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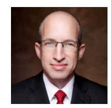
GLOBAL ASSET ALLOCATION: THE VIEW FROM EMEA

MAY 2019

MARKET INSIGHTS

As of April 30, 2019



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Head of Multi-Asset Solutions, EMEA

Earnings: And the "Beats" Go On

After several months of downward earnings revisions and fears of an earnings recession in the U.S., companies are beating lowered expectations this earnings season. The better-than-expected earnings-per-share growth has been supported by slightly better revenue growth, stable margins, and share buybacks. Having seemingly avoided an earnings recession, U.S. equities are sharply outperforming the rest of the world again, with both large-cap and small-cap stocks recording their largest four-month gain since December 2010. With equity prices up more than 15% year-to-date and full-year earnings growth expectations at less than 5%, the market may have gotten a bit ahead of itself.

U.S.: Extending the Cycle

U.S. gross domestic product (GDP) grew 3.2% year over year in the first quarter, extending the current expansion and tying the record from the 1990s, which had been the longest in history. Growth was surprisingly strong in a quarter that featured a government shutdown and severe winter weather. While the current cycle has been durable, it has also been relatively modest from a cumulative growth perspective. However, the recent strength suggests that the cycle may have more room to run with a strong U.S. consumer, stabilizing Chinese growth, and a potential trade deal in the works. The resilience in growth has not been isolated to the U.S., as recent Chinese data and the eurozone's first-quarter GDP also surprised to the upside. Though long in tenure, we are reminded that cycles don't die of old age alone.

Idiosyncratic Risks Rising, Again

While much of the focus in emerging markets has been on the growth trajectory in China, a growing number of hot spots have emerged among some of the large debt issuers once again. The situation in Venezuela continues to deteriorate. Argentina remains in a deep economic recession, prompting the nation's central bank to take further action to stabilize the currency. Turkey suffered its first recession in a decade amid political uncertainty and an unconventional central bank. While emerging markets bond yields remain attractive and broadly supported by positive fundamentals, the recent rise in idiosyncratic risks bears watching.

FIG. 1: S&P 500 EPS Growth
As of April 30, 2019

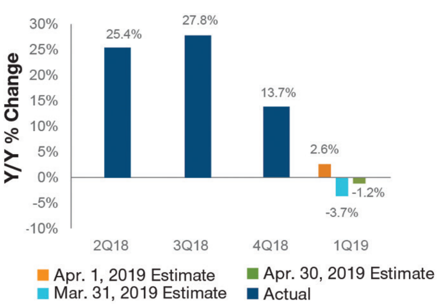


FIG. 2: U.S. Economic Expansions
Q4 (Dec. 31)1949 to Q1 (Mar. 31) 2019

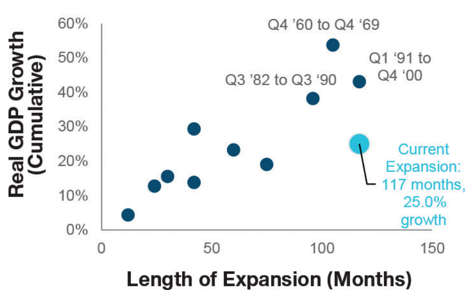
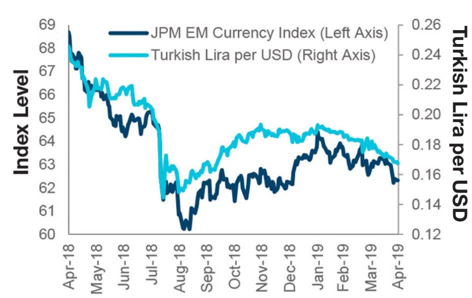


FIG. 3: Emerging Markets Currencies
April 30, 2018, through April 30, 2019



Past performance is not a reliable indicator of future performance.
Sources: J.P. Morgan Chase & Co., Standard & Poor's, Haver Analytics/Bureau of Economic Analysis. Financial data and analytics provided by FactSet.

	Positives	Negatives
Developed Europe	▪ Monetary policy remains very accommodative ▪ Indirect beneficiary of China stimulus ▪ Political headwinds have eased ▪ Economic growth showing signs of stabilization	▪ Eurozone economic growth is muted, with limited scope for European Central Bank (ECB) to respond ▪ Export weakness, vulnerable to trade and China growth ▪ Banking sector remains challenged ▪ Unity remains challenged amid rising populism and protectionism
United Kingdom	▪ The prospects of a no-deal Brexit seem to have diminished, avoiding a “cliff-edge” scenario ▪ A delay to Article 50 increases the possibility of a soft Brexit or no Brexit	▪ Political uncertainty remains very high, which could lead to a range of different macroeconomic outcomes ▪ Weak economic outlook likely to weigh on sterling ▪ Firms have been stockpiling ahead of Brexit, potentially leading to a capex slowdown
United States	▪ Dovish Fed, stable inflation ▪ Healthy consumer spending, improving wages ▪ Lower rates driving a rebound in housing ▪ Trade deal with China appears likely ▪ Greater share of secularly advantaged companies (e.g., cloud computing, internet retail) than rest of world	▪ Moderating economic growth with fading fiscal stimulus ▪ Late-cycle concerns: tight labor market, rising wages, and elevated margins ▪ Political uncertainty and trade tensions ▪ Muted near-term earnings expectations ▪ Elevated corporate and government debt levels

	Positives	Negatives
Japan	• Expectations marked down significantly given poor economic momentum, creating upside surprise risk • Fiscal stimulus measures could provide support later in year, while Bank of Japan (BoJ) monetary policy remains committed to easing • Chatter of postponing VAT hike could take center stage in political debate during upcoming July elections • Foreign investors became net buyers of cash equities, recognizing value in stock market and potential to rebound meaningfully in second half	• Economic activity remains weak, waiting for external catalysts to form bottom • Weak corporate earnings are weighing on stock prices, winning the argument against attractive valuations and weaker Japanese yen (JPY) • A spike in global risk aversion could trigger JPY appreciation • BoJ left with limited options to implement further easing
Asia ex Japan	• Chinese growth is bottoming out, together with trade activity • Benefits from Chinese stimulus measures yet to be seen, boding well for continuous rebound in economic activity • Australian retail sales remain resilient, thanks to strong job market • Rate cut progressively becoming market consensus as Reserve Bank of Australia seems ready to lower rates if necessary	• Highly exposed to slowing global economic growth and trade tensions • Chinese inflation risks due to higher commodity and food prices might put additional pressure on yields • Tone change from Chinese policymakers moving from easing to neutral stance in near future • Australia facing slowing economy with weakness in housing • Australian earnings facing increased margin pressure
Emerging Markets	• Muted (but rising) inflation, more dovish Fed give central banks flexibility to ease • Chinese stimulus appears to be taking hold • U.S.-China trade deal appears likely • Global trade indicators appear to be stabilizing • Equity valuations attractive relative to developed markets • With growing importance of tech sector, less tied to commodity cycle	• 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 • Highly linked to global trade • Currencies facing renewed pressure

ASSET ALLOCATION COMMITTEE POSITIONING

As of April 30, 2019

▼ or ▲ Month Over 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 CLASS	Equities		■				Higher valuations are reflecting fundamentals amid a stable but aging cycle, lower earnings expectations, and lingering trade risk.
	Bonds				■		Yields are range-bound with modest inflation, and Fed is on hold. Credit fundamentals are broadly supportive amid elevated leverage and moderating earnings.
	Cash			■			U.S. yields are most attractive among developed markets but may have peaked with Fed on hold.
	Regions						
EQUITIES	U.S.		■				Earnings growth is moderating with valuations fair. The U.S. market is less vulnerable to slowing global growth.
	Europe			■			The growth outlook is weakening amid concerns over exports, the banking system, and elevated political risks.
	UK			■			Valuations are attractive relative to the U.S., but uncertainty due to Brexit has been prolonged by the European Union's decision to grant a six-month extension.
	Japan			■			Trends in corporate governance and monetary policy are supportive. Export dependency and a stronger yen are potential headwinds.
	Asia ex Japan		■				Valuations are still attractive relative to the U.S. China stimulus measures are likely to flow through to the broader region, and improving economic activity is expected in the second half of 2019.
	Emerging Markets				■		Softer U.S. dollar expectations, China stimulus measures, and easing trade tensions.
	Style						
	Global Equity Growth				■		Quality growth bias, less exposed to global growth slowdown, but valuations are extended versus history.
	Global Equity Value		■				Cyclical orientation and financials exposure are challenged by a persistently low-rate environment and fading growth outlook.
	Capitalization						
	Global Equity Large-Cap			■			Reliant on strength of global trade. The upside is dependent on the impact of China stimulus.
	Global Equity Small-Cap			■			Susceptible to domestic growth trends. Political uncertainty is weighing on corporate and consumer confidence in key markets.

ASSET ALLOCATION COMMITTEE POSITIONING

As of April 30, 2019

▼ or ▲ Month Over 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		Neutral	Overweight		
BONDS	U.S. Investment Grade	▼		■				Yields remain low with limited concerns from growth and inflation upside. Investment-grade (IG) corporate spreads are wider yet still tight relative to history.
	European Investment Grade				■			Yields are lower year-to-date amid slowing growth and modest inflation, and IG corporate spreads are tight relative to history.
	UK Investment Grade					■		Yields are lower year-to-date amid slowing growth and modest inflation. The Bank of England is likely to stay put until the resolution of Brexit.
	Inflation Linked	▼			■			Inflation expectations remain low on slower growth and lower energy prices, making valuation more compelling but lacking catalysts.
	Global High Yield	▲			■			Yield carry is attractive with near-term default expectations low, but the late stage of the credit cycle is a risk.
	Floating Rate Loans				■			The yield level is attractive, but loan terms have weakened and liquidity is a risk.
	EM Dollar Sovereigns					■		Yields are attractive relative to fundamentals supported by the slower Fed path, but rising country-specific risks could result in near-term volatility.
	EM Local Currency					■		Despite a healthy rebound, EM currency valuation remains attractive in select areas.
	EM Corporates					■		Yields are attractive relative to fundamentals. Rising country-specific risks are concerning but unlikely to become systemic.
CURRENCIES	U.S. Dollars				■			The U.S. dollar continues to be relatively range-bound, defying high valuations and worsening fundamentals. However, the incentive to sell remains low.
	Euros					■		Political uncertainties, largely related to Brexit, remain. Continued soggy economic indicators and a dovish tilt to ECB policy continue to hold the common currency in check.
	UK Sterling				■			Despite an ongoing weak economic backdrop, short-term price action in sterling continues to be primarily driven by Brexit. Valuations remain attractive.
	Japanese Yen					■		The JPY has stayed relatively weak of late with dovish BoJ commentary and soft data. External balances and valuations remain supportive, however.

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ADDITIONAL DISCLOSURES

Certain numbers in this report may not equal stated totals due to rounding.

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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.

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 favor depending on market conditions and investor sentiment.

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