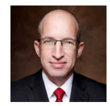
GLOBAL ASSET ALLOCATION: THE VIEW FROM EMEA



Yoram Lustig
Head of Multi-Asset Solutions, EMEA

MARCH 2020

MARKET INSIGHTS

As of February 29, 2020

Coronavirus: Shock to Supply and Demand

While last year's heightened trade tensions weighed on global supply chains, the worldwide spread of the coronavirus has nearly brought activity to a standstill, creating the potential for a global economic shock. The outbreak has not only disrupted supply chains and reduced access to goods, but fears of the infection spreading and associated work stoppages are weighing on consumer spending. This comes at a vulnerable time as growth in many developed markets had just started to recover from last year's lull, particularly across Europe, which is now at risk of deteriorating. Companies closely tied to the consumer—including retail, technology, and consumer goods—are already acknowledging the impacts to sales and earnings expectations. Economies reliant on tourism, particularly in Asia, have also taken a hit as consumers continue to pull back on travel plans as the virus spreads to new regions. Global economic growth will certainly take a hit; however, the full impact is likely to be felt over the course of several months.

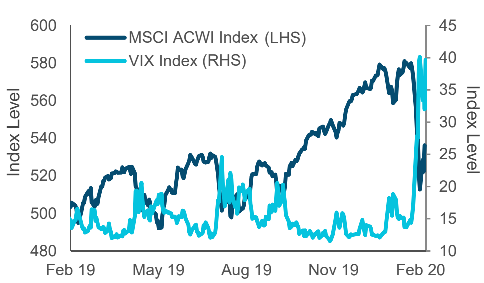
Whatever It Takes 2.0?

Expectations are heightened for central banks, including the U.S. Federal Reserve, to take further policy action to avoid an economic collapse due to the coronavirus outbreak. G-7 central banks pledged to collaborate and take concerted action to provide ample liquidity to ensure stability in the global economy, despite limited room for monetary policy. So far, the Fed has delivered a 50-basis-point inter-meeting cut, and other countries, including Canada, Australia, and Malaysia, have also cut rates. Apart from the Fed, many central banks within developed markets most impacted by the virus are starting from a position of weakness, with already low or negative policy rates and extended balance sheets. With limited tools in their arsenals and questionable ability to stave off the virus's economic impacts with monetary policy alone, "whatever it takes" may need some fiscal help this time around.

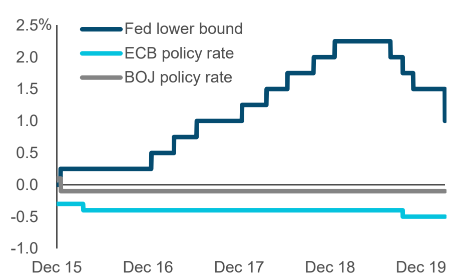
Biden' Time!

Equity markets rallied in response to the outcome of Super Tuesday primary elections after former Vice President Joe Biden, a perceived moderate, secured the lead among Democratic hopefuls to challenge President Donald Trump. Moderate Democrats united in the days leading into Super Tuesday with other key candidates dropping out and pledging support for Biden. For now, Biden's strong performance has quelled investors' fears that had gained traction in February as Senator Bernie Sanders, who is viewed as a less market-friendly candidate, rose to the lead. Notably, managed health care companies, that would be most at risk of Sanders' "Medicare for All," rallied on the news. With former Mayor Mike Bloomberg also dropping out, Biden looks more likely to take the nomination come July. Looking forward, markets will likely refocus on the potential threats to Trump's economy resulting from the spreading coronavirus and the real chance it could derail his reelection prospects.

Global Equity Market vs. Volatility
Fig. 1: As of March 5, 2020



Developed Market Policy Rates
Fig. 2: As of March 5, 2020



S&P 500 Managed Health Care Index
Fig. 3: As of March 5, 2020

Past performance is not a reliable indicator of future performance.

VIX Index is represented by the CBOE Market Volatility Index.

Sources: MSCI, Standard & Poor's, Bloomberg Finance L.P., U.S. Federal Reserve, European Central Bank, and Bank of Japan (see Additional Disclosures).

Developed Europe

Positives

- Monetary policy remains very accommodative
- Services sector of the economy resilient
- Dividend yields remain strong

Negatives

- Weak economic growth, with virus impacts looming
- Limited scope for European Central Bank (ECB) to stimulate further
- Export weakness, vulnerable to trade and China growth
- Banking sector remains weak

United Kingdom

Positives

- Wage growth remains positive despite continued uncertainty over Brexit
- The trade balance deficit remains in a range that can be sustained by the net excess returns on the UK's external balance sheet
- Proactive coordination between the National Health Service, fiscal, financial, and monetary policy makes UK economy well prepared to deal with coronavirus shock

Negatives

- Coronavirus uncertainty to hit UK services sector and temporarily halt "Boris Bounce" in activity
- Sterling will continue to make hard yards
- Weaker global activity due to the coronavirus will affect the UK as well
- Gilts may sell off significantly in the second half of 2020 after the coronavirus crisis is over

United States

Positives

- Fed supportive
- Healthy consumer balance sheets
- Lower interest rates driving a modest rebound in housing
- Pause in trade war escalation
- Greater share of secularly advantaged companies (e.g., cloud computing, internet retail) than rest of the world

Negatives

- Virus concerns rising
- Political uncertainty elevated
- Modest economic growth, with virus impacts looming
- Weak capex spending and corporate confidence
- Late-cycle concerns: tight labor market, rising wages, and corporate margins under pressure
- Elevated corporate and government debt levels

	Positives	Negatives
Japan	▪ Fiscal support is widely expected to counterbalance a technical recession that now appears likely ▪ Investors with a one-year time horizon could potentially benefit from attractive valuations and very low interest in Japanese stocks from global investors ▪ Japanese yen (JPY) is likely to continue to provide safe-haven characteristics at times of crisis ▪ Yields appear stable relative to other sovereign bond markets given the Bank of Japan's policy approach	▪ Technical recession seems inevitable following poor fourth-quarter economic growth and given the current coronavirus outbreak ▪ Earnings will be challenged given domestic companies' high sensitivity to global economic momentum ▪ Quarantine measures and uncertainties regarding the Olympics are clouding the perspective of any imminent rebound in consumer confidence
Asia Pacific ex-Japan	▪ The Chinese policy response to the coronavirus outbreak has been significant, with potentially more support yet to come to help economy reach annual targets ▪ Chinese equity markets appear to be relatively more resilient so far than the rest of the world as the virus spreads outside China ▪ In Australia, further policy support is highly likely in the form of an additional rate cut and more fiscal stimulus ▪ The weakest Australian dollar level in a decade could cushion impact of an economic downturn	▪ Full impact of the coronavirus outbreak remains unknown; the number of Chinese productivity days lost can help estimate the economic loss ▪ As the virus spreads outside China, Chinese exports might continue to face headwinds even if production lines resume ▪ Australian earnings growth had supported positive outlook on stocks but is now expected to moderate amid global backdrop and weak results momentum from last quarter ▪ The combination of devastating bushfires and the coronavirus outbreak will weigh on Australian domestic consumption, reducing the positive impact of higher dwelling prices in the near term
Emerging Markets	▪ Virus outbreak in China appears to be peaking ▪ Policy response from China has been significant ▪ Dovish Fed has given central banks flexibility to ease ▪ Easing trade tensions ▪ Equity valuations attractive relative to developed markets	▪ Modest economic growth, with virus impacts looming ▪ Highly sensitive to global industrial production and trade trends ▪ Commodity prices under pressure ▪ Instability in several key markets could weigh on sentiment ▪ Long-term China growth trajectory remains a headwind

ASSET ALLOCATION COMMITTEE POSITIONING

As of February 29, 2020

Underweight — *Neutral* — *Overweight*   ▼ 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 CLASSES	Equities					■		Valuations more reasonable relative to extreme lows in bond yields amid market sell-off. Central bank policy supportive, outlook clouded by impacts of virus.
	Bonds			■				Yields hitting record lows on risk-off sentiment. Credit spreads wider but not at extreme levels. Fundamentals broadly supportive, monitoring impacts of virus on vulnerable sectors.
	Cash				■			Cash yields retreat amid central banks' intervention; U.S. yields remain higher than other developed markets.
	Regions							
EQUITIES	U.S.			■				Valuations lower but remain elevated versus rest of the world. U.S. markets less exposed to global weakness, but earnings outlook muddied due to impacts of virus.
	Europe					■		Key economies—Germany and Italy—facing contraction amid virus impacts. European Central Bank (ECB) continues to be supportive. Extent of corporate and consumer impact uncertain.
	UK					■		Valuations attractive relative to the U.S., but Brexit uncertainty is likely to remain elevated. The economy has shown some improvements since the December general election.
	Japan					■		Facing major fallout from virus outbreak. Additional monetary and fiscal support pledged to stabilize growth. Extent of economic and trade impacts uncertain, and yen strength a risk.
	Developed Asia ex-Japan			■				Valuations are still attractive relative to the U.S. while China stimulus measures may flow through to the broader region. The coronavirus impacts tourism.
	Emerging Markets (EM)					■		Trade and supply chains threatened by virus. China containment and stimulus efforts supportive. Global central bank easing may provide needed stability. Valuations and currencies cheap.
	Style							
	Global Equity Growth					■		Secular growth companies less sensitive to macro environment. Growth-oriented equities held up in sell-off leading to less attractive relative valuations.
	Global Equity Value			■				Cyclically oriented equities hit hardest amid sell-off, leaving valuations more attractive should economic growth stabilize over the near term.
	Capitalization							
	Global Equity Large-Cap			■				Valuations lower but have fared better than small-caps amid sell-off. Vulnerable to further spread of virus, global supply chain disruption, and the potential impact on earnings.
	Global Equity Small-Cap					■		Relative valuations more extreme as small-caps suffered the most amid sell-off. Remain vulnerable to wider virus outbreak and impacts on consumer spending.

ASSET ALLOCATION COMMITTEE POSITIONING

As of February 29, 2020

Underweight — *Neutral* — *Overweight*

▼ 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.**
BONDS	U.S. Investment Grade (IG)			■				Treasury yields setting record lows amid risk-off sentiment. IG corporate spreads wider, but not at extreme levels. Impact on fundamentals warrants caution.
	European Investment Grade	▼			■			The evolving risks posed by the coronavirus are difficult to assess and have weighed on European investment-grade spreads.
	UK Investment Grade				■			Credit fundamentals to be challenged in the near term from the coronavirus. Nonetheless, the desire for financial and monetary stability may warrant further support from the Bank of England.
	Inflation Linked				■			Inflation expectations lower on growth scare. Central banks remain supportive, but longer-term downward pressures persist.
	Global High Yield					■		Credit spreads wider on risk-off sentiment led by energy sector. Impacts of virus outbreak to weigh on consumer-related sectors in the near term.
	Floating Rate Loans					■		Fed easing, outflows, and liquidity concerns pressuring loan prices. Cyclically oriented loans showing the most vulnerability. Yields remain attractive relative to high yield bonds.
	EM Dollar Sovereigns					■		Relative valuations somewhat expensive as EM bonds have fared well relative to other sectors amid sell-off. Idiosyncratic risks and trade implications are sources of uncertainty.
	EM Local Currency					■		EM currency valuation remains attractive; potential for stabilizing growth, lower developed market rates, and a weaker U.S. dollar could provide support.
	EM Corporates					■		Coronavirus impacts are hard to quantify. Yields remain attractive relative to underlying fundamentals. Rising country-specific risks are concerning but unlikely to become systemic.
CURRENCIES	U.S. Dollar			■				The U.S. dollar continued to rally in the former part of February, as risk rallied and stock markets bounced. However, the tone shifted notably as concern over the coronavirus rose.
	Euro					■		After notable weakness in the euro in the early part of February, the latter part of the month saw a notable retracement as market participants reappraised positioning and expectations.
	UK Sterling					■		Uncertainty around the coronavirus will likely partially mitigate the “Boris Bounce” in the short term. However, greater monetary and especially fiscal easing will likely help support stronger activity.
	Japanese Yen				■			While the JPY closed the month very close to its opening level (for the fifth month in a row), this minimal net move hid substantive volatility during the month.

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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.

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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.

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Style risk—different investment styles typically go in and out of favor depending on market conditions and investor sentiment.

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