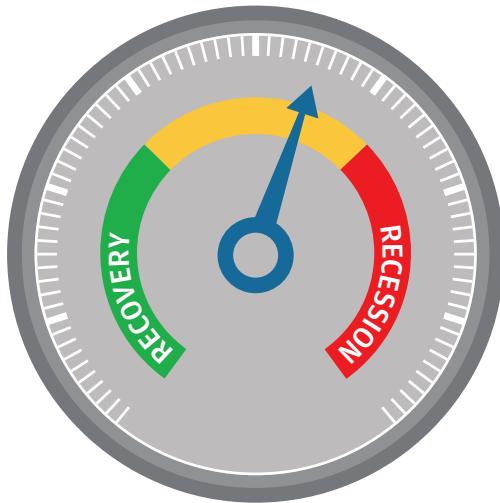


# PORTFOLIO CONSIDERATIONS FOR INVESTORS CONCERNED ABOUT A DOWNTURN

## THE DIAL, IN DETAIL



- 1 MOVE TOWARDS NEUTRAL IN EQUITIES BUT AVOID UNDERWEIGHTS.
- 2 REMAIN REGIONALLY DIVERSIFIED IN EQUITIES.
- 3 ROTATE AWAY FROM OVERWEIGHTS IN MID-AND SMALL-CAP EQUITIES.
- 4 RECONSIDER OVERWEIGHTS IN GROWTH STOCKS, ADD TO QUALITY AND VALUE STOCKS.
- 5 CONSIDER FIXED INCOME STRATEGIES THAT CAN SHIFT ACROSS REGIONS, DURATION AND RISK.
- 6 CASH AND SHORT-DATED LIQUIDITY INSTRUMENTS MAY PROVIDE BALLAST.
- 7 CONSIDER STRATEGIES WITH LOW CORRELATION TO RISK ASSETS.

THE US RECOVERY IS NOW THE LONGEST ON RECORD. NOBODY KNOWS EXACTLY HOW MUCH LONGER THIS EXPANSION WILL LAST. BUT AS WE DISCUSSED IN OUR ***TURNING THE DIAL***<sup>1</sup> PAPER, EXPANSIONS DO NOT LAST FOREVER. FOR THOSE INVESTORS WHO ARE CONCERNED ABOUT AN EQUITY MARKET DOWNTURN, WE OUTLINED A NUMBER OF SHIFTS IN ALLOCATION THAT MIGHT INCREASE THE RESILIENCE OF A PORTFOLIO.

***HERE, WE CONSIDER THESE SEVEN STRATEGIES IN MORE DETAIL.***

---

<sup>1</sup> *Turning the dial: Portfolio considerations in the late cycle*, Karen Ward & Michael Bell, J.P. Morgan Asset Management, September 2018

# 1 MOVE TOWARDS NEUTRAL IN EQUITIES BUT AVOID UNDERWEIGHTS

In the run-up to the start of a US recession equities can deliver strong positive returns. This highlights the risk of going underweight equities too early. For example, an investor who called the dot-com bubble too early would have missed out on a return of 39% in the final two years, or 19% in the final year, of the S&P 500 rally. Once the market starts to price in recession though, equities struggle. Markets have peaked anywhere between zero and 13 months prior to the start of a recession. Given the difficulty of precisely timing market peaks and troughs, investors may want to consider moving closer to neutral in equities in the late stage of the economic cycle.

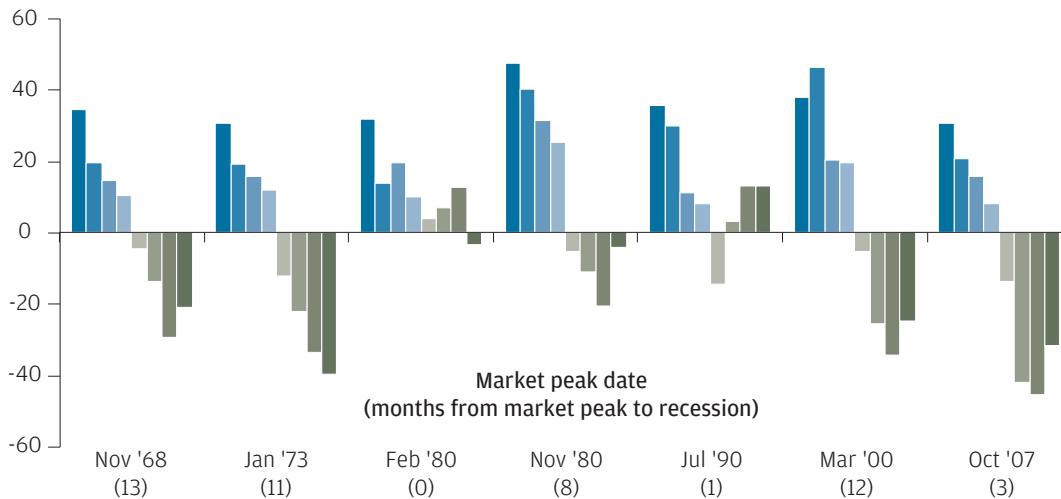
## Late cycle equity returns can be very strong

### S&P 500 RETURNS AROUND MARKET PEAKS

% price return, before and after market peak

Months to market peak:

■ -24   ■ -18   ■ -12   ■ -6   ■ +6   ■ +12   ■ +18   ■ +24



Source: Standard and Poor's, Thomson Reuters Datastream, J.P. Morgan Asset Management. Market peaks are defined as the peak of the S&P 500 prior to a US recession, as defined using US National Bureau of Economic Research (NBER) business cycle dates. Past performance is not a reliable indicator of current and future results. Data as of 31 July 2019.

## 2

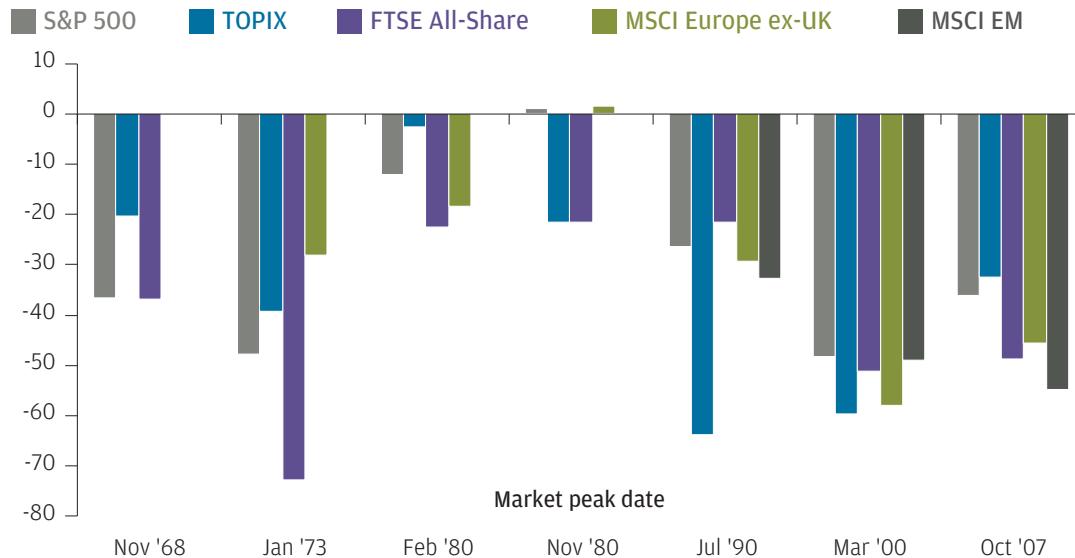
## REMAIN REGIONALLY DIVERSIFIED IN EQUITIES

A shift in regional allocation rarely helps cushion performance in a market correction. Investors concerned about a potential recession in the US may be tempted to shift away from US equities into other equity markets, but during US recessions stock markets in all regions tend to fall—sometimes by more than US equities. When you add in the fact that the dollar appreciated during the last two recessions, it's far from clear that concerns about a US recession should lead investors to shift from US equities into other equity markets. Investors are normally better off maintaining a regionally diversified portfolio.

### US recessions don't mean US equities underperform

#### EQUITY MARKET MAXIMUM DRAWDOWN IN GBP

% price return



Source: FTSE, MSCI, Standard and Poor's, TOPIX, Thomson Reuters Datastream, J.P. Morgan Asset Management. Maximum drawdown is calculated using price index level data and is shown for all indices where available. Market peaks are defined as the peak of the index prior to a US recession, as defined using US National Bureau of Economic Research (NBER) business cycle dates. Past performance is not a reliable indicator of current and future results. Data as of 31 July 2019.

### 3 ROTATE AWAY FROM OVERWEIGHTS IN MID- AND SMALL-CAP EQUITIES

Small-cap stocks tend to underperform the market during recessions, particularly in the UK. Between May 2007 and December 2008, UK mid-cap stocks underperformed the FTSE 100 by 18%. The average UK equity fund has over 40% in mid- and small-cap equities, which is over 20% more than the FTSE All-Share.

#### Small-cap equities often underperform during recessions

##### FTSE SMALL-CAP/FTSE 100 RELATIVE PERFORMANCE

Relative total return index level, rebased to 100 in 1986



Source: FTSE, Thomson Reuters Datastream, J.P. Morgan Asset Management. Periods of “recession” are defined using US National Bureau of Economic Research (NBER) business cycle dates. Past performance is not a reliable indicator of current and future results. Data as of 31 July 2019.

## 4

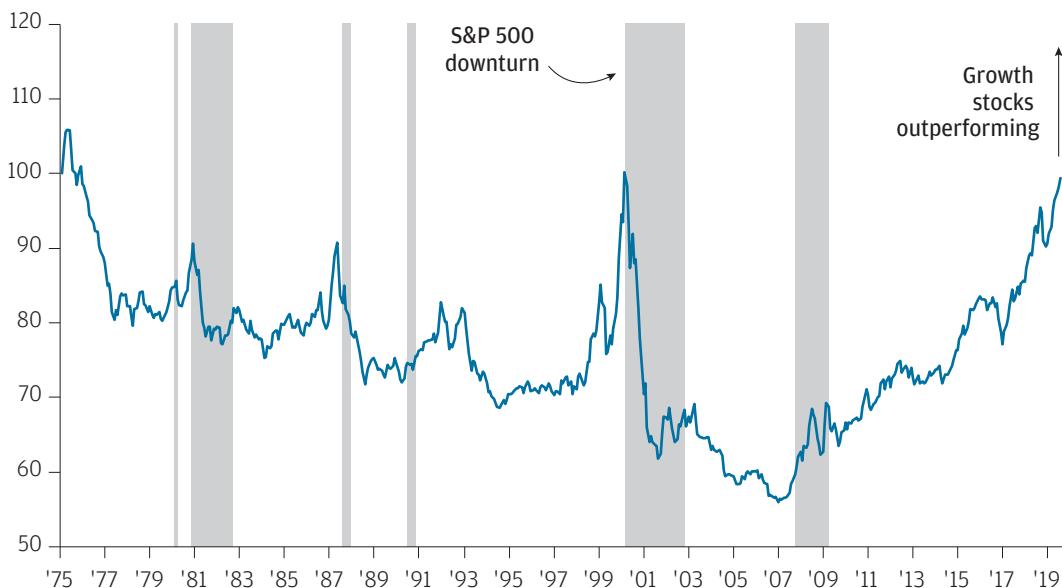
## RECONSIDER OVERWEIGHTS IN GROWTH STOCKS, ADD TO QUALITY AND VALUE STOCKS

Growth stocks have often underperformed value stocks during S&P 500 bear markets. The obvious exception was the global financial crisis, when value underperformed, although this was because of the high weighting of financials in the value index during a crisis in the US financial system. With banks much better capitalised now than they were prior to the last downturn, the next recession is more likely to be a “normal” recession and less likely to turn into a financial crisis. Value stocks have tended to strongly outperform growth when the period preceding the downturn saw a significant rise in the relative performance of growth stocks, such as during the dot-com bubble.

### Growth often underperforms during market downturns

#### MSCI WORLD GROWTH/VALUE RELATIVE PERFORMANCE AND S&P 500 DOWNTURNS

Relative index level, rebased to 100 in 1975



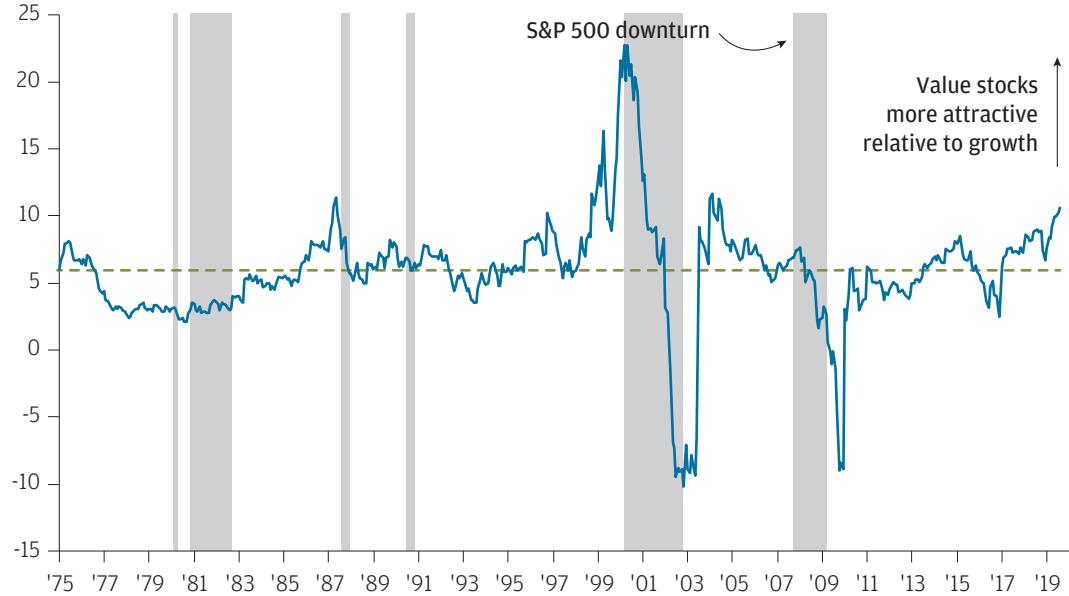
Source: MSCI, Thomson Reuters Datastream, J.P. Morgan Asset Management. Index levels are calculated using price indices in local currency. Past performance is not a reliable indicator of current and future results. Data as of 31 July 2019.

As the name suggests, one would expect value stocks to be cheaper than growth stocks but the valuation difference is now the most extended since 2004.

### Growth is more expensive than usual

#### MSCI WORLD GROWTH AND VALUE PRICE-TO-EARNINGS (P/E) GAP

MSCI World growth minus value trailing 12-month P/E



Source: MSCI, Thomson Reuters Datastream, J.P. Morgan Asset Management. Past performance is not a reliable indicator of current and future results. Data as of 31 July 2019.

## 4

## RECONSIDER OVERWEIGHTS IN GROWTH STOCKS, ADD TO QUALITY AND VALUE STOCKS (CONTINUED)

Quality stocks (defined here as those with high profitability and earnings quality and low financial risk, with a focus on strong cash flow generation) are the only investment style that have outperformed the index in every recent downturn.

### Quality stocks have reliably outperformed during recessions

#### S&P 500 QUALITY/S&P 500 RELATIVE PERFORMANCE

Relative total return index level, rebased to 100 in 1990



Source: J.P. Morgan Asset Management Quantitative Beta Strategies, Standard and Poor's, J.P. Morgan Asset Management. S&P 500 Quality index is the top quartile quality stocks in the S&P 500 determined by JPMAM Quantitative Beta Strategies based on measures of profitability, financial risk and earnings quality. Periods of "recession" are defined using US National Bureau of Economic Research (NBER) business cycle dates. Past performance is not a reliable indicator of current and future results. Data as of 31 July 2019.

## 5

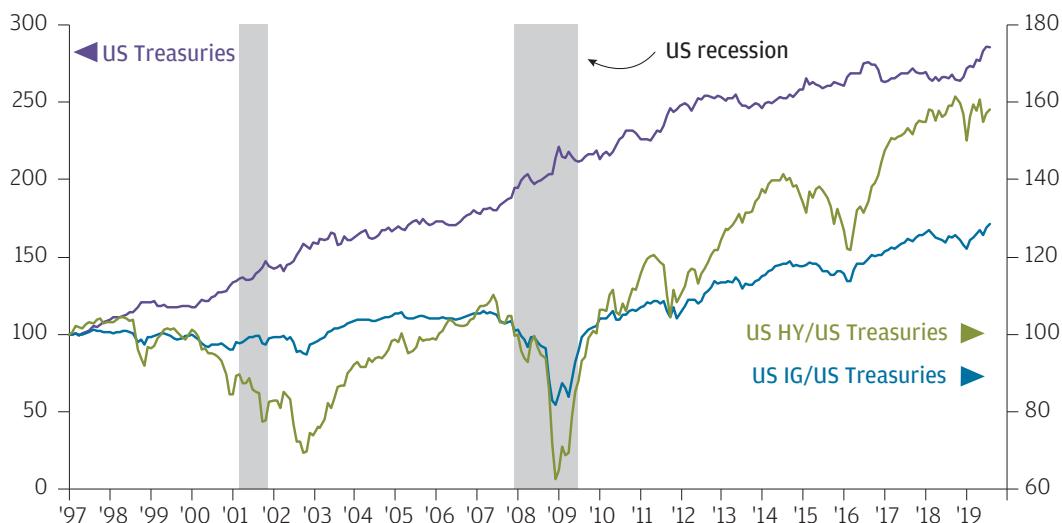
## CONSIDER FIXED INCOME STRATEGIES THAT CAN SHIFT ACROSS REGIONS, DURATION AND RISK

With interest rates still at very low levels in many economies, an ability to shift across regions is critical to take advantage of government bond markets where there is scope for central banks to cut rates and to avoid those markets where the sustainability of government debt could come into question during a downturn. Credit sometimes starts to underperform government bonds before equities peak. Strategies that seek to dynamically reduce credit risk and increase duration as recession risk rises can help to buffer portfolios.

### Treasuries can help protect portfolios during equity downturns, while credit underperforms

#### US TREASURIES TOTAL RETURN VS. US IG/US TREASURIES AND US HY/US TREASURIES RELATIVE PERFORMANCE

Total return index level (LHS); Relative total return index level (RHS); All indices rebased to 100 in 1997



Source: Bank of America Merrill Lynch, Bloomberg, Thomson Reuters Datastream, J.P. Morgan Asset Management. Indices used are as follows: US IG: Bloomberg Barclays US Agg. Corporate - Investment Grade; US Treasuries: Bloomberg Barclays US Agg. Gov. - Treasury; US HY: BofA/Merrill Lynch US High Yield Constrained. Periods of "recession" are defined using US National Bureau of Economic Research (NBER) business cycle dates. Past performance is not a reliable indicator of current and future results. Data as of 31 July 2019.

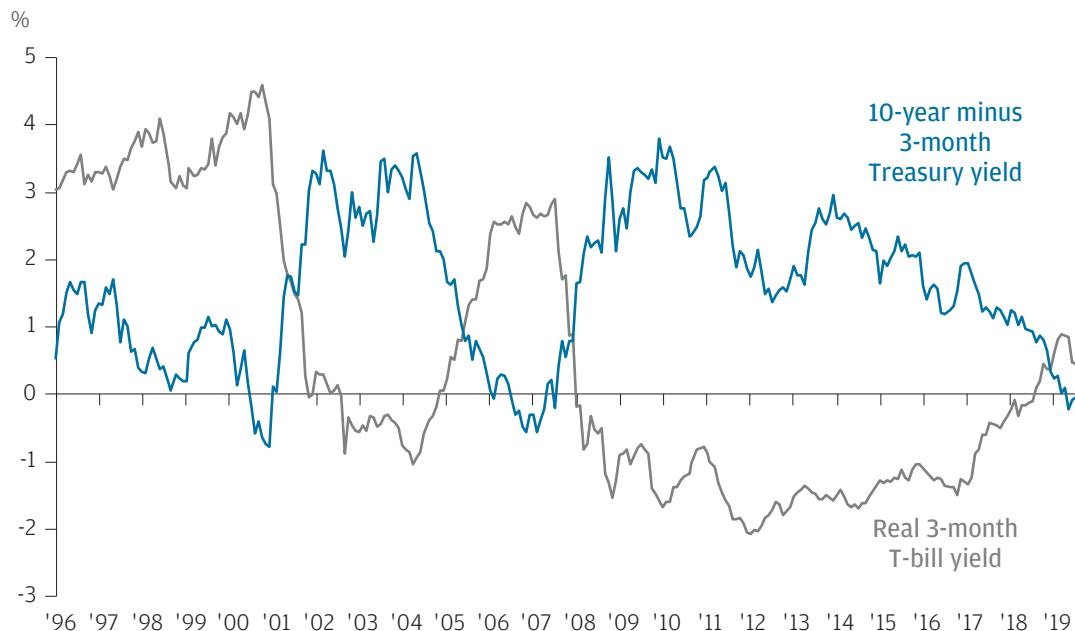
## 6

## CASH AND SHORT-DATED LIQUIDITY INSTRUMENTS MAY PROVIDE BALLAST

Holding cash in recent years when real rates were negative didn't make much sense. But as a tactical allocation, cash or liquidity instruments can add ballast to a portfolio and help investors feel comfortable maintaining some allocation to risk elsewhere in their portfolios. In the US, real yields have improved. The curve has also flattened so investors who are concerned about duration risk can get about as much yield on short-term liquidity instruments as on a 10-year Treasury. Obviously, investors would also need to consider currency risk if investing outside of their home currency.

### Higher yields are now available on US short-dated liquidity instruments

#### US 10-YEAR TREASURY MINUS 3-MONTH T-BILL YIELD VS. REAL 3-MONTH T-BILL YIELD



Source: Bloomberg, BLS, J.P. Morgan Asset Management. Real 3-month T-bill yield is calculated as the yield on the 3-month T-bill minus the year-on-year change in the core Personal Consumption Expenditure (PCE) index. Past performance is not a reliable indicator of current and future results. Data as of 31 July 2019.

# 7

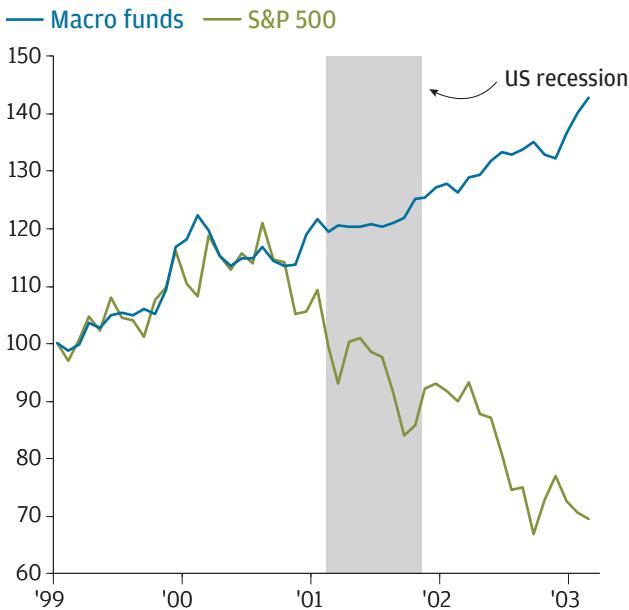
## CONSIDER STRATEGIES WITH LOW CORRELATION TO RISK ASSETS

Strategies with the ability to lower their correlation to risk assets can help buffer portfolios in a downturn. Some examples include macro funds and equity long-short funds, particularly those with the ability to take their net equity exposure to zero. Investors should be aware, though, that some equity long-short funds have a structural positive, albeit lower, beta to equity markets.

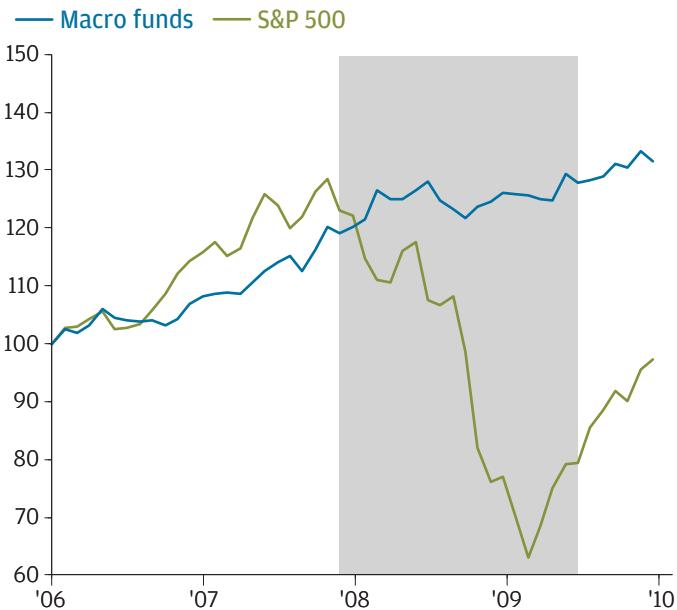
### Strategies with low correlation to risk assets can buffer portfolios during downturns

#### S&P 500 AND MACRO FUNDS TOTAL RETURNS

Total return index level, rebased to 100 in 1999



Total return index level, rebased to 100 in 2006



Source: Bloomberg, Standard and Poor's, J.P. Morgan Asset Management. Macro funds index used is the Hedge Fund Research Macro Index; Periods of "recession" are defined using US National Bureau of Economic Research (NBER) business cycle dates. Past performance is not a reliable indicator of current and future results. Data as of 31 July 2019.

---

Published August 2019.

The Market Insights programme provides comprehensive data and commentary on global markets without reference to products. Designed as a tool to help clients understand the markets and support investment decision-making, the programme explores the implications of current economic data and changing market conditions.

This document is a general communication being provided for informational purposes only. It is educational in nature and not designed to be taken as advice or a recommendation for any specific investment product, strategy, plan feature or other purpose in any jurisdiction, nor is it a commitment from J.P. Morgan Asset Management or any of its subsidiaries to participate in any of the transactions mentioned herein. Any examples used are generic, hypothetical and for illustration purposes only. This material does not contain sufficient information to support an investment decision and it should not be relied upon by you in evaluating the merits of investing in any securities or products. In addition, users should make an independent assessment of the legal, regulatory, tax, credit, and accounting implications and determine, together with their own professional advisers, if any investment mentioned herein is believed to be suitable to their personal goals. Investors should ensure that they obtain all available relevant information before making any investment. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is considered to be accurate at the time of production, but no warranty of accuracy is given and no liability in respect of any error or omission is accepted. It should be noted that investment involves risks, the value of investments and the income from them may fluctuate in accordance with market conditions and taxation agreements and investors may not get back the full amount invested. Both past performance and yield are not a reliable indicator of current and future results.

J.P. Morgan Asset Management is the brand for the asset management business of JPMorgan Chase & Co. and its affiliates worldwide. This communication is issued by the following entities: in the United Kingdom by JPMorgan Asset Management (UK) Limited, which is authorized and regulated by the Financial Conduct Authority; in other European jurisdictions by JPMorgan Asset Management (Europe) S.à r.l.; in Hong Kong by JF Asset Management Limited, or JPMorgan Funds (Asia) Limited, or JPMorgan Asset Management Real Assets (Asia) Limited; in Singapore by JPMorgan Asset Management (Singapore) Limited (Co. Reg. No. 197601586K), or JPMorgan Asset Management Real Assets (Singapore) Pte Ltd (Co. Reg. No. 201120355E); in Taiwan by JPMorgan Asset Management (Taiwan) Limited; in Japan by JPMorgan Asset Management (Japan) Limited which is a member of the Investment Trusts Association, Japan, the Japan Investment Advisers Association, Type II Financial Instruments Firms Association and the Japan Securities Dealers Association and is regulated by the Financial Services Agency (registration number "Kanto Local Finance Bureau (Financial Instruments Firm) No. 330"); in Korea by JPMorgan Asset Management (Korea) Company Limited; in Australia to wholesale clients only as defined in section 761A and 761G of the Corporations Act 2001 (Cth) by JPMorgan Asset Management (Australia) Limited (ABN 55143832080) (AFSL 376919); in Brazil by Banco J.P. Morgan S.A.; in Canada for institutional clients' use only by JPMorgan Asset Management (Canada) Inc., and in the United States by JPMorgan Distribution Services Inc. and J.P. Morgan Institutional Investments, Inc., both members of FINRA/SIPC; and J.P. Morgan Investment Management Inc.

In APAC, distribution is for Hong Kong, Taiwan, Japan and Singapore. For all other countries in APAC, to intended recipients only.

Copyright 2019 JPMorgan Chase & Co. All rights reserved

0903c02a8238fdf3

LV-JPM52296 | 08/19