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

- Global growth is set to remain above trend, but changes to U.S. trade policy and the impact of higher U.S. rates have increased the risks to our outlook. We retain our pro-risk tilt, anticipating an economic and earnings environment consistent with equity outperformance, but moderate our conviction and trim equity positioning a little.
- U.S. real yields are now positive for most maturities, so we upgrade duration to a small overweight, in part as a portfolio hedge to our equity overweight. We expect U.S. policy rates to continue steadily tightening over coming quarters, but even then monetary policy will remain accommodative and supportive for risky assets into early 2019.
- Within asset classes, we have a preference for U.S. stocks, and U.S. Treasuries over most other regions. Credit continues to be supported by strong domestic growth, but tight spreads keep us neutral. We are more cautious on emerging markets and move underweight on emerging market (EM) debt, where we see further headwinds from trade tensions.

IF 2017 WAS MOSTLY ABOUT HOPES, 2018 HAS ARGUABLY BEEN DEFINED MORE BY FEARS. The surge in global growth that set the tone for markets in 2017 moderated early this year, exposing worrying weaknesses in some economies. Faith in U.S. economic strength spreading around the globe is being shaken by escalating tensions over trade. And the optimism about new technology and the prospect of a surge in productivity gave way to anxiety over potential exploitation of data. Finally, fears over an imminent end to this admittedly mature economic cycle are palpable. We believe fears that the cycle is about to abruptly end are premature, and expect the period of above-trend global growth to extend into 2019. Nevertheless, we acknowledge that there is now little slack in the economy. And with policy rates set to tighten further, despite rising geopolitical tensions and weakening sentiment, we believe it is prudent to moderate risk levels and look to insulate portfolios.

From the perspective of growth alone, the outlook is still quite positive. U.S. data in particular imply meaningful domestic strength, and European growth, which dipped markedly early in 2018, is coming back strongly. Moreover, employment trends suggest that activity is brisk and that growth data could well be revised upward. The principal issue in the global economy is vulnerability in some parts of emerging markets, exacerbated by a rebound in the U.S. dollar over the summer and now prompting contagion fears and weighing on sentiment.

The elephant in the room isn't the dollar, but trade. The early read of the ongoing trade dispute anticipated a protracted negotiation leading to an eventual deal and only a modest hit to growth. However, both the U.S. and China are digging in, and increasingly the subtext seems to be as much about advancing a trade ideology as it is about rescinding trade tariffs. As a result, both the extent and depth of any economic impact are being recalibrated. So while we continue to be constructive on the global economy over the coming quarters, it is hard to see the current surge in U.S. activity morphing into another period of coordinated global growth.

Strong data from the U.S. are, however, keeping the Federal Reserve (Fed) on track to hike every quarter into mid-2019 at least. Policy is not currently restrictive, in our view, but during 2019 we do expect fed funds rates to go beyond the neutral rate, ushering in a period of genuinely tight monetary policy. We also expect policy rhetoric in Europe to take on a more hawkish tone, contributing to a gradual but persistent tightening of financial conditions. While this probably acts pre-emptively to contain inflation risks, it equally puts inexorable upward pressure on the cost of capital for emerging market economies, exacerbating pressures from trade and the dollar.

Together these factors may leave some investors a little circumspect, but in our view above-trend global growth and reasonable earnings continue to support a positive, albeit moderated, view on risk. We have reduced our stock-bond overweight (OW) somewhat but remain constructive on equities. At the same time, we have upgraded our aggregate view on duration to a small OW, as the positive level of real yields along the curve is attractive, especially when we consider how bonds act as a portfolio diversifier. Our views on credit, commodities, real estate and cash all remain neutral, and in general our conviction levels are somewhat reduced across the board.

Within most asset classes, our portfolios have a distinct U.S. over rest-of-world tilt. In equities, positive earnings momentum and domestic strength support our pro-U.S. view. We are constructive on Japanese equities, have downgraded emerging markets to neutral and least favor the eurozone, where the currency, not stocks, benefits most from domestic growth. In bonds, too, we favor the U.S. and expect further bear flattening in the yield curve, as long-end yields are still anchored by the persistent global bid for duration. By contrast, we expect yields on German Bunds to rise as the European Central Bank moves to bring quantitative easing to a close by December.

The changes we've made mark a continuation in the direction of travel for our portfolio allocation that started in the spring. We have meaningfully trimmed our risk tolerance, but, to be clear, we are still constructive on economic outcomes around the globe. It is the translation of this view to asset returns that is becoming more nuanced as we progress through late cycle, and the added disruption from trade rhetoric and gradually tighter policy clouds the return outlook. Our U.S. tilt in equities and our upgrade to duration reflect these developments, and across our portfolios we remain modestly risk-exposed through the more liquid asset markets, which we feel is prudent in a late-cycle economy.

KEY THEMES AND THEIR IMPLICATIONS

Theme		Macro and asset class implications
GLOBAL THEMES	Global policy divergence	Divergence between U.S. and other central banks to slow as the Fed approaches neutral and the ECB scales back asset purchases
	Supply-side weakness	Inflation at target in the U.S. but muted elsewhere; signs of life in wage inflation in Europe and Japan, but from a low base
	Widespread technology adoption	Potential to add over a point to trend GDP over the decade, but will disrupt some sectors; tech stocks in a secular uptrend
DEVELOPED MARKETS THEMES	Maturing U.S. cycle	Recession risks remain low despite age of expansion; gradual policy tightening may lengthen cycle; U.S. stocks well supported
	Europe growth recovery	European growth is recovering from soft patch; political risks still a concern, but as these ease expect EUR to rebound
	Japan beyond Abenomics	Corporate governance is improving and BoJ policy unlikely to change in coming quarters; JPY stable, Japanese stocks supported
EMERGING MARKETS THEMES	Emerging market convergence	EM financial conditions have tightened and sentiment has soured, Chinese stimulus and global capex cycle are a partial offset
	China in transition	Confidence hit by U.S. China trade disputes, but fiscal policy turning more expansionary; rotation to services-led economy

Source: J.P. Morgan Asset Management Multi-Asset Solutions; data as of September 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 above-trend, but risks are increasing, so prefer to trim our pro-risk tilt
	Duration	▲	○	○	○	○	●	○	○	Higher yields and less upside risk to inflation make duration more compelling
	Credit		○	○	○	●	○	○	○	Fundamentals improving a little, but remains late in cycle and spreads are tight
	Commodities		○	○	○	●	○	○	○	Supply/demand more balanced in energy for 2019; trade a headwind for base metals
	Real estate		○	○	○	●	○	○	○	Performing well despite late cycle, with supply discipline in evidence
	Cash		○	○	○	●	○	○	○	Neutral on aggregate but positive on USD cash while still negative on EUR cash
PREFERENCE BY ASSET CLASS – EQUITIES	U.S. large cap		○	○	○	○	●	○	○	Earnings delivery strong, becoming a consensus OW but supported by fundamentals
	U.S. small cap		○	○	○	○	●	○	○	Rather expensive but continues to benefit from U.S. domestic strength
	Europe ex-UK		○	○	●	○	○	○	○	Rebound in eurozone growth likely to drive EUR higher, creating a headwind for stocks
	UK		○	○	○	●	○	○	○	Outlook currency-dependent, which in turn is driven by Brexit; thus prefer neutral in 4Q
	Japan		○	○	○	○	●	○	○	Cash distribution improving; earnings have scope to rebound if global capex picks up
	Asia Pacific ex-Japan		○	○	○	●	○	○	○	Earnings growth sluggish and upside constrained by banking sector regulation risks
	Emerging markets	▼	○	○	○	●	○	○	○	Inexpensive but not cheap enough to offset pressure on earnings from trade and USD
REAL ESTATE	Direct real estate		○	○	○	●	○	○	○	Late in cycle for real estate; returns holding up, but prefer to take risk in stocks
	U.S. REITs	▲	○	○	○	●	○	○	○	Better outlook now U.S. rates may be topping out; defensive nature appealing
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		○	○	○	●	○	○	○	Upside risks to inflation dissipating; prefer to be long nominals
	Euro, core (Bund)		○	○	●	○	○	○	○	ECB turning more hawkish and QE ending should see Bund yields higher
	Euro, periphery (BTP)		○	○	○	●	○	○	○	Significant political risk over the Italian budget suggests a neutral stance
	UK Gilts	▼	○	○	○	●	○	○	○	Weak growth supportive of Gilts, but scope for expansionary budget in autumn
	Japanese JGBs		○	○	○	●	○	○	○	Yield peg widened but still in place; yields anchored a little above zero for 10-year JGBs
	Canadian gov't bonds		○	○	●	○	○	○	○	Quite a lot priced in by BoC, but activity remains strong and yields are well below U.S.
	Australian gov't bonds		○	○	○	○	●	○	○	Trading under USTs, but inflation and growth outlook remain muted
CREDIT	Investment grade		○	○	●	○	○	○	○	Interest cover at cycle lows and leverage still high; BBBs account for 50%+ of the index
	U.S. high yield		○	○	○	●	○	○	○	Fundamentals getting better and leverage falling; attractive carry, but prefer stocks
	European high yield		○	○	○	●	○	○	○	Spreads now wider than U.S. but all in-yields still low; diversification potential
	Emerging markets debt	▼	○	○	●	○	○	○	○	Weak outlook on trade risks and strength of USD; expect sellers into any strength
FX	USD		○	○	○	●	○	○	○	Recent broad dollar rally now over; expect further strength vs. EMFX and a dip vs. G3
	EUR		○	○	○	○	●	○	○	Scope to rise as ECB turns more hawkish and growth in eurozone remains strong
	GBP	▲	○	○	○	●	○	○	○	Highly sensitive to Brexit outcomes, GBPUSD < 1.20 on no deal, upper 1.30s on a deal
	JPY		○	○	○	●	○	○	○	Likely range-bound against USD, with BoJ policy stable and domestic growth better

Source: J.P. Morgan Asset Management Multi-Asset Solutions; assessments are made using data and information up to September 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 256 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 June 30, 2018.

NEXT STEPS

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

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