

Global Asset Allocation Views

Insights and implications from the Multi-Asset Solutions Strategy Summit

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IN BRIEF

- The shortest, sharpest recession in memory has now given way to a new early-cycle phase. We expect improving macro data and earnings in the second half to push up risk assets but for tail risks to remain meaningful in both directions, suggesting lingering volatility to contend with.
- Massive fiscal and monetary stimulus were deployed to tackle the economic fallout of COVID-19. We expect this stimulus to persist well into the next cycle, pointing to broad regional diversification across equities and credit markets.
- We continue to add risk to portfolios, a process that started mid-Q2 with investment grade credit and now extends into high yield and equities; our multi-asset portfolios are overweight stocks, notably U.S., Europe and emerging markets, as well as corporate credit; we are mildly underweight duration and have a neutral exposure to cash.

ASSET CLASS VIEWS (PAGE 3)

Underweight ● Neutral ● Overweight ●

Asset class	Opportunity set	UW	N	OW	Change	Conviction	
MAIN ASSET CLASSES	Equities	○	○	●	▲	Moderate	
	Duration	●	○	○		Low	
	Credit	○	○	●	▲	Moderate	
	Cash	○	●	○	▼		
PREFERENCE BY ASSET CLASS	EQUITIES	U.S.	○	○	●		Low
		Europe	○	○	●	▲	Moderate
		UK	●	○	○		Moderate
		Japan	○	●	○		
	Emerging markets	○	○	●		Low	
	FIXED INCOME	U.S. Treasuries	○	●	○		
G4 ex-U.S. sovereigns		●	○	○		Low	
EMD hard currency		○	●	○			
EMD local FX		●	○	○		Low	
Corporate investment grade	○	○	●		Moderate		
Corporate high yield	○	○	●	▲	Moderate		
CURRENCY	USD	○	●	○			
	EUR	○	●	○			
	JPY	○	○	●		Low	
	EM FX	●	○	○		Low	

THE FIRST SIX MONTHS OF 2020 ALTERED THE ECONOMIC, POLICY AND INVESTING LANDSCAPE MORE PROFOUNDLY THAN ANY OTHER HALF-YEAR PERIOD OF MODERN HISTORY. A quick glance at employment data drives this message home—the U.S. unemployment rate leaping from a 51-year low of 3.5% in February to a post-World War II high of 14.7% in April. But equally, the massive policy response, coordinated across fiscal and monetary stimulus in the U.S. and around the world, will shape the global economy for years to come.

Immediately following the shutdown of much of the world’s economy in March, the outlook appeared dire indeed. But today, although we have recorded the deepest economic contraction in 90 years, it looks like it could also be the shortest. Leading economic data already point to a second-half rebound in activity and earnings, and the impact of stimulus is stoking pent-up demand, in turn pushing economic surprise indicators to new record highs.

We believe that the recovery now has a foothold and will extend in the latter half of 2020. To be sure, we anticipate further bouts of volatility, particularly in the runup to the U.S. election, but we believe that the economy is now exiting recession and will move swiftly into, and through, its early-cycle phase. Still, we expect that fiscal and monetary stimulus will remain a significant feature for some time to come—possibly well into the coming

expansion. Over time, this will profoundly shape the next cycle. For the moment, though, we think that the early-cycle phase will largely follow a familiar recovery playbook, with stocks and credit remaining well supported, if choppy.

To some, this scenario might paint an overly optimistic picture, but we would counter that early evidence from Asia indicated significant pent-up demand. Moreover, in regions like Europe the path of the virus has forced long-overdue policy pivots, which can create lasting benefits to the regions' economies and asset markets. Clearly, risks persist, and we will need to be nimble in the months to come, but equally history suggests that a recovering economy should support equity and credit markets.

While the recovery appears to be global—in large part due to the global nature of the virus that triggered the recession—there will still be winners and losers. The capacity to provide fiscal and monetary stimulus is likely to be a key determinant of the pace of recovery. So too will be choices around how to contain any future outbreaks of COVID-19, although we expect many countries will want to avoid a new round of lockdowns, preferring more targeted restrictions that minimize economic damage.

As we adopt a progressively more upbeat outlook, prompted by the turn in economic data, the bottoming of earnings revisions and the ongoing wall of stimulus, we raise our view on stocks and credit from neutral to overweight in our multi-asset portfolios. We recently reduced our view on duration from neutral to underweight, and we maintain this slightly negative tilt while trimming our mild cash overweight back to neutral. These changes represent a more risk-on tone and

reflect the re-risking process that started in our portfolios in mid-Q2. Beginning with a rotation into investment grade (IG) credit and covering shorts in cyclical equities, more recently we added risk in high yield (HY) and global equities.

In equities, we maintain our positive view on U.S. stocks, although with a greater focus on small caps, and keep a positive tilt to European and emerging market (EM) equities. The UK and Canada are our preferred funding markets, but broadly we believe a widely diversified equity overweight is most appropriate, given the widespread recovery in earnings we expect in the second half of the year. In bonds, we favor the U.S. and Australia over German Bunds, while in credit we continue to see merit in investment grade and, increasingly, in high yield, but we are less enthusiastic about EM debt.

In summary, these portfolio tilts combine to give a distinct risk-on feel to our multi-asset portfolios—following a pattern of gradually increasing risk tolerance that began in late April. However, we note that volatility remains rather elevated, and as a result position sizes are still quite modest. Monetary accommodation will likely keep volatility on a gradually downward trajectory, on average, but certainly doesn't preclude episodes of higher volatility. Today we believe that there is sufficient economic momentum to sustain support for stock and credit markets, despite some optically elevated valuations. However, looming political uncertainty over the summer, plus the constant unfolding of the coronavirus story, mean that we are in equal measure optimistic and watchful.

Multi-Asset Solutions Key Insights & “Big Ideas”

In previous editions of our Global Asset Allocation Views, we included a map and table of key global themes. Those themes helped us discuss the economic and market outlook, and shape the asset allocation that Solutions reflected across portfolios. While some of those themes are still in play, we now choose to share the Key Insights and “Big Ideas” discussed in depth at the Strategy Summit. These reflect the collective core views of the portfolio managers and research teams within Multi-Asset Solutions and are the common perspectives we come back to and regularly retest in all our asset allocation discussions. We use these “Big Ideas” as a way of sense-checking our portfolio tilts and ensuring they are reflected in all of our portfolios.

- Recession was short and sharp; we are now in a new cycle.
- Fiscal stimulus is the new normal, but monetary stimulus continues to be the first responder.
- QE is capping yields, but they will rise as growth picks up.
- Credit default risks more than offset by central bank support.
- Equity earnings improving, prefer broad regional exposure.
- The peak in the dollar is passed but for now likely rangebound.
- Continuing to add risk, extending from credit further into stocks.
- The next leg up in stocks likely sees more cyclical leadership.

Active allocation views

In normal times, these asset class views apply to a 12- to 18-month horizon; however, given current volatility and uncertainty, they reflect a horizon of several months but are subject to revision as new information becomes available. We will update this tick chart at minimum monthly during this period of volatility. The dots represent our directional view; up/down arrows indicate a positive (▲) or negative (▼) change in view since the last revision. 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.

Underweight ● Neutral ● Overweight ●

Asset class	Opportunity set	UW	N	OW	Change	Conviction		
MAIN ASSET CLASSES	Equities	○	○	●	▲	Moderate	Earnings revisions starting to turn higher from a low base, yet sentiment remains muted	
	Duration	●	○	○		Low	Disliked on quant signals, central bank buying reflected in prices; real yields negative	
	Credit	○	○	●	▲	Moderate	Strong central bank support, and defaults now largely priced in more speculative ratings	
	Cash	○	●	○	▼		Improving economic outlook reduces attractiveness of cash in portfolios	
PREFERENCE BY ASSET CLASS	EQUITIES	U.S.	○	○	●		Low	Big surge in U.S. large cap makes further upside likely to be led by cyclicals and small cap
		Europe	○	○	●	▲	Moderate	Improved fiscal support in Europe a game changer; strong PMIs point to further gains
		UK	●	○	○		Moderate	Weak domestic outlook and political risks mounting; disliked by quant models
		Japan	○	●	○			Domestic weakness a drag and headwinds from currency a risk, but cyclical tilt helpful
		Emerging markets	○	○	●		Low	Virus still raging in LatAm, but Asia at forefront of global rebound; valuations still cheap
	FIXED INCOME	U.S. Treasuries	○	●	○			Higher yielding and subject to strong demand from Fed and market buyers, but yields low
		G4 ex-U.S. sovereigns	●	○	○		Low	Bunds disliked by quant models and EU policy pivots could pave way for yields to rise
		EMD hard currency	○	●	○			Higher grade EMD at attractive valuation levels, but ongoing funding issues limit upside
		EMD local FX	●	○	○		Low	Geographic footprint less attractive than for EM equity; weakness in EM FX also an issue
		Corporate investment grade	○	○	●		Moderate	Powerful support from Fed for IG, but downgrade risks still need to be considered
	Corporate high yield	○	○	●	▲	Moderate	Improving outlook with Fed support; better energy prices and improving macro data	
	CURRENCY	USD	○	●	○			Key support levels broken, but USD still overvalued; scope to weaken as recovery gains pace
		EUR	○	●	○			Fiscal support packages a game changer for Europe; reduces impetus for ECB to keep easing
JPY		○	○	●		Low	Natural safe haven status lends support if crisis worsens; currency also undervalued	
EM FX		●	○	○		Low	Ongoing virus concerns in some regions a headwind even as acute liquidity fears recede	

Source: J.P. Morgan Asset Management Multi-Asset Solutions; assessments are made using data and information up to June 2020. For illustrative purposes only.

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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 March 31, 2020.

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