

Global Asset Allocation: The View From the UK

June 2024

1 Market Perspective



- Global growth outlook remains positive against a backdrop of gradually easing inflationary pressures across most economies.
- While resilient, recent evidence suggests some cooling in US growth. European growth is stabilising, helped by services, with manufacturing still a laggard. Japanese growth remains stagnant, while Chinese growth shows signs of improvement supported by recent stimulus measures. UK growth has stalled in April following the expansion in the first quarter.
- US Fed rate cuts look to be still in play later this year, with recent signs of moderating growth and inflation. The European Central Bank (ECB) has taken the lead on cuts amongst major central banks, reducing its deposit rate by 25 basis points to 3.75% as expected, but stopping short of indicating that more cuts could follow. After hiking in March, the Bank of Japan (BoJ) is still expected to take additional steps towards tightening. The Bank of England (BoE) is expected to keep rates where they are for a while longer.
- Key risks to global markets include a steeper decline in growth, stubborn inflation, central bank policy divergence, election calendar, geopolitical tensions and trajectory of Chinese growth.

2 Portfolio Positioning

As of 31 May 2024



- We remain modestly overweight equities, supported by a still resilient economic backdrop, positive earnings trends and reasonable valuations beyond heavily concentrated areas of the market.
- We moved to an overweight to cash relative to bonds. Cash provides liquidity and attractive yields with the BoE expected to keep rates at current levels for a while longer.
- Within equities, we are overweight US, with a preference to US large cap value that can benefit from more attractive valuations and potential for cyclical tailwinds. While we remain underweight Europe, we reduced the underweight. Valuations are relatively attractive and economic activity seems to have bottomed, but a further catalyst may be needed to boost relative performance. We remain overweight Japan and neutral emerging markets (EM) and the UK. The upcoming UK election in July may increase market volatility.
- Within fixed income, we continue to favour higher-yielding sectors, including global high yield and EM bonds, as fundamentals remain broadly supportive. However, we trimmed the overweights to these areas in favour of cash because of tight credit spreads and to reduce overall portfolio risk.

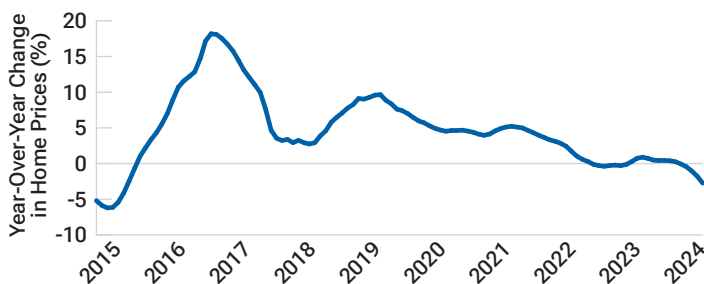
3 Market Themes

Home Improvement

In their latest measures to stabilise the economy, Chinese policymakers took further steps targeted at improving sentiment within the country's challenged housing sector. These measures included reducing downpayment requirements, lowering the floor on mortgage rates and providing low-cost funding to help state-owned enterprises buy unsold homes. Hopes are for these measures to restore some confidence in the housing market, which has continued to see price declines amid outsized supply. On a positive note, economic growth did surprise to the upside in the first quarter, expanding by 5.3%. However, much of the growth was driven by exports and infrastructure spending, while hopes for a rebound in consumption and business spending continue to be held back by housing market woes. While recent measures to expand the Chinese economy into higher value-add sectors, including electric vehicles and semiconductors, will help diversify their economy in the long run, the property sector will likely need a much larger renovation before it turns around.

Hoping to Build Back Confidence in China's Housing Market¹

As of 30 April 2024



¹ Source: Bloomberg Finance L.P. Chart represents year-over-year changes in commercial residential property prices, based on the average of the price change in each city in the National Bureau of Statistics 70 City Index.

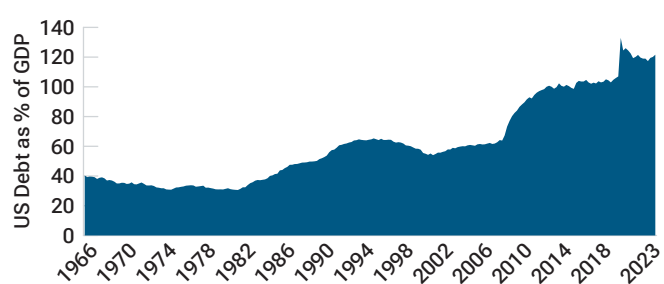
² Source: St. Louis Fed. Most recent data available.

Big Spenders

While the Fed's battle with inflation has been the leading driver in the direction of yields, the move higher over recent weeks was attributed to weaker Treasury auction demand as buyers became wary of even more supply ahead. With the US election looming in the back half of the year, few are expecting either political party to significantly reduce spending or address US debt, now above 120% of gross domestic product (GDP). The unbridled spending has been flagged by the ratings agencies and is causing investors, particularly foreign investors, to demand higher yields to compensate for the risk of more supply. While some argue the big spending in Washington is growth supportive and nothing to worry about, its spillover effects on the private sector can crowd out demand and raise everyone's cost of borrowing. So for those hoping for lower rates ahead as the Fed finally reins in inflation, it could be the Washington big spenders that end up keeping rates higher for much longer.

Spend Now, Pay Later?²

As of 1 October 2023





REGIONAL BACKDROP



Positives

Negatives

United Kingdom

N

- Monetary policy expected to ease
- Inflation has been steadily declining
- Labour market has been resilient

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

Europe

U

- Monetary policy is expected to ease further
- Inflation has been steadily declining
- Economic sentiment is improving

- Economic growth remains weak
- Geopolitical uncertainty is heightened
- Earnings growth remains weak, with minimal tailwinds from innovative technologies

United States

O

- Labour market has been resilient
- Strong corporate earnings driven by artificial intelligence (AI) spending
- Wage growth is moderating to sustainable levels

- Stock valuations have become challenging
- Inflation remains sticky
- Economic data have been surprising to the downside
- Political uncertainty is heightened

Japan

O

- Economic growth is improving
- Corporate governance continues to gradually improve
- BoJ remains more accommodative
- Yen weakness is a tailwind for export businesses

- Sentiment may have peaked
- BoJ may become more hawkish due to higher inflation prints
- Yen weakness creates volatility and uncertainty for domestically oriented businesses

Asia Pacific ex-Japan

N

- Macro data in China are marginally improving
- Sentiment is turning more positive, albeit from depressed levels
- In Australia, government support to the economy is a net positive. The housing market and rebounding commodity prices support the wealth effect

- Prolonged China deflation remains a concern
- China property market issues are dampening consumer confidence and activity
- Australia consumer spending shows signs of weakening on the back of a weaker job market
- The Reserve Bank of Australia (RBA) could pivot to a more hawkish tone given sticky inflation

Emerging Markets

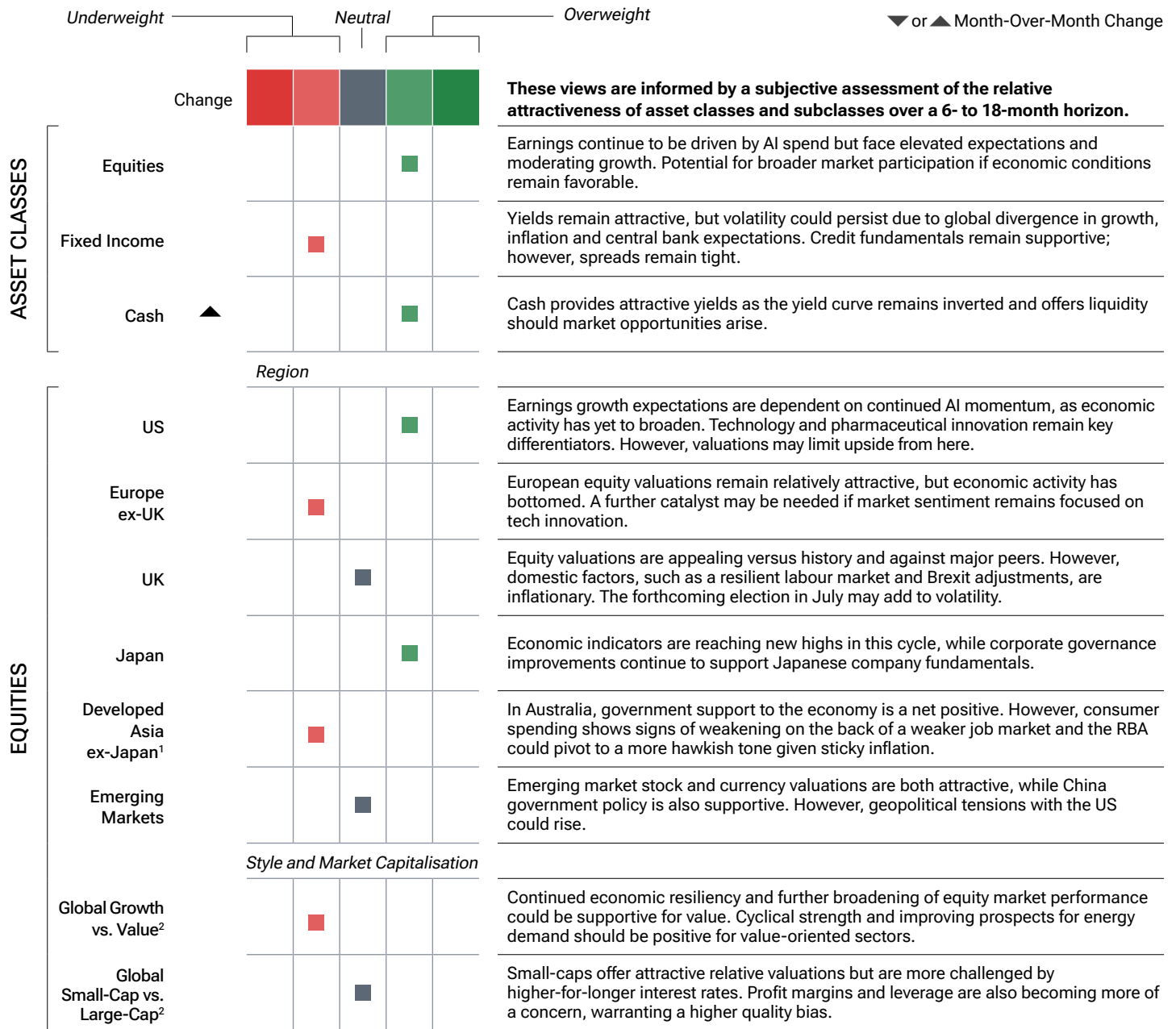
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- Macro data and sentiment are marginally improving
- Equity valuations are attractive relative to the US
- Regulatory concerns are easing

- 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.



UK INVESTMENT COMMITTEE POSITIONING

As of 31 May 2024

		Underweight	Neutral		Overweight	▼ or ▲ Month-Over-Month Change	
Change		Red	Light Red	Grey	Light Green	Dark Green	
FIXED INCOME	UK Gilts		■				Recovering economic activity, persistent services inflation, accelerating quantitative tightening, large gilt issuance and US spillovers may contrive to keep the long-term gilt yields under pressure.
	UK Inflation Linked			■			Inflation indicators (services, core goods) are trending higher, although the UK labour market has eased a little. The BoE's inclination is to cut rates, but we may have to wait a bit longer.
	UK Investment-Grade (IG) Corporates			■			Investment grade credit is looking less attractive in terms of valuations, given the tight nature of spreads.
	US IG Aggregate		■				Stubborn inflation and a resilient economy could see the Fed keeping rates higher for longer than the market expects. Meanwhile, investment grade spreads remain tight.
	European IG Aggregate		■				Expectation of higher global rates and dynamics of quantitative tightening may weigh on European rates. Credit spreads could widen if the economy slows down.
	Global High Yield				■		Attractive absolute yield levels remain supportive, but spread compression is limited from here. Default rates are likely to rise to historical long-term averages, although much appears to be priced in.
	EM Dollar Sovereigns				■		Yields look modestly attractive. With central banks embarking on easing cycles and inflation continuing to moderate, EM bonds may benefit.
	EM Local Currency				■		Central bank easing and lower inflation could be tailwinds, but a higher-for-longer Fed could sustain dollar strength.
	EM Corporates			■			We currently prefer to overweight emerging market sovereigns rather than corporates as credit spreads may widen as the global economy slows.
CURRENCIES	GBP vs. USD				■		In a benign market environment, the US dollar may soften, particularly from current expensive levels.
	GBP vs. EUR				■		After the ECB cut rates in June, the interest rate differential in favour of the GBP has widened.
	GBP vs. JPY				■		Following March's increase, the BoJ is unlikely to make any further interest rate moves in the near term. Interest rate differentials do not favour the yen.

Past performance is not a reliable indicator of future performance.

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



UK 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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