



# Global Asset Allocation: The View From the UK

November 2023

## 1 Market Perspective



- Global central banks' emphasis is moving towards growth stabilisation with increasing evidence that both growth and inflation are trending lower.
- European and UK economic growth is nearing recession levels, putting central banks on hold, while the US economy remains resilient, supported by a strong consumer. China seeks to stabilise weakening growth through increased policy support.
- While global central bank tightening has likely peaked, the US Fed's pledge for 'higher for longer' rates has had worldwide impact on raising longer-term yields that could create vulnerabilities.
- Key risks to global markets include impacts of the sharp move higher in rates, a deeper-than-expected decline in growth, central bank missteps, a reacceleration in inflation, the trajectory of Chinese growth and geopolitical tensions.

## 2 Portfolio Positioning

As of 31 October 2023



- We closed our underweight to equities and are now neutral, taking advantage of recent declines amid the rise in yields. The declining inflation trend amid still stable growth is supportive for the end of the Fed tightening cycle, while equity valuations beyond narrow leadership are attractive. We remain overweight areas of the market with supportive valuations, such as small-caps and Japan.
- We remain underweight Europe because of its vulnerability to slowing economic growth, on the one hand, and the European Central Bank that still needs to keep policy tight to fight inflation, on the other hand.
- Within fixed income, we closed our overweight to cash relative to bonds. While cash provides attractive yields, we took advantage of a recent rise in government bonds yields to reduce our underweight to the asset class, with the expectation of some reversal in the trajectory of yields.
- Within fixed income higher-yielding sectors, we remain overweight high yield and emerging market bonds on still attractive absolute yield levels and reasonably supportive fundamentals.

## 3 Market Themes

### Goldilocks

Earlier this year, positive economic data were welcomed as it meant that the US economy could possibly be skirting past an inevitable hard landing. Now similar good news is seemingly too hot for the markets, raising concerns that the Fed may keep its foot on the brakes for longer. Surprisingly strong third-quarter growth of over 5%, a still tight labour market and unrelenting US consumer spending are all helping fuel the Fed's 'higher for longer' narrative. In reaction, bond yields have spiked to decade-high levels, tightening financial conditions and, in a way, helping advance the Fed's cause. Since the end of July, equity markets have declined over 10%, largely driven by the sharp rise in yields and anticipated impacts should they stay at these levels for longer. For now, too hot data seem unwelcome, and too cold is likely to reignite fears of a hard landing. A good balance of declining inflation and not collapsing growth data ahead may prove just right for investors' appetites.

### Equities Feeling Sharp Rise in US 10-Year Treasuries

As of 31 October 2023



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

Each country/region is represented by its respective S&P Global Composite Purchasing Managers' Indices: US: S&P Global Composite United States; China: S&P Global Composite China; Euro Area: S&P Global Composite Euro Area; UK: S&P Global Composite United Kingdom. See Additional Disclosures.

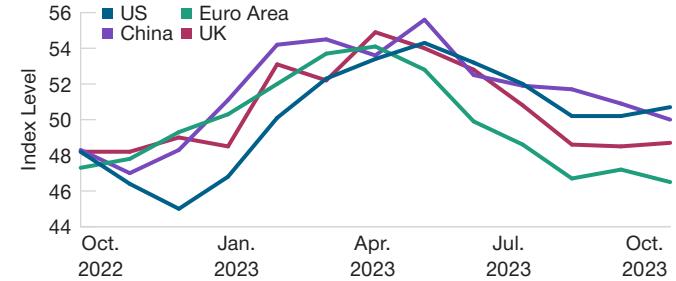
Source: Bloomberg Finance L.P.

### Collateral Damage

While the US economy continues to show resilience in the face of higher interest rates, growth across many parts of the world is showing signs of weakness. Europe looks to have slipped into recession, the UK is not far behind and Chinese growth has disappointed. The emphasis on fighting inflation is steadily being replaced by the need to stabilise declining growth, at least outside the US. Unfortunately, for the rest of the world, the US Fed's policy has far-reaching impacts as seen by the recent spike in longer-term yields globally. With many regions seeing weakening growth, higher yields may not be a welcome sign as global central banks are starting to downshift interest rate policies. The move higher in yields has also sent the US dollar even higher, proving especially painful for many emerging markets economies, their currencies and dollar-denominated bond markets. Should the rest of the world continue to slow while the Fed keeps rates elevated, more collateral damage may be in store for vulnerable economies needing to stabilise growth, defend currencies and compete for capital flows.

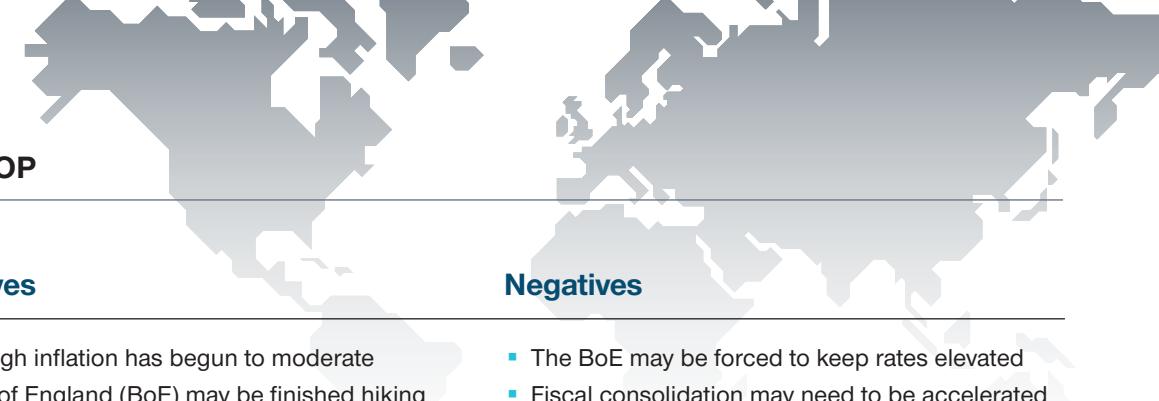
### Divergence in Purchasing Managers' Indices as Global Growth Slows

As of 31 October 2023





## REGIONAL BACKDROP



### Positives

#### United Kingdom

**N**

- Still high inflation has begun to moderate
- Bank of England (BoE) may be finished hiking
- Labour market remains strong

### Negatives

- The BoE may be forced to keep rates elevated
- Fiscal consolidation may need to be accelerated
- Tight labour markets could keep wage inflation elevated

#### Europe

**U**

- Inflation is cooling faster than expected
- European Central Bank (ECB) may be finished hiking
- Labour market has been resilient

- Inflation remains elevated, particularly core inflation
- Economic growth is slowing
- Monetary policy is restrictive

#### United States

**O**

- Consumer spending remains strong
- Labour market has been resilient
- Fiscal spending has supported capex
- Earnings expectations are increasing

- Monetary policy remains very tight
- Banking sector concerns will impact credit availability
- Interest rates are expected to remain elevated

#### Japan

**O**

- Economy benefitting from uptick in inflation
- Corporate governance continues to gradually improve
- Equity valuations remain attractive

- Yen weakness has weighed on equity market returns
- Earnings expectations may need to be revised lower

#### Asia Pacific ex-Japan

**N**

- China economic activity is incrementally improving as policymakers accelerate stimulative measures
- Sentiment is uniformly bearish towards China, suggesting that contrarian investors could look to benefit from cheap valuations
- In Australia, positive demographics and a watchful Reserve Bank of Australia may help curb inflation. Consumers are reducing spending and holding on to excess savings, delaying the expected slowdown

- In China, property deleveraging remains an overarching goal which dampens domestic activity
- China consumer and business confidence are fragile, and saving is being prioritised over spending
- Australia household disposable income is falling to levels reminiscent of past recessions. Company earnings forecasts are significantly lower than other markets

#### Emerging Markets

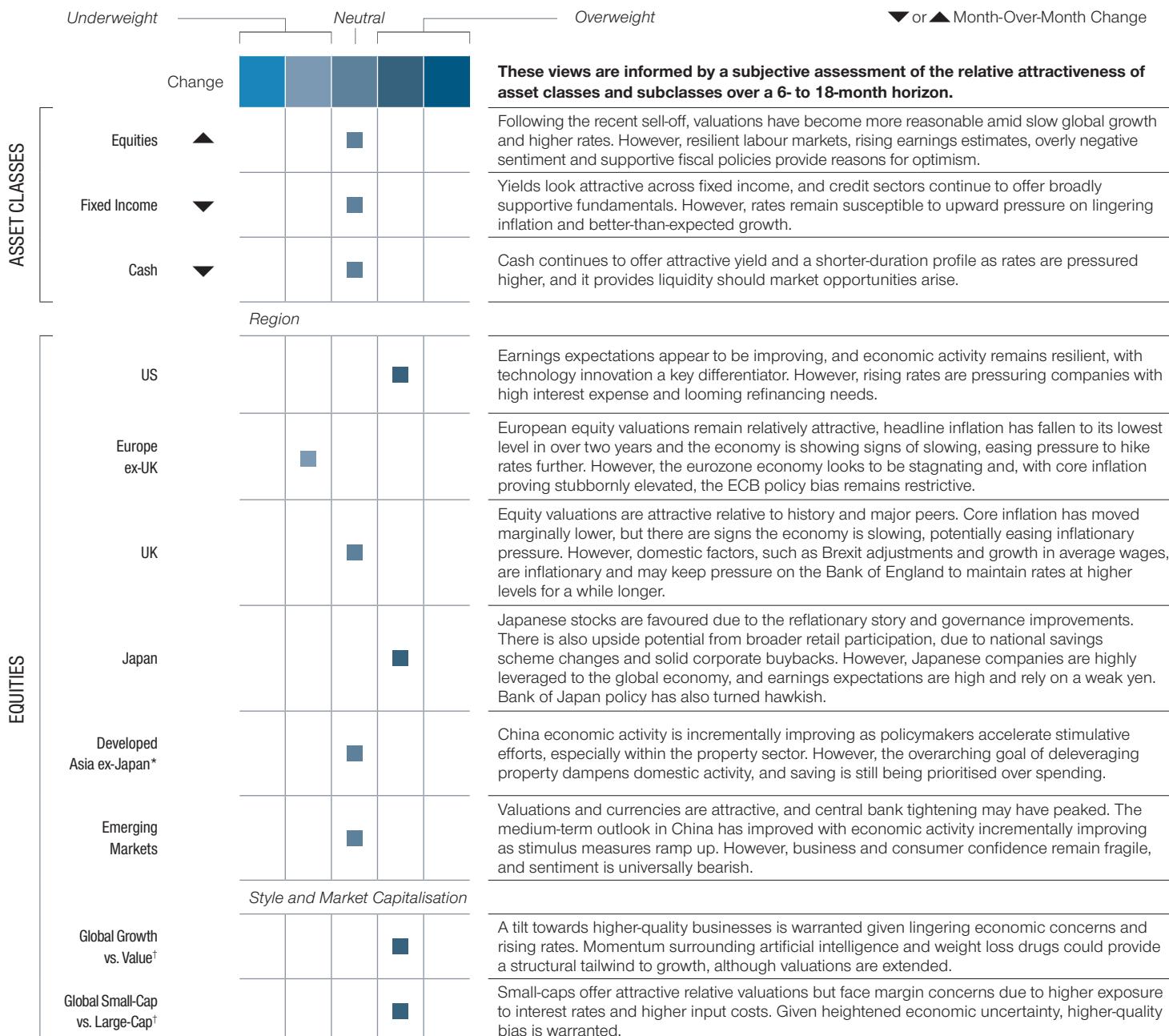
**N**

- 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 tighter monetary conditions
- Geopolitical risks remain elevated
- Chinese consumer and business confidence is fragile

**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.

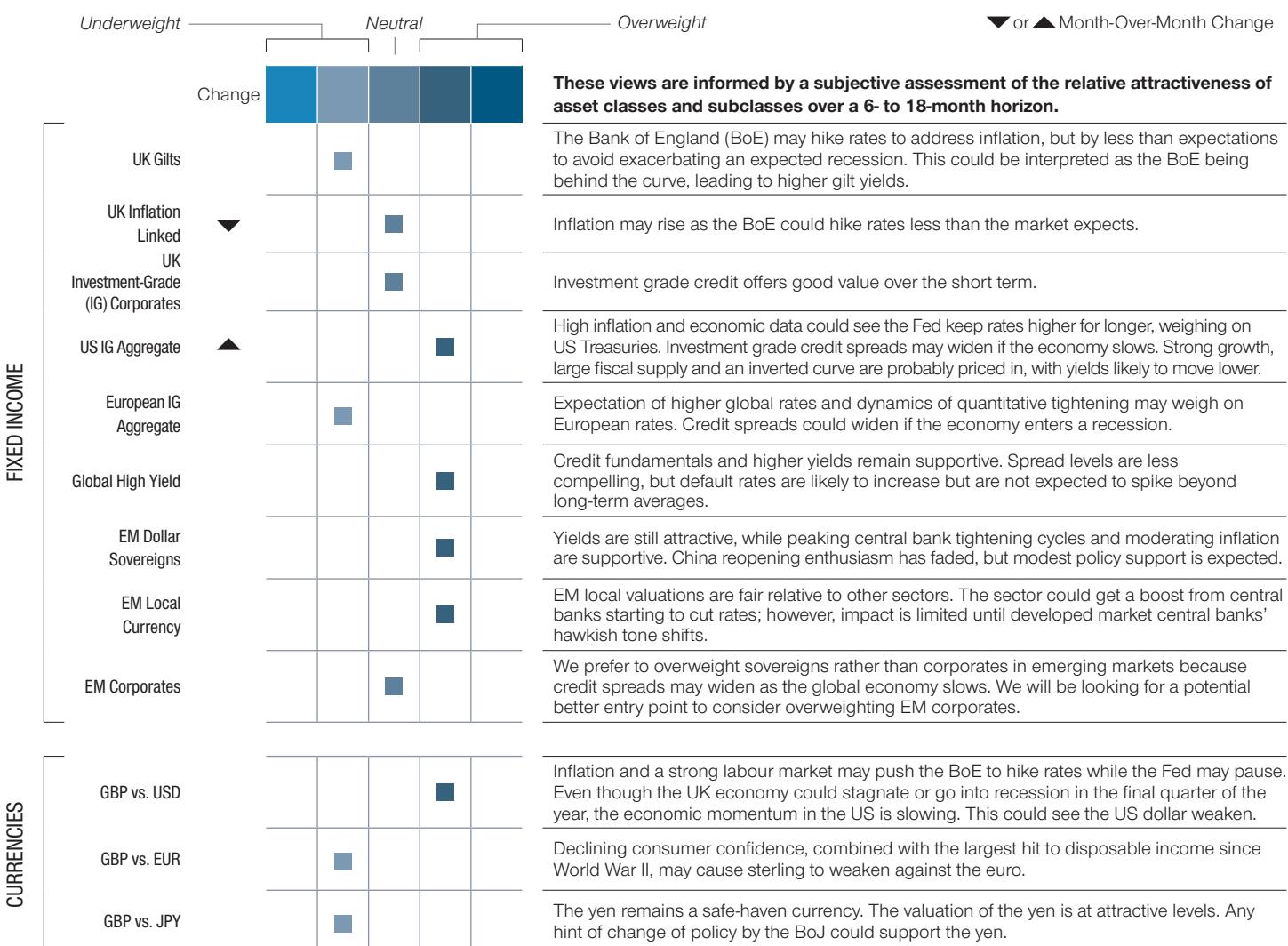
<sup>†</sup> For pairwise decisions in style and market capitalisation, positioning within boxes represents positioning in the first-mentioned asset class relative to the second asset class.

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 October 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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