



Global Asset Allocation: The View From the UK

April 2022

1 Market Perspective



- Geopolitical risks and lingering pandemic impacts are weighing on global economic growth expectations while putting upward pressure on already elevated inflation.
- Despite moderating growth expectations, developed market central banks are expected to advance tightening policies to fend off decades-high inflation. The US Federal Reserve is leading with the most aggressive plans and the Bank of England has raised its policy rate for the third time in March back to pre-pandemic levels.
- Emerging market central banks remain biased towards tightening to fend off inflation and defend currencies, while China policy continues moving in the opposite direction to stimulate growth.
- Key risks to global markets include escalating geopolitical concerns, persistent inflation near already high levels, central bank missteps and the impact of a COVID-19 outbreak in China on global growth and supply chains.

2 Portfolio Positioning

As of 31 March 2022



- While valuations are off recent peaks, we remain underweight equities given a moderating growth and earnings outlook amid an active Fed and lingering inflation concerns. Within fixed income, we remain overweight cash.
- Within equities, we remain underweight growth to provide a hedge should inflationary pressures persist longer than expected given heightened uncertainty and government bond rates trending higher.
- Within fixed income, we moderated our underweight to government bonds following recent moves higher in rates to provide portfolio ballast in a risk-off scenario.
- We continue to favour shorter-duration and higher-yielding sectors through overweights to inflation-linked securities, high yield bonds and emerging market debt supported by our still positive outlook on fundamentals, while keeping a cautious eye on liquidity amid higher volatility.

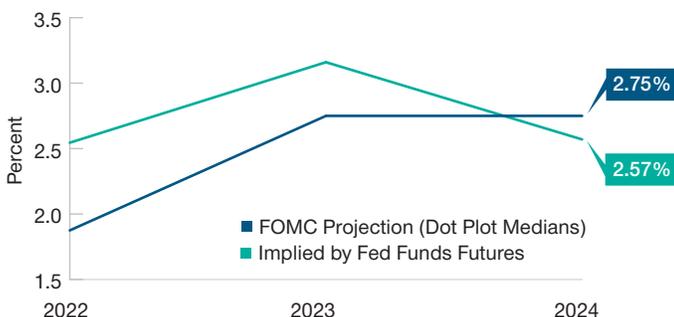
3 Market Themes

Beginning of the End?

The more than four-decade bull market for bonds, supported by low inflation and declining rates, that provided a tailwind of price appreciation on top of income, may finally be coming to an end. For bond investors, this is a particularly precarious time given heightened rate sensitivity through extended duration levels and still low yields, providing little income to offset capital losses as rates rise. For the US Federal Reserve, which had enjoyed the luxury of acting aggressively when needed amid multiple crises while not stoking inflation, the tables have turned. Now due to exogenous factors impacting supply—the pandemic and the conflict in Ukraine—inflation has spiked higher, forcing the Fed into a battle that it hasn't had to fight in decades. The market seems to agree that the Fed will remain steadfast, for now, in its battle against inflation over the course of the year. However, the market is saying the Fed could be lowering rates as soon as the end of next year, meaning bonds may not be out of favour for long.

Fed Funds Rate Projections

As of 31 March 2022



Past performance is not a reliable indicator of future performance.

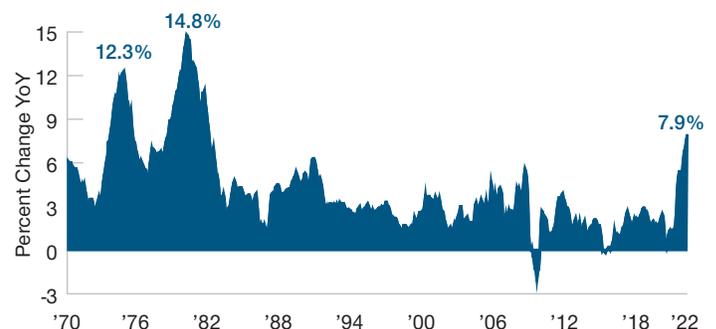
For illustrative purposes only. Actual future outcomes may differ materially.
Source: Bloomberg Finance L.P.

History Lessons

While the world has been battling to overcome the impacts of a global pandemic not seen in decades, we now face new, heightened challenges that may similarly have precedence with other periods in history. While coronavirus variants have extended supply chain issues and stoked higher inflation, expectations just a few months ago were that these issues would be transient. Unfortunately, the invasion of Ukraine in Europe, the likes not seen since the start of World War II in 1939, has exacerbated inflation risks and economic uncertainty. The narrative today has quickly turned to fears of 'stagflation' with comparisons being made to the oil embargo of 1973 in the US that served as a catalyst for runaway inflation, unprecedented rate hikes and a recession. While the world is very different today and some of the challenges are distinct, history can repeat itself. So while stagflation is not our base case, the potential for tail risk events is heightened and warrants caution.

US Consumer Price Index (CPI) YoY

As of 31 March 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 from pandemic restrictions 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 prospect of second-round effects could lead to more persistent inflation

Developed Europe

- Fiscal stimulus increasing
- Equity valuations attractive relative to the US

- Russia-Ukraine conflict likely to continue to exacerbate energy shortages
- Industrial production dampened by supply chain challenges and energy shortages
- 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

- Significantly elevated inflation
- Fed tightening at a rapid pace
- Supply chain issues constraining economic activity
- Elevated stock valuations

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
 - A weak yen may offset the negative impact of oil prices for the exporting sector

Negatives

- Leading economic indicators continue to be weak due to supply shortages and rising input prices
- The Japanese yen is reaching levels that may prove a headwind to domestic activity
- Inflationary pressures may be underappreciated due to rising commodity prices, communication cost increases and hopeful wage negotiations

Asia Pacific ex-Japan

- Chinese policymakers will have to implement larger stimulus measures to hit their set growth target
- 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)
- Depressed sentiment and positioning make Chinese stocks an interesting contrarian, medium-term investment amidst appealing valuations
- Australian assets proved to be more resilient to current geopolitical risks than some other markets, benefiting from their relative isolation from the rest of the world

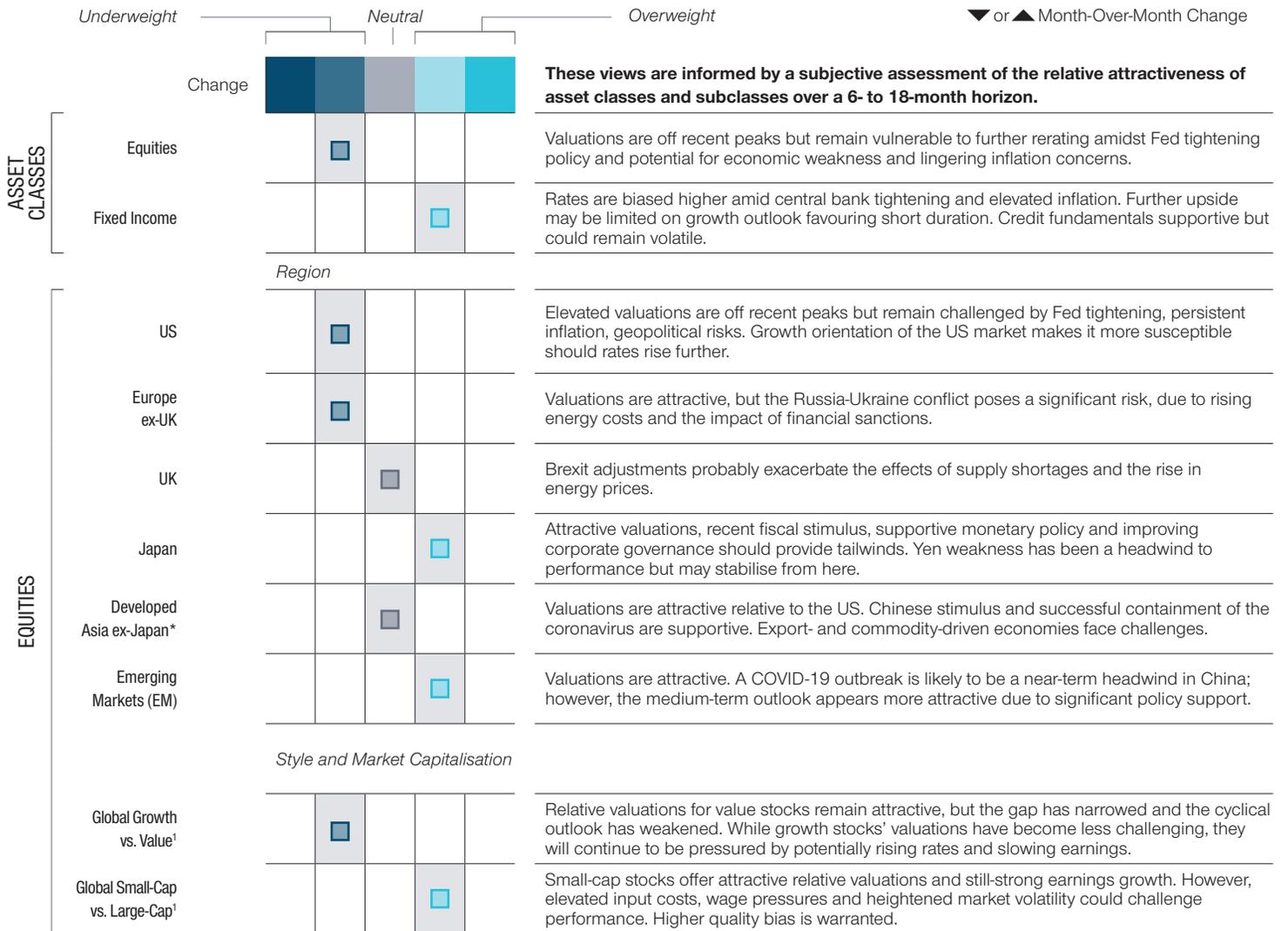
- Chinese COVID-19 outbreaks are challenging the Dynamic Clearance policy, severely impacting mobility indicators
- The RBA's dovish stance looks unsustainable and might create volatility when it catches up to market expectations
- Earnings momentum in China hasn't yet bottomed given the uncertain environment
- Rising yields on the horizon raise concerns over a hot Australian property market

Emerging Markets

- Affirmation of China's GDP growth targets suggests more supportive policy environment
- Equity valuations attractive relative to the US

- COVID-19 outbreak in Asia weighing on economic activity
- Chinese regulatory actions have impacted investor confidence
- Global trade remains impacted by supply chain issues, geopolitical uncertainty and COVID-19 restrictions
- Central bank accommodation is fading

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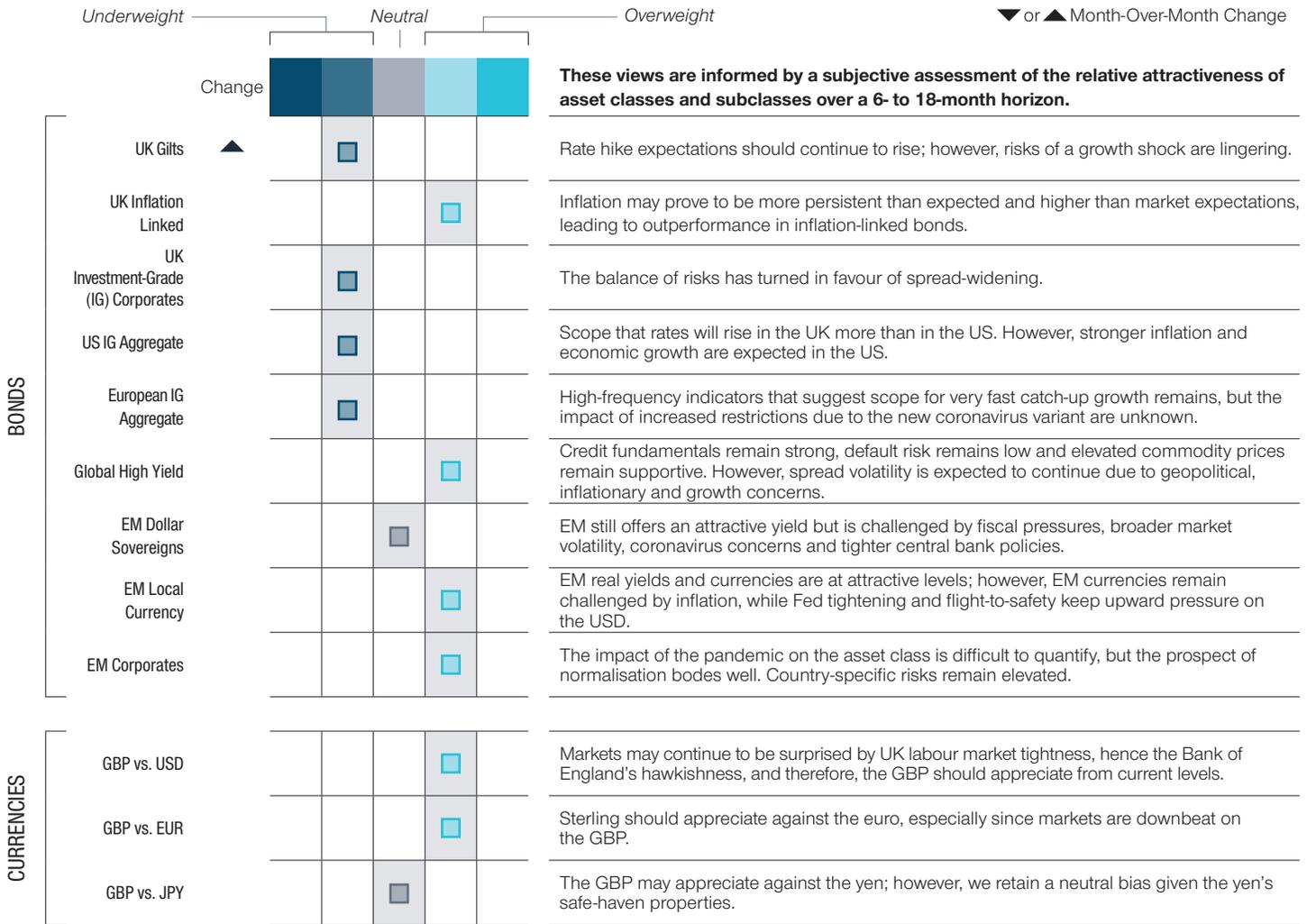
*Includes Australia.

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.



UK INVESTMENT COMMITTEE POSITIONING

As of 31 March 2022



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