

Global Asset Allocation: The View From Europe

May 2024

1 Market Perspective



- The global growth outlook remains positive against a backdrop of gradually easing inflationary pressures across most economies.
- US growth continues to be resilient, buoyed by a strong consumer, while optimism around European growth is building. Japanese growth remains challenged, and in China, there are signs that policy support is helping stabilise the economy, although risks remain.
- The US Fed is still looking towards rate cuts this year, but sticky inflation and resiliency in the economy have tempered expectations. Meanwhile, the European Central Bank (ECB) appears closer to easing given progress with inflation. After hiking in March, the Bank of Japan (BoJ) continues to assess further hikes. The Bank of England (BoE) indicated that it could ease policy as soon as June.
- Key risks to global markets include a retrenchment in growth, stubborn inflation, volatility surrounding central banks' policy divergence, geopolitical tensions and the trajectory of Chinese growth.

2 Portfolio Positioning

As of 30 April 2024



- We remain modestly overweight equities, supported by resilient economic growth, positive earnings trends and areas with more reasonable valuations.
- Within equity, we reduced the underweight to Europe because it seems the worst is behind the region in terms of economic growth and inflation. We increased the overweight to Japan due to continued improvements in corporate governance, the BoJ remaining accommodative and the weak yen supporting exporters.
- Within fixed income, we reduced the allocation to inflation-linked bonds because inflation is expected to ease further. We neutralised the allocation to Euro investment grade corporates because of more attractive opportunities elsewhere in fixed income.
- Additionally, across fixed income, we remain overweight high yield and emerging markets bonds on still attractive absolute yield levels and reasonably supportive fundamentals.

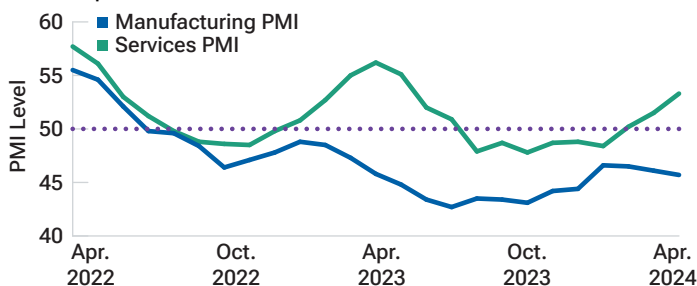
3 Market Themes

Green Shoots?

Economic growth in Europe is showing signs of life after several years of teetering near recessionary levels, with better-than-expected first-quarter GDP growth, largely driven by a services-led revival. Muted foreign demand especially from China, fears around a natural gas shortage and decades-high inflation had all weighed on European sentiment in recent years. But the tide appears to be turning on the back of a milder-than-expected winter and falling inflation, increasing the odds for an upcoming rate cut by the ECB in June. This has given way to an uptick in consumer spending and provided a boost to Europe's tourism and hospitality sectors—notably coming from countries such as Spain, Portugal and Greece. However, it's Europe's manufacturing powerhouse, Germany, that continues to struggle given its dependence on exports to China and consequences of having relied on Russian energy, with no quick fix on the horizon. For now, positive sentiment on the heels of better-than-expected growth, lower inflation and hopes for near-term rate cuts may draw investors' attention, but questions remain whether these green shoots will lead to a broader and more sustainable recovery.

Eurozone: All About Services as Manufacturing Lags

As of 30 April 2024



Past performance is not a reliable indicator of future performance.

Source: Bloomberg Finance L.P.

¹ Data are represented by the US Dollar Index (DXY).

The Almighty Dollar

Despite multiple calls for the end of the US dollar's dominance over recent years, it remains near all-time highs and has strengthened against every major currency in the world so far this year. Its most recent push higher has stemmed from resilient growth in the US sustained in part by elevated fiscal spending along with sticky inflation, causing a shift to less aggressive Fed rate cut expectations. Meanwhile, many other countries have seen a faster decline in inflation, which has put downward pressure on their currencies versus the dollar on expectations that their central banks move sooner on rate cuts. The strong dollar has many countries seeing their currencies falling to multi-decade relative lows, with talk of intervention, as in the case of Japan struggling with a slumping yen. While a weaker currency has aided many of these countries' exporters, it comes with other consequences, including capital competition versus higher-yielding markets such as the US, import inflation and raising dollar-denominated borrowing costs for countries that are funding in US dollars. With the Fed expected to move slower on rate cuts, US growth remaining resilient, a packed election calendar and a still unsettled geopolitical environment, it's hard to see what breaks the buck before it may break something else.

US Dollar: Holding Its Strength¹

As of 30 April 2024





REGIONAL BACKDROP



Positives

Negatives

Europe

U

- Inflation has been steadily declining
- ECB is expected to cut rates soon
- Economy is gradually improving
- Inflation is moderating

- Monetary policy is restrictive
- Economic growth remains weak
- Geopolitical uncertainty is heightened

United Kingdom

N

- Inflation has been steadily declining
- Bank of England is likely to cut rates this year
- Labour market has been resilient

- Fiscal consolidation may need to be accelerated
- Tight labour markets could keep wage inflation elevated

United States

O

- Earnings expectations are increasing
- Consumer spending remains strong
- Labour market has been very resilient

- Progress on inflation has stalled
- Stock valuations have become challenging
- Lagged effects of monetary policy remain a risk
- Political uncertainty is heightened

Japan

O

- Economy welcomes inflation after decades fighting deflation
- Corporate governance continues to gradually improve
- BoJ remains more accommodative
- Yen weakness is a tailwind for export businesses

- Expectations are high, raising the bar for upside surprises
- Yen weakness and rising inflation could raise pressure on the BoJ to hike

Asia Pacific ex-Japan

N

- Macro data in China are marginally improving
- China investment flows are turning positive, seconded by attractive valuations
- In Australia, government support to the economy continues to be a net positive. However, Australia consumer spending shows early signs of weakening on the back of a weaker job market

- Prolonged China deflation is a concern
- China property market issues are dampening consumer confidence and retail sales
- Australia consumer spending shows early signs of weakening on the back of a weaker job market

Emerging Markets (EM)

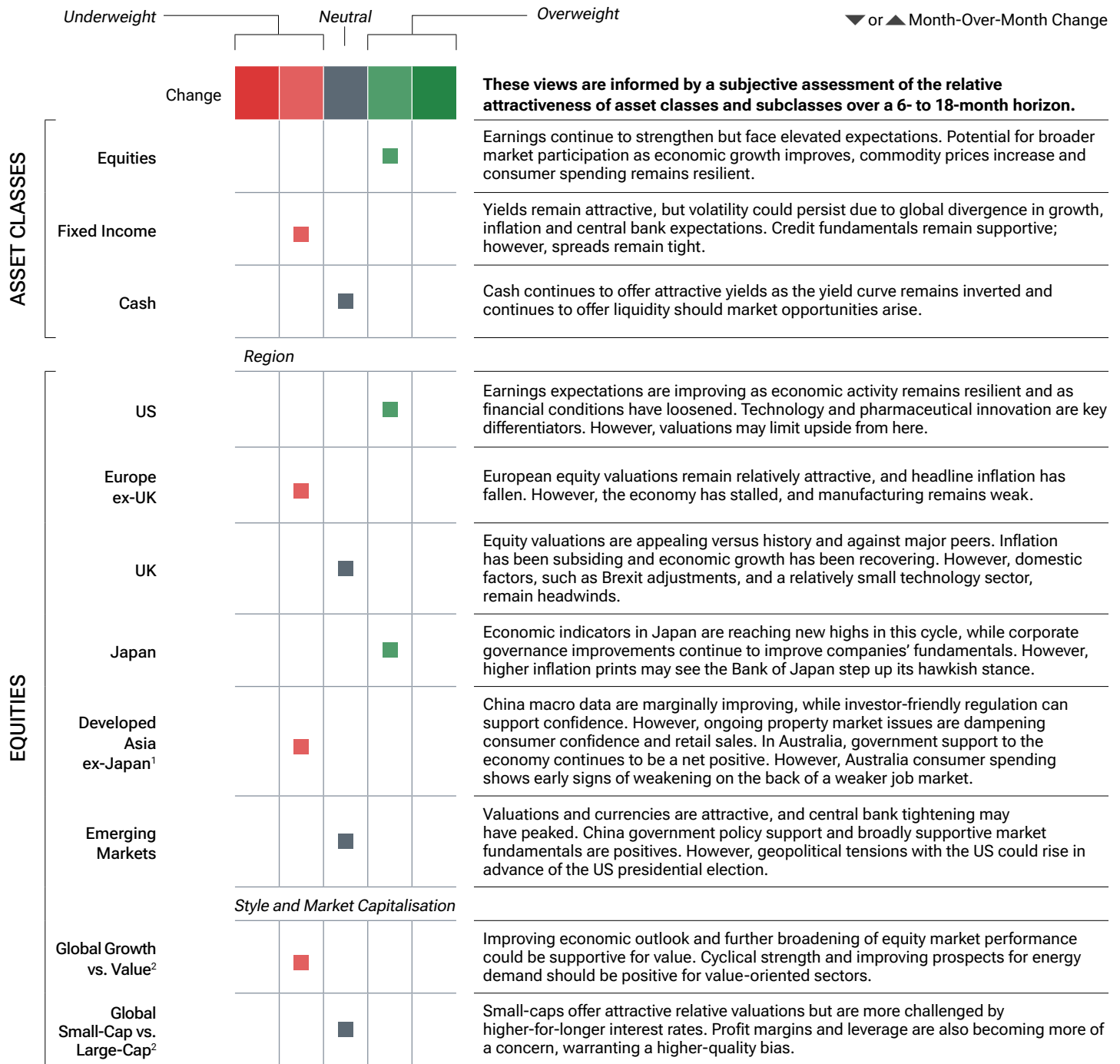
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- Equity valuations are attractive relative to the US
- Chinese economy is incrementally improving
- Investment flows are positive
- Regulatory concerns are easing

- Chinese property deleveraging continues to weigh on activity
- Chinese consumer and business confidence are fragile
- Meaningful fiscal stimulus measures appear unlikely

U Underweight **N** Neutral **O** Overweight

Views are informed by the Asset Allocation Committee and regional investment committees (United Kingdom, Europe, Australia, Japan and Asia) and reflect the equity market.



Past performance is not a reliable indicator of future performance.

¹ Includes Australia.

² For pairwise decisions in style and market capitalisation, positioning within boxes represents 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 and market capitalisation asset classes are represented as pairwise decisions as part of our tactical asset allocation framework.



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The specific securities identified and described are for informational purposes only and do not represent recommendations.



EUROPEAN INVESTMENT COMMITTEE



Elias Chrysostomou
Associate Portfolio Manager, Equity Division



Andrew Keirle
Portfolio Manager, Emerging Markets Local Currency Bonds



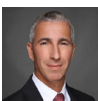
Yoram Lustig
Head of Multi-Asset Solutions, EMEA



Tobias Mueller
Portfolio Manager, Equity Division



Ken Orchard
Head of International Fixed Income



David Stanley
Portfolio Manager, European Corporate Bonds



Toby Thompson
Portfolio Manager, Multi-Asset Division



Michael Walsh
Portfolio Manager, Multi-Asset Division



Tomasz Wieladek
International Economist

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