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GLOBAL ASSET ALLOCATION: THE VIEW FROM EMEA

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MARKET INSIGHTS

As of June 30, 2020

Double Dip?

With the coronavirus largely contained across Europe and Asia and some parts of the U.S., there is a sense that the worst of the pandemic may be behind us. As the global economy continues to reopen, many are still hopeful of a V-shaped economic recovery, as economic data such as purchasing managers' indices are showing signs of life. Aggressive monetary and fiscal support, improved liquidity conditions, and lack of inflation provide a supportive backdrop for the rebound in economic activity. However, the recent uptick in infections in parts of the U.S. has raised fears that economic activity could once again be derailed. If these outbreaks fail to be contained and another round of lockdowns is enacted, it would deal a terrible blow to an economy already facing a severe contraction. A second wave could further paralyze business investment and consumer behavior—turning hopes for a V-shaped recovery into hopes for a W.

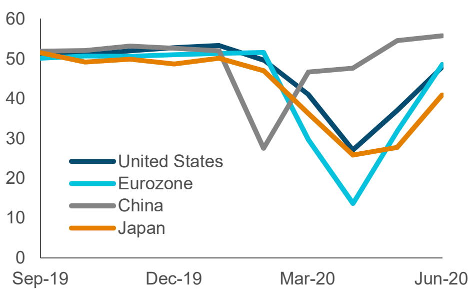
Fueling the Rally

Oil prices have continued to rebound from lows reached in late April, trending near USD 40 per barrel, yet still below pre-crisis levels. Amid the virus-related shutdowns, global demand for oil was down nearly 30% year over year as economic activity worldwide was brought to a halt. At the same time, tensions flared between Russia and OPEC+ regarding market share, resulting in increased supply and further downward pressure on prices. As stay-at-home restrictions have eased across the globe and supply remains constrained, oil prices have rebounded. However, if a second wave of the coronavirus ends the rally in oil prices, hopes for a quick recovery in the energy sector could be dashed as we are already seeing rising bankruptcies and energy-exporting economies facing severe fiscal pressures.

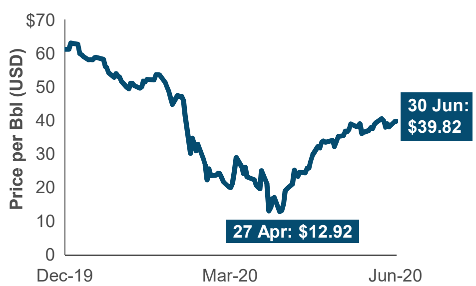
The Buck Stops Here?

The U.S. dollar (USD), a traditional safe-haven currency, has been volatile as it weighs evidence of improving global economic data against a resurgence in coronavirus infections. Over the past quarter, the U.S. Dollar Index has fallen by almost 3% amid the global risk-on environment sparked by economic reopenings across the globe. However, there is no shortage of risks that could cause the USD's recent downtrend to reverse course. Evidence of a second wave of the coronavirus growing, uncertainty surrounding the upcoming U.S. presidential election, and resurfacing tensions with China could send investors flocking back to the USD. But for now, a weaker dollar could be a respite for emerging market economies and their currencies as they struggle with the impacts of the global pandemic.

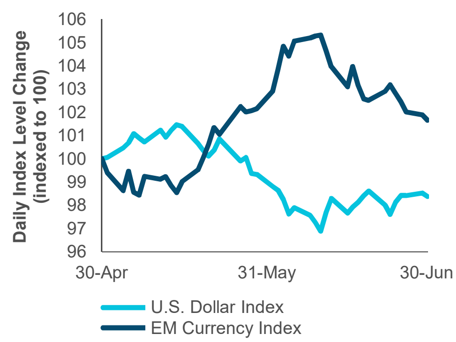
Composite Purchasing Managers' Index
Fig. 1: As of 30 June, 2020



WTI Oil Price
Fig. 2: As of 30 June, 2020



U.S. Dollar Versus EM Currencies[1]
Fig. 3: As of 30 June, 2020



Past performance is not a reliable indicator of future performance.

Sources: FactSet. Financial data and analytics provider FactSet. Copyright 2020 FactSet. All Rights Reserved. J.P. Morgan Chase & Co. (see Additional Disclosures).

[1]EM Currency Index is represented by J.P. Morgan EM Currency Index.

Europe

Positives

- Virus containment and reopening strategies have been largely successful
- Long-awaited fiscal stimulus is coming
- Monetary policy remains very accommodative
- Equity valuations are inexpensive

Negatives

- Weak economic growth going into crisis
- Limited scope for European Central Bank (ECB) to stimulate further
- Lower share of secularly advantaged companies
- Banking sector was weak going into the crisis

United Kingdom

Positives

- Generous furlough scheme, keeping employees ready to go, will support economic rebound and social stability
- The trade balance deficit remains in a range that can be sustained by the net excess returns on the UK's external balance sheet
- A long lockdown will lead to a very large government deficit of 17% to 20%, but aggressive quantitative easing should keep a lid on yields

Negatives

- Lockdown easing raises risks of a second wave of the coronavirus
- Sterling will likely continue to make hard yards
- Weaker global activity to provide additional headwinds to UK economy
- Perception of year-end Brexit risks to weigh on asset prices

United States

Positives

- Unprecedented levels of monetary and fiscal support
- Healthy consumer balance sheets prior to the crisis
- Health care infrastructure is stronger than most regions
- Greater share of secularly advantaged companies (e.g., cloud computing, internet retail) than rest of the world

Negatives

- Size of country, freedom of movement, and inconsistent policies mean there is higher potential for continued outbreaks
- Heightened political tensions
- Elevated corporate leverage going into the crisis
- Margins under pressure going into the crisis
- Elevated government debt levels

Japan

Positives

- Fiscal stimulus and accommodative monetary stance provide a solid backdrop for an economic rebound
- Economic data should finally show signs of life from dismal levels after coronavirus control measures were lifted and as economy progressively reopens
- Japanese stocks have been relatively cheap and carry cash on the balance sheet. They offer optionality to the global economic recovery

Negatives

- A broad deterioration in employment data is clouding the rebound in consumer spending
- Japanese stocks already outperformed their peers since the market trough in March, boosted by foreign flows
- The yen could appreciate if risk aversion spikes up again, reducing companies' competitiveness and profitability

Asia Pacific ex-Japan

Positives

- High-frequency data suggest that economic activity in China has returned to pre-crisis levels, while official data have surprised on the upside
- China's policy measures remain targeted and measured in size. Employment and livelihood have replaced growth and investment as economic goals this year
- Policy measures from the Australian government and the Reserve Bank of Australia were deployed quickly and aggressively
- Australian consumer spending could surprise on the upside given high savings rate and pent-up demand, especially as consumers appear eager to move forward from crisis

Negatives

- Geopolitical tensions on multiple fronts could dampen foreign sentiment toward Chinese investment
- Leading Chinese indicators for exports have been weak, creating job uncertainties and disinflationary pressures
- Containing the coronavirus in Australia has proven to be more challenging, suggesting that local lockdowns and social distancing could continue longer than expected
- Some Australian stimulus measures are due to end in September; there are risks to the downside if they are not extended further

Emerging Markets

Positives

- Younger population likely to be less affected by virus
- Dovish Fed has given central banks flexibility to ease
- USD strength has eased
- Demand from China has largely rebounded
- Equity valuations attractive relative to developed markets

Negatives

- Weak health care infrastructure in many regions
- Limited ability to enact fiscal stimulus (excluding China)
- Trade tensions have been reignited
- Highly sensitive to global industrial production and trade trends
- Commodity prices under pressure

ASSET ALLOCATION COMMITTEE POSITIONING

Underweight — *Neutral* — *Overweight*

▼ or ▲ Month-Over-Month 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		
ASSET CLASSES	Equities	▼			■			Limited upside to equities as market has outpaced still uncertain economic recovery. Fiscal and monetary stimulus are key supports, as earnings outlook remains clouded.
	Bonds	▲			■			Yields near record lows despite risk rally. Credit remains attractive as spreads have narrowed amid liquidity stabilization and monetary/fiscal support while digesting increased supply.
	Cash					■		U.S. cash yields anchored at low levels by Fed but remain attractive versus other developed markets at or below zero levels.
	Regions							
EQUITIES	U.S.				■			Heavily defensive sector profile supportive despite extended valuations. Fiscal and monetary stimulus providing backstop, while earnings recovery timetable remains uncertain.
	Europe				■			Regional economies benefiting from successful reopening; however, long-term outlook remains challenged. Monetary and fiscal stimulus remain supportive.
	UK				■			After heavy sell-off, price level is compelling. The UK continues to be heavily impacted by the virus. Bank of England and fiscal stimulus are supportive. Brexit uncertainty remains.
	Japan				■			Fiscal and monetary stimulus could provide a solid backdrop for economic recovery. Remains highly sensitive to trade, and yen could strengthen if global risk aversion spikes again.
	Developed Asia ex-Japan*				■			Valuations are attractive relative to the U.S. Chinese stimulus and successful containment of virus are supportive. Tourism and export- and commodity-driven economies face challenges.
	Emerging Markets (EM)					■		China stabilization and weaker USD supportive for EM broadly. However, unable to provide the same level of stimulus as developed markets.
	Style							
	Global Equity Growth					■		Valuations of growth-oriented equities remain extended as pandemic has accelerated secular growth trends in key industries. Sector benefits from less sensitivity to macro environment.
	Global Equity Value			■				Cyclically oriented equities hit hardest amid sell-off, leaving valuations more attractive should economic growth stabilize over the near term.
	Capitalization							
	Global Equity Large-Cap			■				Larger companies better positioned to weather economic downturn but offer limited upside due to full valuations. Remain vulnerable to global supply chain disruption.
	Global Equity Small-Cap					■		Vulnerable area due to high debt levels, but small-caps offer significant upside potential and have typically outperformed during economic recovery periods.

* Includes Australia

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As of June 30, 2020

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BONDS							
U.S. Investment Grade			■				Despite risk-on environment, Treasury yields remain anchored at low levels amid low inflation expectations. Caution warranted on credit fundamentals amid weak earnings trends.
European Investment Grade					■		The ECB's recent decision to expand the Pandemic Emergency Purchasing Programme shows it is willing to further support the eurozone's recovery.
UK Investment Grade					■		Market technicals remain supportive, but there are still plenty of uncertainties around corporate fundamentals given the size of the economic shock.
Inflation Linked				■			Inflation expectations remain low amid slightly improving growth outlook. Central banks remain supportive, but longer-term downward pressures on inflation persist.
Global High Yield					■		Credit spreads remain at attractive levels. Cautious on downgrade/default risks. Impacts of virus outbreak could weigh on consumer-related and energy sectors.
Floating Rate Loans					■		Yield spreads remain attractive, although Fed anchored at zero rate level. Relative to high yield bonds, less exposure to energy sector and higher in capital structure.
EM Dollar Sovereigns					■		Relative valuations attractive versus history. Select opportunities among distressed areas.
EM Local Currency					■		EM currency valuation remains attractive; developed market central banks and reversal in USD strength supportive.
EM Corporates					■		Country-specific risks are elevated, but several cheap assets are not as vulnerable as prices reflect and represent attractive opportunities.
CURRENCIES							
U.S. Dollar			■				Valuations are expensive, interest rate differentials are no longer supportive, and concerns over the coronavirus are growing. Political risks remain high.
Euro					■		We see ongoing improvement in the eurozone economy on the back of proactive fiscal policy at the country- and EU-wide level. Coronavirus infection rates remain low.
UK Sterling				■			Progress on dealing with the coronavirus threats, and the pace of unwinding the lockdown, should determine the attractiveness of the pound over the second half.
Japanese Yen				■			Interest rate differentials imply a stronger yen, but stronger global growth implies the currency will weaken.

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