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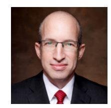
GLOBAL ASSET ALLOCATION: THE VIEW FROM EMEA

JANUARY 2020

MARKET INSIGHTS

As of December 31, 2019



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Making "Global ex-U.S." Great Again?

In 2019, the U.S. stock market continued its streak of outperforming, rising by more than 31% versus 21% for the rest of the world, as measured by the S&P 500 Index and the MSCI All Country World ex-US Index (in USD). More surprising is that the U.S. market has outpaced the rest of the world by nearly 200% over the past decade. Markets outside the U.S. were plagued by a decade that saw the European debt crisis; two recessions in Europe; bouts of political uncertainty across the globe, including Brexit; and, more recently, the impacts of the trade war. Entering 2020, markets outside the U.S. are benefiting from easing trade tensions and stabilizing global growth, which could be a tailwind given their more cyclically oriented economies.

Un-pricing a Recession

The U.S. yield curve has reached its steepest level since October 2018 as investors continued to gain confidence in the growth outlook amid waning concerns about trade. In fact, yield curves around the world are showing signs of re-steepening as investors begin to shed lower-yielding assets for riskier ones. The curve steepening reflects a reversal of the safe-haven trade we saw in August that drove the U.S. yield curve into inversion, a common predictor of a recession. Although consensus is not calling for a full-blown reflation trade at this stage of the cycle, investors' appetite for sectors that benefit from higher rates, like financials, has increased alongside inflation protected securities. Further improvement in sentiment and growth could lead to a continued repricing higher of inflation and rate expectations.

Show Me the Earnings!

After 2018's tumultuous close to the year, U.S. stocks didn't look back throughout 2019, with the S&P 500 Index closing near record levels, up more than 31%, although up just 12% annually over the past two years. Stocks found support from improving trade negotiations and the Federal Reserve's success in engineering a "mid-cycle adjustment." Strong performance and flat earnings growth pushed the price-to-earnings multiple for the S&P from 14.4 to 18.2 over the year. As we move into 2020, markets will be challenged to keep the momentum given the higher valuation starting point, without seeing earnings growth materialize.

FIG. 1: U.S. vs. Global Ex-U.S. Equity Market Returns
December 31, 2009, to December 31, 2019
Figures Are in USD

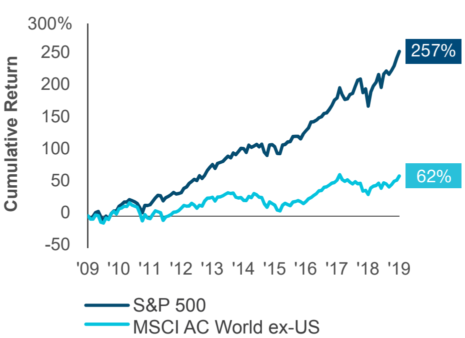
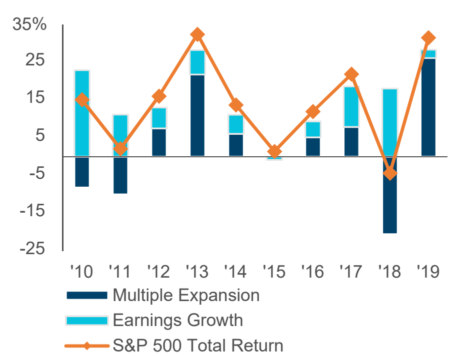


FIG. 2: U.S. Treasury Yield Curve Slope
Difference Between 10-Yr. and 2-Yr. Yield
June 30, 2018, to December 31, 2019

FIG. 3: S&P 500 Return Drivers
Earnings Growth vs. Multiple Expansion
December 31, 2009, to December 31, 2019



Past performance is not a reliable indicator of future performance.

Sources: Standard & Poor's, MSCI, Bloomberg Finance L.P. (see Additional Disclosures), and financial data and analytics provider FactSet.

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REGIONAL BACKDROP

As of December 31, 2019

Developed Europe

Positives

- Monetary policy remains very accommodative
- Indirect beneficiary of China stimulus
- Services sector of the economy resilient
- Dividend yields remain strong
- Political uncertainty waning

Negatives

- Economic growth is challenged, with notable weakness in the manufacturing sector
- Limited scope for European Central Bank (ECB) to stimulate further
- Export weakness, vulnerable to trade and China growth
- Banking sector remains weak

United Kingdom

Positives

- Wage growth remains positive despite continued uncertainty over Brexit
- Services purchasing managers’ index (PMI) begins recovery due to reduction of Brexit phase one uncertainty
- 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

Negatives

- Rise in uncertainty about comprehensive trade deal (phase two) by December 2020
- Sterling will continue to make hard yards
- PMI data continue to suggest sluggish business activity

United States

Positives

- Fed likely on hold, inflation low
- Growth expected to stabilize
- Healthy consumer spending, strong employment, and improving wages
- Lower interest rates driving a modest rebound in housing
- Pause in trade war escalation
- Greater share of secularly advantaged companies (e.g., cloud computing, internet retail) than rest of the world

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

	Positives	Negatives
Japan	▪ Economic data should improve amid global recovery and following disruptions from value-added tax hike and typhoons ▪ Large fiscal stimulus announced in December should be additive to growth in 2020 and relieve some pressure from the Bank of Japan ▪ Japanese stocks remain attractive from a valuation perspective. Earnings momentum is finally improving	▪ Topline growth and earnings are subdued relative to global peers ▪ Consumer and business confidence indices remain weak ▪ A U-turn in expectations regarding the next move from the Bank of Japan is pushing yields and potentially the Japanese yen higher
Asia ex-Japan	▪ Chinese economic data are showing signs of improvement amid global recovery and resolution of phase one trade deal with U.S. ▪ Policymakers downplayed deleveraging and overcapacity issues while calling for more infrastructure spending and housing market support in annual planning meetings ▪ The Australian economy is expected to improve on the back of a rebound in housing and commodity prices ▪ The Australian dollar could modestly appreciate, reinforcing investors' sentiment toward growth assets	▪ Chinese macro policies are intended to stop downward trajectory in growth, not to revive it. The focus is on quality growth, so expectations for additional stimulus should remain measured ▪ Consumer spending has been weaker than expected amid a spike in food inflation. Car sales data and housing prices could signal future trends ▪ Beware of overly optimistic expectations already being priced in for the Reserve Bank of Australia ▪ Rebound in housing market is not yet filtering through to consumer spending due to high consumer leverage and job market concerns
Emerging Markets	▪ Muted (but rising) inflation, dovish Fed has given central banks flexibility to ease ▪ Easing trade tensions ▪ Equity valuations attractive relative to developed markets ▪ With growing importance of tech sector, less tied to commodity cycle	▪ Instability in several key markets could weigh on sentiment ▪ Long-term China growth trajectory remains a headwind ▪ China stimulus more measured and domestically focused ▪ Commodity prices remain under pressure

Underweight — *Neutral* — *Overweight*

▼ or ▲ Month-Over-Month Change

		Change	Underweight		Neutral		Overweight	**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 CLASSES	Equities	▲				■		Above-average valuations with improving global growth sentiment and higher earnings expectations.
	Bonds	▼		■				Yields off recent lows on improving growth and inflation expectations, yet valuations remain extended. Credit spreads remain tight, with fundamentals broadly supportive.
	Cash				■			U.S. cash yields less attractive post-Fed easing but remain higher than other developed markets.
	Regions							
EQUITIES	U.S.			■				Valuations extended with margins under pressure; however, earnings expected to recover amid improving growth outlook.
	Europe	▲				■		Growth outlook stabilizing, but German manufacturing and banking system remain concerns. ECB continues to be supportive.
	UK				■			Valuations attractive relative to the U.S., but uncertainty due to Brexit is likely to remain elevated as long as the UK and the EU negotiate their future relationship.
	Japan	▲				■		Monetary and fiscal policy supportive; export dependency and yen remain key drivers.
	Developed Asia ex-Japan			■				Valuations are still attractive relative to the U.S. While China stimulus measures may flow through to the broader region, the ongoing trade dispute between the U.S. and China weighs on the region.
	Emerging Markets (EM)					■		Fed on hold, cheap currencies, and China stimulus supportive; improving trade and growth outlook could provide tailwind.
	Style							
	Global Equity Growth	▲				■		Valuations extended as sector has benefited from defensive characteristics. Improving growth could prove less favorable for higher-quality sectors.
	Global Equity Value	▼		■				Valuations attractive with cyclical orientation and financials exposure likely to benefit from improving growth and higher rates.
	Capitalization							
	Global Equity Large-Cap	▼		■				Central banks, stabilizing growth, and improved trade outlook supportive.
	Global Equity Small-Cap	▲				■		Improving domestic growth trends and waning political uncertainty could provide support.

▼ or ▲ Month-Over-Month Change

		Change	Underweight	Underweight	Neutral	Overweight	Overweight	These views are informed by a subjective assessment of the relative attractiveness of asset classes and subclasses over a 6- to 18-month horizon.
BONDS	U.S. Investment Grade (IG)			■				Yields higher on growth improvement, but upside limited amid still-low inflation. IG corporate spreads remain tight relative to history.
BONDS	European Investment Grade					■		Historically low yields continue to be underpinned by a dovish ECB. Credit remains trapped between tight valuations, weakening credit fundamentals, and ever looser monetary policy.
BONDS	UK Investment Grade				■			Yields are near all-time lows amid weakening growth and modest inflation. While no-deal Brexit risk has been replaced by election uncertainty, the base case is for an orderly exit from the EU.
BONDS	Inflation Linked				■			Inflation expectations rebounding from low levels amid improving growth sentiment.
BONDS	Global High Yield					■		Yield carry attractive with near-term default expectations low. Vigilant on late-stage risks of credit cycle.
BONDS	Floating Rate Loans					■		Yields remain attractive with limited new issuance and lower duration profile supportive.
BONDS	EM Dollar Sovereigns					■		Yields remain attractive, with central banks supportive; idiosyncratic/political risks remain sources of uncertainty.
BONDS	EM Local Currency					■		EM currency valuation remains attractive; improving growth and a weaker U.S. dollar could provide tailwinds.
BONDS	EM Corporates					■		Yields are attractive relative to fundamentals. Rising country-specific risks are concerning but unlikely to become systemic.
CURRENCIES	U.S. Dollar			■				The U.S. dollar weakened notably into year-end. While positioning has moved against the dollar, this should not prevent the currency from falling further.
CURRENCIES	Euro					■		Recent data flow in Europe supports our view that growth appears to have floor and recent PMI and industrial production prints are supportive of this nascent trend.
CURRENCIES	UK Sterling	▲				■		With UK electoral uncertainty now gone, we are more willing to give British pound outperformance a chance given extremely attractive valuations.
CURRENCIES	Japanese Yen				■			The yen has remained largely range-bound into the end of 2019. We expect the yen trend to tilt modestly weaker over time.

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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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