



Global Asset Allocation Viewpoints

September 2022

1 Market Perspective

As of 31 August 2022



- While seeing increasing evidence of moderating inflationary pressures in some countries, central banks to remain steadfast in tightening policies as inflation is not likely to return to target levels in the near term.
- The US Federal Reserve (Fed) strongly reinforced its commitment this past month to its tightening policy, prioritizing inflation fighting over economic growth. Despite facing prospects of weaker growth, the European Central Bank (ECB) is expected to ramp up rate hikes to fend off energy-driven inflation pressures, while the Bank of Japan (BoJ) remains on the sidelines.
- Several emerging markets (EM) are being forced to tap in to reserves to defend their currencies against the rallying US dollar and elevated import costs, while China continues to try and incrementally bolster growth through supportive policies as the country contains the spread of the coronavirus.
- Key risks to global markets include central bank missteps, persistent inflation, potential for a sharper slowdown in global growth, China's balance between containing the coronavirus and growth and geopolitical tensions.

2 Portfolio Positioning

As of 31 August 2022



- We remain moderately cautious on risk, through our underweight to equities and bonds and overweight to cash. Slowing growth and declining earnings remain a challenge for equities, while persistent inflation and higher rates could weigh on bonds. Cash is an attractive alternative with higher short rates.
- Within equities, we are nearly balanced between value and growth. Slowing growth backdrop unfavorable for cyclicals, while higher rates weigh on growth-oriented equities.
- Within fixed income, although we remain constructive on floating rate loans, we took an opportunity to trim our overweight position in the sector as spreads have rallied sharply over the past month.

3 Market Themes

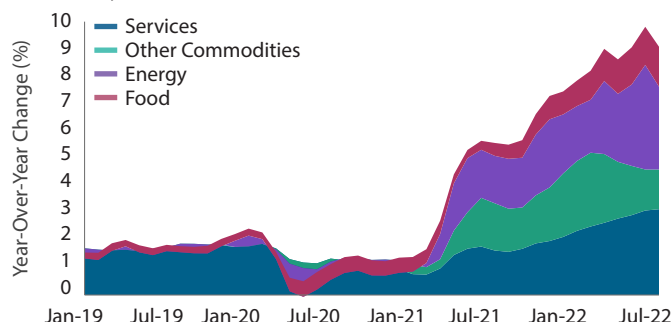
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It Fooled You Once...

Coming out of the annual Jackson Hole meeting, Fed Chairman Jerome Powell's speech, unsurprisingly, had a strong tone reinforcing the Fed's intention to fight inflation at any cost, a 180-degree reversal of his 'inflation is transient' tone delivered the same time last year. But, just like last year when the Fed misread the growing threat of persistent inflationary forces and underacted, they may be misreading the trajectory of inflation once again. While lingering supply chain impacts from the pandemic and the Russia-Ukraine conflict over the past year further exacerbated inflationary pressures, we are now starting to see key input costs—such as oil, lumber, and copper—sharply decline. Recent jobs data has also pointed to higher participation rates, which should help ease the tight labor market and pressure on wages and while other 'stickier' components of inflation—such as rents and owners' equivalent rents—are still on the rise, the pace has moderated in recent months. Although it is unlikely that inflation returns to the Fed's 2% target anytime soon, it could be falling a lot faster than suggested by the Fed's tightening, leaving markets to wonder if next year's speech is about rate cuts.

Contribution to CPI by Category

As of 31 July 2022

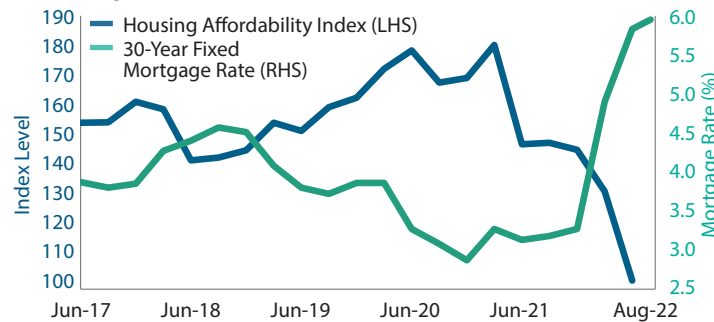


House of Cards

Pandemic-fueled demand for space, ultra-low mortgage rates, and low supply proved the perfect mix that set the housing market on fire, with home prices surging over 40% since the start of the pandemic. Unfortunately, the tides have turned amid tighter Fed policy, as mortgage rates have spiked higher, with the 30-year fixed rate moving from below 3% up to 6% since early 2021. That abrupt leap in rates has quickly stifled demand, sending prices and sales lower, and is already forcing some mortgage lenders to begin layoffs amid the downturn. While there is clearly some excess in home valuations, particularly in certain regions that saw the strongest demand, it may be a stretch to draw parallels to the 2008 house of cards that came crashing down, as credit fundamentals of borrowers today are less of an issue. In fact, many buyers, and particularly first-time home buyers, have been sidelined as climbing financing costs are continuing to keep affordability out of reach and more than offsetting the recent softness in home prices. However, going forward, the real impact of a weakening housing market may be on sectors of the economy, such as construction spending and mortgage lending, as well as broader consumer spending.

Housing Affordability vs. Mortgage Rates

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Past performance is not a reliable indicator of future performance.

Sources: Bloomberg Finance L.P.

The 30-Year Fixed Mortgage Rate reflects the U.S. Home Mortgage 30 Year Fixed National Average Index (Source: Bankrate.com).

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4 Regional Backdrop

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Positives

United States

- Strong corporate and consumer balance sheets
- Pent-up demand for services and capex
- Resilient labor market
- Supply chain issues improving rapidly

Negatives

- Persistently high inflation
- Restrictive monetary policy
- Challenging environment for earnings

Europe

- Fiscal spending likely to increase
- Equity valuations attractive relative to the US
- European Union unity is strengthening

- Recession risk is very high
- Industrial production will be dampened by energy shortages
- ECB is tightening
- Sovereign debt risks are rising
- Limited long-term catalysts for earnings growth

Developed Asia/Pacific

- Very attractive equity valuations
- Improving corporate governance
- Monetary policy remains accommodative
- Low inflation relative to the rest of the world

- Limited long-term catalysts for earnings growth
- Global trade volumes are slowing
- Uptick in inflation is leading to tighter monetary conditions

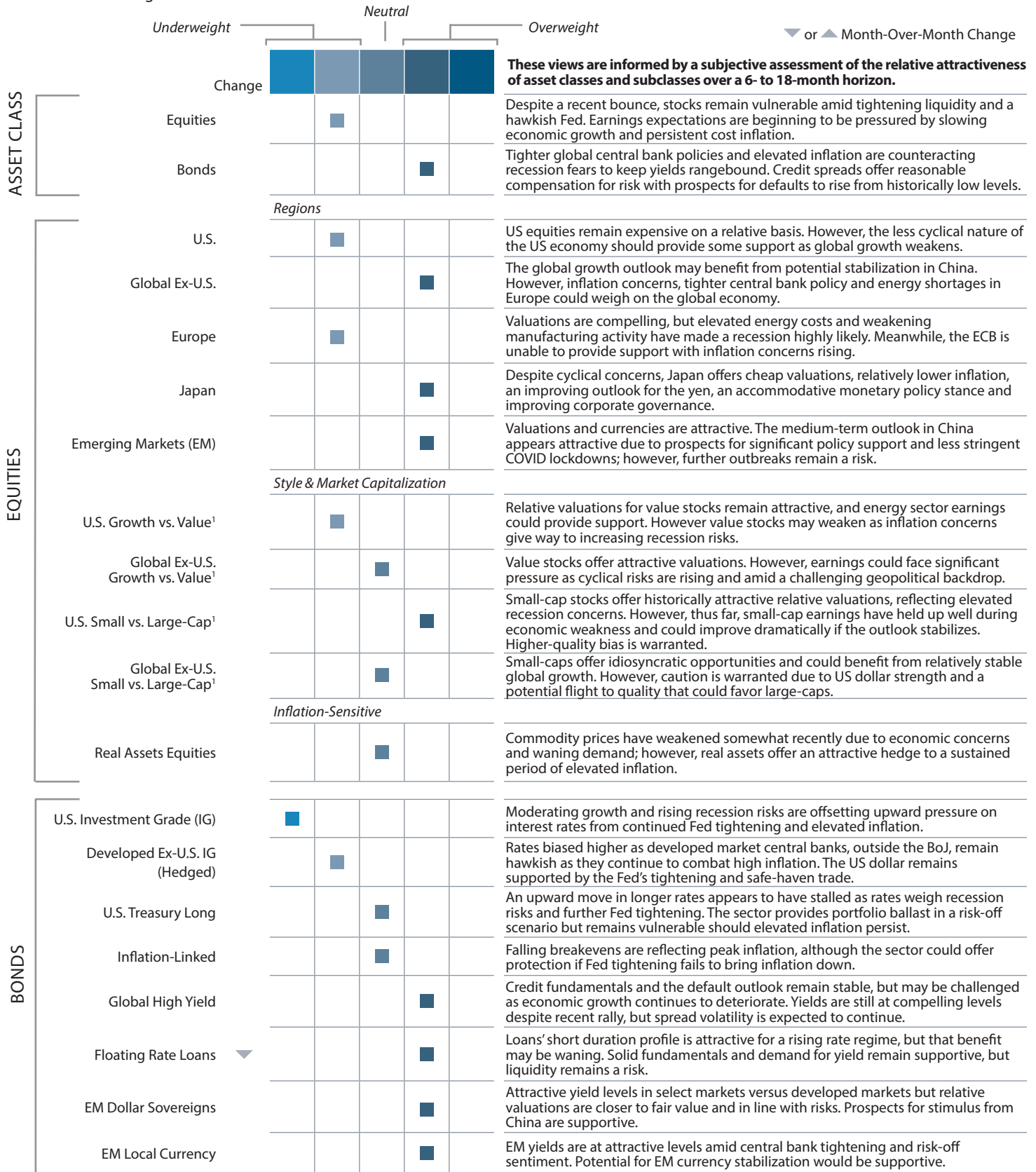
Emerging Markets

- Chinese authorities are easing monetary, regulatory and credit conditions
- Equity valuations are attractive relative to the US
- COVID concerns have decreased

- Chinese regulatory actions are weighing on confidence
- Chinese housing concerns have impacted industrial activity
- Geopolitical risks are elevated
- Global trade volumes are slowing

5 Asset Allocation Committee Positioning

As of 31 August 2022



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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