PORTFOLIO INSIGHTS

Global Asset Allocation Views

Themes and implications from the Multi-Asset Solutions Strategy Summit

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ASSET CLASS VIEWS (PAGE 3)

Max negative ● ● ● Neutral ● Max positive ● ● ●

Asset class		Opportunity set	Change	Negative			Neutral	Positive		
MAIN ASSET CLASSES		Equities/bonds	▼	○	○	●	○	○	○	○
		Duration		○	○	○	○	●	○	○
		Credit		○	○	○	●	○	○	○
		Commodities		○	○	○	●	○	○	○
		Real estate		○	○	○	●	○	○	○
		Cash	▲	○	○	○	○	●	○	○
PREFERENCE BY ASSET CLASS	EQUITIES	U.S. large cap		○	○	○	○	●	○	○
		U.S. small cap	▼	○	○	○	●	○	○	○
		Europe ex-UK	▼	○	●	●	○	○	○	○
		UK		○	○	○	●	○	○	○
		Japan	▼	○	○	○	●	○	○	○
		Asia Pacific ex-Japan		○	○	○	●	○	○	○
		Emerging markets	▼	○	○	●	○	○	○	○
	REAL ESTATE	Direct real estate		○	○	○	●	○	○	○
		U.S. REITs		○	○	○	●	○	○	○
	SOVEREIGN FIXED INCOME	U.S. Treasuries		○	○	○	○	●	○	○
		U.S. TIPS	▲	○	○	○	○	●	○	○
		Euro, core (Bund)		○	○	●	○	○	○	○
		Euro, periphery (BTP)		○	○	○	●	○	○	○
		UK Gilts		○	○	○	●	○	○	○
		Japanese JGBs		○	○	○	●	○	○	○
		Canadian gov't bonds	▲	○	○	○	●	○	○	○
		Australian gov't bonds		○	○	○	○	●	○	○
	CREDIT	Investment grade		○	○	●	○	○	○	○
		U.S. high yield		○	○	○	●	○	○	○
		European high yield		○	○	○	●	○	○	○
		Emerging markets debt		○	○	●	○	○	○	○
	FX	USD		○	○	○	●	○	○	○
		EUR	▼	○	○	○	●	○	○	○
		GBP		○	○	○	●	○	○	○
		JPY	▲	○	○	○	○	●	○	○

IN BRIEF

- The economic outlook is reasonable, and the risk of recession in the next 12 months remains quite low; however, global growth reverted to trend more quickly than expected, U.S. monetary policy is tightening, and trade rhetoric is escalating—all of which represent downside risks.
- Slowing economic momentum and tightening policy lead us to de-risk our multi-asset portfolios, most visibly by reducing stock-bond to a small underweight (UW). This continues down a gradual de-risking path that began in the middle of the year.
- Within equities, we still most favor the U.S., least favor eurozone equities and bring emerging market equity to a small UW. We keep our small overweight (OW) to duration, and we raise our cash allocation to OW, specifically for USD cash, where real policy rates are edging to positive territory. We stay neutral on credit but note increased headwinds to fundamentals. This allocation mix is, in our view, appropriate for an environment of slowing earnings growth and rising macroeconomic risks.

IN THE CLOSING WEEKS OF THE YEAR, A SOMBER MOOD HAS GRIPPED MARKETS. January's optimism faded long ago, and now, as investors recalibrate the level of future growth and markets reprice what multiple to put on that growth, risk appetite is under attack from all sides. Earlier in the cycle, we treated such bouts of caution as opportunities to add risk to portfolios. Today, however, the cycle is distinctly mature, with limited capacity to absorb shocks, and financial conditions are tightening inexorably. Most crucially, the hurdle for sustained positive economic surprises, sufficient to reignite the bull market in risky assets, is beyond any reasonable scenario we can paint today.

At present, the objective probability of a recession in the next 12 months remains low, and higher frequency economic data are reasonable. However, the pickup in capex anticipated for the second half of the year hasn't fully materialized, growth is dipping back to trend more quickly than expected, and data outside the U.S. are a mixed bag. In sum, economic momentum is moderating just as U.S. monetary policy is quickly approaching—some would argue is already in—tight territory. Given the shift in the economic environment, the ongoing path of policy tightening and the slowing of earnings growth we expect in 2019, we have chosen to meaningfully de-risk our multi-asset portfolios—most visibly by reducing stock-bond to a small underweight for the first time in nine years.

The decision to de-risk is not a sharp *volte-face*, but continues down a path that began in the middle of the year. The moderation of economic growth back to trend may yet play out benignly. If employment remains robust, the Federal Reserve (Fed) does not overtighten and the trade dispute ends positively, then optimism should eventually return to markets. Even so,

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this case would likely take several months to play out, during which time risk asset markets could well struggle. Moreover, any sign that a benign "soft landing" was under threat would likely weigh on markets. Simply put, the risk-reward calculus has shifted slowly but decisively over the course of 2018.

As global growth rates come back to trend, we expect renewed scrutiny on monetary policy. The Fed has followed a seemingly preordained path of rate hikes for much of 2018, and we expect hikes to continue, quarterly, until mid-2019. Nevertheless, Fed speakers are beginning to lay the groundwork for a shift to data dependency in their rate setting. With other central banks also withdrawing stimulus and increasing rates, Fed data dependency may be cold comfort to investors should growth falter and the market narrative pivot toward a sense that U.S. policy is tight. To be clear, tighter policy doesn't imply looming recession. But in combination with softer growth it makes for a more fragile economic mix in which business, investor and consumer confidence may struggle to withstand negative news flow from issues like trade and geopolitics.

In terms of asset allocation, we reduced stock-bond from a small overweight (OW) to a small underweight (UW), remain neutral on credit but with increasing caution on some sectors and are OW duration and cash—though specifically USD cash. These changes are a continuation of the increasing caution we've voiced over the course of 2018, but we would acknowledge that the decision to move from optimism on equities to a more circumspect stance is a meaningful change.

Within equities, we still favor the U.S. and are skeptical of eurozone stocks. The U.S. has led throughout this cycle and in weak markets this autumn failed to outperform, but we believe the earnings resilience of the U.S. is superior and will be supportive over 2019. By contrast, political woes are simmering once again in Europe, recent earnings seasons were lackluster at best, and valuations aren't cheap enough to be compelling. In our view, the same is true in emerging markets, where slower growth and the higher cost of USD funding both weigh on the earnings outlook; thus we take emerging market (EM) equity to a small UW. In fixed income, there is a stark real yield gap between the U.S. and other regions at all points on the curve, so our cash and duration OWs really distill down to OWs in U.S. cash and Treasuries—where ex-ante Sharpe ratios are now well ahead of those for U.S. stocks for the first time in a decade. Finally, credit continues to offer reasonable carry, but the fundamentals for investment grade (IG) credit have deteriorated; U.S. high yield (HY) is a relative bright spot, but illiquidity risk is an important consideration late in the cycle.

Over most of the last decade, fading dips in sentiment and adding risk on market weakness worked well. We are now more inclined to reduce risk on any bounce in growth expectations or sentiment, since the constellation of factors that might trigger another surge in global growth, while not impossible, are, for the time being at least, implausible.

KEY THEMES AND THEIR IMPLICATIONS

Theme		Macro and asset class implications
GLOBAL THEMES	Global policy divergence	U.S. policy continues to tighten, lending support to USD and U.S. cash; other central banks turning hawkish very gradually
	Supply-side weakness	Wage inflation picking up a little in the U.S., probably keeps Fed on a tightening path leading to flatter U.S. curves
	Widespread technology adoption	Recent weakness in tech stocks mostly an earnings expectations reset, tech innovation and adoption continue to accelerate
DEVELOPED MARKETS THEMES	Maturing U.S. cycle	Policy approaching neutral and growth slowing to trend caps upside in U.S. stocks in absolute but not necessarily relative terms
	Europe in the balance	European growth has slowed back to trend and political risks are increasing; EUR likely supported but equities may still struggle
	Japan beyond Abenomics	Corporate governance improving and BoJ policy remains easy; little scope for further JPY weakness means limited upside for equities
EMERGING MARKETS THEMES	Emerging market convergence	Rising cost of USD funding beginning to weigh on EM momentum; valuations cheap but falling global risk appetite still a headwind
	China in transition	2018 growth data so far solid, but response to the ongoing trade dispute is likely to dominate outlook in early part of 2019

Source: J.P. Morgan Asset Management Multi-Asset Solutions; data as of November 2018. For illustrative purposes only.

Active allocation views

These asset class views apply to a 12- to 18-month horizon. Up/down arrows indicate a positive (▲) or negative (▼) change in view since the prior quarterly Strategy Summit. These views should not be construed as a recommended portfolio. This summary of our individual asset class views indicates strength of conviction and relative preferences across a broad-based range of assets but is independent of portfolio construction considerations.

Max negative ● ● ● Neutral ● Max positive ● ● ●

Asset class	Opportunity set	Change	Negative			Neutral	Positive			Rationale
MAIN ASSET CLASSES	Equities/bonds	▼	○	○	●	○	○	○	○	Global growth reverting to trend more quickly than expected; earnings revisions falling
	Duration		○	○	○	○	●	○	○	U.S. yields close to our estimate of fair value; growth concerns offer further support
	Credit		○	○	○	●	○	○	○	Fundamentals poor in IG, better in HY, but illiquidity risk in late cycle a consideration
	Commodities		○	○	○	●	○	○	○	Supply/demand more balanced in energy for 2019; trade a headwind for base metals
	Real estate		○	○	○	●	○	○	○	Holding up despite late-cycle environment; supply discipline adds support
	Cash	▲	○	○	○	○	●	○	○	Move to OW on U.S., as real yields positive and economic outlook is slowing
PREFERENCE BY ASSET CLASS – EQUITIES	U.S. large cap		○	○	○	○	●	○	○	Earnings growth is slowing, but quality of earnings and valuations remain supportive
	U.S. small cap	▼	○	○	○	●	○	○	○	Domestic growth reverting to trend; boost from tax and fiscal stimulus fading
	Europe ex-UK	▼	○	●	●	○	○	○	○	Economic growth moderating, ECB set to turn more hawkish, and EPS revisions weak
	UK		○	○	○	●	○	○	○	Defensive market with attractive yield and valuation, but Brexit clouds outlook for now
	Japan	▼	○	○	○	●	○	○	○	Cash distribution improving, but slowing global growth a headwind for Japan cyclicals
	Asia Pacific ex-Japan		○	○	○	●	○	○	○	Australia fundamentals weak, but sector mix is defensive; HK geared to slowing growth
	Emerging markets	▼	○	○	●	○	○	○	○	Inexpensive but not cheap enough to offset pressure on earnings from trade and USD
REAL ESTATE	Direct real estate		○	○	○	●	○	○	○	Late cycle for real estate; returns holding up, but prefer to take risk in U.S. stocks
	U.S. REITs		○	○	○	●	○	○	○	Some support if U.S. rates remain in check; valuation support less clear-cut now
SOVEREIGN FIXED INCOME	U.S. Treasuries		○	○	○	○	●	○	○	Positive real yields along most of the curve; rates may rise a little, but carry is good
	U.S. TIPS	▲	○	○	○	○	●	○	○	Recent jump in nominal yields led by real rates; offers protection if breakevens catch up
	Euro, core (Bund)		○	○	●	○	○	○	○	More hawkish ECB and resolution of Italian political risks likely mean higher Bund yields
	Euro, periphery (BTP)		○	○	○	●	○	○	○	Significant political risk over the Italian budget suggests a neutral stance
	UK Gilts		○	○	○	●	○	○	○	Brexit outcome unclear; risk-off if no deal supports Gilts vs. BoE hikes if a deal is done
	Japanese JGBs		○	○	○	●	○	○	○	Yield peg widened but still in place; yields anchored a little above zero for 10-year JGBs
	Canadian gov't bonds	▲	○	○	○	●	○	○	○	BoC hikes likely fully priced; lack of catalysts for underperformance
	Australian gov't bonds		○	○	○	○	●	○	○	Trading under USTs, but inflation and growth outlook remain muted
CREDIT	Investment grade		○	○	●	○	○	○	○	Outlook deteriorating and BBBs are especially concerning; leverage at 25-year highs
	U.S. high yield		○	○	○	●	○	○	○	Recent rise in spreads offers some valuation support, but credit cycle quite mature
	European high yield		○	○	○	●	○	○	○	Spreads widened over 2018, but end of ECB CSPP support a headwind for EU credit
	Emerging markets debt		○	○	●	○	○	○	○	Attractive spreads vs. U.S. HY, but global growth concerns a persistent headwind
FX	USD		○	○	○	●	○	○	○	Scope to decline modestly in trade-weighted terms, but likely still supported vs. EMFX
	EUR	▼	○	○	○	●	○	○	○	ECB ending QE lends support, while political risks and slower growth are a drag
	GBP		○	○	○	●	○	○	○	Highly sensitive to Brexit outcomes; GBPUSD < 1.20 on no deal, upper 1.30s on a deal
	JPY	▲	○	○	○	○	●	○	○	Autumn's risk-off tone failed to send JPY higher; scope to rally if sentiment worsens

Source: J.P. Morgan Asset Management Multi-Asset Solutions; assessments are made using data and information up to November 2018. For illustrative purposes only.

Diversification does not guarantee investment returns and does not eliminate the risk of loss. Diversification among investment options and asset classes may help to reduce overall volatility.

MULTI-ASSET SOLUTIONS

J.P. Morgan Multi-Asset Solutions manages USD 260 billion in assets and draws upon the unparalleled breadth and depth of expertise and investment capabilities of the organization. Our asset allocation research and insights are the foundation of our investment process, which is supported by a global research team of 20-plus dedicated research professionals with decades of combined experience in a diverse range of disciplines.

Multi-Asset Solutions' asset allocation views are the product of a rigorous and disciplined process that integrates:

- Qualitative insights that encompass macro-thematic insights, business-cycle views and systematic and irregular market opportunities
- Quantitative analysis that considers market inefficiencies, intra- and cross-asset class models, relative value and market directional strategies
- Strategy Summits and ongoing dialogue in which research and investor teams debate, challenge and develop the firm's asset allocation views

As of September 30, 2018.

NEXT STEPS

For more information, contact your J.P. Morgan representative.

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