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Global Asset Allocation: The View From Europe

April 2024

1 Market Perspective

- Constructive near-term outlook on global economic growth against a backdrop of gradually easing inflationary pressures across most economies.
- US growth remains the most resilient amongst developed economies, while European and Japanese growth teeter near recession. The outlook for many emerging markets' economies is improving, supported by easing inflation and lower rates, with signs that policy support is helping stabilise growth in China, although risks remain.
- The US Fed is looking towards rate cuts this summer, but sticky inflation and resiliency in the economy have tempered expectations for an aggressive start to the cutting cycle. The European Central Bank (ECB) appears closer to easing amidst fragile growth and continued progress with inflation. The Bank of Japan (BoJ) took its first step in unwinding ultra-easy monetary policy, although the path remains uncertain.
- Key risks to global markets include a retrenchment in growth, stubborn inflation, volatility surrounding central banks' policy divergence, geopolitical tensions and the trajectory of Chinese growth.

2 Portfolio Positioning

As of 31 March 2024

- We remain overweight equities, supported by firming growth and moderating inflation, positive earnings trends and reasonable valuations outside of large-cap growth.
- We shifted to a neutral position in US small-caps, balancing valuation considerations against the likelihood that interest rates remain higher for longer, weighing more on smaller companies.
- We shifted to neutral cash. While cash continues to provide attractive yields with the yield curve remaining inverted, we shifted to overweight inflation-linked bonds to add some duration and inflation protection should inflation settle higher.
- We shifted to neutral euro versus the US dollar. The ECB may cut interest rates before the Fed does, increasing the interest rate differential between the two currencies and weighing on the euro.

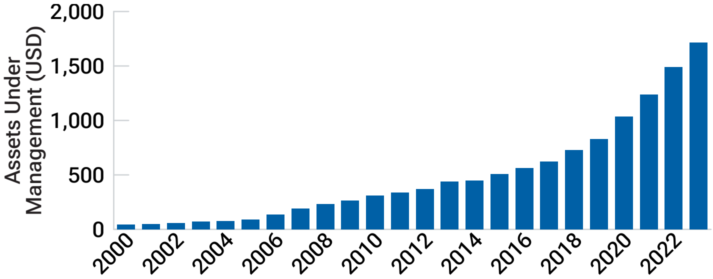
3 Market Themes

Gimme Some Credit!

Since the 2008 financial crisis, private credit markets have grown to nearly USD 1.7 trillion and are expected to double over the next five years, as investors continue to recognise the potential benefits from diversification and enhanced income offered by the asset class. Recent interest has not just been driven by investors, but by borrowers seeking flexible financing arrangements amidst a backdrop of rising rates and fewer options as banks have stepped back from lending. This retreat by banks has been due to a confluence of factors, including recent losses, exposure to commercial real estate, tightening regulations and de-risking following the 2023 regional bank failures. Private credit firms were able to fill the void in lending, expanding their market share and moving up in deal sizes. With the higher-for-longer rate environment persisting, many existing borrowers are feeling the stresses, notably those with floating rate obligations or those needing to refinance. Private credit firms' expertise in lending across different quality and types of companies, including distressed and commercial real estate, could prove beneficial as these areas could see increasing opportunities in the near term.

Private Credit Market's Rapid Growth[1]

As of 31 December 2023

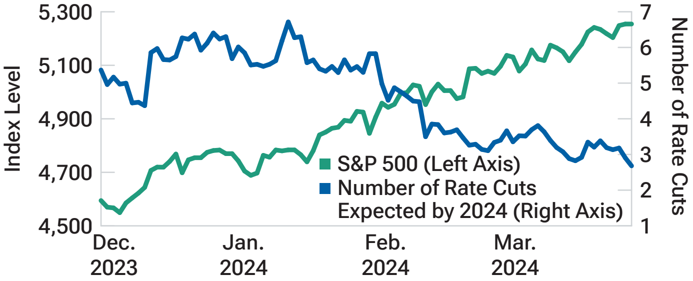


Back in the Money?

US equity markets are trading close to record levels fuelled by a 10%+ gain in the first quarter. While the equity rally began with the 'Magnificent Seven' stocks and euphoria around artificial intelligence companies, markets are starting to broaden out. Worries about the Fed delaying the start of interest rate cuts following recent rounds of disappointingly sticky inflation data haven't slowed the momentum. Rather, equity investors have chosen to focus on the positives, including better-than-expected economic growth, a broadly resilient job market and rising earnings estimates. Perhaps the biggest positive of all is signs that the 'Fed put' may soon be back in the money, after having been abandoned as the Fed focused solely on fighting inflation, no matter the downside risks. Now, despite inflation still above target, Chairman Jerome Powell seems pretty intent on getting started on rate cuts this year. Perhaps the motivation is to get ahead of the elections or a worry that the lagged effects of tightening will finally start to crack the labour market. Whatever the reason, for now, equity investors seem to have yet another reason to rally, believing the Fed may be back to help mitigate downside risk.

Equities Undeterred by Fewer Cuts[2]

As of 31 March 2024



Past performance is not a reliable indicator of future performance.

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[1] Source: Federal Reserve.

[2] Source: Bloomberg Finance L.P. and S&P. Please see Additional Disclosures page for additional legal notices and disclaimers.

REGIONAL BACKDROP

		Positives	Negatives
Europe	U	– Inflation has been steadily declining – ECB is expected to cut rates soon – Labour market has been resilient	– Monetary policy is restrictive – Economic growth remains weak – Geopolitical uncertainty is heightened
United Kingdom	N	– Inflation has been steadily declining – Bank of England (BoE) is likely to cut rates this year – Labour market has been resilient	– Fiscal consolidation may need to be accelerated – Tight labour markets could keep wage inflation elevated
United States	O	– Expectations are for favourable earnings growth – Consumer spending remains strong – Labour market has been very resilient – Fed is expected to cut rates this year	– Stock valuations have become challenging – Lagged effects of monetary policy remain a risk – Wage growth could pressure corporate margins – Political uncertainty is heightened
Japan	O	– Economy welcomes inflation after decades fighting deflation – Corporate governance continues to gradually improve – BoJ remains accommodative despite recent hike	– Expectations are high, raising the bar for upside surprises – Yen weakness could raise pressure on the BoJ to hike rates
Asia Pacific ex-Japan	N	– China investment flows are turning positive, supported by attractive valuations – Macro data in China is stabilising – In Australia, government support to the economy is positive; recent economic data are surprising on the upside	– Prolonged China deflation is a concern – Housing market concerns in China are impacting investor and consumer confidence – The Reserve Bank of Australia is more hawkish than other central banks, suggesting a delayed easing cycle; valuations are rich, and earnings continue to be at risk
Emerging Markets	N	– Monetary tightening in most EMs has peaked – Equity valuations are attractive relative to the US – Chinese economy is incrementally improving	– Chinese property deleveraging continues to weigh on activity – Chinese consumer and business confidence are fragile – Meaningful fiscal stimulus measures appear unlikely

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 March 2024

▼ or ▲ Month-Over-Month Change

			Underweight		*Neutral*	*Overweight*		
		Change	🟥	🟥	⬛	🟩	🟩	**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					■		Sentiment remains positive as the firming economic growth and inflation outlook should continue to drive earnings higher. Valuations are challenging, meaning earnings growth is needed to drive further upside.
	Fixed Income			■				Yields remain attractive but could be volatile as central bank expectations continue to shift on growth and inflation backdrop. Credit fundamentals are supportive; however, spreads remain tight.
	Cash	▼			■			Cash continues to offer attractive yields as the yield curve remains inverted and continues to offer liquidity should market opportunities arise.
			Region					
EQUITIES	US					■		Earnings expectations are improving as economic activity remains resilient and financial conditions are loosening. Technology and pharmaceutical innovation are key differentiators. However, valuations may limit upside from here.
	Europe ex-UK			■				European equity valuations remain relatively attractive, and headline inflation has fallen. However, the economy has stalled, and fears are that Europe is on the verge of recession.
	UK				■			Equity valuations are appealing versus history and against major peers. However, domestic factors, such as Brexit adjustments, are inflationary and may keep rates higher for a while longer.
	Japan					■		The inflationary impulse is real given the latest wage negotiation round. The BoJ also remains accommodative, despite removing the negative interest rate policy. However, expectations are high, raising the bar for upside surprises, and yen weakness may cause the BoJ to hike rates faster than expected.
	Developed Asia ex-Japan[1]			■				In Australia, economic data are bottoming, but fears are that the country could slip into recession.
	Emerging Markets				■			Valuations and currencies are attractive, and central bank tightening may have peaked. China government policy support and broadly supportive market fundamentals are positives. However, geopolitical tensions with the US could rise in advance of the US presidential election.
			Style and Market Capitalisation					
	Global Growth vs. Value[2]			■				Improving economic outlook and further broadening of equity market performance could be supportive for value. Higher-for-longer rates and improving prospects for energy demand should be positive for value-oriented sectors.
	Global Small-Cap vs. Large-Cap[2]	▼			■			Small-caps offer attractive relative valuations but are more challenged by higher-for-longer rates. Profit margins and leverage are also becoming more of a concern, warranting a higher quality bias.

Past performance is not a reliable indicator of future performance.

[1] Includes Australia.

[2] 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 March 2024

▼ 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	Euro Government Bonds			🟥				Euro government bonds remain under pressure as monetary policy expectations are repriced. Because the macroeconomic environment is different from past cutting cycles, the ECB could adopt a gradual cutting path.
	Euro Inflation Linked	▲				🟩		Inflation is expected to ease further as the economy slows down. The labour market, however, remains tight.
	Euro Investment-Grade (IG) Corporates					🟩		Euro investment-grade credit offers good value over the short term, although spreads remain tight.
	US IG Aggregate			🟥				Stubborn inflation and a resilient economy could see the US Federal Reserve keep rates higher for longer than the market currently expects. Meanwhile, investment-grade spreads remain tight.
	Global High Yield					🟩		Attractive absolute yield levels remain supportive, but tight spreads may be reflecting too optimistic of a backdrop. Default rates are likely to rise to historical long-term averages, although much appears to be priced in.
	EM Dollar Sovereigns					🟩		Yields still look modestly attractive. With central banks embarking on easing cycles and inflation continuing to moderate, EM bonds may benefit.
	EM Local Currency					🟩		Yields are close to historical averages, as expectations are for central bank easing and lower inflation. A softer dollar could be supportive of local rates and 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 look for a potentially better entry point to consider overweighting EM corporates.
CURRENCIES	EUR vs. USD	▼			■			The markets may price more interest rate cuts once the ECB possibly cut rates in June.
	EUR vs. JPY				■			The yen remains a safe-haven currency, and current valuation levels are attractive. Any hint of policy change by the BoJ could support a stronger 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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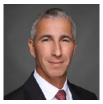

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