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

- Recession risk is muted and high frequency data are beginning to trough. Even then, we expect slightly subtrend global growth in 2019, and although the capex cycle should come off its recent lows we do not see the kind of rebound we enjoyed in 2016. Easier U.S. policy is a boost, but eventually we expect a further one to two rate hikes.
- We retain our mild underweight to stocks and prefer to add risk, at the margin, in carry assets like credit. We see equity supported by subdued earnings expectations and easy policy, but in today’s mature, late-cycle environment we don’t see many catalysts for strong upside to earnings. We also expect trade concerns to linger.
- U.S. stocks are our most preferred region and Europe our least preferred; we are warming up to emerging market stocks where potential for a softer dollar lends support. Given slower growth and more dovish U.S. policy, we maintain our overweight to duration and take cash back to neutral. On balance, our portfolio allocation reflects an environment that supports carry a little more than capital growth.

SOMETIMES STARS SEEM TO ALIGN; OTHER TIMES THEY SIMPLY DON’T, NO MATTER HOW MUCH YOU TWIST AND TURN. And sometimes a directional view on markets is clear, while at other times being a little more nimble and tactical is the prudent approach. We certainly acknowledge that the dovish pivot from the Federal Reserve (Fed), as well as other central banks, helped fuel a sharp rebound in risk assets over the first quarter. It has probably also extended this cycle a little. Nevertheless, we can’t shake the nagging feeling that asset markets are merely desensitized to the macroeconomic challenges that fueled the late 2018 sell-off even as those issues still lurk just beneath the surface.

We are unconvinced that the Fed’s pivot fired the starting gun on an extended, 2016–17-style rally: Financial conditions may have eased, but the economy is in later cycle, and there is less scope for an unleashing of pent-up demand. For all that, we have observed enough of the vagaries of post-global financial crisis (GFC) central bank maneuverings not to want to stand in the way of easier policy. This leaves us in a somewhat unsatisfactory holding pattern, and we expect equity markets to trade sideways in a range for the time being, while carry assets and duration remain supported.

From a macroeconomic perspective, let’s start with the good news. The objective probability of a recession in the next 12 months remains low by late-cycle standards. And with the Fed communicating a pause in its rate hiking cycle, we think the business cycle is probably extended by a couple of quarters. With higher frequency macro data at a low ebb and corporate earnings forecasts back to levels commensurate with slightly subtrend global GDP growth, the frothy sentiment of 2018 has dissipated and there is potential for modest upside surprise in the next quarter or two.

This, however, could be as good as it gets. To be clear, we are not outright bearish, but equally we struggle to see the catalysts to build meaningful upside momentum. Our principal concern is that once the Fed judges its dovish pivot to have been successful – as evidenced by data and asset market performance over a relatively short time frame – the easy policy tone will start to reverse. We acknowledge that Fed members have tacitly stated they will run the economy a little "hot," but tolerating inflation a couple of tenths of a percent above long-run targets strikes us as tepid at best.

While we think that investors could be overestimating how dovish the Fed is on rates – we expect one or two hikes yet to come – equally we believe that investors may be underestimating how dovish the Fed is on the balance sheet. The stable level of reserves the Fed is targeting implies a larger balance sheet than hitherto assumed, suggesting that the Fed could end the balance sheet runoff as early as 3Q19. A combination of unexciting, slightly subtrend growth and monetary policy that is anchoring longer-end yields might not set equity markets on fire, but at the same time it supports carry assets and puts a floor under risk assets and sentiment – for the time being.

At the global level, trade is still the biggest macroeconomic swing factor. Recent trade data are understandably muted, so any accord reached between China and the U.S. is likely to provide a boost. However, we conclude that structurally the two sides remain divided on many issues; as a result, we would interpret any agreement as a cease-fire rather than a lasting resolution. Europe has suffered from the Sino-American trade spat despite not being the direct target, with trade woes coming on top of a slide in domestic demand and an uptick in political tension. We anticipate a modest rebound in European higher frequency data but expect any turn in sentiment to be muted, at least until after the European Parliament elections in late May.

While the economic outlook is neither hot nor cold, Goldilocks it isn't. In our multi-asset portfolios, we maintain the slight underweight (UW) stance to stocks and the overweight (OW) to duration, but in both cases we expect markets to be quite range-bound. At the margin, we are increasing risk appetite modestly but feel this is best expressed in carry assets and so take credit to a small OW, preferring U.S. and European high yield (HY) and emerging market (EM) debt over investment grade (IG). At the same time, we take cash back to neutral and feel that the small OW we ran in U.S. cash over the volatility of late 2018 did indeed provide us welcome flexibility in our portfolios. Within equities, we continue to favor U.S. over European stocks, and we are becoming incrementally more positive on emerging markets. In FX, we believe that any rebound in the European data will impact the currency first, and so we replace our modest JPY OW with an EUR OW.

Our allocation today could be reasonably interpreted as a staging post. But in any journey, when the map is a little unclear, a staging post can be a welcome opportunity to reassess and, most importantly, gather further guidance for the next leg.

KEY THEMES AND THEIR IMPLICATIONS

Theme		Macro and asset class implications
GLOBAL THEMES	Global policy divergence	The Fed's dovish tack takes some pressure off of USD, but other CBs following suit
	Supply-side weakness	Wage inflation is picking up, creating mild headwinds for margins. On the bright side, the Fed will be slow to respond
	Widespread technology adoption	Tech innovation and adoption continue to accelerate amid periodic doubts over the sector's earnings trajectory
DEVELOPED MARKETS THEMES	Maturing U.S. cycle	The U.S. cycle could go on for some time, but upside risks to equity fundamentals are lower than in 2015-16
	Europe in the balance	Growth is edging out of its 2018 malaise. Political risk premium will restrain equities
	Japan beyond Abenomics	Corporate governance improving and BoJ on hold, with JPY strength a frequent spoiler for equities
EMERGING MARKETS THEMES	Emerging market convergence	A patient Fed and a U.S.-China truce provide some breathing room with respect to financial condition spillovers
	China in transition	Structural changes subverted to growth stabilization objectives; magnitude of stimulus lower than recent experiences

Source: J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2019. 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		○	○	●	○	○	○	○	Stocks supported by policy, but upside capped by low prospect of strong EPS rebound
MAIN ASSET CLASSES	Duration		○	○	○	○	●	○	○	Subtrend global growth and potential end to Fed QT in 2H19 support global duration
MAIN ASSET CLASSES	Credit	▲	○	○	○	○	●	○	○	Fed pause and limited imminent recession risk support carry assets
MAIN ASSET CLASSES	Commodities		○	○	○	●	○	○	○	Some upside potential in oil as supply issues grow and inventory build restarts
MAIN ASSET CLASSES	Real estate		○	○	○	●	○	○	○	Past peak supply, but sluggish growth probably caps upside in the near term
MAIN ASSET CLASSES	Cash	▼	○	○	○	●	○	○	○	Fed on pause and real cash rates drifting back down reduce attractiveness of cash
PREFERENCE BY ASSET CLASS – EQUITIES	U.S. large cap	▲	○	○	○	○	●	●	○	EPS expectations reset to realistic level; domestic data also starting to stabilize
PREFERENCE BY ASSET CLASS – EQUITIES	U.S. small cap		○	○	○	●	○	○	○	Rebounded strongly from lows, but baseline GDP growth too low to favor small caps
PREFERENCE BY ASSET CLASS – EQUITIES	Europe ex-UK		○	●	●	○	○	○	○	A consensus UW, but margin expectations remain elevated, and not really that cheap
PREFERENCE BY ASSET CLASS – EQUITIES	UK		○	○	○	●	○	○	○	Could face some headwinds as GBP moves higher, but offers compelling all-in yield
PREFERENCE BY ASSET CLASS – EQUITIES	Japan		○	○	○	●	○	○	○	Geared to any bounce in the industrial cycle, but unlikely to see currency support
PREFERENCE BY ASSET CLASS – EQUITIES	Asia Pacific ex-Japan		○	○	○	●	○	○	○	Split between a positive view on Hong Kong and a weak outlook for Australia
PREFERENCE BY ASSET CLASS – EQUITIES	Emerging markets	▲	○	○	○	●	○	○	○	Outlook improving markedly; second most preferred market after the U.S.
PREFERENCE BY ASSET CLASS – REAL ESTATE	Direct real estate		○	○	○	●	○	○	○	Late in cycle for real estate; returns decent, but limited upside given sluggish growth
PREFERENCE BY ASSET CLASS – REAL ESTATE	U.S. REITs		○	○	○	●	○	○	○	A little rich relative to U.S. large cap stocks now; AFFO unlikely to rise year-on-year
PREFERENCE BY ASSET CLASS – SOVEREIGN FIXED INCOME	U.S. Treasuries		○	○	○	○	●	○	○	Positive real yields along most of the curve; rates may rise a little, but carry is good
PREFERENCE BY ASSET CLASS – SOVEREIGN FIXED INCOME	U.S. TIPS		○	○	○	○	●	○	○	Fed willing to accept slightly higher inflation, so TIPS could remain supported for now
PREFERENCE BY ASSET CLASS – SOVEREIGN FIXED INCOME	Euro, core (Bund)	▲	○	○	○	●	○	○	○	Bund yields exceptionally low, but ultra-loose ECB policy limits how far they can rise
PREFERENCE BY ASSET CLASS – SOVEREIGN FIXED INCOME	Euro, periphery (BTP)		○	○	○	●	○	○	○	Significant ongoing political risk in Italy; somewhat offset by ECB easy policy
PREFERENCE BY ASSET CLASS – SOVEREIGN FIXED INCOME	UK Gilts	▼	○	○	●	○	○	○	○	Hard Brexit risk waning, opening up scope for fiscal expansion and higher BoE rates
PREFERENCE BY ASSET CLASS – SOVEREIGN FIXED INCOME	Japanese JGBs		○	○	○	●	○	○	○	Yield peg widened but still in place; yields anchored a little above zero for 10-yr JGBs
PREFERENCE BY ASSET CLASS – SOVEREIGN FIXED INCOME	Canadian gov't bonds	▼	○	○	●	○	○	○	○	Rebound in oil prices could create upside yield pressure; BoC has nothing priced in
PREFERENCE BY ASSET CLASS – SOVEREIGN FIXED INCOME	Australian gov't bonds		○	○	○	○	●	○	○	Australian economy flagging; further pricing of RBA cuts likely; prefer the 3-yr sector
PREFERENCE BY ASSET CLASS – CREDIT	Investment grade		○	○	●	○	○	○	○	Interest cover at cycle lows and leverage still high; BBBs account for 50%+ of the index
PREFERENCE BY ASSET CLASS – CREDIT	U.S. high yield	▲	○	○	○	○	●	○	○	Low risk of U.S. recession plus accommodative Fed supports carry assets like credit
PREFERENCE BY ASSET CLASS – CREDIT	European high yield	▲	○	○	○	○	●	○	○	Spreads have widened more than U.S. HY; attractive carry, especially hedged to USD
PREFERENCE BY ASSET CLASS – CREDIT	Emerging markets debt	▲	○	○	○	○	●	○	○	Bid for duration, growth slow but stable, and USD upside limited all support EMD
PREFERENCE BY ASSET CLASS – FX	USD	▼	○	○	●	○	○	○	○	Easier Fed reduces upside risk for USD against G3; more mixed vs. EMFX
PREFERENCE BY ASSET CLASS – FX	EUR	▲	○	○	○	○	●	○	○	ECB at max dovish probably marked low in EURUSD; scope now to rise as data stabilize
PREFERENCE BY ASSET CLASS – FX	GBP	▲	○	○	○	○	●	○	○	No deal seems to be off table; opens up GBPUSD upside to upper 1.30s
PREFERENCE BY ASSET CLASS – FX	JPY	▼	○	○	○	●	○	○	○	Seems range-bound at 105–115; still, could catch a bid if global macro worries return

Source: J.P. Morgan Asset Management Multi-Asset Solutions; assessments are made using data and information up to March 2019. 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 240 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 December 31, 2018.

NEXT STEPS

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

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