB) has telegraphed its plan to end asset purchases and begin raising rates despite a fragile macro backdrop, while the Bank of Japan (BOJ) remains steadfast on its policy of yield curve control.
- Emerging market (EM) central banks continue to tighten policy in response to heightened inflation and weak currencies, while China's policies continue moving in the opposite direction to counter weakening growth caused by zero-COVID policy.
- Key risks to global markets include central bank missteps, lingering inflation, the commodity impact of the Russia-Ukraine conflict, the sharp slowdown in economic data and China balancing growth amid COVID-related lockdowns.

2 Portfolio Positioning

As of 31 May 2022



- While equity valuations are more reasonable after recent declines, we remain cautious on the earnings growth outlook and inflationary impacts on margins supporting our modest underweight. Within fixed income, we remain modestly overweight cash.
- Within fixed income, we added to emerging market dollar sovereigns as it has been an unloved asset class, and flows and positioning have been so negative that it is a buy signal.
- Within fixed income, we moderated our credit risk exposure by neutralising the overweights to global high yield and emerging market corporates as spreads may widen with slowing economic growth and tightening financial conditions.
- Despite attractive carry from elevated inflation levels, we trimmed our position in Euro inflation linked securities as we expect inflation to moderate from current highs.
- Taking advantage of higher yields, we added to Euro government bonds, providing mitigation against heightened global market risks.

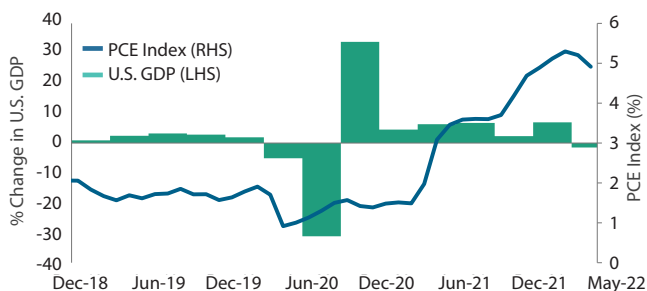
3 Market Themes

So Far, So Good...

With inflation at multi-decade highs and growth already slowing, investors were rightfully sceptical about the Fed's ability to aggressively tackle inflation without sending the economy into recession having waited too long. Now two hikes in and messaging front-loading future hikes with 50 basis point moves, recent data suggest that the broader economy is largely holding up. Although first-quarter gross domestic product (GDP) showed that the economy surprisingly contracted by 1.5%, it appeared an anomaly due to temporary disruptions in trade and inventories, masking underlying support from consumer and capex spending. And while expected to slow, full year 2022 growth estimates still expect a 2.6% expansion, near pre-pandemic averages. Inflation too is showing some early signs of cooperating, with recent data suggesting easing in producer prices and wages, giving Fed officials a sigh of relief. While far from out of the woods, with topline CPI still expected to be near 6% levels at year-end, so far it seems like maybe, just maybe, a Fed-driven recession or stagflation are not inevitable.

US GDP and Inflation¹

As of 31 May 2022



Past performance is not a reliable indicator of future performance.

¹ U.S. GDP is represented by the U.S. Gross Domestic Product Index quarter over quarter. The PCE Index is represented by the Personal Consumption Expenditure Core Price Index year over year.

² Chart represents the difference between growth and value indices. Growth is represented by the Russell 1000 Growth Index and value is represented by the Russell 1000 Value Index.

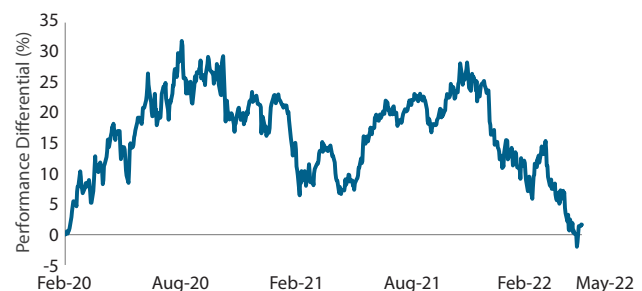
Sources: Bloomberg Finance L.P. and London Stock Exchange Group plc and its group undertakings (collectively, the "LSE Group"). See Additional Disclosures.

Growth Spurt?

After more than a decade of outperformance versus value amid years of low economic growth, growth stocks went nearly parabolic during COVID lockdowns as many large-cap technology companies disproportionately benefitted from stay-at-home trends, sending valuations to record levels. That trend abruptly ended at the end of last year and has continued amid a spike higher in interest rates and threats of aggressive Fed tightening to battle multi-decade high inflation. The sharp drawdown in growth stocks has led to more reasonable valuations, and the move higher in rates appears to be largely priced in as expectations for economic growth are moderating—historically a time when growth stocks have tended to outperform. While time will tell if this is a pivotal inflection in style back toward growth stocks, they still face near-term challenges on upcoming earnings comparisons and uncertainty around the path of Fed policy. But for now, growth could be due for a spurt higher as many of the tailwinds for value—higher energy prices and rates—may be peaking.

Growth vs. Value²

As of 31 May 2022





REGIONAL BACKDROP

Positives

- Europe**
- Fiscal spending is likely to increase
 - Equity valuations are attractive relative to the US
 - European Union unity is strengthening

Negatives

- The Russia-Ukraine conflict has driven energy prices sharply higher
- Industrial production has been dampened by supply chain challenges
- Limited long-term catalysts for earnings growth
- ECB support is likely to fade in the near term

- United Kingdom**
- Purchasing managers' surveys remain firm
 - The labour market is historically very strong
 - Energy resilience has improved with the sourcing of liquefied petroleum gas supplies that are not dependent on Russia

- The Bank of England is raising interest rates and may need to do much more if its forecast that inflation will roll over does not transpire
- Consumer confidence has fallen to very low levels, reflecting high energy costs, and this seems likely to drive a slowdown in economic growth with recessionary risks rising over time
- Very tight labour market means higher wage growth, and the prospect of second-round effects could lead to more persistent inflation

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

- The Fed is tightening at a rapid pace
- Significantly elevated inflation
- Supply chain issues are limiting economic activity

Positives

Negatives

- Japan**
- Earnings remain healthy; with buybacks at record levels, shareholders should be rewarded
 - The policy setting remains accommodative
 - The Japanese yen is cheap; with interest rate differentials stabilising, the currency should appreciate

- Leading economic indicators continue to be weak due to supply shortages and rising input prices
- Inflation is back and may encourage the BOJ to change its policy guidance
- The global slowdown, especially in China, is impacting the export sector

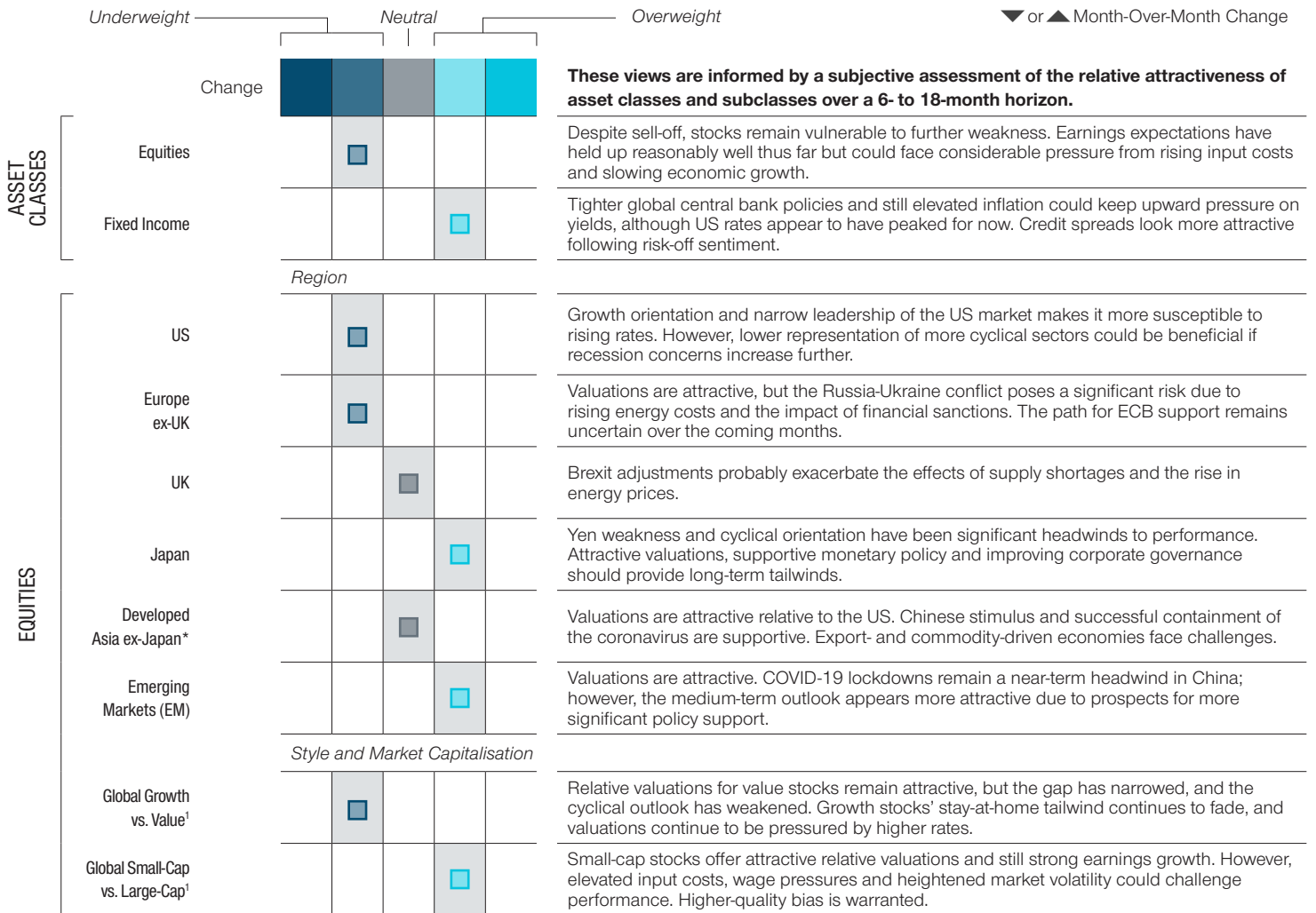
- Asia Pacific ex-Japan**
- Chinese policymakers are becoming more forceful in their stimulus measures, suggesting that the worst may be behind us already
 - Depressed sentiment and positioning make Chinese stocks an interesting contrarian, medium-term investment amidst appealing valuations
 - A tight Australian labour market and healthy saving rates support the ongoing recovery in consumer spending
 - Australian assets proved to be more resilient to current geopolitical risks than the rest of the world, benefitting from the country's relative isolation

- Chinese mobility indicators are still significantly below normal levels, indicating that the reopening story will take time to develop
- The economic slowdown in China appears to be even greater than in first-quarter 2020
- Australian business and consumer confidence indices deteriorate on the back of rapid price increases
- Unpredictable Reserve Bank of Australia policies have added to volatility in bond yields

- Emerging Markets**
- Chinese authorities are easing monetary, regulatory and credit conditions
 - Equity valuations are attractive relative to the US

- The COVID-19 outbreak is significantly weighing on economic activity
- Chinese regulatory actions have challenged investor confidence
- Global trade remains impacted by supply chain issues, geopolitical uncertainty and COVID-19 restrictions

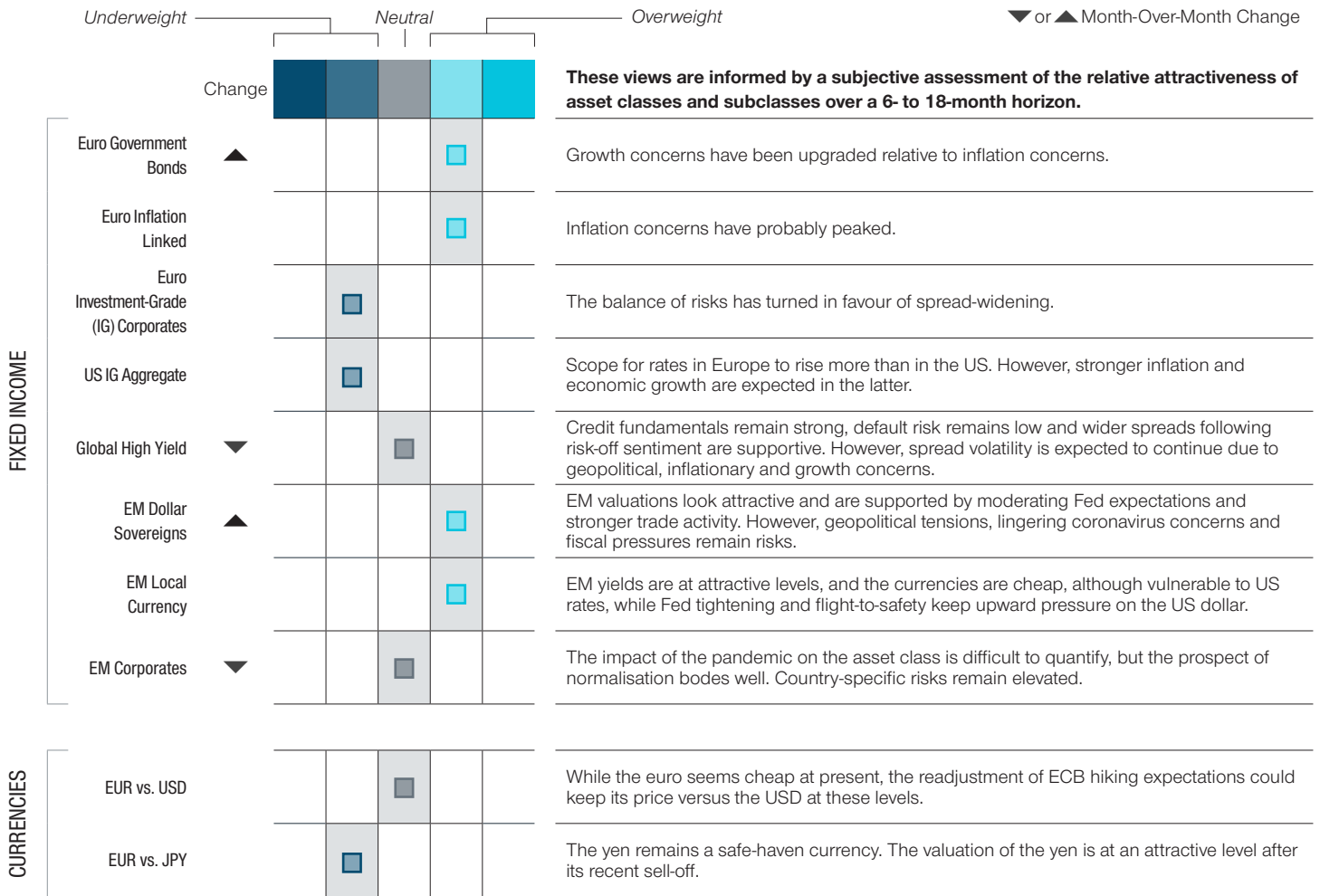
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*Includes Australia.

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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