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Global Asset Allocation Viewpoints

February 2022

1 Market Perspective

As of 31 January 2022

- Global economic growth expected to moderate through the year, but remains above trend. Elevated inflation remains a headwind, but expected to recede over the course of the year amid central bank tightening and supply chain improvement.
- Developed market central banks advancing tighter policies, with the US Federal Reserve continuing to reduce its balance sheet and expected to raise rates and in March, European Central Bank curbing asset purchases, while Bank of Japan remains on hold. Emerging market central banks may be nearing peak tightening, while China policy moving in opposite direction, with a series of easier policy moves.
- Short-term rates biased higher with central banks tightening, while long-term rates balance impacts of slowing growth and stickiness of inflation.
- Key risks to global markets include central bank missteps, persistent inflation, increasing geopolitical concerns, emergence of COVID variants, and China growth trajectory.

2 Portfolio Positioning

As of 31 January 2022

- We remain underweight equities as valuations—although off recent highs—remain extended. Elevated inflation and rising wages are likely to weigh on corporate margins and earnings growth.
- Within equities, we continue to tilt toward cyclicality, maintaining overweights to value-oriented equities globally, U.S. small-caps, and emerging market stocks, where valuations are more reasonable and which should benefit from a continued path of recovery.
- Broadly across our fixed income allocation, we continue to favor shorter duration and higher yielding sectors through overweights to short-term TIPS, floating rate loans, and high yield bonds supported by our still constructive outlook on fundamentals.

3 Market Themes

As of 31 January 2022

Gimme Five, Powell!

Equity markets are off to their worst start of the year since 2009 as they continue to price in the Federal Reserve's hawkish pivot and the probability of over five rate hikes this year. The drawdown in equities has been led by high growth-oriented companies, notably in the technology and discretionary sectors, many of which rose to high valuations last year having benefitted from changes in consumer behavior related to COVID. Undaunted by the recent market weakness, Chairman Powell, at the Fed's meeting last month reiterated their intentions to aggressively remove policy accommodation, citing strong labor markets and high inflation. With 10-year US Treasury yields already jumping over 40 basis points this year and mortgage rates following suit with a near 50 basis point jump, the impacts are flowing through to the real economy. While the Fed seems set on its aggressive path forward, the flattening yield curve seems more worried about its potential impacts on growth and is questioning if we'll get the high five from Powell this year.

Pulling Out All the Stops

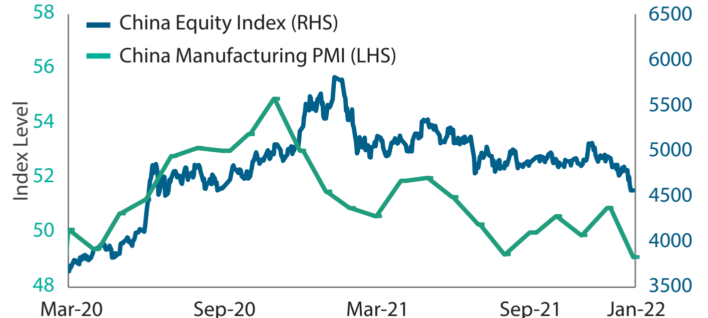
After a rocky 2021, investors were hopeful for a rebound in China amid signs of easier policy support and slowing regulatory reform, however, the year has started with continued signs of slowing growth, much of which has been attributed to strict zero-tolerance policies around COVID. Investor confidence is waning as equity markets have slumped nearly 8% to start the year and creditors are still waiting to find a bottom in prices for much of China's real estate-related debt sector. In response, China policymakers have taken early steps to ease policy, including cutting lending rates, lowering reserve requirements, and flipping course on the property sector by freeing up home loans to stabilize prices, and more support is likely on the way. With China hosting the Winter Olympics and President Xi Jinping looking to extend his leadership to an unprecedented third term, policymakers are especially eager to pull out all the stops to avoid an economic crisis this year.

Difference in U.S. 10Y and 2Y U.S. Treasury Yield

As of 31 January 2022

China Equity Index & Manufacturing PMI

As of 31 January 2022



Past performance is not a reliable indicator of future performance.

China Equity Index represented by the Shanghai Shenzhen CSI 300 Index. China Manufacturing PMI Index represented by Caixin China Manufacturing PMI Index.

Source: Bloomberg Finance L.P.

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4 Regional Backdrop

As of 31 January 2022

United States

Positives

- Strong corporate and consumer balance sheets
- Pent-up demand for services and capex
- Moderating, but still above trend growth

Negatives

- Anticipated pace of Fed tightening
- Elevated stock and bond valuations
- Supply chain issues limiting economic activity
- Significantly elevated inflation

Europe

Positives

- Improving economic outlook
- Fiscal stimulus increasing
- Monetary policy remains accommodative
- Equity valuations attractive relative to the US

Negatives

- Ukraine conflict potential impacts on energy and inflation
- Demand from China is fading both cyclically and structurally
- Limited long-term catalysts for earnings growth
- U.S. dollar strength likely to remain a headwind

Developed Asia/Pacific

Positives

- Very attractive equity valuations
- Improving corporate governance
- Monetary policy remains accommodative

Negatives

- Limited long-term catalysts for earnings growth
- Supply chain issues and COVID restrictions weighing on trade

Emerging Markets

Positives

- China easing regulatory and credit conditions
- Equity valuations attractive relative to the US
- COVID vaccination rate is rapidly increasing

Negatives

- Bottlenecks continue to impact global trade
- U.S. dollar strength likely to remain a headwind
- EM central banks (ex-China) tightening policy

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5 Asset Allocation Committee Positioning

As of 31 January 2022

▼ 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.

		Underweight		Neutral	Overweight		
	Change						
ASSET CLASS	Equities		■				Valuations off recent peaks, but remain vulnerable to further rerating amid Fed tightening policy. Earnings growth to remain positive but moderating, with potential headwinds from rising wage and input costs. Waning of omicron impacts and inventory rebuild to meet demand could be supportive.
	Bonds				■		Tighter global central bank policies and elevated inflation pressuring yields higher, supportive of short duration posture. Credit sector fundamentals remain favorable; yield advantage should remain supportive, although limited upside to valuations.
EQUITIES	*Regions*						
	U.S.		■				Elevated valuations are being challenged by Fed tightening, persistent inflation, waning fiscal stimulus, and decelerating earnings growth. Growth orientation of U.S. market makes it more susceptible to rising rates.
	Global Ex-U.S.				■		Less challenging valuations, procyclical sector profile and easing of supply chain bottlenecks should prove beneficial amid strong growth environment and rising rates. Chinese growth concerns also appear to have bottomed.
	Europe		■				Cyclical orientation and reasonable valuations attractive as omicron risk fades, but uncertainty surrounding Ukraine/Russia is a risk and could push energy prices even higher in the region.
	Japan				■		Attractive valuations, recent fiscal stimulus, rebound in global trade outlook, and improving corporate governance should provide tailwinds.
	Emerging Markets (EM)				■		Valuations are very attractive and Chinese growth appears to have stabilized. Global trade should improve in 2022 as supply chain concerns ease and vaccination levels continue to improve, however, risk-off sentiment could remain a headwind.
	Style & Market Capitalization						
	U.S. Growth vs. Value[1]		■				Value's cyclical orientation should benefit from pent-up consumer demand, elevated savings, and economic strength. Meanwhile, elevated valuations of growth stocks are challenged by higher rates.
	Global Ex-U.S. Growth vs. Value[1]		■				Cyclical orientation of value stocks combined with attractive relative valuations could be catalysts for outperformance. Supply chain improvement could offer additional tailwinds.
	U.S. Small vs. Large-Cap[1]				■		Small-caps should be supported by economic growth, attractive relative valuations, and strong earnings outlook. However, elevated input costs, wage pressures, and heightened market volatility could challenge performance. Higher quality bias is warranted.
	Global Ex-U.S. Small vs. Large-Cap[1]			■			Strong domestic growth trends remain supportive for small-caps, representing a favorable environment for idiosyncratic opportunities. However, U.S. dollar strength could remain a headwind.
	Inflation-Sensitive						
	Real Assets Equities		■				Supply/demand imbalances and rising geopolitical threats driving energy prices higher, although supply shortages expected to fade over near-term. Real estate remains attractive in the context of economic recovery, but remain vulnerable to rising rates.
BONDS	U.S. Investment Grade (IG)		■				Shorter rates to move higher with path of Fed tightening, while longer rates balance impacts of moderating growth and stickiness of inflation. Corporate fundamentals remain strong; however, tight valuations could be vulnerable to the pace of slowing growth.
	Developed Ex-U.S. IG (Hedged)			■			Rates likely to be biased higher on elevated inflation. Central banks' pace of tightening diverging as they weigh inflation and growth trajectories, with ECB and BoJ likely to remain laggards toward tighter policy. USD supported by Fed's lead on developed market tightening.
	U.S. Treasury Long		■				Longer rates not expected to move significantly higher with Fed signaling a more aggressive path to tightening, but remain vulnerable should elevated inflation persist.
	Inflation-Linked				■		Inflation-linked bonds offer a hedge to upside risk on inflation, however, inflation upside likely limited with Fed in tightening mode and anticipated easing in supply chain bottlenecks.
	Global High Yield				■		Credit fundamentals remain strong and default risk remains low, however, further upside is limited due to tight spreads and slowing growth.
	Floating Rate Loans				■		Shorter-duration profile and rate resets provide defense against rising short rates. Solid fundamentals and demand for yield should provide tailwinds. Cautious on new issuance quality amid increased demand.
	EM Dollar Sovereigns			■			Attractive valuations in a low-rate environment; however, EM remains at risk to Fed tightening, fiscal pressures, coronavirus concerns, and China-related uncertainty.
	EM Local Currency				■		Yields remain modestly attractive as many EM central banks have recently raised rates. However, risks related to China, central bank tightening, USD strength, and persistent inflation are near-term headwinds.

[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:

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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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