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INVEST WITH CONFIDENCE

Global Asset Allocation: The View From Europe

September 2023

1 Market Perspective

- Global economic growth has been mixed across regions, with inflationary pressures and central bank policies starting to diverge.
- US and Japanese economies are proving more resilient, although the US is seeing evidence of cooling amid recent jobs data. Weakness is seen across Europe as the region works through a mild recession and elevated, albeit softening, inflation. Chinese growth is mixed as recent slowing is met with stimulus measures amid growing concerns surrounding its property sector.
- While global central bank tightening is likely peaking, the paths and rates of disinflation vary across regions, which is likely to lead to divergence in policy ahead.
- Key risks to global markets include a deeper than expected decline in growth, central bank missteps, reacceleration in inflation, trajectory of Chinese growth, and geopolitical tensions.

2 Portfolio Positioning

As of 31 August 2023

- We maintain a balanced view on risk with a modest underweight to equities as valuations remain elevated amid a less dire outlook for growth and expectations for peaking central bank policy.
- Within equities, we remain neutral on the US and the UK, underweight Europe, and modestly overweight in Japan and emerging markets.
- Within fixed income, we remain underweight bonds in favour of cash as cash offers attractive yields and liquidity should market opportunities evolve. We have an underweight to government bonds and an overweight to inflation-linked bonds. This acts as ballast to risk assets and as a hedge against inflation settling above central banks' targets, as well as the potential for higher commodity prices over the intermediate term, reflecting reduced capex and moderating productivity trends.
- Within fixed income yield-seeking sectors, we remain overweight high yield and emerging market bonds on still attractive absolute yield levels and reasonably supportive fundamentals.

3 Market Themes

A Jolt of Confidence

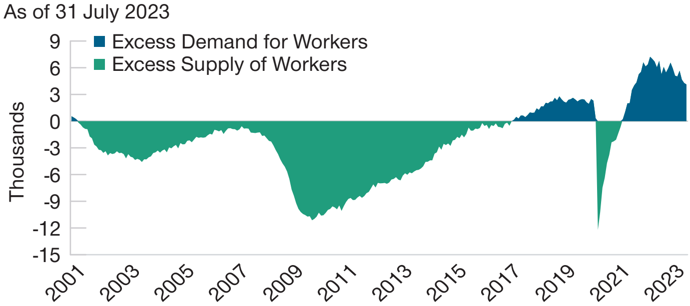
The most recent JOLTS[1] data, a measure of labour demand, showed job openings have come down significantly and are now the lowest since March 2021, a welcomed sign for the Fed that excess demand in the labour market may finally be starting to cool. The data also showed that fewer workers were quitting their jobs and that hiring broadly moderated, both moving in favourable directions for balancing the labour market and easing wage growth concerns. Layoffs were relatively flat, meaning that the labour market has cooled by removing some of the froth in demand without increasing unemployment, helping support the narrative of a soft landing. However, while wage growth data have showed evidence of slowing, they are still elevated; the number of job openings per unemployed person is still high; and the labour market remains tight by historical measures, with the unemployment rate at just 3.8%. So, while the recent softening jobs data have provided a jolt of confidence that the Fed may navigate a soft landing, we still have further to go to align the jobs market and wages with the Fed's 2% inflation target.

Diverging Markets?

After a strong start to the year surrounding optimism around China's reopening, recent emerging markets' performance has disappointed. Although there have been some bright spots across emerging markets (EM), as some Latin American countries have successfully brought down inflation, Mexico is seeing the benefits from nearshoring and India's growth is surprising to the upside, these countries have largely been overshadowed by doubts surrounding China's growth trajectory. Concerns surrounding China's troubled property sector have reemerged and weighed heavily on household confidence and willingness to spend. This comes at the same time as structurally rising unemployment weighs against Chinese policymakers' multiyear efforts to move the economy away from an export-driven economy into a more sustainable, consumption-driven and domestically focused economy. In response to today's issues, policymakers have been targeted in deploying stimulus measures such as liquidity support for property developers, relaxing some housing policies, and incremental cuts to its key policy rate, as a conscious effort to not reinflate a bubble. So, while there are pockets of opportunity in EMs, it's likely that the broader group's outlook will largely depend on China's ability to restore confidence domestically and globally.

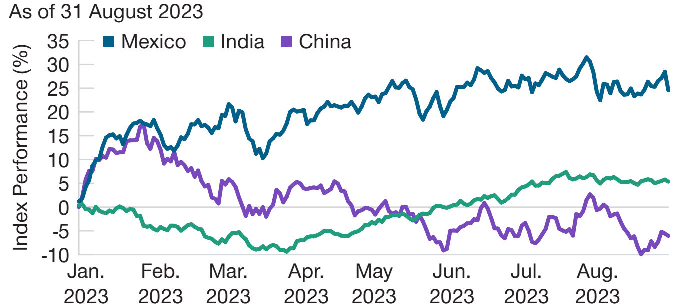
Job Openings Less Unemployed Workers*

As of 31 July 2023



China Underperforming Other Emerging Market Countries†

As of 31 August 2023



Past performance is not a reliable indicator of future performance.

*Source: Bureau of Labor Statistics. Unemployed is defined as looking for full-time work.

†Source: Bloomberg L.P. Country returns are represented by the following MSCI Indices: MSCI Mexico Index, MSCI India Index and MSCI China Index. Please see Additional Disclosure for more information about this MSCI information.

[1] Job Openings & Labor Turnover Survey.

REGIONAL BACKDROP

Region	View	Positives	Negatives
Europe	U	▪ Inflation showing signs of cooling ▪ European Central Bank (ECB) close to peak tightening ▪ Oil and gas prices have eased over the last year	▪ Inflation remains elevated, particularly core inflation ▪ Economic growth is slowing ▪ Monetary policy is restrictive
United Kingdom	N	▪ Inflation has begun to moderate ▪ Labour market remains strong ▪ Economy has proven more resilient than expected	▪ Wage inflation is very elevated ▪ The Bank of England may be forced to hike rates further ▪ Fiscal consolidation may need to be accelerated
United States	N	▪ Consumer spending remains strong ▪ Labour market has been resilient ▪ Manufacturing appears to be stabilising ▪ Artificial intelligence-related spending is a powerful tailwind	▪ Monetary policy remains very tight ▪ Banking sector concerns will impact credit availability ▪ Equity valuations are elevated
Japan	O	▪ Uptick in inflation catalyst for increase in wages ▪ Corporate governance continues to gradually improve ▪ Equity valuations remain attractive	▪ Businesses and consumers more cautious given return of inflation ▪ Earnings expectations may need to be revised lower
Asia Pacific ex-Japan	N	▪ China economic activity is expected to pick up into year-end, as evidenced by positive surprises in leading indicators ▪ Sentiment is so negative towards China that contrarian investors could look to benefit from cheap valuations ▪ In Australia, inflationary pressures are easing, while housing prices are proving resilient amid a higher rate environment	▪ Growth in China remains muted, and consumer and business confidence are fragile ▪ Property deleveraging remains an overarching goal, dampening domestic activity ▪ Australian consumers are starting to feel the effects of tightening, and upside surprises in recent economic data may suggest rates may stay higher for longer
Emerging Markets	O	▪ Monetary tightening in most emerging markets has peaked ▪ Equity valuations are attractive relative to the US ▪ Further Chinese stimulus is expected	▪ Global trade could suffer with tighter monetary conditions ▪ Chinese consumer and business confidence is fragile ▪ Geopolitical risks remain elevated

U Underweight N Neutral O Overweight

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

EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 August 2023

▼ or ▲ Month-Over-Month Change

	Change	Underweight		Neutral	Overweight		These views are informed by a subjective assessment of the relative attractiveness of asset classes and subclasses over a 6- to 18-month horizon.
ASSET CLASSES							
Equities			■				Slowing global growth is balanced with reasonable valuations in many markets. In the US, valuations are less compelling; however, a resilient labour market, supportive fiscal policies and positive sentiment about artificial intelligence (AI) are supportive.
Fixed Income					■		Central banks continue to balance lingering inflation and growth concerns, which could keep rates volatile. Yields look attractive across fixed income, and credit sectors continue to offer broadly supportive fundamentals.
Cash					■		Cash currently offers attractive yields and a shorter-duration profile (if rates drift higher) and provides liquidity should market opportunities arise.
EQUITIES	*Region*						
US				■			Despite expensive valuations, earnings expectations appear to be improving, economic activity is stabilising, market breadth has widened and technology innovation remains a key differentiator.
Europe ex-UK			■				European equity valuations remain reasonably appealing, headline inflation has notably cooled and the economy is slowing, easing pressure to hike rates much further. However, core inflation is stubbornly high, and the ECB policy bias remains restrictive.
UK				■			Equity valuations are attractive relative to history and major peers. The jobs market is resilient, and headline inflation fell to 6.9% in July. Wage inflation and Brexit adjustments, however, keep pressure on the Bank of England to stay the tightening course.
Japan					■		Japanese stocks are favoured due to the reflationary story, governance improvements and the Bank of Japan's dovish stance. Earnings could disappoint if a global recession occurs, while a strengthening yen, from very cheap levels, would be a headwind for large exporters.
Developed Asia ex-Japan*				■			China economic activity is expected to improve as policymakers accelerate stimulative measures. Negative sentiment could also tempt contrarian bargain hunters back to China. However, consumer and business confidence are fragile, and saving is prioritised over spending.
Emerging Markets					■		Valuations and currencies are attractive, and central bank tightening may have peaked. Meanwhile, the medium-term outlook in China has improved with policymakers accelerating the pace of stimulative measures, especially focusing on the property sector.
	Style and Market Capitalisation						
Global Growth vs. Value†				■			A tilt towards higher-quality businesses is warranted given elevated valuations and lingering economic concerns. Momentum surrounding AI could provide a structural tailwind to growth.
Global Small-Cap vs. Large-Cap†					■		Small-caps offer attractive relative valuations but face margin concerns due to higher exposure to interest rates and higher input costs. Given heightened economic uncertainty, higher-quality bias is warranted.

Past performance is not a reliable indicator of future performance.

* 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.

EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 August 2023

▼ or ▲ Month-Over-Month Change

		Underweight	Underweight	Neutral	Overweight	Overweight	**These views are informed by a subjective assessment of the relative attractiveness of asset classes and subclasses over a 6- to 18-month horizon.**
FIXED INCOME	Euro Government Bonds	■					The ECB should continue rate hiking. Bond supply may increase due to energy compensation. High-quality duration can mitigate some risks given the decreasing likelihood of the eurozone economy dodging a recession.
FIXED INCOME	Euro Inflation Linked				■		Inflation is expected to ease with healing supply chains, lower energy prices and a committed ECB. The labour market, however, remains tight, and inflation may stay above the ECB's target for some time.
FIXED INCOME	Euro Investment-Grade (IG) Corporates				■		Euro investment-grade credit offers good value over the short term.
FIXED INCOME	US IG Aggregate	■					Scope for rates in Europe to rise more than in the US. However, stronger economic growth is expected in the latter.
FIXED INCOME	Global High Yield				■		Credit fundamentals and higher yields remain supportive. Default rates are rising from historically low levels but are not likely to spike.
FIXED INCOME	EM Dollar Sovereigns				■		Yields are still attractive, while peaking central bank tightening cycles and moderating inflation are supportive. China's reopening enthusiasm has faded, but modest policy support is expected.
FIXED INCOME	EM Local Currency				■		EM local yields are at fair values, reflective of cautious sentiment. A weaker US dollar would also be supportive of EM currencies.
FIXED INCOME	EM Corporates			■			We prefer to overweight sovereigns rather than corporates in emerging markets because credit spreads may widen as the global economy slows. We will be looking for a potential better entry point to consider overweighting EM corporates.
CURRENCIES	EUR vs. USD				■		The US dollar may continue to weaken against narrowing growth and interest rate differentials as the Fed nears its anticipated terminal rate and the ECB keeps hiking.
CURRENCIES	EUR vs. JPY		■				The yen remains a safe-haven currency. The valuation of the yen is at attractive levels. Any further changes of policy by the Bank of Japan could support the yen.

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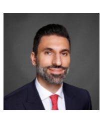
The specific securities identified and described are for informational purposes only and do not represent recommendations.

EUROPEAN INVESTMENT COMMITTEE



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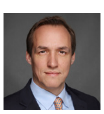

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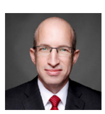

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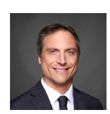

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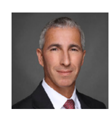

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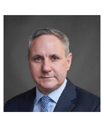

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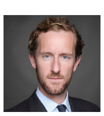

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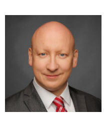

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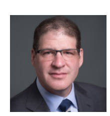

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