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INVEST WITH CONFIDENCE

Global Asset Allocation: The View From the UK

July 2023

1 Market Perspective

- The global macro backdrop is uneven as some regions are proving more resilient in the face of tighter financial conditions, although the broad trend remains for slowing growth in the back half of the year.
- The US economy surprises to the upside, while Europe slips into a mild recession, challenging the European Central Bank (ECB) as inflation remains elevated. Meanwhile, hopes for a strong global impact from China's reopening are lagging expectations, prompting fresh policy support.
- While global central banks are likely nearing peak tightening, they remain vigilant on inflation as it is proving stickier in some regions 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, persistent inflation and geopolitical tensions.

2 Portfolio Positioning

As of 30 June 2023

- We maintain a cautious stance with an underweight to equities and bonds in favour of cash. A slowing economy and weaker earnings could weigh on equities, while persistent inflation could keep bonds vulnerable to further central bank tightening. Cash offers liquidity in an uncertain environment and still attractive yields.
- Within equities, we reduced our modest overweight to global ex-US equities and are now neutral between US and global ex-US markets. Despite still favourable relative valuations outside of the US, slower economic momentum in Europe and less stimulus from China could weigh on markets outside the US, while US markets could benefit from their less cyclical, more defensive growth bias and recent trends in artificial intelligence (AI).
- Within fixed income, we are overweight return-seeking sectors such as high yield and emerging market bonds, with duration ballast through inflation-linked government bonds.

3 Market Themes

Out of Gas

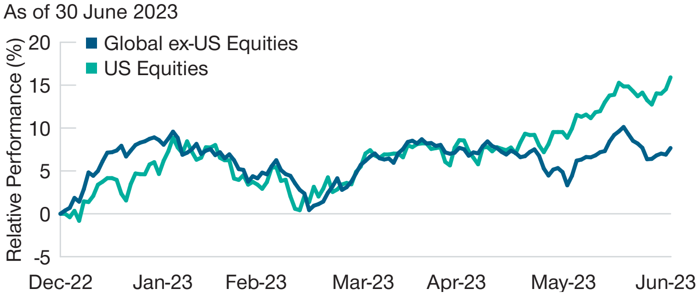
At the start of the year, it looked like the stars were aligning for markets outside of the US to finally outperform, supported by China's reopening from COVID lockdowns, Europe staving off an energy crisis due to a mild winter, moderating inflation pressures, expectations for a weaker US dollar and benefitting from much more attractive relative valuations than the US. However, those tailwinds have faded as China's reopening has disappointed and inflation is proving to be more persistent across Europe and the UK, leading markets outside the US to underperform by over 7% year-to-date. At the same time, the US has surprised to the upside on many fronts, bolstered by a still strong labour market, resilient consumer and housing market strength. With a lot more positives supporting US markets, not to mention the euphoria around AI, it's very possible that if global economic growth falters in the back half of the year, the US's outperformance may continue given its defensive characteristics. For now, it looks like markets outside the US have run out of gas, and it's difficult to identify near-term catalysts that may turn that around.

House Arrest

Homebuilder confidence has moved sharply higher into expansion territory, benefitting from strong consumer demand, improving supply chains and, most notably, limited competition from the existing home sales market. With 30-year US fixed mortgage rates hovering around 7%, and the average outstanding mortgage rate at just 3% levels, current homeowners are feeling like they're under house arrest, unwilling to leap into the expense of a much higher mortgage. This dynamic has led to much lower existing home inventory, that typically dominates the market, and created the perfect environment for new home sales and US homebuilders. Outside the US, in countries such as the UK and Canada, existing homeowners don't have the same luxury of staying put and avoiding the higher expenses as their mortgage markets are dominated by loans linked more closely to market rates. This dynamic is leading to much higher mortgage payments for homeowners, higher rates for new buyers and is directly flowing into inflation pressures, all putting more strain on consumers in these regions. With housing such a key driver within these economies and a large portion of consumer expenses, hopes for relief are only likely to come with lower rates, which are likely to come with their own set of problems.

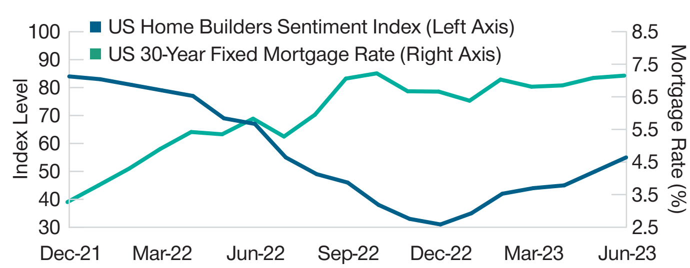
US Equities Back on Top*

As of 30 June 2023



Higher Rates Ironically a Boon for New Home Sales†

As of 30 June 2023



Past performance is not a reliable indicator of future performance.

*Global ex-US Equities is represented by the MSCI ACWI ex-US Index. US Equities is represented by the S&P 500 Index. See Additional Disclosures.

† US Home Builders Sentiment Index is represented by the National Association of Home Builders Market Index. US 30-Year Fixed Mortgage Rate is represented by the Bankrate.com US Home Mortgage 30-Year Fixed National Average.

Source: Bloomberg Finance L.P.

REGIONAL BACKDROP

Region	View	Positives	Negatives
United Kingdom	N	▪ Oil and gas prices have fallen significantly ▪ Headline inflation is falling rapidly ▪ Labour market remains resilient	▪ Wage inflation is very elevated ▪ Inflation remains the highest among major economies ▪ The Bank of England may be forced to hike rates further
Europe	U	▪ Headline inflation showing signs of cooling ▪ Oil and gas prices have fallen significantly ▪ European Central Bank close to peak tightening	▪ Inflation remains elevated, particularly core inflation ▪ Monetary policy remains restrictive ▪ Geopolitical uncertainty remains a concern
United States	N	▪ Consumer spending remains strong ▪ Labour market has been resilient ▪ Manufacturing appears to be stabilising ▪ AI-related spending could be a powerful tailwind	▪ Monetary policy remains very tight ▪ Banking sector concerns will impact credit availability ▪ Inflation has proven more persistent than expected ▪ Quantitative tightening and Treasury General Account rebuild could impact liquidity
Japan	O	▪ Uptick in inflation catalyst for increase in wages ▪ Inflows from foreign investors are likely to continue ▪ Corporate governance continues to gradually improve	▪ Monetary policy normalisation may surprise the market ▪ A stronger Japanese yen may weigh on the export sector
Asia Pacific ex-Japan	N	▪ China's recovery, which has been consumer and services driven so far, should continue with a rebound in private investment ▪ Corporate earnings can continue to grow in China as it is still early in its business cycle ▪ In Australia, a tight job market and early signs of a housing rebound could extend this economic cycle longer	▪ Mixed signals are raising doubts about the sustainability of China's economic rebound, particularly in relation to exports ▪ Prioritising national security does not help China's fragile business environment ▪ The Reserve Bank of Australia may need to hike more given accelerated wage growth data
Emerging Markets	O	▪ China's reopening supports an increase in private investment ▪ Further Chinese stimulus is expected ▪ Monetary tightening in most emerging markets (EM) has peaked	▪ Global trade could suffer with slowing global growth ▪ China's reopening has lagged expectations ▪ 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.

UK INVESTMENT COMMITTEE POSITIONING

As of 30 June 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			■				Outlook is improving but remains uncertain due to a slowing economy, tighter financial conditions and elevated valuations. However, a resilient labour market and positive sentiment about AI are providing support.
ASSET CLASSES	Fixed Income					■		Central banks continue to balance lingering inflation and growth concerns, which could keep rates volatile. Credit sectors continue to offer reasonable valuations with broadly supportive fundamentals.
ASSET CLASSES	Cash					■		Cash currently offers attractive yields and a shorter-duration profile (if rates drift higher) and provides liquidity should market opportunities arise.
	Region							
EQUITIES	US	▲			■			Despite persistent concerns about Fed policy and expensive valuations, earnings appear to be bottoming, economic activity is stabilising, market breadth has widened slightly, while technology innovation remains a key differentiator.
EQUITIES	Europe ex-UK			■				European inflation has notably cooled, and the economy is slowing, easing pressure to hike rates much further. That said, inflation remains elevated, and while the ECB is close to peak rates, the bias is towards at least one or two rate hikes. Equity valuations remain appealing.
EQUITIES	UK				■			Equity valuations are attractive relative to history and versus major peers. The UK job market is strong, headline inflation is trending lower and the economy is proving resilient. However, wage inflation is emerging, meaning the Bank of England may need to keep hiking.
EQUITIES	Japan					■		Japan's market valuation is attractive relative to global peers, and the reflation/improving governance stories offer unique advantages. Earnings could disappoint if a global recession occurs, and a rising yen would be a headwind for large exporters.
EQUITIES	Developed Asia ex-Japan*				■			China's recovery should continue as private investment rebounds. Earnings can continue to grow, given China is still early in its business cycle. However, some mixed signals, particularly in relation to Chinese exports, raise doubts about the sustainability of the economic rebound.
EQUITIES	Emerging Markets					■		Valuations and currencies are attractive, and central bank tightening may have peaked. The medium-term outlook in China has improved with reopening and an easing regulatory environment.
	Style and Market Capitalisation							
EQUITIES	Global Growth vs. Value†	▲				■		A tilt towards higher-quality businesses is important given the weakening macro backdrop, and AI could provide a structural tailwind to growth. However, valuation is somewhat challenging for growth stocks.
EQUITIES	Global Small-Cap vs. Large-Cap†					■		Small-caps offer attractive upside potential having already priced in a negative economic scenario with attractive relative valuations. 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.

UK INVESTMENT COMMITTEE POSITIONING

As of 30 June 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.**
FIXED INCOME	UK Gilts		■					The Bank of England (BoE) may hike rates to address inflation, but by less than expectations to avoid exacerbating an expected recession. This could be interpreted as the BoE being behind the curve, leading to higher gilt yields.
	UK Inflation Linked					■		Inflation may rise as the BoE may hike rates less than market expectations.
	UK Investment-Grade (IG) Corporates	▲			■			Investment grade credit offers reasonable value over the short term.
	US IG Aggregate			■				Elevated inflation and recent economic data could lead the Fed to keep rates higher for longer, weighing on US Treasuries. Investment grade credit spreads may widen if the economy slows down.
	European IG Aggregate			■				Expectation of higher global rates and dynamics of quantitative tightening may weigh on European rates. Credit spreads may widen as the economy enters a recession.
	Global High Yield						■	Credit fundamentals and higher yields remain supportive. Default rates are rising from historically low levels.
	EM Dollar Sovereigns					■		Yields still attractive, while peaking central bank tightening cycles and moderating inflation are supportive. China reopening enthusiasm has faded, but modest policy support is expected.
	EM Local Currency					■		EM local yields at fair values, reflective of cautious sentiment. A weaker US dollar would also be supportive of EM currencies.
	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	GBP vs. USD					■		Inflation and a strong labour market may push the BoE to hike rates while the Fed may pause. Even though the UK economy could stagnate or go into recession in the second half of the year, the economic momentum in the US is slowing. This may lead to a weakening of the US dollar.
	GBP vs. EUR			■				Declining consumer confidence, combined with the largest hit to disposable income since World War II, may cause sterling to weaken against the euro.
	GBP vs. JPY			■				The yen remains a safe-haven currency. The valuation of the yen is at attractive levels. Any hint of change of policy by the BoJ could support the yen.

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

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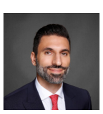

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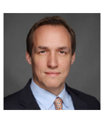

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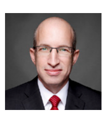

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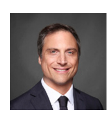

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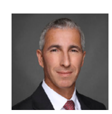

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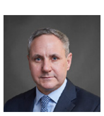

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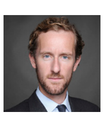

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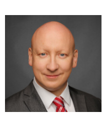

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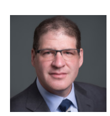

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