



GLOBAL ASSET ALLOCATION: THE VIEW FROM THE UK

July 2020

MARKET INSIGHTS

As of June 30, 2020

Double Dip?

With the coronavirus largely contained across Europe and Asia and some parts of the U.S., there is a sense that the worst of the pandemic may be behind us. As the global economy continues to reopen, many are still hopeful of a V-shaped economic recovery, as economic data such as purchasing managers' indices are showing signs of life. Aggressive monetary and fiscal support, improved liquidity conditions, and lack of inflation provide a supportive backdrop for the rebound in economic activity. However, the recent uptick in infections in parts of the U.S. has raised fears that economic activity could once again be derailed. If these outbreaks fail to be contained and another round of lockdowns is enacted, it would deal a terrible blow to an economy already facing a severe contraction. A second wave could further paralyse business investment and consumer behaviour—turning hopes for a V-shaped recovery into hopes for a W.

Fueling the Rally

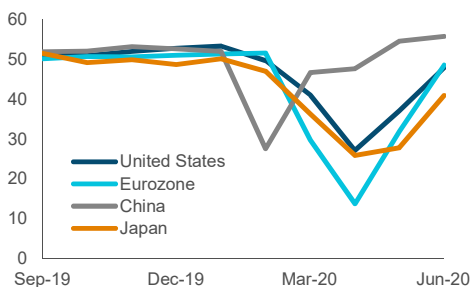
Oil prices have continued to rebound from lows reached in late April, trending near USD 40 per barrel, yet still below pre-crisis levels. Amid the virus-related shutdowns, global demand for oil was down nearly 30% year over year as economic activity worldwide was brought to a halt. At the same time, tensions flared between Russia and OPEC+ regarding market share, resulting in increased supply and further downward pressure on prices. As stay-at-home restrictions have eased across the globe and supply remains constrained, oil prices have rebounded. However, if a second wave of the coronavirus ends the rally in oil prices, hopes for a quick recovery in the energy sector could be dashed as we are already seeing rising bankruptcies and energy-exporting economies facing severe fiscal pressures.

The Buck Stops Here?

The U.S. dollar (USD), a traditional safe-haven currency, has been volatile as it weighs evidence of improving global economic data against a resurgence in coronavirus infections. Over the past quarter, the U.S. Dollar Index has fallen by almost 3% amid the global risk-on environment sparked by economic reopenings across the globe. However, there is no shortage of risks that could cause the USD's recent downtrend to reverse course. Growing evidence of a second wave of the coronavirus, uncertainty surrounding the upcoming U.S. presidential election, and resurfacing tensions with China could send investors flocking back to the USD. But for now, a weaker dollar could be a respite for emerging market economies and their currencies as they struggle with the impacts of the global pandemic.

Composite Purchasing Managers' Index

Fig. 1: As of 30 June, 2020



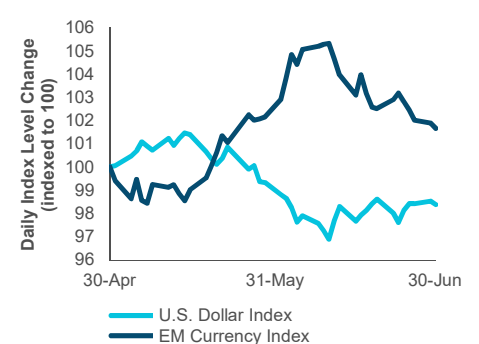
WTI Oil Price

Fig. 2: As of 30 June, 2020



U.S. Dollar Versus EM Currencies¹

Fig. 3: As of 30 June, 2020



Past performance is not a reliable indicator of future performance.

Sources: FactSet. Financial data and analytics provider FactSet. Copyright 2020 FactSet. All Rights Reserved. J.P. Morgan Chase & Co. (see Additional Disclosures).

¹ EM Currency Index is represented by J.P. Morgan EM Currency Index.



Positives

Negatives

United Kingdom

- Generous furlough scheme, keeping employees ready to go, will support economic rebound and social stability
- The trade balance deficit remains in a range that can be sustained by the net excess returns on the UK's external balance sheet
- A long lockdown will lead to a very large government deficit of 17% to 20%, but aggressive quantitative easing should keep a lid on yields

- Lockdown easing raises risks of a second wave of the coronavirus
- Sterling will likely continue to make hard yards
- Weaker global activity to provide additional headwinds to UK economy
- Perception of year-end Brexit risks to weigh on asset prices

Developed Europe

- Virus containment and reopening strategies have been largely successful
- Long-awaited fiscal stimulus is coming
- Monetary policy remains very accommodative
- Equity valuations are inexpensive

- Weak economic growth going into crisis
- Limited scope for European Central Bank (ECB) to stimulate further
- Lower share of secularly advantaged companies
- Banking sector was weak going into the crisis

United States

- Unprecedented levels of monetary and fiscal support
- Healthy consumer balance sheets prior to the crisis
- Health care infrastructure is stronger than most regions
- Greater share of secularly advantaged companies (e.g., cloud computing, internet retail) than rest of the world

- Size of country, freedom of movement, and inconsistent policies mean there is higher potential for continued outbreaks
- Heightened political tensions
- Elevated corporate leverage going into the crisis
- Margins under pressure going into the crisis
- Elevated government debt levels

 **Positives** **Negatives**

- Japan**
- Fiscal stimulus and accommodative monetary stance provide a solid backdrop for an economic rebound
 - Economic data should finally show signs of life from dismal levels after coronavirus control measures were lifted and as economy progressively reopens
 - Japanese stocks have been relatively cheap and carry cash on the balance sheet. They offer optionality to the global economic recovery

- A broad deterioration in employment data is clouding the rebound in consumer spending
- Japanese stocks already outperformed their peers since the market trough in March, boosted by foreign flows
- The yen could appreciate if risk aversion spikes up again, reducing companies' competitiveness and profitability

**Asia Pacific
ex-Japan**

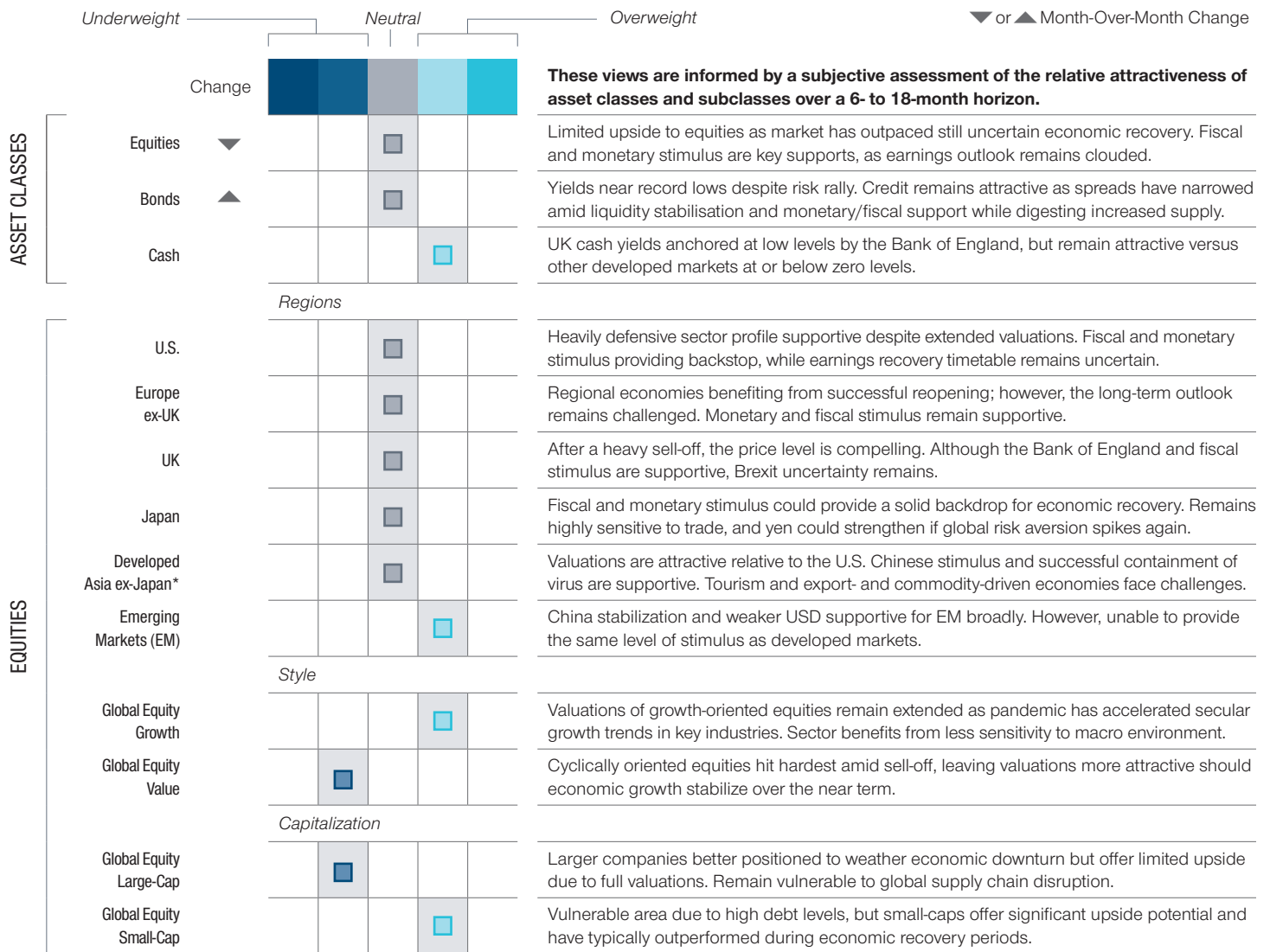
- High-frequency data suggest that economic activity in China has returned to pre-crisis levels, while official data have surprised on the upside
- China's policy measures remain targeted and measured in size. Employment and livelihood have replaced growth and investment as economic goals this year
- Policy measures from the Australian government and the Reserve Bank of Australia were deployed quickly and aggressively
- Australian consumer spending could surprise on the upside given high savings rate and pent-up demand, especially as consumers appear eager to move forward from crisis

- Geopolitical tensions on multiple fronts could dampen foreign sentiment toward Chinese investment
- Leading Chinese indicators for exports have been weak, creating job uncertainties and disinflationary pressures
- Containing the coronavirus in Australia has proven to be more challenging, suggesting that local lockdowns and social distancing could continue longer than expected
- Some Australian stimulus measures are due to end in September; there are risks to the downside if they are not extended further

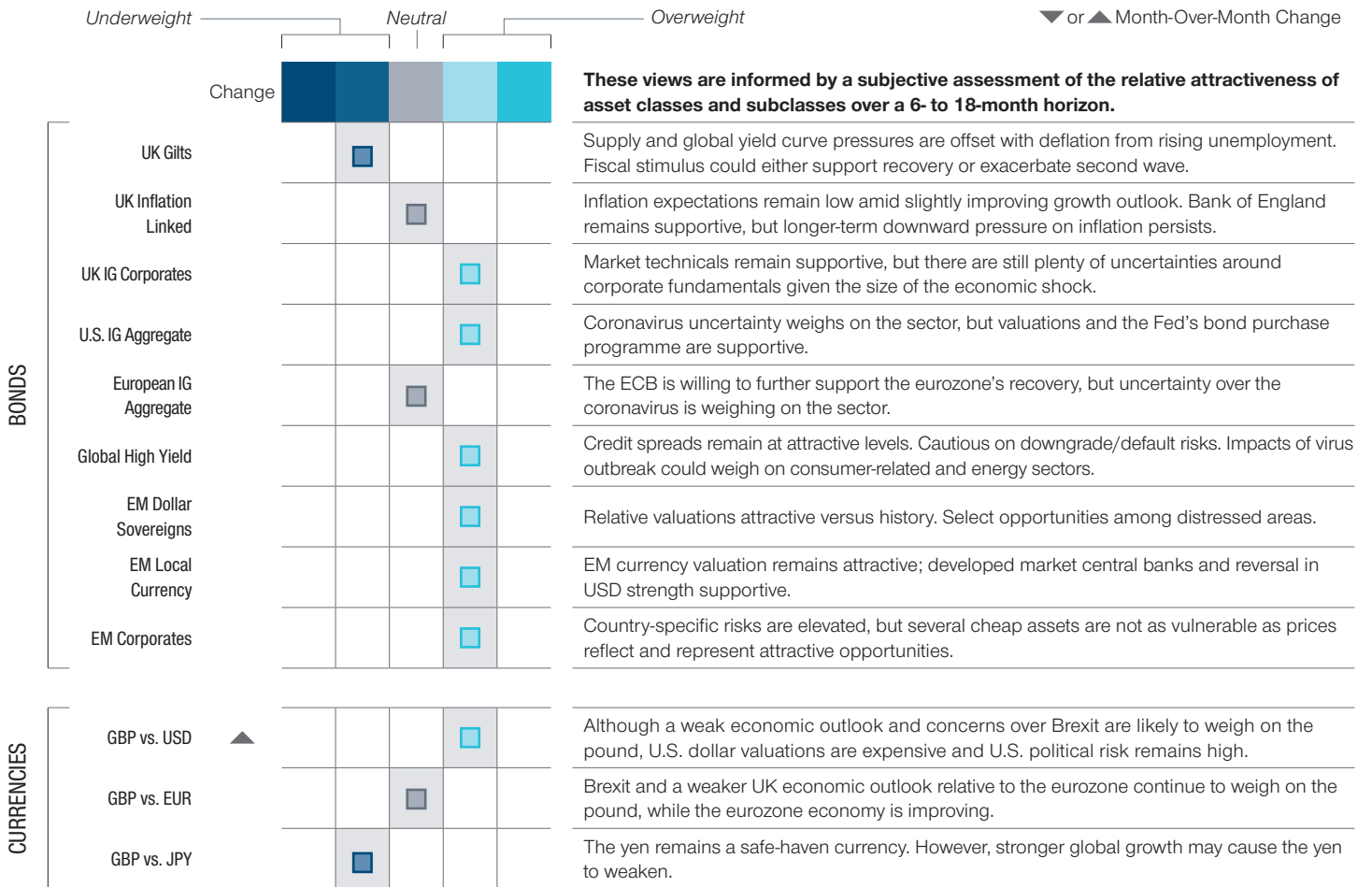
**Emerging
Markets**

- Younger population likely to be less affected by virus
- Dovish Fed has given central banks flexibility to ease
- USD strength has eased
- Demand from China has largely rebounded
- Equity valuations attractive relative to developed markets

- Weak health care infrastructure in many regions
- Limited ability to enact fiscal stimulus (excluding China)
- Trade tensions have been reignited
- Highly sensitive to global industrial production and trade trends
- Commodity prices under pressure



* Includes Australia



UK INVESTMENT COMMITTEE



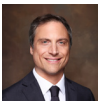
Quentin Fitzsimmons
Senior Portfolio Manager,
Fixed Income Division



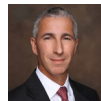
Andrew Keirle
Portfolio Manager, Emerging
Markets Local Currency Bonds



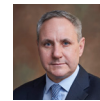
Yoram Lustig
Head of Multi-Asset
Solutions, EMEA



Ken Orchard
Senior Portfolio Manager,
Fixed Income Division



David Stanley
Portfolio Manager,
European Corporate Bonds



Toby Thompson
Portfolio Manager,
Multi-Asset Division



Mitchell Todd
Co-head of EMEA Equity



Michael Walsh
Solutions Strategist, EMEA



Tomasz Wieladek
International Economist

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