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Global Asset Allocation Viewpoints
July 2022

1 Market Perspective

As of 30 June 2022

- Inflation concerns remain at the forefront for central banks and investors as global growth continues to trend lower amid supply disruptions, geopolitical challenges and reduction of liquidity, setting the stage for a challenging macro backdrop.
- The US Federal Reserve (Fed) remains committed to its tightening policy, hinting at a steady path forward to further combat inflation. The European Central Bank (ECB) has telegraphed its plan to end asset purchases and begin raising rates despite a fragile macro backdrop, while the Bank of Japan remains steadfast on its policy of yield curve control.
- While most emerging market (EM) central banks continue to tighten policy in response to heightened inflation and weak currencies, China policies remain supportive following the easing of pandemic-related lockdowns to help bolster growth.
- Key risks to global markets include central bank missteps, persistent inflation, impacts of the Russia-Ukraine conflict, potential for a sharper slowdown in global growth and China's balance between containing COVID and growth.

2 Portfolio Positioning

As of 30 June 2022

- Despite more attractive valuations following recent declines, we remain cautious on equities given more challenging earnings environment into slowing growth and tighter financial conditions. Within fixed income, we remain underweight bonds and overweight cash.
- We reduced our overweight to value stocks globally and favor core strategies to moderate the cyclical exposure of our equity allocation amid a backdrop of slowing economic growth.
- Within fixed income, we moderated our exposure to floating rate loans in favor of high yield bonds. While we remain constructive on fundamentals for both sectors, high yield bonds may offer a yield advantage.
- We trimmed our position in short-term TIPS and added to cash as inflation expectations appear to have peaked amid aggressive Fed tightening prospects.

3 Market Themes

As of 30 June 2022

Kaput!

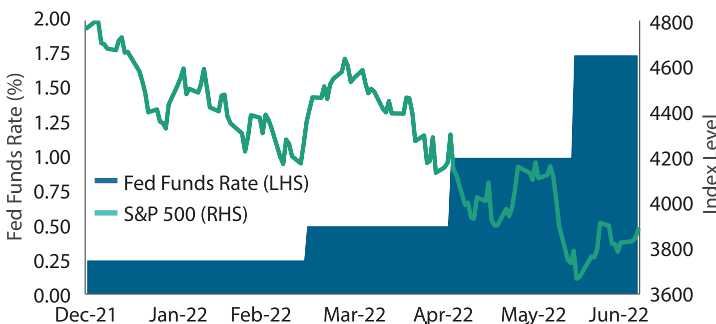
For the last several decades, the Fed has had the luxury of pursuing its dual mandate—maximum employment while maintaining price stability—amid anchored low inflation. Major shocks to the economy and markets, including the great financial crisis and outbreak of COVID, could be combatted with aggressive rate-cutting and trillions of dollars in quantitative easing with little fear of stoking inflation. This environment was beneficial for the Fed and investors who became complacent in expecting a Fed "put" would be there to provide a backstop when a crisis occurred. Unfortunately, the Fed's aggressive easing this time around came alongside unprecedented fiscal stimulus, flooding consumers and corporations with cash and the release of pent-up demand colliding with severe supply shortages related to COVID lockdowns. Add in the energy and agricultural shortages tied to the Russia-Ukraine conflict and you have the perfect storm for runaway inflation. Unfortunately for the Fed, they can't fix supply and will likely remain steadfast in tightening policy to combat inflation, even if it risks pushing the economy into recession—meaning for now that the Fed "put" is kaput.

Change of Tone

China's stock market had fallen by nearly 24% towards the end of April this year as strict lockdowns related to the country's zero-COVID policy weighed on the growth outlook. With evidence now showing COVID-19 infections are abating, lockdowns have been eased and inbound traveler quarantine requirements have been halved, allowing China's economy to gradually reopen. This shift in sentiment comes at a time when the People's Bank of China has pledged to maintain supportive monetary policy to aid the country's recovery, with a cautious eye on stability. Recent statements from President Xi Jinping pledging government support for parts of the technology sector, citing their larger role in the economy's future, also seemed to suggest an easing of regulatory crackdowns experienced last year. In a matter of months, the negative sentiment surrounding China has shifted to it being the "new bull market," with Chinese stocks up close to 20% off April's lows. While still early in reopening and with China's economic data just starting to show signs of improvement, the tone inside and outside China suggests that the worst may be behind, at least for now.

Fed Funds Rate vs. US Equities

As of 30 June 2022



Chinese Equities Rebounding Sharply since April

As of 30 June 2022

Past performance is not a reliable indicator of future performance.

Sources: Bloomberg Finance L.P. and S&P. Please see the last page for information about this S&P information.

Chinese equities are represented by the Shanghai Shenzhen CSI 300 Index. Figures shown in Chinese yuan.

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4 Regional Backdrop

As of 30 June 2022

	Positives	Negatives
United States	▪ Strong corporate and consumer balance sheets ▪ Pent-up demand for services and capex	▪ Fed tightening at a rapid pace ▪ Inflation remains elevated ▪ Supply chain issues limiting economic activity
Europe	▪ Fiscal spending likely to increase ▪ Equity valuations attractive relative to the US ▪ European Union unity is strengthening	▪ Russia-Ukraine conflict has driven energy prices sharply higher ▪ Industrial production is dampened by supply chain challenges ▪ Limited long-term catalysts for earnings growth ▪ ECB support is likely to fade in the near term
Developed Asia/Pacific	▪ Very compelling equity valuations ▪ Improving corporate governance ▪ Monetary policy remains accommodative	▪ Limited long-term catalysts for earnings growth ▪ Global trade remains impacted by supply chain issues and geopolitical uncertainty ▪ Uptick in inflation is leading to tighter monetary conditions
Emerging Markets	▪ Chinese authorities are easing monetary, regulatory and credit conditions ▪ Equity valuations are attractive relative to the US	▪ Global trade remains impacted by supply chain issues and geopolitical uncertainty ▪ Fiscal pressures remain a challenge

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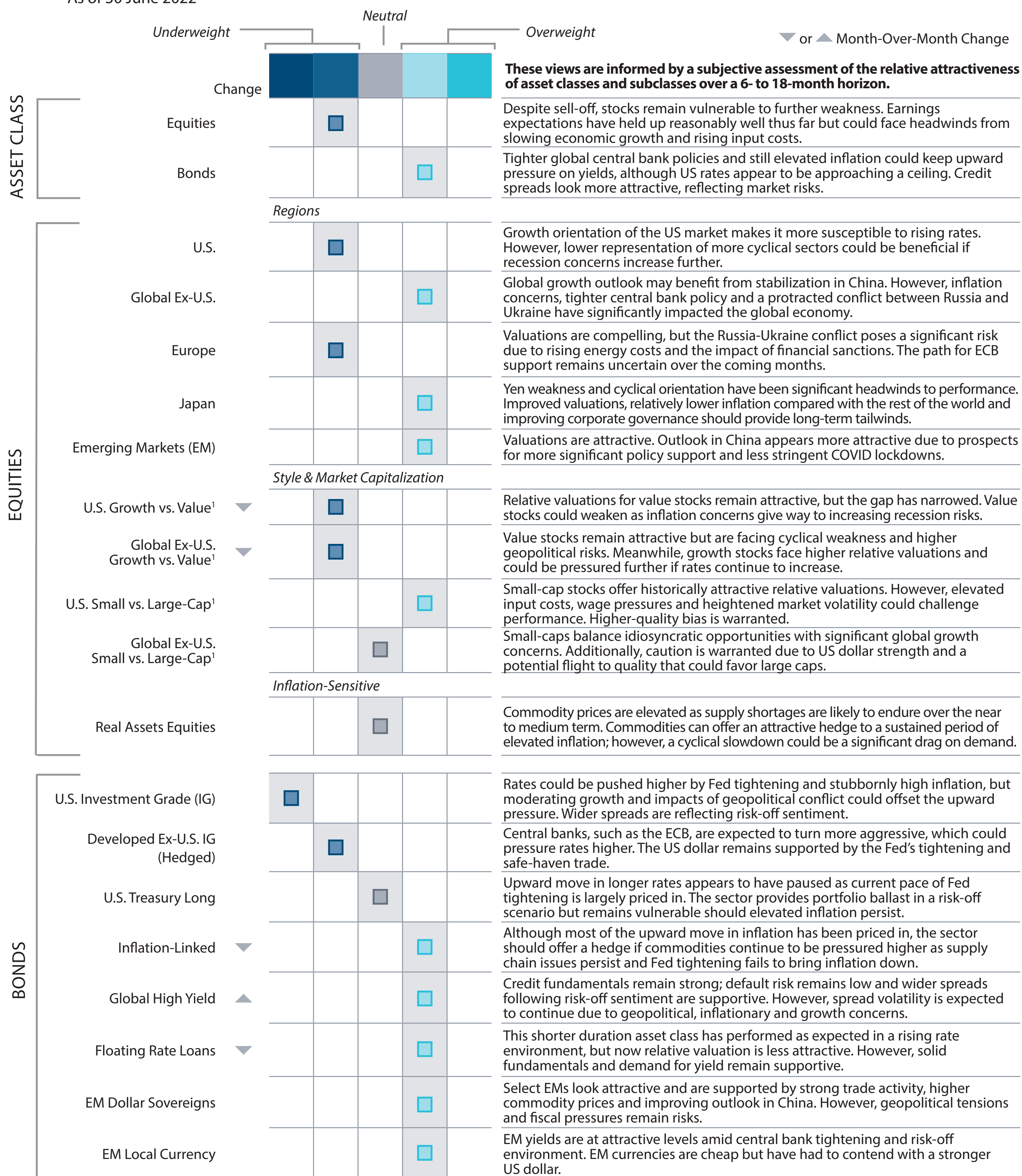
5 Asset Allocation Committee Positioning

As of 30 June 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.

		Change	Underweight	Underweight	Neutral	Overweight	Overweight	
ASSET CLASS	Equities			■				Despite sell-off, stocks remain vulnerable to further weakness. Earnings expectations have held up reasonably well thus far but could face headwinds from slowing economic growth and rising input costs.
ASSET CLASS	Bonds					■		Tighter global central bank policies and still elevated inflation could keep upward pressure on yields, although US rates appear to be approaching a ceiling. Credit spreads look more attractive, reflecting market risks.
	Regions							
EQUITIES	U.S.			■				Growth orientation of the US market makes it more susceptible to rising rates. However, lower representation of more cyclical sectors could be beneficial if recession concerns increase further.
EQUITIES	Global Ex-U.S.					■		Global growth outlook may benefit from stabilization in China. However, inflation concerns, tighter central bank policy and a protracted conflict between Russia and Ukraine have significantly impacted the global economy.
EQUITIES	Europe			■				Valuations are compelling, but the Russia-Ukraine conflict poses a significant risk due to rising energy costs and the impact of financial sanctions. The path for ECB support remains uncertain over the coming months.
EQUITIES	Japan					■		Yen weakness and cyclical orientation have been significant headwinds to performance. Improved valuations, relatively lower inflation compared with the rest of the world and improving corporate governance should provide long-term tailwinds.
EQUITIES	Emerging Markets (EM)					■		Valuations are attractive. Outlook in China appears more attractive due to prospects for more significant policy support and less stringent COVID lockdowns.
	Style & Market Capitalization							
EQUITIES	U.S. Growth vs. Value[1]	▼		■				Relative valuations for value stocks remain attractive, but the gap has narrowed. Value stocks could weaken as inflation concerns give way to increasing recession risks.
EQUITIES	Global Ex-U.S. Growth vs. Value[1]	▼		■				Value stocks remain attractive but are facing cyclical weakness and higher geopolitical risks. Meanwhile, growth stocks face higher relative valuations and could be pressured further if rates continue to increase.
EQUITIES	U.S. Small vs. Large-Cap[1]					■		Small-cap stocks offer historically attractive relative valuations. However, elevated input costs, wage pressures and heightened market volatility could challenge performance. Higher-quality bias is warranted.
EQUITIES	Global Ex-U.S. Small vs. Large-Cap[1]				■			Small-caps balance idiosyncratic opportunities with significant global growth concerns. Additionally, caution is warranted due to US dollar strength and a potential flight to quality that could favor large caps.
	Inflation-Sensitive							
EQUITIES	Real Assets Equities				■			Commodity prices are elevated as supply shortages are likely to endure over the near to medium term. Commodities can offer an attractive hedge to a sustained period of elevated inflation; however, a cyclical slowdown could be a significant drag on demand.
BONDS	U.S. Investment Grade (IG)		■					Rates could be pushed higher by Fed tightening and stubbornly high inflation, but moderating growth and impacts of geopolitical conflict could offset the upward pressure. Wider spreads are reflecting risk-off sentiment.
BONDS	Developed Ex-U.S. IG (Hedged)			■				Central banks, such as the ECB, are expected to turn more aggressive, which could pressure rates higher. The US dollar remains supported by the Fed's tightening and safe-haven trade.
BONDS	U.S. Treasury Long				■			Upward move in longer rates appears to have paused as current pace of Fed tightening is largely priced in. The sector provides portfolio ballast in a risk-off scenario but remains vulnerable should elevated inflation persist.
BONDS	Inflation-Linked	▼				■		Although most of the upward move in inflation has been priced in, the sector should offer a hedge if commodities continue to be pressured higher as supply chain issues persist and Fed tightening fails to bring inflation down.
BONDS	Global High Yield	▲				■		Credit fundamentals remain strong; default risk remains low and wider spreads following risk-off sentiment are supportive. However, spread volatility is expected to continue due to geopolitical, inflationary and growth concerns.
BONDS	Floating Rate Loans	▼				■		This shorter duration asset class has performed as expected in a rising rate environment, but now relative valuation is less attractive. However, solid fundamentals and demand for yield remain supportive.
BONDS	EM Dollar Sovereigns					■		Select EMs look attractive and are supported by strong trade activity, higher commodity prices and improving outlook in China. However, geopolitical tensions and fiscal pressures remain risks.
BONDS	EM Local Currency					■		EM yields are at attractive levels amid central bank tightening and risk-off environment. EM currencies are cheap but have had to contend with a stronger US dollar.

[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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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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