



Global Asset Allocation: The View From the UK

November 2022

1 Market Perspective



- The outlook for the global economy remains uncertain as central banks navigate battling stubbornly high inflation in the face of weakening growth expectations.
- Taming inflation remains the US Federal Reserve's number one goal despite the risk of creating more economic pain. Energy-driven inflation gives the European Central Bank (ECB) a more challenging task amid a divergence in fiscal flexibility across the European Union's members. While having held steadfast, the Bank of Japan (BOJ) may be forced to ease yield curve controls as inflation has started taking hold.
- Emerging market (EM) central banks are ahead in the global tightening cycle but may need to hold rates high to defend weak currencies. In contrast, China eases policy to balance growth risk from COVID lockdowns.
- Key risks to global markets include central bank missteps, persistent inflation, potential for a sharper slowdown in global growth, China's balance between containing the coronavirus and growth and geopolitical tensions.

2 Portfolio Positioning

As of 31 October 2022



- We are underweight stocks as we remain cautious on the environment for equities given still-aggressive central bank tightening and a weakening outlook for growth and earnings.
- We remain modestly overweight cash relative to bonds given the risk of higher rates weighing on bonds, while cash offers safety and more attractive yields given the push higher in short-term policy interest rates.
- Within equities, we are nearly balanced between value and growth. The slowing growth backdrop is unfavourable for cyclicals, while higher rates weigh on growth-oriented equities.
- Within fixed income, we are overweight EM dollar-denominated and local currency sovereign debt. EM bond yields offer reasonable compensation for risks. Default rates are expected to rise from today's historically low levels, although yields at current levels help provide a buffer. We also hold an overweight to gilts as a risk-off ballast to equities.

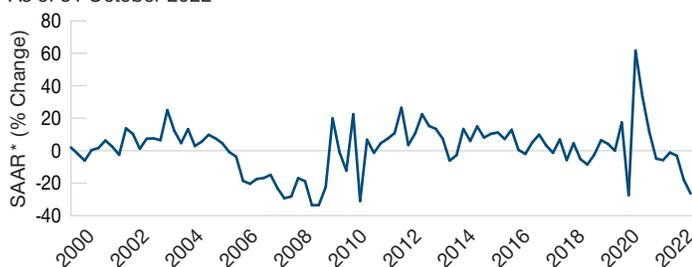
3 Market Themes

When Bad News Is Good

On the surface, the better-than-expected rebound in US gross domestic product (GDP) growth in the third quarter would reinforce the Fed's need to remain aggressive on tightening policy. However, looking at the details, there is growing evidence that the economy is feeling the bite of sharply higher rates. Consumer spending, contains nearly 70% of GDP, declined while residential fixed investment, a broad measure of housing activity, slumped by more than 26%. Consumer confidence data last month also flashed warning signs that consumers were increasingly concerned about the impact of high inflation and are worried about the job market ahead. Signs of slowing were seen in the October ISM Manufacturing Index that fell to levels last seen in May 2020, although it did show promising signs on the inflation front with supplier deliveries and prices paid easing. US markets have responded positively to the batch of bad news, with US Treasury yields easing and equity markets climbing higher. While the Fed remains vigilant in its battle to fight inflation, evidence is building that its front-loaded rate hikes are having an impact, at least on growth and potentially preceding softer inflation data. Meanwhile, investors are likely to continue to cheer bad economic data in hopes that it brings good news of a Fed pivot in policy.

Real Private Residential Investment

As of 31 October 2022



Past performance is not a reliable indicator of future performance.

*SAAR = Seasonally Adjusted Annual Rate.

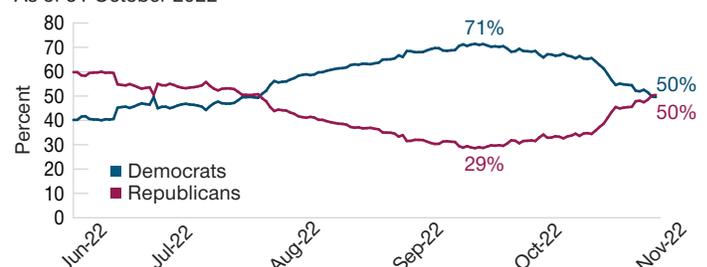
Sources: Haver Analytics/Bureau of Economic Analysis and FiveThirtyEight.com

Divided, We Rally?

US markets have historically championed periods of divided government, and with the midterm elections imminent, polls suggest that may occur with the increasing odds of Republicans taking control of the House of Representatives—and with the Senate now being a toss-up. Amongst voters' top issues are record-high inflation and a slowing economy, which are weighing on Democrats, whose two-year reign saw them advance progressive policies and spending that voters may now blame for fueling inflation. Historically, a divided government has been seen as a positive, providing checks and balances of power, reducing the likelihood of extreme policies being passed and for legislation that requires more bipartisan compromise. Similarly, uncertainty that impacts corporate and household spending plans eases as the likelihood of significant changes to spending, taxation and regulatory policies ebbs. However, while gridlock may be welcomed by the markets, a divided government could raise the potential for volatility in other areas, such as raising the debt ceiling limit, support for Ukraine and regulation of the technology sector. China policy has been an area which has witnessed broader bipartisan agreement representing a potential risk to markets. So, while markets could rally on news of a divided government, we shouldn't expect political uncertainty to go away, particularly in today's world.

Chances of Controlling the Senate

As of 31 October 2022





REGIONAL BACKDROP

Positives

United Kingdom

- Energy cap will partially offset mortgage and energy shocks to household finances
- The labour market remains strong

Negatives

- The Bank of England will raise interest rates to high levels
- Fiscal consolidation will further weigh on demand next year
- A recession and sharp house price declines next year appear likely

Developed Europe

- Fiscal spending is likely to increase
- Very attractive equity valuations
- ECB sovereign bond-buying backstop

- Recession risk is very high
- Industrial production will be curtailed by energy shortages
- ECB is tightening
- Sovereign debt risks are rising
- Limited long-term catalysts for earnings growth

United States

- Strong corporate and consumer balance sheets
- Resilient labour market
- Supply chain issues are improving rapidly
- Inflation eased in October

- Persistently high inflation
 - Restrictive monetary policy
 - Labour supply shortages
 - Deteriorating corporate margins
-

Positives

Negatives

- Japan**
- Earnings outlook remains healthy relative to other regions
 - The policy setting remains accommodative with no change expected
 - The Japanese yen is cheap, helping the export sector

- Leading economic indicators continue to be weak due to elevated input prices
- Inflation is pushing investors to question the BOJ's commitment to its yield curve control policy
- The global slowdown is a concern for the export-heavy stock market

Asia Pacific ex-Japan

- Bad news is seen as good news, with the economic slowdown in China implying further stimulus support
- China company valuations remain undemanding with solid earnings growth being forecast in the next 12 months
- In Australia, consumer spending remains healthy despite headwinds. Consensus expects the Reserve Bank of Australia to moderate the pace of tightening going forward, reducing pressure on rising yields

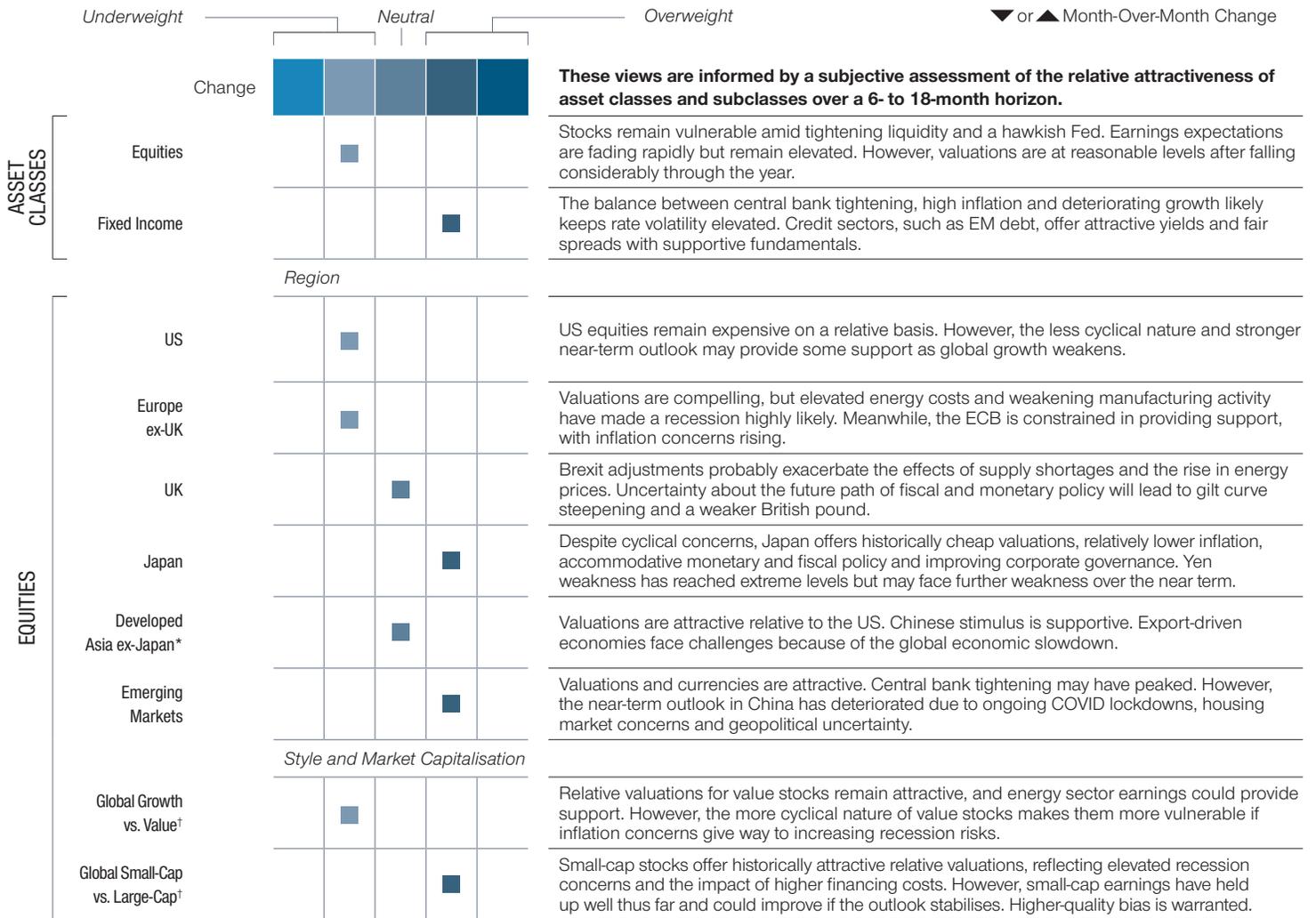
- Risks of renewed mobility restrictions in China are increasing with the coronavirus spreading further
- The risk premium increased following China's Communist Party Conference
- In Australia, expectations for future earnings are becoming more cautious to reflect the slowing domestic economy. The housing market has peaked as evidenced by prices/activity levels

Emerging Markets

- Chinese authorities are easing monetary and credit conditions
- Equity valuations are attractive relative to the US
- EM central banks are further along in the tightening cycle
- Attractive currency valuations

- Global trade volumes are slowing
- COVID policy remains a headwind to economic growth
- Chinese housing concerns have impacted industrial activity
- Chinese regulatory actions are weighing on confidence
- Geopolitical risks are elevated

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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 31 October 2022



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