



GLOBAL ASSET ALLOCATION: THE VIEW FROM EMEA

DECEMBER 2019

MARKET INSIGHTS

As of November 30, 2019

Let's Get Cyclical!

Cyclical stocks have had an impressive comeback since September, outperforming defensive stocks as investors have become increasingly more confident in the global economy. Trade war abatement, improvement in economic data, and higher bond yields have allowed sectors such as financials and industrials and business services to recover, while other more rate-sensitive sectors such as utilities and real estate have lagged. Global equities outside the U.S., which are more trade-dependent, have also seen a pickup as progress in trade talks has improved sentiment. Although it is difficult to identify catalysts that can support a sustained rally in cyclicals, a potential Phase I U.S.-China trade deal could boost global risk-taking.

What Lies Beneath?

While equity markets are reaching all-time highs, investors in the lowest-quality portion of the high yield market (CCCs) are demanding the highest credit spreads in over three years. A range of challenges, such as secular shifts in consumer spending and low commodity prices, are weighing on some lower-tier companies, causing their spreads to balloon. Fortunately, the broader high yield market has seen its overall quality increase in recent years, with BBs making up nearly half the market. While the risks among CCCs appear contained for now, these companies will be increasingly vulnerable to a downturn.

Changing of La-Garde

As markets question the effectiveness of monetary policy and its diminished range of tools, particularly in the eurozone, the new European Central Bank (ECB) chief, Christine Lagarde, is calling for a new policy mix to combat slowing economic growth and weak inflation. With interest rates already at extremely low (negative) levels and bond buying back, she believes it is an attractive time for countries to increase fiscal spending to provide another means to boost growth. This is easier said than done, as countries with budget surpluses, such as Germany and the Netherlands, have been reluctant to increase their debt levels. If it does materialize, fiscal spending could augment monetary policy by increasing the number of bonds available for the ECB to purchase.



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FIG. 1: MSCI ACWI Industrials vs. Utilities
September 30, 2019, through November 30, 2019

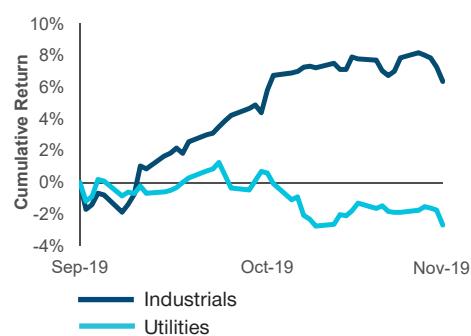
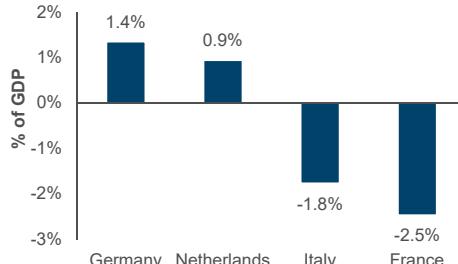


FIG. 2: Global High Yield Index Bifurcation
December 31, 2018, through November 30, 2019



FIG. 3: Fiscal Surplus/Deficit
As of December 31, 2018



Past performance is not a reliable indicator of future performance.

Sources: J.P. Morgan Chase & Co., IMF, and MSCI (see Additional Disclosures). Financial data and analytics provider FactSet. Copyright 2019 FactSet. All Rights Reserved.



Positives

Developed Europe

- Monetary policy remains very accommodative
- Beneficiary of trade-related supply chain disruptions
- Signs of stabilization in manufacturing
- Services sector of the economy resilient
- Dividend yields remain strong
- Political uncertainty waning

Negatives

- Political uncertainty
- Modest economic growth with fading fiscal stimulus
- Muted near-term earnings expectations
- Weak capex spending and corporate confidence
- Late-cycle concerns: tight labor market, rising wages, and corporate margins under pressure
- Elevated corporate and government debt levels

United Kingdom

- Wage growth remains positive despite continued uncertainty over Brexit
- Inflation remains steady, albeit below target
- The trade balance deficit remains in a range that can be sustained by the net excess returns on the UK's external balance sheet
- Britain's fiscal position provides flexibility for government spending to be increased should the economy weaken

- Investment remains weak due to persistent Brexit uncertainty
- Sterling will continue to make hard yards
- PMI data continues to suggest sluggish business activity

United States

- Fed likely on hold, inflation low
- Growth stabilizing
- Healthy consumer spending, strong employment, and improving wages
- Low interest rates driving a modest rebound in housing
- Greater share of secularly advantaged companies (e.g., cloud computing, internet retail) than rest of world

- Political uncertainty
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Positives

Japan

- Consumer confidence shows signs of rebound after months of slowdown. Need to see a trend develop after the disruptions from the VAT hike and typhoons
- The fiscal stimulus should become additive to growth in 2020, focusing on the domestic economy
- Japanese stocks remain attractive from a valuation perspective. Meanwhile, corporate and foreigners' buying activities support local markets



Negatives

- Topline growth and earnings are subdued relative to global peers
- Economic momentum remains weak when looking at manufacturing and exports data
- Expectations for further support from the Bank of Japan (BoJ) need to be revised as the central bank is unlikely to act beyond its forward guidance

Asia ex Japan

- The Chinese economy is stabilizing, and leading indicators are pointing to a rebound in manufacturing activity
- China's fiscal and monetary policy have room to accommodate further if needed
- The Australian economy is expected to improve next year on the back of a rebound in housing prices
- Australian business and consumer confidence indices are pointing upward

- Macro policies are intended to stop the downward trajectory in growth, not to revive it. The focus is on deleveraging, so expectations for additional stimulus should be measured
- Weak industrial production and fixed asset investment data suggest sluggish economic momentum
- Beware of overly optimistic expectations already being priced in for the Reserve Bank of Australia
- Equity valuations are at record high levels since the global financial crisis, requiring strong earnings growth to compensate for potential price multiple contraction

Emerging Markets

- Muted (but rising) inflation and a more dovish Fed have given central banks flexibility to ease
- Equity valuations attractive relative to developed markets
- With growing importance of tech sector, less tied to commodity cycle
- Beneficiary of China stimulus

- Export-driven economies are highly vulnerable to rising trade tensions
- Instability in several key markets (Turkey, Argentina, and Brazil) could persist
- Long-term China growth trajectory remains a headwind
- China stimulus more measured and domestically focused
- Commodity prices remain under pressure

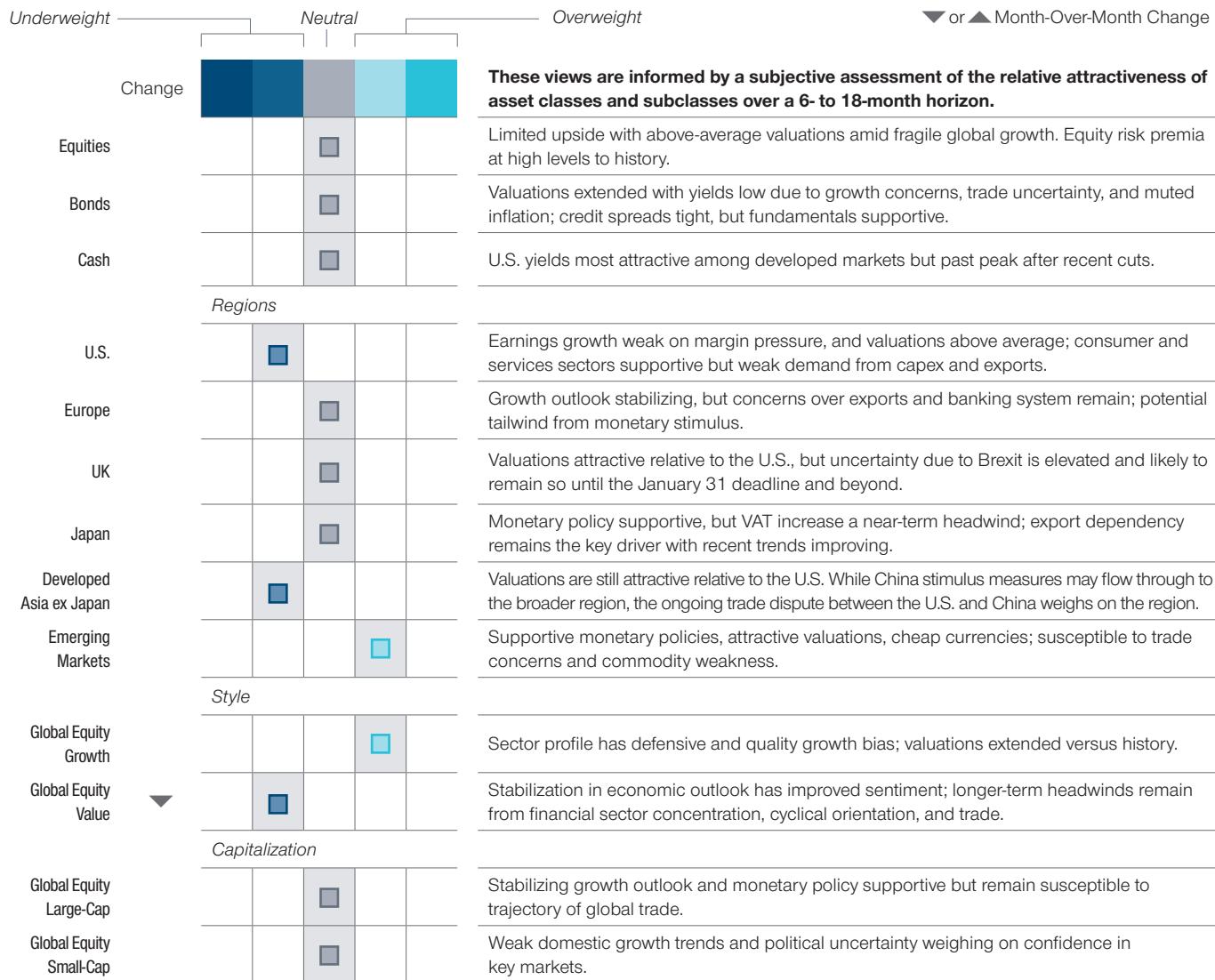


ASSET ALLOCATION COMMITTEE POSITIONING

As of November 30, 2019

ASSET CLASSES

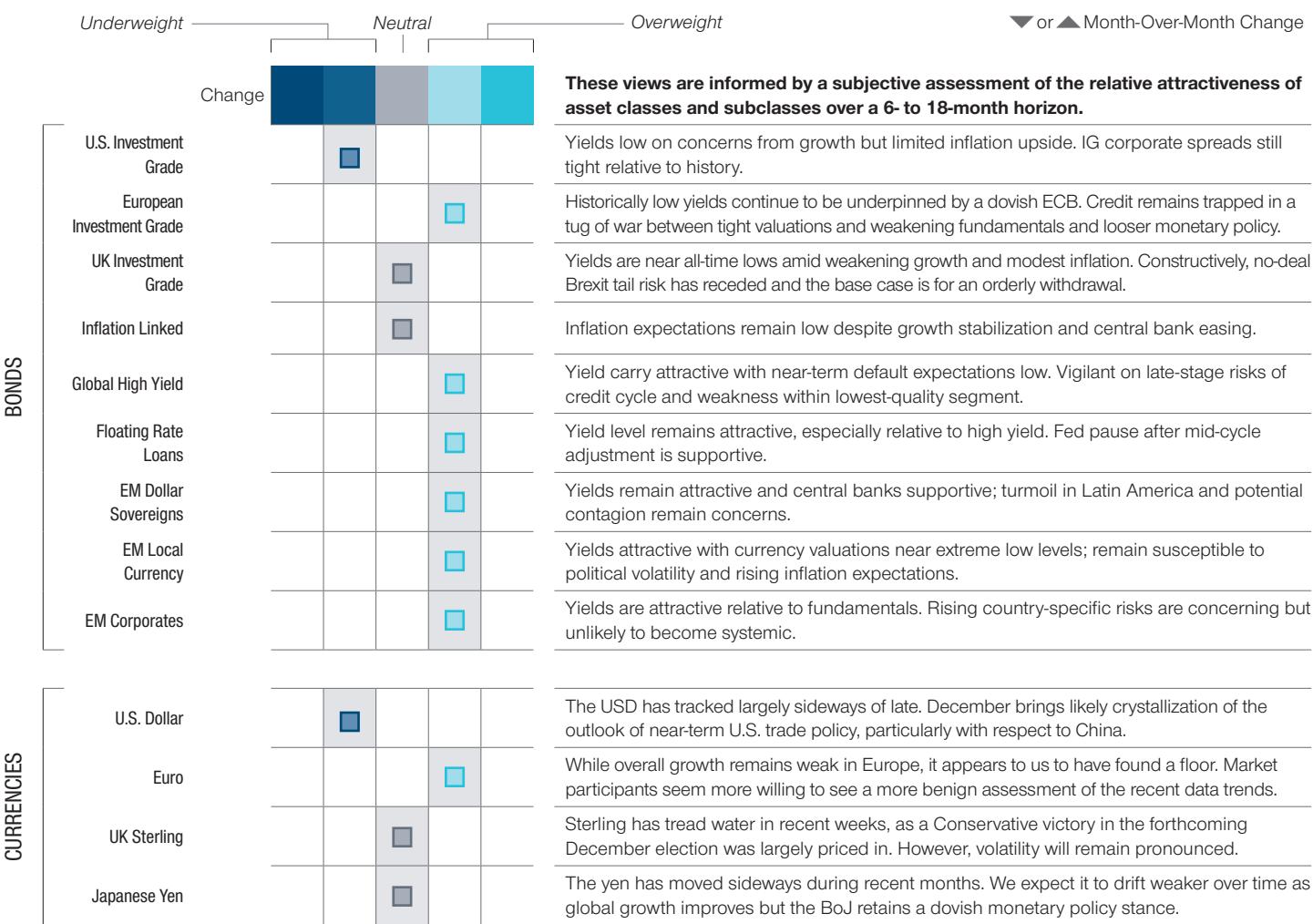
EQUITIES





ASSET ALLOCATION COMMITTEE POSITIONING

As of November 30, 2019



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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.

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.

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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.

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