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Global Asset Allocation Viewpoints

September 2023

1 Market Perspective

As of 31 August 2023

- Global economic growth was mixed across regions, with inflationary pressures and central bank policies starting to diverge.
- U.S. and Japanese economies are proving more resilient, although the U.S. is seeing evidence of cooling amid recent jobs data. While weakness is seen across Europe as they work through a mild recession and elevated, albeit softening inflation, Chinese growth is mixed as recent slowing is being 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.
- We added to our overweight position in real assets-related equities, sourcing from emerging market and small-cap equities, as a hedge against inflation settling in 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, we remain underweight bonds in favor of cash as cash offers attractive yields and liquidity should market opportunities evolve. We also have a modest overweight to long-term U.S. treasuries as ballast to risk assets.
- Within fixed income yield-seeking sectors, we remain overweight high yield, floating rate loans, and emerging market bonds on still attractive absolute yield levels and reasonably supportive fundamentals.

3 Market Themes

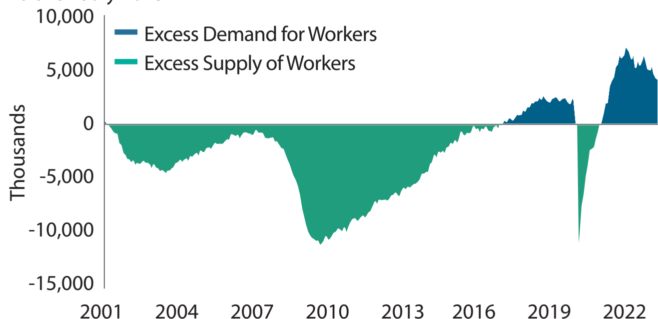
As of 31 August 2023

A Jolt of Confidence

The most recent JOLTS[1] data, a measure of labor 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 labor market may finally be starting to cool. The data also showed that fewer workers were quitting their jobs and hiring broadly moderated, both moving in favorable directions for balancing the labor market and easing wage growth concerns. Layoffs were relatively flat, meaning that the labor 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 has showed evidence of slowing it is still elevated, the number of job openings per unemployed person is still high, and the labor market remains tight by historical measures with the unemployment rate at just 3.8%. So, while the recent softening jobs data has provided a jolt of confidence that the Fed may navigate a soft landing, we still have a ways to go to align the jobs market and wages with the Fed's 2% inflation target.

Job Openings Less Unemployed Workers[2]

As of 31 July 2023

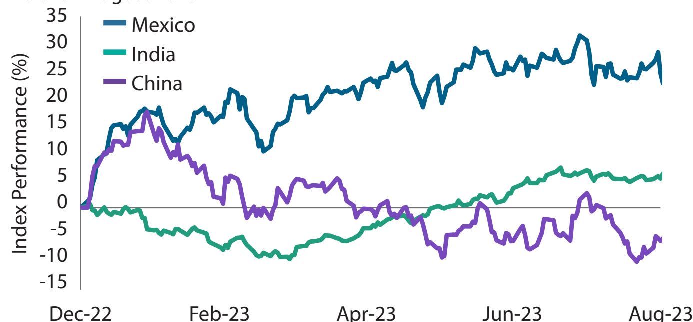


Diverging Markets?

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 EM, as some Latin American countries have successfully brought down inflation, Mexico seeing the benefits from nearshoring, and India's growth surprising to the upside, they have largely been overshadowed by doubts surrounding China's growth trajectory. Concerns surrounding China's troubled property sector have re-emerged and weighed heavily on household confidence and willingness to spend. This comes at the same time as structurally rising unemployment weighs against Chinese policymakers' multi-year 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.

China Underperforming Other Emerging Market Countries[3]

As of 31 August 2023



Past performance is not a reliable indicator of future performance.

[1] Job Openings & Labor Turnover Survey.

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

[3] 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 Disclosures for more information about this MSCI information.

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4 Regional Backdrop

As of 31 August 2023

Region	Views	Positives	Negatives
United States	N	▪ Consumer spending remains strong ▪ Labor market has been resilient ▪ Manufacturing appears to be stabilizing ▪ Artificial intelligence related spending powerful tailwind	▪ Monetary policy remains very tight ▪ Banking sector concerns will impact credit availability ▪ Equity valuations are elevated
Canada	N	▪ Monetary tightening is close to a peak ▪ Wage growth has moderated ▪ Commodity prices could see support against constrained supply (OPEC+)	▪ Consumer savings balances are fading sharply ▪ Consumer leverage is elevated
Europe	U	▪ Inflation showing signs of cooling ▪ European Central Bank 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 ▪ Labor market remains strong ▪ Economy has proven more resilient	▪ Wage inflation is very elevated ▪ The BoE may be forced to hike rates further ▪ Fiscal consolidation may need to be accelerated
Japan	O	▪ Uptick in inflation catalyst for increase in wages ▪ Corporate governance continues to gradually improve ▪ Equity valuations remain very attractive	▪ Businesses and consumers more cautious given return of inflation ▪ Earnings expectations may need to be revised lower
Australia	N	▪ Easing inflationary pressures allowing central bank to pause ▪ Housing market has been resilient despite higher rates ▪ Stabilization in global growth ▪ Commodity demand from clean energy/EV	▪ Consumer savings balances are deteriorating ▪ Upside economic surprises keeping yields higher for longer ▪ Soft demand for materials from continued weakness in Chinese property
Emerging Markets	O	▪ Monetary tightening in most emerging markets has peaked ▪ Equity valuations are attractive relative to the U.S. ▪ Further Chinese stimulus is expected	▪ Global trade could suffer with tighter monetary conditions ▪ Chinese consumer and business confidence is fragile ▪ Geopolitical risks remain elevated

O Overweight
N Neutral
U Underweight

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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5 Asset Allocation Committee Positioning

As of 31 August 2023

▼ or ▲ Month-Over-Month 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.

		Change	Underweight	Underweight	Neutral	Overweight	Overweight	
ASSET CLASS	Equities			■				Slowing global growth balanced with reasonable valuations in many markets. In the U.S. valuations less compelling, however, a resilient labor market, supportive fiscal policies, and positive sentiment about AI supportive.
ASSET CLASS	Bonds			■				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.
ASSET CLASS	Cash					■		Cash currently offers attractive yields, a shorter duration profile if rates drift higher, and provides liquidity should market opportunities arise.
	Regions							
EQUITIES	U.S.				■			Despite expensive valuations, earnings expectations appear to be improving, economic activity is stabilizing, market breadth has widened, while technology innovation remains a key differentiator.
EQUITIES	Global Ex-U.S.				■			Valuations are attractive on a relative basis and local currencies have room to appreciate. However, the macroeconomic backdrop remains concerning amid a stumbling recovery in China and still tight global monetary policy.
EQUITIES	Emerging Markets (EM)	▼				■		Valuations and currencies are attractive and central bank tightening is peaking. However, Chinese equities a significant concern amid housing and consumer confidence weakness as well as ineffective stimulus thus far.
	Style & Market Capitalization							
EQUITIES	U.S. Growth vs. Value[1]				■			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.
EQUITIES	Global Ex-U.S. Growth vs. Value[1]				■			Value stocks offer attractive valuations. Cyclical and geopolitical risks remain a concern, but higher oil prices could offer a tailwind.
EQUITIES	U.S. Small vs. Large-Cap[1]	▼				■		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.
EQUITIES	Global Ex-U.S. Small vs. Large-Cap[1]				■			Small-caps offer reasonable valuations against a slowing growth backdrop. However, caution is warranted due to a potential flight to quality that could favor large-caps.
	Inflation-Sensitive							
EQUITIES	Real Assets Equities	▲				■		Commodities are cheap and offer an attractive hedge to potentially stickier inflation and energy price shocks. Additionally, oil prices may be set for structural increases due to peaking productivity.
BONDS	U.S. Investment Grade (IG)		■					Sector pressured by potential for further Fed hikes as inflation remains above Fed's 2% target, while spread and duration profile less attractive relative to sub-IG credit.
BONDS	Developed Ex-U.S. IG (USD Hedged)			■				Developed ex-US yields could remain volatile as global central banks continue to balance lingering inflation versus slower growth.
BONDS	U.S. Treasury Long					■		While yield volatility could persist on mixed growth, inflation and technical backdrop, however, longer duration Treasury bonds should offer ballast amid a decelerating macro backdrop.
BONDS	Inflation-Linked				■			Although inflation is showing signs of slowing and lower inflation is already priced into breakeven levels, risks of inflation reaccelerating still remain.
BONDS	Global High Yield					■		Credit fundamentals and higher yields remain supportive. Default rates are rising from historically low levels, but are not likely to spike.
BONDS	Floating Rate Loans					■		Valuations and yields remain attractive, but as the Fed moderates its tightening path the benefits of loans' rate resetting feature and lower duration profile become less compelling.
BONDS	EM Dollar Sovereigns					■		Yields still attractive, while peaking central bank tightening cycles and moderating inflation supportive. China reopening enthusiasm has faded, but modest policy support expected.
BONDS	EM Local Currency					■		EM local yields at fair values, reflective of cautious sentiment. A weaker U.S. dollar would also be supportive of EM currencies.

[1] For pairwise decisions in style & market capitalization, positioning within boxes represent 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 & market capitalization asset classes are represented as pairwise decisions as part of our tactical asset allocation framework.

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ADDITIONAL DISCLOSURES:

Certain numbers in this report may not equal stated totals due to rounding.

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Key risks –The following risks are materially relevant to the information highlighted in this material:
Even if the asset allocation is exposed to different asset classes in order to diversify the risks, a part of these assets is exposed to specific key risks.
Equity risk – in general, equities involve higher risks than bonds or money market instruments.
ESG and Sustainability risk – May result in a material negative impact on the value of an investment and performance of the portfolio.
Credit risk – a bond or money market security could lose value if the issuer's financial health deteriorates.
Currency risk – changes in currency exchange rates could reduce investment gains or increase investment losses.
Default risk – the issuers of certain bonds could become unable to make payments on their bonds.
Emerging markets risk – emerging markets are less established than developed markets and, therefore, involve higher risks.
Foreign investing risk – investing in foreign countries other than the country of domicile can be riskier due to the adverse effects of currency exchange rates; differences in market structure and liquidity, as well as specific country, regional, and economic developments.
Interest rate risk – when interest rates rise, bond values generally fall. This risk is generally greater the longer the maturity of a bond investment and the higher its credit quality.
Real estate investments risk – real estate and related investments can be hurt by any factor that makes an area or individual property less valuable.
Small- and mid-cap risk – stocks of small and mid-size companies can be more volatile than stocks of larger companies.
Style risk – different investment styles typically go in and out of favour depending on market conditions and investor sentiment.

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