



Global Asset Allocation: The View From the UK

August 2023

1 Market Perspective



- Despite expectations for slowing global growth in the back half of the year, some regions are proving more resilient in the face of tighter financial conditions, bolstered by strong household and corporate balance sheets.
- The US economy has been more robust than expected, while Europe has navigated a mild recession in Germany and continues to combat inflationary pressures. Chinese growth has disappointed, while Japan continues to benefit from an uptick in domestic demand.
- While global central banks are likely near peak tightening, they remain vigilant on inflation as it is proving stickier in some regions, such as Europe and the UK, and are at the ready to take further steps towards tightening depending on trends in the data.
- Key risks to global markets include a deeper-than-expected decline in growth, central bank missteps, reacceleration in inflation, tight credit conditions and geopolitical tensions.

2 Portfolio Positioning

As of 31 July 2023



- We modestly trimmed our underweight to equities; however, we maintain a cautious stance as valuations remain elevated despite expectations for the global economy to slow in the back half of the year. Within fixed income, we increased cash holdings as bonds remain vulnerable to further central bank tightening, while cash offers liquidity in an uncertain environment and still-attractive yields.
- Within equities, we remain overweight in areas of the market with more attractive valuation support, such as small-caps and emerging markets, which could benefit from broader equity participation in the recent rally.
- Within fixed income, we now hold reduced overweight positions in return-seeking sectors such as high yield and emerging market sovereign and local currency bonds. We also favour inflation linked over fixed interest government bonds.

3 Market Themes

Insensitive

Despite the Federal Reserve's ('Fed') funds rate reaching its highest level in over 20 years, the US economy has proven more insensitive to higher interest rates than many would have expected so far. Typically, as rates move higher the economy slows, leading to weakness in the labour market, which then flows through to the consumer. However, labour market tightness has supported real income gains amid moderating inflation, and excess savings have kept consumer balance sheets strong, ultimately buoying the broader economy. Additionally, with fixed rate mortgages making up most of the US home loan market, higher rates have not had the same impact that they have had in other regions dominated by floating rate mortgages. Corporations have also proven less sensitive to higher rates given that they previously refunded debt at low rates and that capital expenditure funding was supplemented by fiscal stimulus programmes rather than from loans at high interest rates. While so far it appears the economy may be less sensitive to higher rates than in previous cycles, it is also possible that policy has not been restrictive for long enough to have its desired effects on the economy.

Resilient Economic Growth Despite Higher Rates*

As of 31 July 2023



Past performance is not a reliable indicator of future performance.

*GDP Growth Barometer represented by NY Fed Weekly Y/Y GDP Barometer, on a 12-month lag.

† Home Price Index represented by S&P Corelogic Case-Shiller Home Price Index (Y/Y%). See Additional Disclosure.

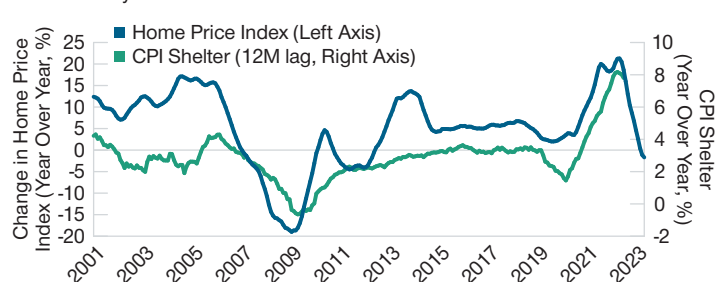
Source: Bloomberg Finance L.P.

Taking Shelter

Shelter inflation, which includes rent of primary residences and owners' equivalent rent of residences (OER), is coming off its recent highs. OER closely tracks home prices, which have shown declines year over year. Given the two components make up nearly one-third of US consumer price index (CPI) and have a lagged impact on CPI, hopes are for softening data to start to pull down overall inflation in the coming months. While this would be a welcomed sign for the Fed, recent data showing resilience in the US economy are starting to raise concerns of inflation stagnating or possibly inflecting higher. With a backdrop of a still-tight labour market, a strong services sector, consumers still holding excess savings and a recent spike in energy and food prices, there are plenty of reasons for the Fed to remain cautious. Investors and the Fed, alike, will be eyeing details as the decline in shelter inflation may be masking a move higher in other underlying components if the economy continues to surprise to the upside.

Shelter Inflation Expected to Fall†

As of 31 May 2023





REGIONAL BACKDROP

Positives

Negatives

United Kingdom

- N** Inflation has begun to moderate
- Labour market remains strong
- Economy has proven more resilient

- Wage inflation is very elevated
- The Bank of England (BoE) may be forced to hike rates further
- Fiscal consolidation may need to be accelerated

Europe

- U** Inflation showing signs of cooling
- European Central Bank ('ECB') close to peak tightening
- Equity valuations remain attractive

- Inflation remains elevated, particularly core inflation
- Economic growth is slowing
- Geopolitical uncertainty remains a concern

United States

- N** Consumer spending remains strong
- Labour market has been resilient
- Earnings expectations may have bottomed
- 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
- Inflows from foreign investors are likely to continue
- Corporate governance continues to gradually improve

- A stronger Japanese yen may weigh on the export sector
- Earnings expectations may need to be revised lower

Asia Pacific ex-Japan

- N** China economic activity is expected to pick up in the second half, especially as policymakers appear willing to provide additional support
- Cheap valuations and positive earnings growth are also supportive of equities
- In Australia, the jobs market remains bright, while housing prices are resilient amid higher rates

- Growth in China remains muted, and consumer and business confidence are fragile
- Saving in China is being prioritized over spending
- Australian consumers are starting to feel the effects of tightening, and more hikes may be needed amid accelerating wage growth data

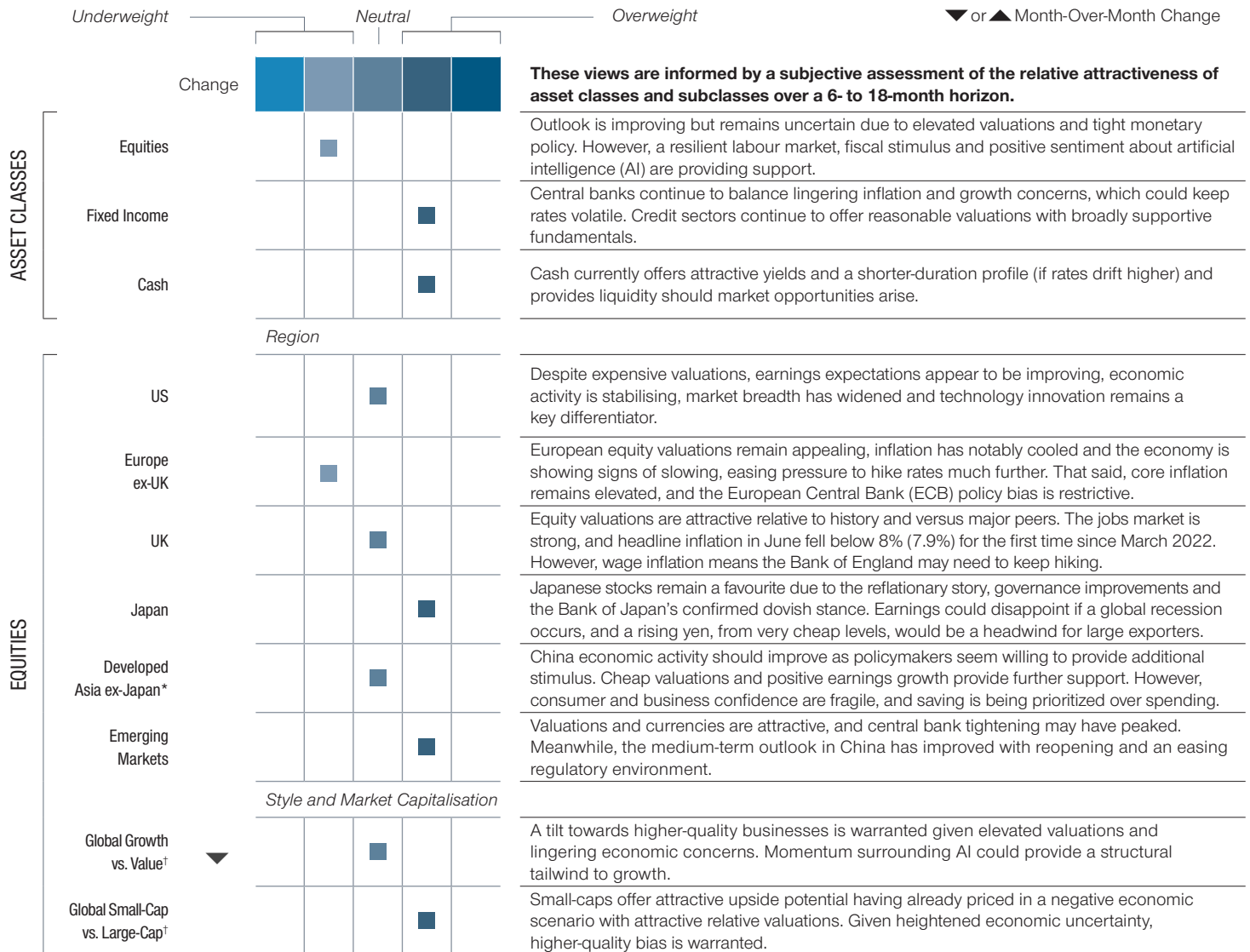
Emerging Markets

- O** Monetary tightening in most emerging markets (EM) has peaked
- Equity valuations are attractive relative to the US
- Further Chinese stimulus is expected

- Global trade could suffer with slowing global growth
- China's reopening has been underwhelming
- 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.



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*Includes Australia.

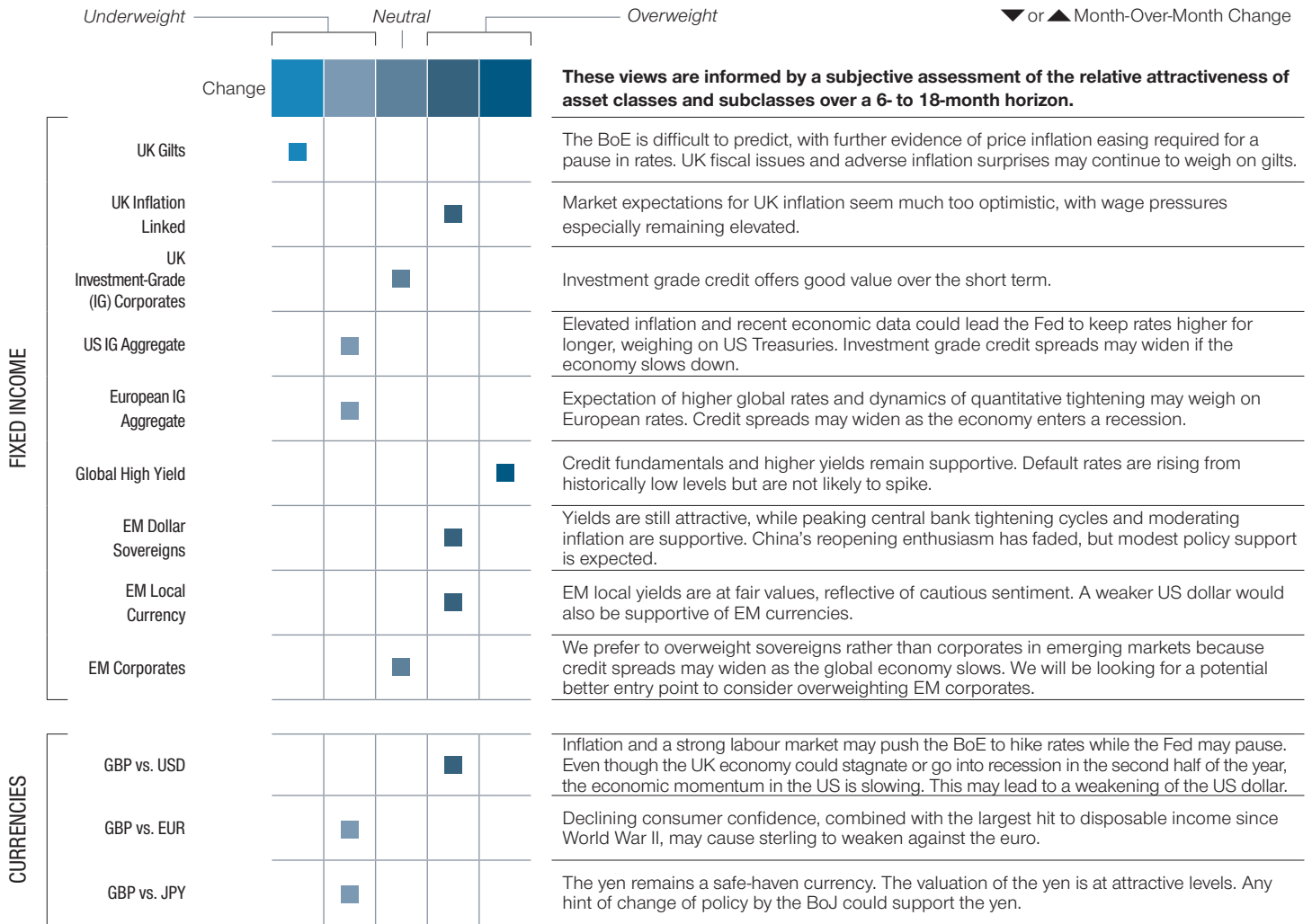
† For pairwise decisions in style and market capitalisation, positioning within boxes represents positioning in the first-mentioned asset class relative to the second asset class.

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 July 2023



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



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