GLOBAL ASSET ALLOCATION: THE VIEW FROM EMEA

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MARKET INSIGHTS

As of 31 October 2020

Blue Ripple?

A Biden presidency, with Republicans maintaining control of the Senate, is a possible outcome of the US elections. Most polls heading into the election were predicting the possibility of a 'Blue Wave', leading to a Democratic president, Senate and House that could have resulted in higher levels of fiscal spending countered by the potential for policies of higher taxes. Markets appeared to be celebrating the potential for a divided government, tempering the chances for more aggressive policies by either party and hopefully leading to an environment of more compromise. One area that may come into focus is regulation, with a spotlight on the technology sector, as there appears to be bi-partisan support for such measures. If the increasingly likely outcome of a divided government holds, a more balanced political environment could potentially lead to reduced market volatility and a more supportive backdrop for risk assets.

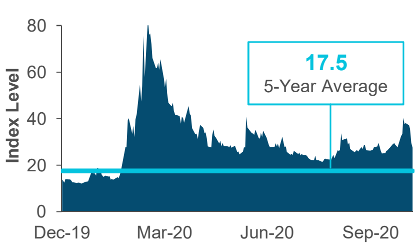
Insurance Cancelled

Heading into the election, US Treasury yields remained range-bound to slightly higher despite bouts of increased volatility and stocks selling off. While stock and bond correlations move around over time, their prices historically have been negatively correlated during periods of market stress where risk assets sell off with investors fleeing to the safety of US Treasuries. As volatility picked up, investors took notice as this reliable insurance policy did not respond. It appeared stocks were reacting to short-term risks of an unsettled, chaotic election, while bonds looked through to the potential for fiscal spending that could move yields higher. With yields hovering at record-low levels, investors may not be getting compensated for the increased duration risk if rates were to revert higher. While investors may be rethinking how to hedge against their equity exposures, US Treasuries still provide ballast even if their positive appreciation may be tempered at current levels, and importantly provide liquidity when it is at a premium.

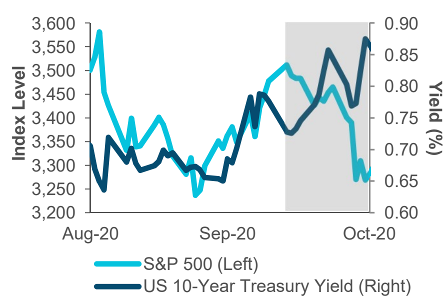
There's No Place Like Housing

Amid the upheaval brought on by the coronavirus pandemic, real estate markets across the board have been impacted on an unprecedented scale. On one hand, the residential housing market continues to boom, spurred on by low rates and a resilient consumer. Many homebuyers are fleeing big cities for more space, as several major companies have extended work from home provisions. However, in stark contrast, commercial real estate, particularly retail, office space and hotels, have continued to face headwinds. Trends that began to take hold pre-coronavirus, such as moves towards online versus brick-and-mortar retail, have been further perpetuated by the pandemic. Similarly, demand for office space could be impaired going forward as working from home trends may become more permanent. If these trends persist, areas of the market exposed to commercial real estate, such as office and retail real estate investment trusts (REITs) will remain challenged.

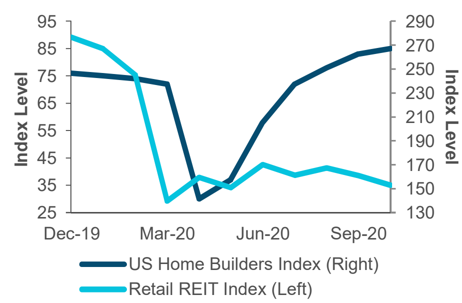
VIX Index[1]
As of 5 November 2020



S&P 500 vs. US 10-Year Treasury Yield
As of 31 October 2020



Residential vs. Commercial Real Estate
As of 31 October 2020



Past performance is not a reliable indicator of future performance.

[1] VIX represents CBOE Volatility Index (VIX).

US Home Builders Index is represented by the National Association of Home Builders Market Index. Retail REIT Index is represented by FTSE NAREIT Retail Property Sector Index. Grey shaded area represents the recent sell-off in S&P 500.

Sources: Bloomberg Finance L.P., Bloomberg Services Limited, Standard & Poor's, NAREIT/FTSE (see Additional Disclosures).

	Positives	Negatives
Europe	▪ EU recovery fund provides significant fiscal stimulus and is the first step towards a fiscal union ▪ Monetary policy remains very accommodative ▪ Equity valuations are inexpensive ▪ Stronger long-term euro outlook	▪ Second wave of virus leading to new lockdowns ▪ Elongated process to enact further stimulus ▪ Brexit likely to negatively impact trade ▪ Lower share of secularly advantaged companies ▪ Banking sector weakened by negative rates ▪ Limited scope for European Central Bank to stimulate further
United Kingdom	▪ Vaccine news means that the heavily service-based UK economy is seeing a light at the end of the tunnel ▪ An exuberant housing market, driven by stamp duty cuts and pent-up demand, will support consumption for now	▪ The second lockdown could be extended or long-term restrictions may be imposed upon exit ▪ The transition to post-Brexit trade arrangements will be very economically disruptive ▪ More fiscal accommodation this year will require greater consolidation thereafter ▪ All these risks make negative rates in the UK more likely, weighing on the sterling, but positive for UK gilts
United States	▪ Unprecedented levels of monetary and fiscal support ▪ Greater share of secularly advantaged companies (e.g., cloud computing, internet retail) than rest of the world ▪ Healthy consumer balance sheets prior to the crisis	▪ Heightened political tensions ▪ Elevated corporate leverage going into the crisis ▪ Elevated government debt levels ▪ US dollar strength has faded

	Positives	Negatives
Japan	▪ Smooth political transition signals reforms may continue, especially in governance and digitisation ▪ Japanese stocks are under-owned; they remain relatively cheap under conservative expectations and offer optionality to global economic recovery ▪ Economic data have improved following effective containment of the coronavirus spread and amid boost to domestic sentiment through government's 'Go To Travel' domestic tourism campaign	▪ The economic recovery has been slower than in other developed economies ▪ Japanese small-cap stocks have reached new highs on the back of retail trading ▪ Market indicators continue to signal a stronger yen, which would reduce companies' competitiveness and profitability
Asia Pacific ex-Japan	▪ The Chinese economy has largely returned to normal; domestic and services sectors could drive future growth after recent rebound in retail sales ▪ We expect the renminbi to remain strong and Chinese bonds to stay attractive given the global low-yield environment ▪ Australian consumer spending could surprise on the upside given solid data from retail sales, housing, job reports and cash balances ▪ Fiscal and monetary policy support in Australia has been comprehensive and significant	▪ Stimulus has started to fade after the economy showed signs of recovery ▪ Chinese stocks face concentration and style divergence risk, with the MSCI China Index having recently hit an all-time high ▪ Australian support measures could be wound down too quickly, creating a hangover effect if fiscal tap is turned off ▪ Having effectively contained COVID-19 outbreaks to this point, the Australian market might be less sensitive to positive vaccine developments than other markets yet to slow virus spread
Emerging Markets	▪ Chinese economy has largely rebounded ▪ US dollar strength has eased ▪ Relatively high share of secularly advantaged companies (e.g., cloud computing, internet retail) ▪ Equity valuations attractive relative to developed markets	▪ Limited ability to enact fiscal stimulus (excluding China) ▪ Highly sensitive to global industrial production and trade trends, which have improved but remain muted

ASSET ALLOCATION COMMITTEE POSITIONING

As of 31 October 2020

Underweight — Neutral — Overweight; ▼ 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			■			Elevated valuations reflecting optimistic pace in earnings recovery. Fiscal and monetary stimuli are key supports amid still-nascent economic recovery.
ASSET CLASSES	Bonds			■			Short-term yields remain anchored amid central bank pledges of support. Longer rates remain vulnerable to moving higher on improving growth. Spreads attractive within some credit sectors.
	Region						
EQUITIES	US			■			Defensive sector profile supportive despite extended valuations. Fiscal and monetary stimulus providing backstop and improved sentiment around earnings.
EQUITIES	Europe			■			Cyclically oriented sector profile and fiscal support could ultimately provide tailwinds. However, second wave, limited tech representation and weakness in financials remain reasons for caution.
EQUITIES	UK			■			After heavy sell-off, price level is compelling. Bank of England and fiscal stimulus are supportive, but Brexit uncertainty remains.
EQUITIES	Japan			■			Successful transition to new prime minister signaling continued fiscal and monetary stimulus support and potential refocusing on reform efforts. Global trade remains a key driver.
EQUITIES	Developed Asia ex-Japan*			■			Valuations attractive relative to the US. Chinese stimulus and successful containment of virus are supportive. Export- and commodity-driven economies face challenges.
EQUITIES	Emerging Markets (EM)				■		Chinese economic strength, weaker US dollar and strong tech exposure are supportive. However, most countries have limited stimulus levers to offset coronavirus weakness.
	Style						
EQUITIES	Global Equity Growth		■				Vulnerability to extended valuations, narrow leadership and improving economic growth outlook could drive rotation towards more cyclical companies. Earnings trends remain supportive.
EQUITIES	Global Equity Value				■		Value equities could benefit from early stages of recovery. Relative valuations remain supportive versus history. Support from higher rates and energy prices remains elusive.
	Capitalisation						
EQUITIES	Global Equity Large-Cap		■				Larger companies better positioned to weather weaker growth environment but could lag as recovery advances due to extended valuations, particularly in tech.
EQUITIES	Global Equity Small-Cap				■		Relative valuations attractive and continue to offer upside to potential economic recovery. Fiscal stimulus and consumer confidence have tempered bankruptcy risks thus far.

* Includes Australia

ASSET ALLOCATION COMMITTEE POSITIONING

As of 31 October 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.

BONDS

	Change	Underweight	Underweight	Neutral	Overweight	Overweight	
Government Bonds		■					Yields remain range-bound near record lows with extended duration and are vulnerable to steepening at the long end of the yield curve should growth expectations improve.
US Investment Grade	▼		■				Nominal Treasury yields remain at low levels. However, the potential for improving growth and additional fiscal stimulus could place upward pressure on yields.
European Investment Grade				■			Supportive technicals and a dovish European Central Bank are likely to keep spreads somewhat insulated from uncertainties surrounding politics and the spreading coronavirus pandemic.
UK Investment Grade	▲				■		Fallout from the pandemic and looming Brexit risks weigh on fundamentals. However, market technicals remain in the driving seat with the Bank of England widely expected to expand QE.
Inflation Linked				■			Inflation expectations could continue to rise amid improving growth outlook and highly accommodative monetary policy and supportive fiscal policy.
Global High Yield					■		Credit spreads remain at attractive levels. Risks remain with potential for downgrades and defaults. Impacts of virus outbreak could further weigh on consumer-related and energy sectors.
Floating Rate Loans					■		Yield spreads remain attractive, although Fed anchored at zero rate level. Relative to high yield bonds, less exposure to energy sector and higher in capital structure.
EM Dollar Sovereigns	▼			■			Although the sector offers attractive yield versus developed markets, relative valuations less attractive after recent rally and concerns around fiscal support remain.
EM Local Currency					■		Valuations remain attractive with continued accommodative monetary policy from developed market central banks and potential for weaker US dollar.
EM Corporates	▼			■			The impact on the asset class of the global recession and the US election is difficult to quantify. Country-specific risks are elevated, but there are attractive opportunities.

CURRENCIES

	Change	Underweight	Underweight	Neutral	Overweight	Overweight	
US Dollar			■				We see the dollar as relatively expensive and remain underweight overall from a medium-term perspective. The US election results have done little to change our view.
Euro	▼		■				Weaker manufacturing performance and Brexit transition risks may weigh on the euro in January and February. However, we expect the currency to appreciate in the spring.
UK Sterling			■				While we expect the UK and EU to reach a deal on Brexit, the transition to new trading arrangements will likely be disruptive. The risk of negative rates continues to rise.
Japanese Yen					■		The outlook for the yen is positive, reflecting weaker near-term global growth, support from interest rate differentials and a more benign outlook for outflows.

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