



# Global Asset Allocation: The View From the UK

April 2023

## 1 Market Perspective



- Lagged impacts of central banks' tightening are to weigh on growth and the earnings outlook in the back half of the year, with expectations of lower inflation but still above central bank targets.
- The recent banking crisis and unexpected oil supply cuts complicate inflation and the financial stability puzzle for central banks and could keep interest rate volatility elevated.
- While consensus builds for a slower growth outlook, China reopening and resilient growth in Europe offer balance to an otherwise negative sentiment.
- Key risks to global markets include central bank missteps, resilient inflation, steeper growth decline, a broadening banking crisis and geopolitical tensions.

## 2 Portfolio Positioning

As of 31 March 2023



- We remain underweight equities and fixed income in favour of cash. Equities are vulnerable to the weaker growth and earnings backdrop, and still aggressive central banks could weigh on fixed income as they continue to battle inflation, while cash continues to offer safety and attractive yields.
- Within equities, we remain overweight to areas with more attractive valuation support, including small-/mid-caps, global ex-US and emerging markets.
- Within fixed income, we are underweight gilts but added to inflation-linked bonds. While rate volatility is to remain elevated, rates are likely to move higher from current levels. Nevertheless, duration offers ballast within our multi-asset portfolios amid a potentially choppy back half of the year and inflation-linked bonds offer some protection should inflation prove more persistent than expected.

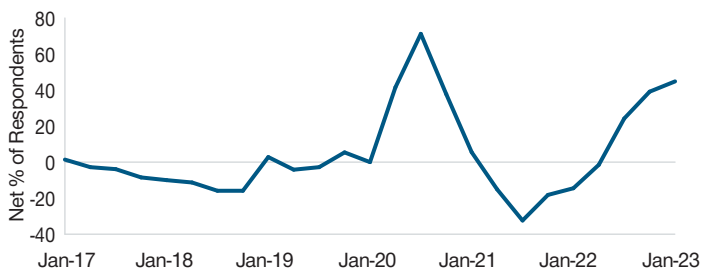
## 3 Market Themes

### It's Complicated

In light of the recent banking crisis, global central banks' narrow focus on combating inflation has gotten more complicated as they now face the added task of maintaining financial stability. In an effort to thread the needle in reinstating price stability while shoring up confidence in the banking system, the US Fed announced a 25bps increase at its March meeting—an apparent compromise between a 50bps hike and no move at all—while at the same time swiftly launching a new emergency lending facility, the Bank Term Funding Program. This move is not unlike the Bank of England's hurried rescue of the gilts market in October while still pursuing a tighter monetary policy. While rescue measures have seemed to quell a broader contagion for now, the immediate impact may be a further tightening of credit within the banking industry, which was already occurring prior to the crisis. This added dimension has only made central banks' mandates more complex, given the already limited visibility into the lagged impacts of their own tightening measures.

### Banks Have Already Been Tightening Standards\*

As of 31 January 2023



**Past performance is not a reliable indicator of future performance.**

\*Source: Bloomberg Finance L.P. Fed Lending Conditions Survey is represented by the Net % of Respondents Tightening Standards for Commercial & Industrial Loans (Large & Middle-Market Firms).

†Sources: Bloomberg Finance L.P. and MSCI. China Services PMI represented by China Non-Manufacturing PMI Diffusion Index (see Additional Disclosures).

### Finding the Sweet Spot

With consensus calling for an economic slowdown in the back half of the year as tighter financial conditions take hold, it is increasingly challenging to find areas of optimism amid the impending gloom. However, emerging markets are one area that has done well recently—up over 17% off October's bottom—that could continue to benefit from a lessening of headwinds. The recent outperformance was largely triggered by China's surprise reopening from COVID lockdowns last fall, and while some of the euphoria has faded, recent data continue to show momentum and China policymakers are committed to stable growth, potentially providing a further boost. And while global growth is expected to slow, this should come with an easing of inflation pressures, lower rates and further weakening of the US dollar, all of which could be supportive for emerging markets. So unless global growth surprises significantly to the downside, emerging markets could find themselves in a sweet spot as we enter a period of slower, but not 'off the rails' growth.

### Positive Signals Across Emerging Markets†

Two years ended 31 March 2023





## REGIONAL BACKDROP

### Positives

### Negatives

#### United Kingdom

- N** Energy price caps continue to benefit household finances
- Inflation expectations have reverted to normal levels
- Labour market remains resilient

- A recession and house price declines in 2023 appear likely
- The Bank of England is limited by financial stability concerns
- Brexit adjustments continue to weigh on the economy

#### Europe

- U** Unusually warm winter has driven energy costs lower
- Fiscal spending is rising
- Equity valuations remain attractive

- Inflation remains elevated, particularly core inflation
- Monetary policy remains restrictive
- Geopolitical uncertainty is heightened due to the war in Ukraine

#### United States

- U** Consumer spending remains strong
- Labour market has been extremely resilient
- Services sector remains remarkably strong

- Recession risk remains elevated
- Inflation has proven more persistent than expected
- Labour supply remains scarce

#### Japan

- O** Equity valuations remain very attractive
- Benefitting from uptick in inflation, particularly wages
- Corporate governance continues to gradually improve

- Earnings expectations prone for disappointment
- Monetary policy normalisation may surprise the market
- Stronger yen may weigh on the export sector

#### Asia Pacific ex-Japan

- N** China's economic data are surprising on the upside, especially on the services sector. The tone of policymakers is also supportive
- China's earnings are beating estimates and being revised higher, boding well for future returns
- Australia's labour market is tight, but not yet seeing wage pressure; the economy remains surprisingly resilient, with the Reserve Bank of Australia likely to err on the dovish side to extend this cycle

- Some mixed signals may raise doubts about the sustainability of China's economic rebound, particularly related to exports
- Geopolitical risks remain with US-China tensions top of mind
- Australia's consumer spending is at risk with mortgage rates being reset; latest earnings results also highlight concerns on margins going forward

#### Emerging Markets

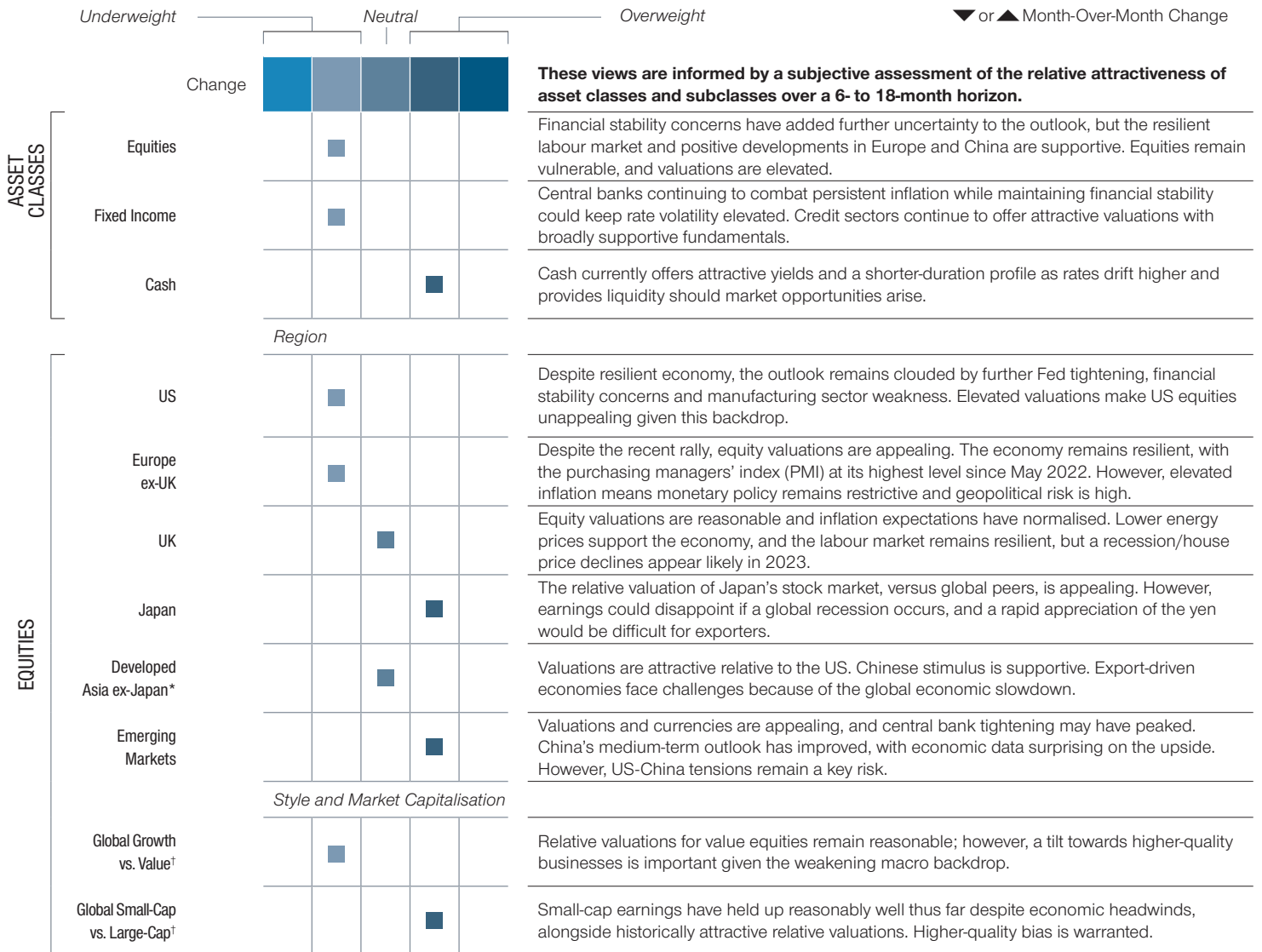
- O** China reopening has been slow but supportive
- Economic data are surprising to the upside
- Equity valuations are attractive relative to the US

- Global trade is challenged with tighter monetary conditions
- Geopolitical risks remain elevated
- Credit formation in China remains weak

**U** Underweight   **N** Neutral   **O** Overweight

#### Past performance is not a reliable indicator of future performance.

Views are informed by the Asset Allocation Committee and regional investment committees (United Kingdom, Europe, Australia, Japan and Asia) and reflect the equity market.



\* Includes Australia.

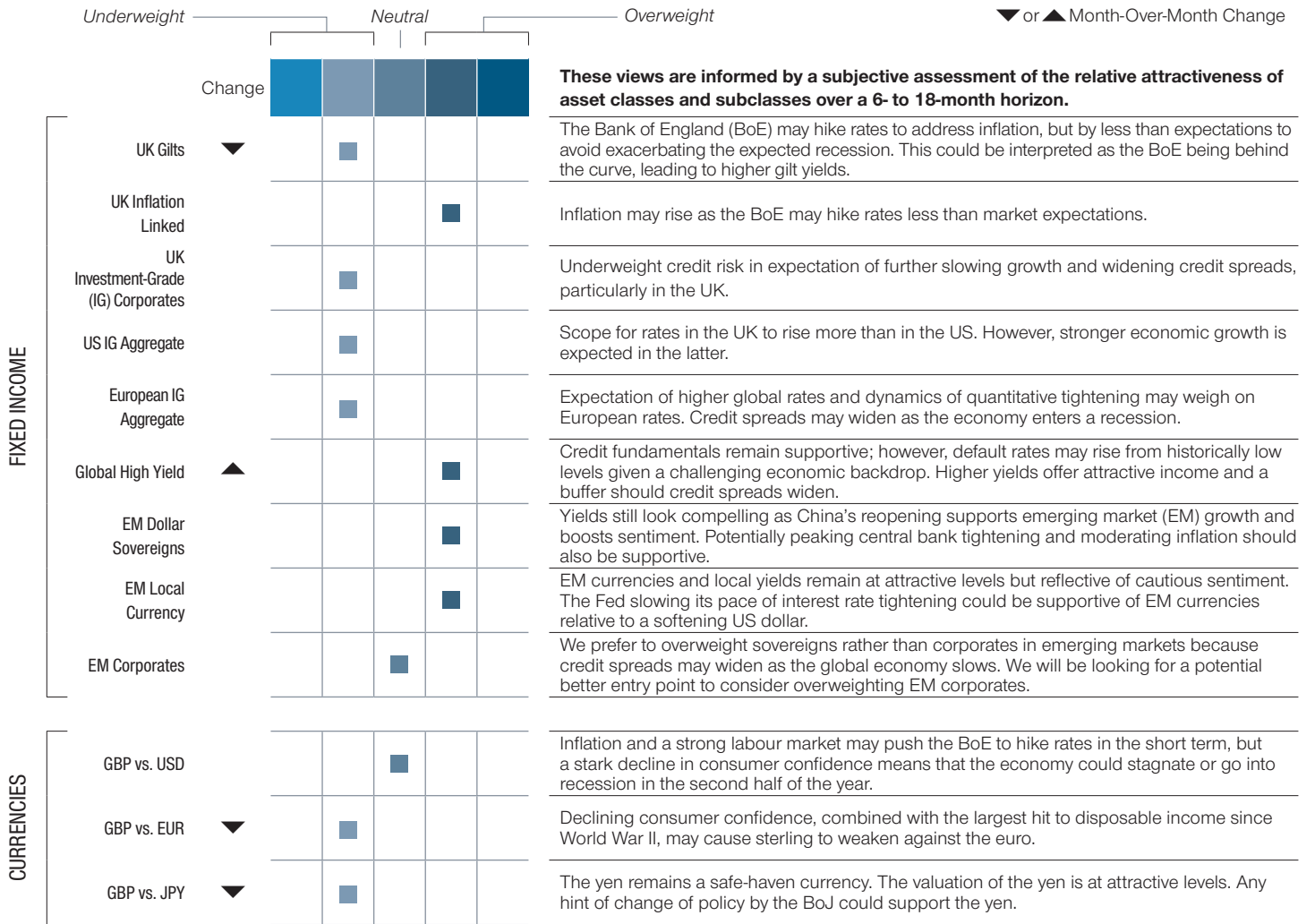
† For pairwise decisions in style and market capitalisation, positioning within boxes represents positioning in the first-mentioned asset class relative to the second asset class.

The asset classes across the equity and fixed income markets shown are represented in our multi-asset portfolios. Certain style and market capitalisation asset classes are represented as pairwise decisions as part of our tactical asset allocation framework.



# UK INVESTMENT COMMITTEE POSITIONING

As of 31 March 2023



The specific securities identified and described are for informational purposes only and do not represent recommendations.



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