

PORTFOLIO INSIGHTS

# Global Asset Allocation Views

## Key findings from the Multi-Asset Solutions Strategy Summit

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AUTHOR



**John Bilton**

Managing Director  
Head of Global Multi-Asset Strategy  
Multi-Asset Solutions

### IN BRIEF

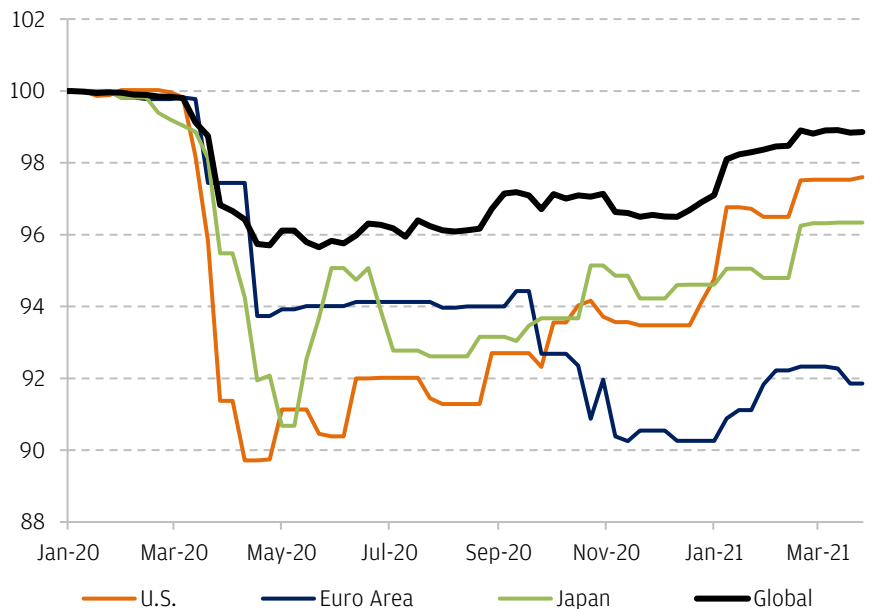
- An extended period of above-trend global growth lies ahead in 2021, initially powered by the U.S. recovery but with other regions picking up by mid-year. Inflation is set to be volatile but ultimately contained while monetary policy remains accommodative.
- Despite economic optimism, expressing a risk-on view is likely to be more nuanced in 2021; we expect equity markets to do well, but with rates also rising, sector and style leadership is shifting, and, above all, earnings growth rather than multiple expansion is set to drive stocks in 2021.
- We favor cyclical equity regions and value as a style, preferring U.S. small cap, Europe and Japan to U.S. large cap and emerging markets. U.S. yields have scope to rise further - in turn supporting the dollar - and high yield remains our preferred fixed income asset.
- Risks around policy, reopening and vaccines persist, but above all we wish to lean into the U.S.-led global economic recovery, even though the precise way we position for this demands a more clinical allocation approach.

EXHIBIT 1: MAS ASSET CLASS VIEWS

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

Amid above-trend global growth, the U.S. economy currently leads given the scale of its policy stimulus and relative success in vaccine rollout

EXHIBIT 2: G3 AND GLOBAL GROWTH FORECAST REVISION INDICES (JAN 2020 = 100)



Source: Bloomberg, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

## SUMMARY

The tone of our quarterly Strategy Summit in mid-March 2021 stood in marked contrast to the mood of the March 2020 summit. A year back, we stared into the abyss – economic and social – and wondered just how bad the damage would turn out to be. Today, while significant challenges of course remain, the combination of ongoing policy support and the quickening pace of vaccine distribution helps create an aura of high optimism.

Beneath the surface, while confidence in the economic outlook is strong, expectations for asset returns are rather more circumspect. Even those who are overwhelmingly positive on the economy accept that expressing such a view in portfolio positioning now requires a more clinical approach than merely buying stocks and selling bonds.

We expect a prolonged period of above-trend global growth that will last through 2021 and well into next year. Initially, the U.S. economy is likely to lead, given the scale of stimulus and relative success of the vaccine rollout. However, we expect other regions to catch up over the course of 2021. Regions such as Europe that are likely at peak pessimism now over vaccine delays seem poised to accelerate later in the year. By contrast, the leadership by Asian economies that was especially strong in 2020 may moderate a little as global services start to catch up to the surge already underway in global goods markets.

Inflation remains a persistent concern for investors. We expect headline inflation to be volatile in the second and third quarters, with the potential for some sticker shock as annualized base effects generate optically elevated year-on-year readings. However, we believe that many of the secular disinflationary forces – globalization, technology adoption, etc. – continue to anchor core inflation so that even allowing for huge policy stimulus, inflation rates should remain contained in 2021.

Policymakers have thus far telegraphed a very sanguine view of inflation. We believe that even if core inflation moves reasonably above target, the Federal Reserve (Fed) will be reluctant to signal policy tightening. At the end of 2021, the Fed may communicate a tapering of bond purchases that would gradually take place over 2022, but even should that occur, we do not see any change to fed funds rates until well into 2023 at the earliest. With other global central banks well behind the Fed, we see a prolonged period of easy financial conditions but steeper yield curves.

The economic and policy backdrop calls for a pro-risk tilt in our multi-asset portfolios. Nevertheless, we acknowledge that the early innings of this market cycle are over and the pace of returns will moderate from here. Picking the best spots to deploy risk is today a more nuanced process. For instance, we want to continue to position for U.S. economic strength, but we will need to rethink the way we express this view. Simply put, the sectors and style tilts that worked so well in the last cycle are unlikely to perform so well as rates rise and curves steepen.

In our multi-asset portfolios we are overweight equities and credit, and underweight duration and cash. The complexion of our equity overweight is shifting, and in 2021 we expect earnings growth to be the primary driver of returns while multiple expansion takes a back seat. As the economy gathers steam, we also expect operating leverage to be important. Sectors with positive gearing to higher rates – such as financials – have scope to rerate.

In equities, we lean into cyclical sectors and regions, and value styles, while reducing our exposure to long-duration equity sectors such as technology, and growth styles. Overall, this leaves us preferring U.S. small caps, Europe and Japan at the expense of emerging markets – which could be further constrained by strength in the dollar – and U.S. large caps. In some of our portfolios, we are further modifying our U.S. exposure to favor an equally weighted S&P 500 in place of the traditional market cap-weighted index.

In fixed income, we see credit returns being primarily driven by carry and favor high yield over investment grade. In sovereign bonds, we are now modestly underweight duration, in particular in U.S. Treasuries, since the Fed has shown little inclination to push back on rising yields.

Overall, our portfolios are geared to above-trend growth, higher yields and a cyclical earnings recovery. Key risks are unjustified withdrawal of policy stimulus stopping the recovery in its tracks, unwarranted consumer caution as economies reopen, or vaccine nationalism deteriorating into wider trade disputes. Nevertheless, our central case remains a strong recovery and an economy moving rapidly from early to mid-cycle, with asset markets continuing to offer decent upside, albeit demanding a more targeted approach than they did last year.

## MACRO OVERVIEW

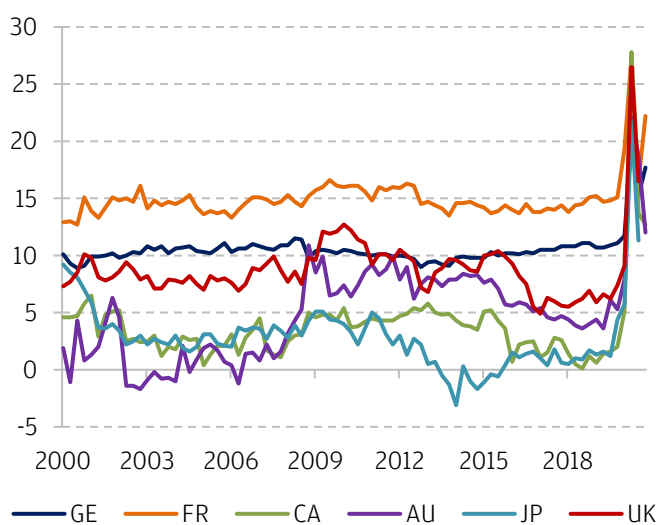
## GLOBAL GROWTH: READY TO SURGE

We expect strongly above-trend growth at least through the end of 2021, with developed market (DM) economies performing particularly well. Following an initial surge as the global economy rebounded from the early-2020 pandemic shock, growth slowed a bit around the turn of the year. Still, this pullback, which owed mostly to a resurgence of the virus in many jurisdictions, proved much milder than initially feared, and we estimate that global GDP expanded only slightly below its trend rate in 1Q21. With vaccination programs now underway, restrictions easing in many countries and fiscal and monetary policies still highly supportive, we look for sharp near-term reacceleration.

At the March Strategy Summit, we discussed several factors, beyond accommodative policy, that support our expectation of strong growth. First, while elevated saving rates in the U.S. have attracted considerable attention, the phenomenon extends much more broadly (**Exhibit 3**). Indeed, household saving rates in DM economies are generally running about 8 percentage points above their pre-shock norms. With confidence rising in most places, the precautionary motive for saving should decline alongside the lifting of restrictions, facilitating strong consumer spending in virtually all jurisdictions.

The pandemic has caused household savings to balloon globally

EXHIBIT 3: HOUSEHOLD SAVING RATES (% OF DISPOSABLE INCOME)



Source: Haver Analytics, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

Second, the profit drag on business investment has diminished. When capex began picking up last year, we thought that weak corporate profitability might represent a near-term constraint on such spending, given the typical relationship between profits and capex. As profitability has strengthened more recently, though, this headwind has disappeared. We therefore expect capex to respond fully to the surge in goods demand, aided as well by easy financing conditions. Indeed, businesses are reporting significantly stronger capex intentions than is usual at this early stage of the expansion.

Third, the retreat from globalization that seemed plausible amid the pandemic shock has not yet materialized. Global exports have moved in line with industrial production. Both bounced strongly in the second half of 2020, with the relationship between the two showing no obvious change relative to the prior expansion. The import market share in both the U.S. and China has held steady as well. To be sure, reorientation of supply chains could take years to develop. For now, though, the lack of any sudden pullback leaves emerging market (EM) economies well positioned to continue benefiting from strength in the global goods cycle.

Fourth, in contrast with some previous downturns, EM economies are showing very little path-dependence. Rather than being blown persistently off course, the EM economies that suffered the largest initial losses have enjoyed the strongest subsequent bounces, even in cases where concerns linger about medium-term policy stances, such as Brazil, Mexico and Turkey. Some of this resilience reflects the ability of local banking sectors to boost credit availability, in contrast to the deleveraging that took hold (outside of China) during the global financial crisis. After external positions strengthened and inflation expectations stabilized in recent years, EM central banks could deliver more policy easing than in prior recessions, including the use of unconventional tools like bond purchases. This accommodation has passed through into local credit availability.

While virus risks no longer dominate our outlook, neither have they disappeared. The “links in the chain” among mobility, cases, bad health outcomes and the economy have weakened, but they still exist. Only when the links are unmistakably broken will the pandemic have finally run its course, at least for the purposes of economic forecasting. Mobility has increased almost everywhere

recently, consistent with our expectation for a strong pickup in activity. But in places where vaccination programs are lagging, such as the euro area, we may continue to see a stop-and-go pattern of restrictions loosening and then tightening again some weeks later. We therefore expect a somewhat staggered reopening process to continue for the next quarter or so.

That caveat aside, we expect the intersection of reopening and fiscal stimulus to push global growth to a booming pace in the second quarter, with our current estimate at nearly a 9% quarter-over-quarter, seasonally adjusted annual rate (Q/Q, SAAR). In our forecast, the pace of global growth peaks in 2Q21, but we think it will remain quite fast in the second half of this year - over 5%, on average. That would be a stronger six-month pace than at any point in the previous expansion. We look for broadly synchronized global expansion, with DM economies growing at similar rates. Especially large and targeted fiscal stimulus gives the U.S. a natural advantage, but its economy has already recovered to a greater extent than others, and we see room for pent-up demand to boost non-U.S. DM economies. Unusually, we expect DM economies to grow as fast as their EM counterparts through the remainder of 2021. This mostly reflects the fact that China's economy has already recovered, although other EM economies should benefit from the booming global goods cycle and the rise in commodity prices.

**EM GROWTH: THE RISK OF CHINA OVERTIGHTENING, EM HERD IMMUNITY**

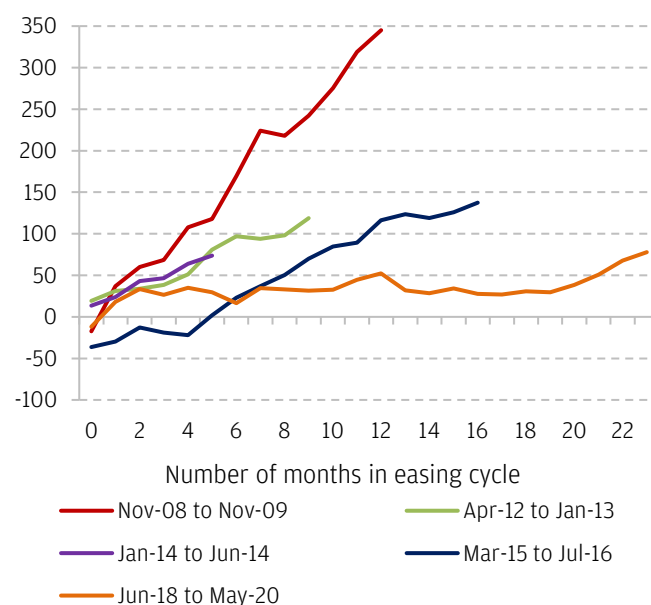
Following a slowdown in sequential momentum in early 2021, we expect China's economic recovery to continue as private consumption and manufacturing investment take the lead in spurring growth this year. In our view, policy overtightening by Beijing represents the key downside risk to our positive economic outlook for China and the global economy.

China's overall policy stance has turned less accommodative since mid-2020 as it has rebounded from the pandemic shock. However, the exit from loose monetary policy has been more gradual than previous tightening cycles. Broad credit growth, as measured by total social financing, only edged down to 13.3% year-over-year (y/y) in February from a recent peak of 13.7% in October last year. That remains high when compared with the pre-recession trend (an average of 10.8% y/y in 2019). Liquidity conditions in the short-term interbank market also appear largely

neutral, as the seven-day interbank repo rate for depository institutions has been hovering around the People's Bank of China's (PBoC's) open market operations seven-day reverse repo rate of 2.2% since the start of March. On the fiscal side, the targets for both the headline fiscal deficit and local government bond issuance revealed at the National People's Congress meeting in early March exceeded market expectations. Fiscal tightening is also on track to be more modest than in previous tightening phases in 2010 and 2017 (Exhibit 4).

**Policy easing was more muted during the last easing cycle (mid-2018 to mid-2020)**

EXHIBIT 4: CHINA FINANCIAL CONDITIONS INDEX (2007=100)



Source: WIND, CEIC, J.P. Morgan Asset Management Multi-Asset Solutions; data as of February 2021.

We continue to expect a gradual withdrawal of policy support. Marginal monetary policy tightening may come in the form of slower credit growth, but we do not expect any hikes in China's benchmark policy rates this year.

While China's GDP growth rebounded to the pre-virus trend level of around 6% in 4Q20, the recovery has been uneven, with small and medium-sized enterprises (SMEs) and the services sector lagging. This two-speed recovery was exacerbated by tighter mobility restrictions amid a COVID-19 resurgence in January and February, which affected services sectors and smaller enterprises more. A sharp monetary tightening would likely hit those sectors hard. That would pose a challenge to labor market stability, as

services sectors are more labor-intensive than manufacturing sectors and SMEs account for around 80% of China's urban employment.

In addition, inflationary pressure is unlikely to be a concern for the PBoC. Over the course of the year, CPI inflation is expected to rise as a result of easier base effects, a further recovery of consumer demand and higher energy prices. But we think CPI inflation this year is unlikely to breach the PBoC's ceiling of 3%.

At the same time, Chinese policymakers are looking to keep the overall leverage ratio largely stable in 2021. Given that we expect China's nominal GDP growth to rebound to over 10% y/y in 2021 from 3% last year, only a moderate decline in credit growth to around 10%-11% is needed to achieve this goal. What's more, the magnitude of easing this time around (from mid-2018 to mid-2020) looks modest compared with the 2008-09 and 2015-16 easing cycles. This lessens the need to tighten aggressively this year.

Policymakers have voiced concerns about a potential property bubble, although this does not seem to be a nationwide problem. While home prices are rising quickly in the top-tier cities, many lower tier cities are still struggling with housing oversupply. As a result, broad-based monetary tightening may be too blunt a tool, and we anticipate more city-specific property policies will attack more specific overheating situations. On balance, though, we expect China's policymakers to focus more on containing financial risks than their counterparts in other major economies, given that China is ahead in the recovery process.

The pace of growth presents the main risk to our relatively sanguine base-case outlook. If China's economic growth turns out to be much stronger than we expect, especially with a fast recovery in the services sectors, it could potentially lead to complacency among China's policymakers and trigger stronger policy tightening than our current expectations.

Beyond China, progress toward herd immunity to the coronavirus seems to vary significantly across the different EM regions. EM Asia is running notably behind Latin America and EEMEA economies in natural immunity because of its relative success in controlling COVID-19 so far. Vaccine rollouts also seem less urgent in EM Asia compared with the other regions. On the whole, major economies in EEMEA and Latin America are likely to achieve herd immunity later this year, while most EM Asia

economies will approach herd immunity only in 2022. In addition, social distancing measures are still significant in emerging markets outside of Asia. As more people are vaccinated and virus-related restrictions are lifted, we could see more growth upside for LatAm and EEMEA economies vs. EM Asia.

#### THE STATE OF THE CYCLE: OVERHEATING AHEAD?

The strong growth forecast for coming quarters, after the already impressive bounce in the second half of 2020, implies an expansion that is very different from the one that followed the global financial crisis. Then, spare capacity in labor and product markets lingered for years. This time around, economies seem likely to absorb that slack much more quickly. Indeed, the U.S. economy will likely climb above its pre-shock level of activity by mid-year. That raises an obvious question: Will overheating pressures soon develop?

Given that the degree of slack in the economy cannot be directly observed, we estimate it in various ways. We create a path for potential GDP using trend-growth projections from our Long-Term Capital Market Assumptions, and we also use the Congressional Budget Office's econometric calculations. These approaches currently tell similar stories. At the end of 2020, the economy was probably operating with considerable slack, to the tune of roughly 1%-2% of GDP, while we forecast the U.S. will move about 2%-3% above that trend by the close of this year. Relative to potential, that would put the economy more or less where it was just before the pandemic shock.

An examination of the labor market produces a similar result directionally but points to a bit more spare capacity. While the unemployment rate is around its long-term average (though still well above its late-2019 level), the sharp fall in the participation rate (the share of the population actively engaged in the labor market) means that open joblessness understates slack. Correcting for this distortion, we believe spare capacity in the labor market currently amounts to about 2%-3% of the working-age population, which based on our forecasts would dwindle to about 1% by the end of 2021. But given the nature of the damage suffered by the labor market in the downturn - concentrated in worker-intensive sectors that stand to rehire on a large scale as restrictions ease - the "jobless growth" pattern of the last two expansions seems unlikely to recur this time.

Other DM economies are likely lagging a bit behind the U.S. in reabsorbing spare capacity. But a calculation of 2019 output gaps based on unemployment rates, combined with our trend-growth assumptions for each economy and our forecasts for the rest of this year, generally implies the output gap will close by the end of 2021. Still, we think that only in 2022 will these economies push more clearly into above-potential territory. And we see a much more heterogeneous situation in EM economies.

Manufacturing-oriented Asian economies, which suffered less during the downturn and are now experiencing export booms, are likely operating at or above potential. But significant slack probably exists in many economies in Eastern Europe, Africa and Latin America.

Our business-cycle scorecard for the U.S. reflects the fast-moving nature of this expansion. Already, we have moved 10 of the 17 categories into “mid-cycle” territory. Does that judgment imply an early and abrupt end to this cycle? At the moment, that conclusion seems premature. Extremely elevated saving rates make a recessionary pullback in private sector spending highly unlikely (outside of another crushing wave of the virus). And policy remains highly supportive against a backdrop of low inflation. While some vulnerabilities identified during the last cycle persist, such as high corporate leverage, we do not currently see a plausible path from those weaknesses to an across-the-board slump in growth. Instead, we think the current configuration of the scorecard suggests only limited remaining “catch-up” lift to the economy beyond this year. That by no means rules out strong growth in 2022 and beyond. But it implies that such buoyancy will need to come from some combination of stimulative policies, exuberant private sector sentiment and rapid productivity growth (perhaps benefiting from technological change). Pent-up demand alone won’t do the trick.

#### **INFLATION: A NEAR-TERM SURGE, A LONG-TERM SLOG**

Although the initial pandemic shock damaged both demand and supply, it quickly became apparent that in net terms the recession would prove disinflationary. Indeed, a few short-term gyrations notwithstanding, headline and core inflation in both DM and EM economies moved lower in the quarters following the outbreak of the virus. In the U.S., while the level of goods prices rose as demand surged amid supply constraints, services prices, which carry a much heavier weight in the inflation basket, slowed significantly.

From here, the path for inflation looks more complicated. In coming months, we expect upward pressure on inflation from two sources. First is the simple base effect, as year-on-year rates will jump in the second quarter, thanks to the comparison with the pandemic-related trough. This phenomenon will be particularly clear in headline rates, given much higher energy prices this year than last. Second, as restrictions on mobility ease, we expect a surge in demand for various services, such as air travel, that will likely create bottlenecks and give firms temporary pricing power. We think these reopening price jumps will likely fade toward the end of 2021.

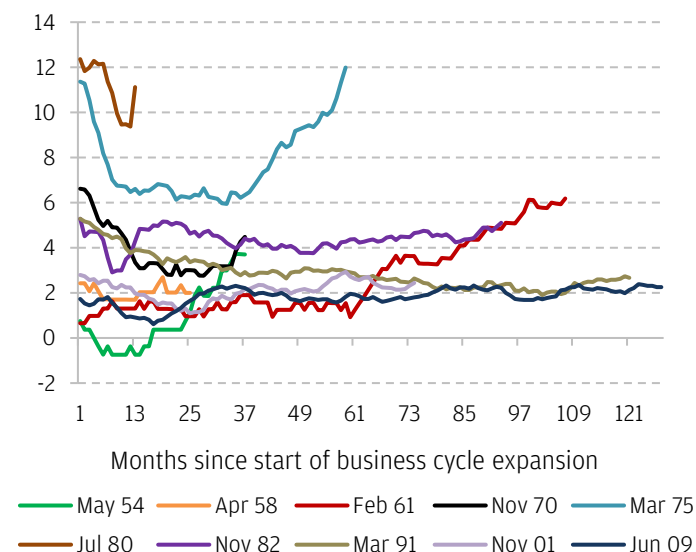
Beyond this year, we expect a slower upward grind. We model inflation primarily as a function of inertia, expectations and slack, with small roles for energy prices and currency fluctuations. In our view, these influences point to slightly higher inflation in the U.S. during the next year or two than was the case a few months ago, but only marginally so. The effect of inertia, following years of below-target inflation, should remain a powerful dampener, although some of the upward jolt we expect in coming months could linger. Inflation expectations appeared to be falling in mid-2020. They have rebounded since but still seem anchored around, or perhaps slightly below, the Federal Reserve’s 2% target. And while slack is in the process of moving from a restraint to an accelerant, its influence on inflation outcomes has diminished greatly in recent decades. Indeed, inflation displayed almost no cyclical in the past several expansions (**Exhibit 5**), including the last one, which featured a very low unemployment rate for an extended period but no sustained pickup in price increases.

Our top-down analysis of inflation points to a gradual pickup in its underlying trend, with core consumer price inflation running just above 2% in 2022. A bottom-up examination of the various components leads us to a similar but slightly lower conclusion, especially for the core personal consumption deflator that the Fed targets. Significant parts of the index, such as health care and shelter prices, respond to the economy in more complicated ways, and we think they will exercise some restraint on inflation relative to what overall conditions might suggest.



## Inflation has shown little cyclical in recent decades

EXHIBIT 5: U.S. CORE CPI BY BUSINESS CYCLE EXPANSION (%Y/Y)



Source: Haver Analytics, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

Outside the U.S., we think the inputs into inflation forecasts for other DM economies tilt to the low side in the euro area and Japan. While we do not expect Japan to move back into deflation, we see limited prospects for an acceleration away from the current inflation trend of around zero. Euro area inflation displays slightly more vibrancy, but the region has been well shy of its inflation target for several years, and expectations appear to have downshifted significantly. Slack seems likely to persist for longer than in the U.S., and the currency's appreciation over the past year will not help. Canada and possibly the UK stand on the other side. Inflation in both economies has run closer to the target recently than is the case for the U.S. The unknown effects of the Brexit transition on the UK economy and its productivity, though, complicate medium-term inflation forecasting there.

**POLICY: DM CENTRAL BANKS DOVISH, SOME EM HIKES**

How will monetary policymakers react to an environment of strong growth, tightening resource constraints and choppy inflation data? We expect DM central banks to stay dovish, with tightening moves lagging improvements in economic conditions, as policymakers seek to boost inflation expectations and get closer to their targets than was generally possible in the last expansion.

We think the Federal Reserve's approach has evolved in at least three ways. First, the Federal Open Market Committee (FOMC) is now prioritizing realized inflation rather than relying on forecasts alone. It will act based on what inflation has actually done rather than what it is projected to do. Second, with inflation forecasts deemphasized, the role of the labor market in the Fed's thinking has shifted. Previously, low unemployment served not only as a goal for the Fed but also as a driver of higher inflation projections. Instead of "too much of a good thing," a tighter labor market is now, in the eyes of the Fed, a welcome phenomenon. Third, under the average inflation targeting framework, the Fed wants to overshoot its 2% target at least temporarily in this cycle in order to lean against the long-term downtrend in expectations. Given this goal and the Fed's greater confidence in its ability to lower inflation rather than raise it, we see the FOMC's current preferences as asymmetric. In other words, we think the Fed would be happier with inflation a bit above 2% than slightly below that mark.

Based on this understanding of what the Fed is trying to achieve, we think around the end of this year the Fed will likely announce its intention to scale back asset purchases, with the actual reduction beginning in early 2022. By that time, we think the unemployment rate will be just above 4%, with core inflation running just shy of 2%, which should meet the criterion of "substantial progress" toward the Fed's goals. We think the process of winding down quantitative easing (QE) will take a little more than a year, longer than the exit of the previous cycle's "QE3" purchase program because of the higher run rate this time around.

We pencil in a first rate hike in the second half of 2023, about two quarters after the end of asset purchases. That expectation depends on core inflation having been above 2% for quite some time and the jobless rate having dropped below 4%, with corresponding compression in unemployment rates for historically disadvantaged groups. In contrast with the asset purchase taper, the Fed has made the triggers for rate hikes fairly clear, and we believe the FOMC will not mind waiting longer to hike if those conditions have not been met. In that sense, we think the risks to our forecast tilt to a later rather than earlier first rate hike.

While today all DM central banks look to hold maximally accommodative stances, we expect some variation to creep into the policy outlook in the coming quarters. The European Central Bank (ECB) has been pushing back harder against the recent rise in bond yields than the Fed has done, and we think the ECB will continue to plant itself at the most dovish end of the spectrum, alongside the Bank of Japan (BoJ). In short, we doubt the euro area's policy interest rate will rise for the foreseeable future. By contrast, the Bank of Canada (BoC) will likely stake out more hawkish territory, given its more comfortable recent inflation track record and a bright cyclical outlook for the Canadian economy. The BoC will likely precede the Fed in ending asset purchases and raising interest rates. In the previous cycle, the Reserve Bank of Australia (RBA) joined the BoC in acting quite cyclically, but inflation has fallen far short of the RBA's target in the past decade and the bank has adopted an aggressive goal for labor market tightness. Thus, we expect the RBA to lag the Fed in this cycle.

Finally, considerable uncertainty surrounds the Bank of England (BoE), given that difficult-to-forecast consequences of Brexit will manifest themselves in coming years. Until recently, the BoE was hinting at a rate cut into negative territory, but its latest communication has moved in a less dovish direction. Ultimately, we think it will act more or less like the Fed, albeit with the specific nuance that BoE policymakers have recently suggested they will tighten first by reducing balance sheet size before raising short-term interest rates. Notwithstanding these various small differences, we expect all DM central banks to echo the Fed. That is, they'll be patient and demonstrate a greater willingness than they have in the past to allow economies to run hot in the service of somewhat higher inflation.

In emerging markets, we expect most central banks to maintain easy policy stances this year, but we see greater risk of policy tightening in the high yielder space. We identify two potential constraints on EM monetary policy this year: inflation pressure and rising global bond yields, each of which could force EM central banks to tighten earlier than previously expected.

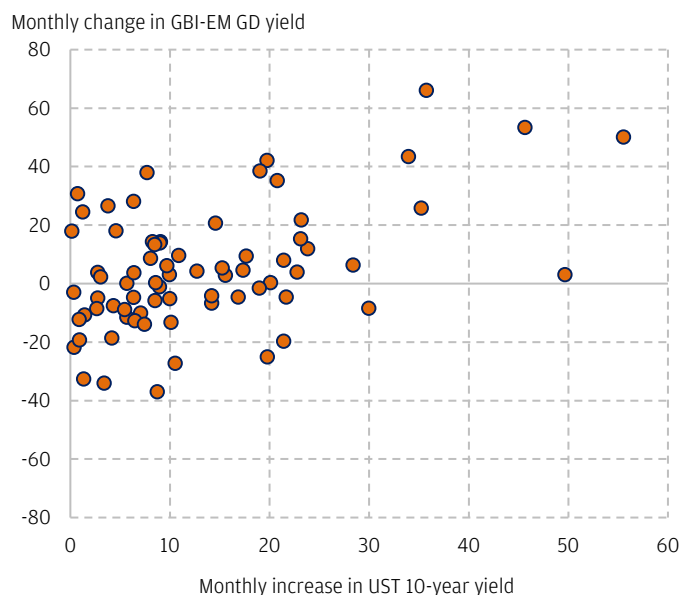
On the inflation front, while we are not seeing broad-based EM inflationary risks, there are selected pressures in key components of the EM CPI basket: food and fuel prices. Fortunately, the starting point in the EM aggregate is one of low inflation at both the headline and core levels, which leaves some room for

increases before triggering concern for most EM central banks. Moreover, demand-pull price pressure, outside of a few EM Asia economies, looks likely to be insignificant this year, given the amount of slack in most EM economies. Nevertheless, headline CPI inflation for some high yielders, such as Russia and Brazil, is expected to breach the upper bound of official inflation targets, which has already motivated one rate hike each from these two central banks.

The impact of prospective Fed normalization on emerging markets depends on the pace and magnitude of the rise in U.S. rates. Past data suggest that higher U.S. rates cause a problem for EM economies if the 10-year U.S. Treasury yield rises at a pace faster than 30 basis points (bps) per month (**Exhibit 6**). Pressure from higher U.S. rates is also compounded in the presence of external vulnerabilities, which in the past have compelled EM central banks to hike rates sharply. Most EM economies display greater external stability now than during the taper tantrum episode of 2013, mitigating the risk of disruptive policy tightening.

### Sharp increases in US 10y yield tend to put more upward pressure on EM yields

EXHIBIT 6: MONTHLY CHANGE IN GBI-EM GLOBAL DIVERSIFIED YIELD VS. UST 10-YEAR YIELD (BASIS POINTS)



Source: Bloomberg, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.



The U.S. economy is advancing rapidly through the early-cycle phase

EXHIBIT 7: THE BUSINESS-CYCLE SCORECARD FOR THE U.S.

		Early cycle	Mid cycle	Late cycle	Recession
Economic metrics	Overall economic output	<b>Below potential, rising</b>	Near potential, rising	Above potential, rising	Contracting
	Consumption	Low, lagging income	<b>Recovering</b>	High, ahead of income	Falling
	Capital investment	Low as % of GDP	<b>Rising, moderate as % of GDP</b>	High as % of GDP	Falling
	Residential investment	Low as % of GDP	<b>Rising, moderate as % of GDP</b>	High as % of GDP	Contracting
	Price inflation	<b>Below central bank target, stable</b>	Below CB target, rising	Above CB target	Falling
	Wage inflation	<b>Low, stable</b>	Moderate, rising	High	Falling
	Private credit formation	Low, starting to rise	<b>Rising in line with output</b>	Rising faster than output	Falling
	Personal savings rate	High relative to income	<b>Starting to decline</b>	Low relative to income	Rising vs. income
	Unemployment	<b>Well above NAIRU</b>	Above NAIRU	Around or below NAIRU	Rising sharply
	Consumer confidence	Low	<b>Moderate</b>	Exuberant	Falling
Asset market metrics	EPS revision ratios	Downgrade cycle, improving trend	<b>Upgrade cycle, improving trend</b>	Upgrade cycle, falling trend	Downgrade cycle, falling trend
	Corporate margins	<b>Rising</b>	Peaking	Declining	Low
	Credit spreads	Wide, contracting	<b>Tight, stable</b>	Past cyclical trough	Wide, unstable
	Aggressive issuance	<b>Low as share of total</b>	Moderate as share of total	High as share of total	Nonexistent
	M&A activity	Low	<b>Moderate</b>	High	Nonexistent
	Yield curve	<b>Rates low, curve steep</b>	Rates rising, curve flattening	Rates high, curve flat	Rates falling, curve steepening
	Volatility	Vol high, skew falling	<b>Vol low, skew low</b>	Vol starting to rise, skew rising	Vol high, skew high

Source: J.P. Morgan Asset Management Multi-Asset Solutions; assessments as of March 2021.

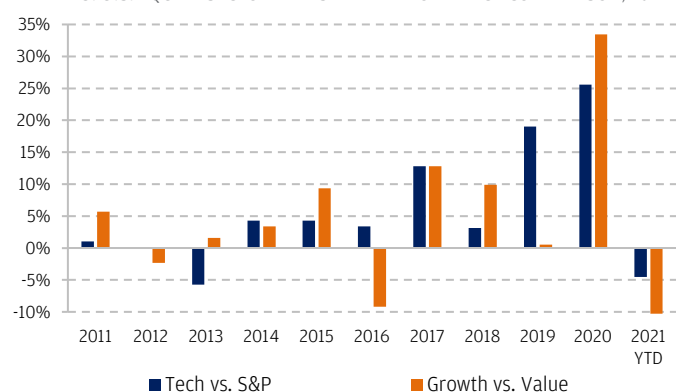
## LEVEL ONE ASSET ALLOCATION

Given our upbeat growth outlook, and our expectation that inflation will be both contained and insufficient to trigger a hawkish policy reset, we maintain a broadly risk-on tone in our multi-asset portfolios. Nevertheless, we acknowledge the awkwardness of expressing a positive economic view in assets that are, by many objective measures, already expensive. Over the last 12 months, global equities powered to new highs exclusively on expanding multiples while earnings declined in lockstep with the economic contraction. In 2021, we expect robust earnings growth, while easy policy lends some support to valuations. Though valuations are now demanding, the strength of the economic rebound, and the upside risks presented by fiscal stimulus and an emerging investment cycle, call for a pro-risk tilt.

Of course, as growth picks up, interest rates cannot stay compressed indefinitely. However, as market price action in the first quarter demonstrated, if rates are going up for the “right” reasons - better growth as opposed to tighter policy - then equity and credit markets can take the move in their stride. Yet we do see implications for which sectors, styles and regions lead and lag. As rates rise, we prefer to lean into cyclical sectors and value styles (**Exhibit 8**), but above all we are targeting those parts of the market most exposed to improving corporate earnings. This is in contrast to 2020, when expanding multiples supported a broad-based risk exposure. This year, we need a more clinical approach as differentiation across sectors, regions and styles becomes more acute.

**For the first time in over a decade, the tech sector and growth style are both underperforming**

EXHIBIT 8: U.S. EQUITY SECTOR AND STYLE PERFORMANCE COMPARISON, %



Source: Bloomberg, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

At the broad asset class level, we continue to be overweight equity with moderate conviction. We also maintain our overweight to credit but with low conviction, given the practical limitations to further spread compression. We keep our underweight on cash and take duration to a low conviction underweight as well, reflecting the likelihood that rates continue to move gradually upward from current levels.

As earnings rebound over 2021, we expect equity markets to offer reasonable upside. Nevertheless, high valuations and lingering concerns over inflation and policy mean a slower pace of gains than the leap-from-the-lows we saw in 2020. Base effects in the first and second quarters, together with analysts’ reluctance to upgrade forecasts, suggest the potential for robust earnings seasons in the first half of 2021. In our view, this favorable environment will persist through the year, given the scale of pent-up consumer demand, increases in corporate capex and rerating potential in the banking sector. While unwarranted policy tightening could upset the party, this seems unlikely. And even as nominal yields follow inflation higher, we expect real yields to remain negative - and thus supportive for stocks.

Credit spreads tightened extremely quickly from their 1Q20 wides - initially spurred on by central banks backstopping credit markets but increasingly by evidence that fears of double-digit default rates would not materialize. As the economy continues to recover, realized defaults are likely to remain depressed. This will offer modest scope for further spread tightening in more speculative rating sectors. Risks in higher quality credits are more tilted to duration than spread at this point, but we nevertheless anticipate steady ongoing demand, particularly from corporate and public pension plans seeking to de-risk after windfall equity gains.

During 2020, our quantitative models pointed to higher yields. However, within the context of a multi-asset portfolio we preferred to express our positive economic view mainly through overweights in equity and credit rather than underweights in duration. Over the first quarter, as the repricing of growth has driven yields higher, it has become clear that the Federal Reserve sees little need to push back on higher long-dated yields. This new information leads us to consider a modest underweight to duration, especially in U.S. Treasuries, in our portfolio mix. To be clear, we expect the Fed to keep short rates locked until at least mid-2023 and begin any tapering only in early 2022. But this

does not preclude modestly higher yields and steeper curves over the course of 2021 as the recovery broadens further.

Given this policy perspective, we keep cash at an underweight. We anticipate some volatility in headline inflation and see the potential for a spike in the second quarter, which will keep real yields firmly negative. With central banks around the globe continuing to provide ample liquidity and economic risks abating, the negative premium on holding cash is likely to persist throughout 2021, in our view.

In sum, we maintain a positive view on growth, with the U.S. economy in pole position at least for the first part of 2021. This likely supports the dollar in the short term and points to steeper curves. But while the outlook for the U.S. economy is clearly positive, the asset class impact is more nuanced. Steeper curves and a broadening recovery lend support to cyclical sectors and regions. Meanwhile, the longer-duration, growth style sectors that dominate U.S. cap-weighted indices and are highly prevalent in emerging markets look set to take a back seat. As a result, our portfolio tilts seek a more considered exposure to the continuing U.S. economic recovery while leaning into the wider global rebound that we expect to emerge over the course of 2021.

Our Level One scorecard favors equities and credit

EXHIBIT 9: LEVEL ONE SCORECARD

	Considerations	Comment	Stock	Bond	Credit	Cash
Macro factors	Economic growth	An period of above-trend growth lies ahead in 2021, with leadership broadening out beyond the U.S.	+	-	+	0
	Financial conditions	We see a prolonged period of easy financial conditions ahead, with spreads to remain contained	+	0	+	0
	Monetary policy	DM central banks to stay accommodative, rolling back stimulative policy only very gradually	+	+	+	-
	Tail risks	Withdrawal of policy stimulus; vaccine nationalism; inflation upside; China over-tightening	-	0	-	0
Market factors	Valuation - absolute	Global equities expensive; balanced risks to bond yields; less scope for spreads to tighten further	-	0	0	0
	Valuation - relative	Equity risk premium, though lower, remains elevated; duration cheaper but not cheap; credit looks rich	+	0	-	-
	Fundamentals	EPS recovery in train; policy balancing growth recovery for bonds; leverage still extended in credit	+	0	0	0
	Positioning	Equity positioning elevated; bonds more evenly balanced; credit only slightly overweight	-	0	0	-
	Flows/sentiment	Substantial flows into stocks recently; outflows from bonds; credit flows remain positive	+	-	+	-
	Overall Score		+	-	+	-

Source: J.P. Morgan Asset Management Multi-Asset Solutions; assessments as of March 2021.

## LEVEL TWO ASSET ALLOCATION

At this juncture, we shift our perspective. In the preceding pages, we examined our Level One asset choices, the basic portfolio decisions involving broad asset classes (for example, stocks vs. bonds). We now present our Level Two asset decisions. Here we look within asset classes and determine, for example, what type of credit (investment grade, high yield or emerging market debt) appears most attractive.

### RATES

We shift to a negative stance on duration, though we hold that view with low conviction. Over the last quarter, the JPM GBP global bond yield has risen 40bp, with real yields driving the move higher. Two primary factors prompt our change in outlook. First, we note the larger than expected U.S. fiscal stimulus package of USD 1.9 trillion. Second, we take into account the Federal Reserve's willingness to accept the rise in yields as a reflection of stronger growth and not necessarily a tightening of financial conditions. We thus expect yields to continue rising this year as the recovery strengthens, fiscal policy turns more pro-cyclical globally and vaccine delivery speeds up across both emerging and developed markets. Our quantitative models remain underweight duration. Yields have already risen quite a bit - a total move of nearly 100bp in U.S. 10y yields since November - so our conviction in this view is low.

For coming quarters, we think the main risks to our asset allocation views stem from the bond market and inflation. Perceptions that inflation may start to rise sharply and persistently could take hold in the second quarter as investors navigate inflation volatility. In Q2, headline inflation should move well above 2% based on base effects, reopening activity and temporary supply-chain disruption. We expect that this rise is temporary and that core inflation will settle back into a gradual rate of increase in H2. But markets may start to latch on to this inflationary narrative and overshoot on inflation expectations amid the buoyant growth of Q2 (consensus expects over 7% quarter-over-quarter U.S. growth in Q2). The risk of high and rising inflation is quite different from the risks we foresaw in recent years. Critically, it challenges the role of bonds acting as diversifiers to pro-risk positioning. In sum, we expect bond yields to rise further before the diversification benefits of duration in multi-asset portfolios become relevant again.

Global central banks' quantitative easing programs are still likely to continue well into the economic recovery as central banks focus on keeping real yields low. But we learned that central banks cannot always alter the direction of a bond yield move and for now are affecting only the magnitude of the rise or fall. In a world where fiscal policy is being used more pro-cyclically, the balance between government bond supply and demand is shifting toward excess supply. Moreover, we expect more differentiation across bond markets based on central bank willingness and ability to resist the cyclical move higher in bond yields.

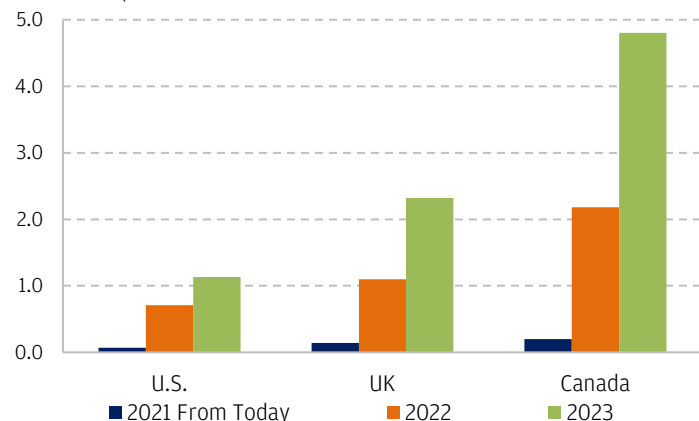
In determining our relative preferences among government bonds, we evaluate a bond market's beta to global growth (its cyclicity) and the outlook for the country's central bank. The first quarter of 2021 revealed a new central bank divergence in which countries with weak inflation outcomes and weak inflation expectations (Europe and Japan) are likely to see their central banks remain dovish while countries with a better record of meeting inflation targets (the U.S., Canada, the UK) should see their government bond yields rising faster. The result: We now prefer Japan's bond market, where we expect yields to rise the least.

Our least preferred markets are the U.S., Australia, the UK and Canada. Yields have risen across all four markets, and market participants are already pricing in steep rate hiking pathways in most of the regions. But in an environment of above-trend global growth, with services-related sectors reopening and unprecedented fiscal easing underway, these economies should experience larger rate rises than Europe and Japan. In the U.S., Australia, the UK and Canada, central banks are likely to first remove policy accommodation by reducing QE (tapering asset purchases) and then signal the start of policy normalization (**Exhibit 10**).

Market pricing points to the U.S., UK and Canada as leaders in the eventual normalization of monetary policy

EXHIBIT 10: CUMMULATIVE NUMBER OF HIKES PRICED BY YEAR

# of 25 basis point hikes



Source: Bloomberg, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

In the U.S., the long end of the yield curve led yields higher over the last quarter as inflation expectations reflat and long-term growth expectations normalized. In the next phase of the bond sell-off, we expect catch up from the belly of the curve (5- to 10-year) as the market prices in the reopening, recovery and eventual normalization in Fed rate policy. Real yield rises are crucial in this equation. We expect a larger component of the rise in yields to come from higher real yields as growth recovers. But this process should be gradual and managed by central bank purchases and forward guidance. While there is a risk of a sharp and disorderly repricing of 10-year real yields, we assign a low probability to this outcome, as real yields have already adjusted (up 40bps since January) and central bank guidance is acting to counter real yield rises.

We have been largely positive on inflation bond markets since last March. But with inflation breakeven rates over 2.2% and forward inflation measures (5y5y) already pretty extended, our positive outlook has cooled somewhat. We continue to expect that a rebound in realized inflation will support inflation markets in Q2. But our medium-term views still point to only a gradual pickup in inflation and do not signal significant overshooting of market pricing over central bank targets. Moreover, with the Fed now allowing markets to reprice bond yields higher, including pricing in an eventual normalization in policy, we see limited room for inflation breakevens to rise significantly from current levels (Exhibit 11).

Over the last 12 months, breakeven inflation rates have risen; real yields have only just started rising

EXHIBIT 11: DECOMPOSITION OF U.S. 10Y NOMINAL YIELDS: BREAKEVENS VS. REAL YIELDS



Source: Bloomberg, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

In the UK, Gilt investors focus on the superior rollout of vaccines and the faster reopening trajectory in the UK vs. other regions (such as Europe). In an environment where better vaccine rollout maps to faster reopening and the associated boost in economic activity, Gilts have been very sensitive to the global duration sell-off. In the midst of this improving growth outlook, the Bank of England turned away from a discussion of negative rate policy and now contemplates upside risks to inflation in certain instances. We expect Gilts to exhibit higher cyclicality (and beta) as global bond yields rise, and thus we moved Gilts to an underweight stance for now. Eventually, the uncertainty on Brexit outcomes and the likely drag on growth should dominate the price action, but for the moment the reopening play prevails.

Canada and Australia sit in the higher beta camp and should follow U.S. yields higher. Central banks in both jurisdictions are likely to start tapering asset purchases in H2 of this year, and the market is already signaling that rate hikes in these markets are on the way. While we are more skeptical on the timing of rate liftoff in these markets, we do expect these 10-year yields will rise as global economic data rebound strongly this year. Yields have risen sharply in both Canada and Australia in the last month - a theme we expect to continue, albeit at a more measured pace in coming quarters.

Within an overall underweight duration view, we prefer low beta markets like Japan. Japanese government bond (JGB) yields have exhibited relatively low sensitivity to global duration, and the Bank of Japan’s affirmation on yield curve control bands (albeit 5bps wider) is anchoring 10-year JGBs while yields rise in other bond markets. We see another support for JGBs: low entrenched inflation and inflation expectations, which then force the central bank to remain easy even while growth rebounds. As the BoJ targets the 10-year yield through yield curve control, it allows JGBs to outperform other markets. This is a key reason we prefer Japanese duration at this stage of the cycle.

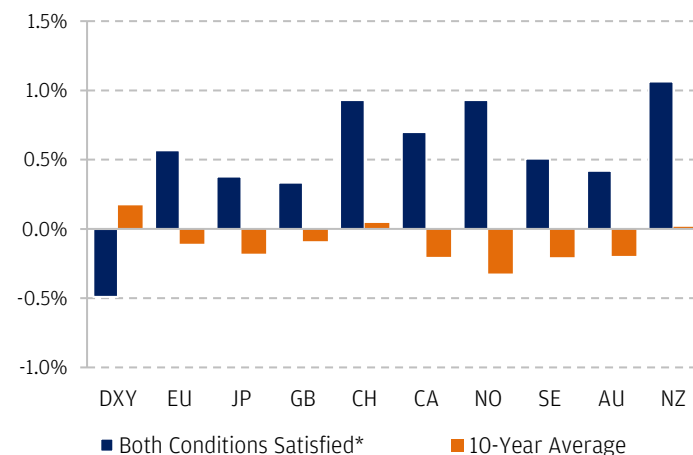
We think the European Central Bank will migrate more to the BoJ framework than to the Federal Reserve, given the ECB’s poor record on achieving inflation targets and the fact that inflation expectations are becoming less sensitive to the amount of slack in the economy. The ECB recently stepped up the pace of asset purchases in an effort to counter the rise in European bond yields and differentiate Europe’s fixed income market from its U.S. counterpart. We expect this approach to remain in place while the recovery in Europe is fragile and the pace of vaccine rollout lags other regions. But in the second half of this year, even the ECB may be forced to slow the pace of QE. We are neutral on German Bunds and expect the UST-Bund spread to widen over the short term. The preferred expression of our views on European bonds: We are pro-carry, with a positive view on peripheral spreads vs. core markets, especially while the ECB is ramping up the pace of QE.

FX

As we have noted in the past, strong implications for FX performance stem from our macro base case - that is, above-trend global growth through 2021 and higher yields reflecting better growth rather than tighter financial conditions. Those implications include depreciation of USD vs. growth-sensitive (Exhibit 12), cyclical currencies and equity flows supportive of currencies geared to the value style. At the March strategy summit, we concluded that the U.S. is set to lead global growth in 1H21, with other regions starting to catch up from mid-year. So while we continue to anticipate a secular decline in the dollar, in the short run an episode of USD support and modest appreciation is plausible in 1H21.

Historically, synchronized global growth and global monetary easing have held strong implications for G10 FX performance

EXHIBIT 12: AVERAGE MONTH-ON-MONTH FX PERFORMANCE VS. USD, %



Source: Bloomberg, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

\*Conditions of macro base case are (1) synchronous global growth - proxied as any month when U.S. growth revisions do not outpace the global average, and (2) globally easy monetary conditions - proxied as any month when the UST10-Bund yield spread is tighter than its 10-year average.

USD

Recent developments in U.S. rates have driven markets globally, FX included, in 1H21. Though yields have been on the rise for months, recent repricing has been more aggressive and, crucially, driven by real yields. These moves have widened differentials back in favor of USD; also, in the context of larger than expected U.S. fiscal stimulus, the Fed has accepted the repricing of longer dated yields while reiterating its dovish approach to policy rates. In our view rising Treasury yields entirely reflect stronger domestic growth prospects rather than tightening financial conditions. Year-to-date, this reassertion of U.S. cyclical exceptionalism led to broad-based appreciation of USD. Our newly revised neutral stance on USD reflects the balance between near-term and longer-term factors.

Currently, U.S. cyclical exceptionalism supports the dollar. Growth leadership, in particular as the U.S. exits the pandemic, as well as eventual policy normalization seem likely to occur at a more differentiated pace than was previously anticipated.

Meanwhile, over the medium term we expect a synchronized reacceleration of global growth to depreciate USD. Specifically, non-U.S. growth should rebound as laggards in vaccine rollout and reopening catch up. Moreover, as previously discussed, we



expect both fiscal and monetary stimulus to persist, limiting yield momentum while supporting activity.

Comparison to the taper tantrum of 2013 offers a guide to how this opposition may evolve. In both periods, a sharp pickup in Treasury yields coincided with DXY strength, but there the similarity ends. Today, higher yielding, commodity-sensitive currencies have been more resilient while lower yielding reserve FX have lagged vs. USD. The inverse held true in 2013.

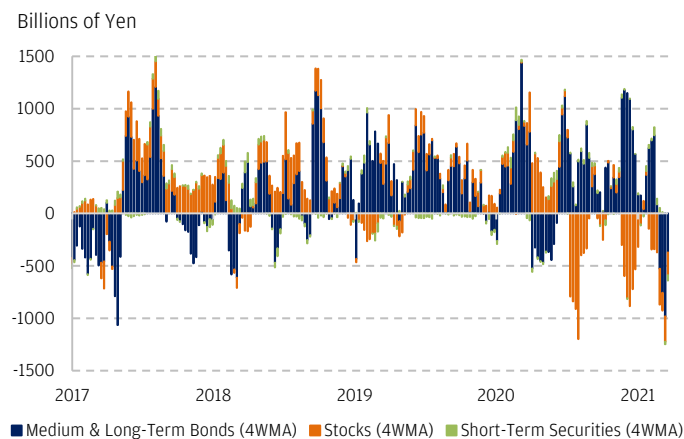
We emphasize the post-pandemic recovery backdrop as the key differentiator. During 2013, medium-term growth revisions across emerging markets, the euro area and the U.S. were not as simultaneously constructive as they are today. Following the taper tantrum, DXY strength persisted as U.S. exceptionalism intensified. By contrast, in 2021 we do continue to expect other regions to catch up to the U.S. growth acceleration later in the year; meaning that the current period of USD support is likely time limited, with scope for the secular downward pressures on USD to come back into play in 2H21.

### JPY

While global themes of higher rates, steeper yield curves and an aggressive rebound in growth counteract each other in the USD outlook, the yen is vulnerable in both dimensions. We thus downgrade JPY to underweight, though with moderate conviction. The yen's combination of favorable long-term valuations and Japan's current account surplus should support JPY as and when broad-based dollar depreciation starts again. However, in the near term the upward trajectory of U.S. real yields and the broader reflation narrative will continue to depress JPY as a lower yielding currency that has also traditionally traded with a safe-haven premium. An important point of scrutiny is the pace of Japanese portfolio outflows: in recent years these have depressed the yen via the unhedged purchases of foreign debt. But currently Japan is a net seller of debt, which could act as a countervailing force against near-term JPY weakness (**Exhibit 13**).

### Purchase of foreign assets by Japanese investors has decelerated

EXHIBIT 13: WEEKLY JAPANESE NET INVESTMENT IN FOREIGN SECURITIES



Source: Bloomberg, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

### EUR

The EURUSD cross has rallied from 1.17 to over 1.23 after the November 2020 U.S. presidential election, signaling the resilience of positive market sentiment on EUR, despite the promise of U.S. fiscal expansion. However, so far in 2021, EURUSD has given back all of these gains as the euro area lagged the U.S. in terms of economic growth, yield level, pace of vaccination and COVID-19 restrictions on activity. Rather than a renewed yield disadvantage, though, the euro area's underperformance in growth forecasts were the key factor reducing bullish sentiment on EUR. We believe that the recovery in European activity is merely delayed rather than thwarted, and from mid year we expect a marked acceleration in economic growth as the economy reopens. So, albeit with reduced conviction, we maintain our EUR overweight.

Our overweight stance reflects bullishness stemming from structural factors, namely the European Union's fiscal fund and strong balance of payment fundamentals. These have not waned. Moreover, European equities have outperformed during the recent global growth-to-value rotation, a trend that can persist, in our view. That's important because equity inflows present a cyclical tailwind for the euro that can drive EURUSD notably higher (**Exhibit 14**). Clearly, the recent widening of yield spreads works to the detriment of EUR, but we expect flow dynamics to be a net positive for the currency, even as we note some circularity as eventually a stronger EUR will act as a headwind to

EU equity. By such a time that this becomes a factor, however, we believe that the recovery in Europe will be contributing to an improved corporate outlooks that should support both earnings and the currency itself.

#### In 2017, equity flows contributed to EURUSD appreciation

EXHIBIT 14: U.S. INFLOWS INTO EUROPEAN ASSETS AND EURUSD



Source: Bloomberg, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

#### GBP

The UK continues to face a difficult combination of COVID-19-related damage to the economy and the reality of Brexit. This tempers our enthusiasm for the currency over the medium term, despite GBP's strong performance this year (it is the second best performer vs. USD year-to-date). The UK's remarkably successful vaccination rollout and its prospects for early reopening seem to have kept sterling resilient to the repricing in rates.

The Bank of England has also supported near-term GBP sentiment by dismissing the need for negative interest rate policy on the basis of a quickly closing output gap. When combined with the large fiscal boost delivered by Chancellor Rishi Sunak, the near-term outlook for UK growth is justifiably more upbeat. That said, we emphasize that this improvement is relative to prior expectations. Going forward, we expect the UK's leadership in COVID-19 outcomes to naturally diminish as laggard countries catch up. We remain neutral on GBP but continue to scrutinize the medium-term outlook. Investor focus will naturally emphasize post-pandemic growth prospects, which remain structurally pessimistic in the UK.

#### EQUITY

Since our December Strategy Summit, equity markets have continued to rise. Year-to-date, the MSCI ACWI index is up roughly 4%. Leadership has begun to rotate toward cyclically geared and value-oriented parts of the asset class, such as U.S. small caps and euro area and Japanese equities, while defensive and growth-oriented names – U.S. large caps, EM equities and Australia equities – have begun to lag.

Given the extremely strong macro backdrop of surging economic growth and supportive policy, it is difficult not to be positive on equities as an asset class. However, we do think returns in 2021 will be constrained by valuations that are very elevated after the past year's strong performance. In short, we'd expect returns in 2021 to be characterized by strongly rising profits – taking them beyond their pre-COVID-19 levels – offset to a large degree by contracting valuation multiples. Overall, that should deliver equity returns in the high single to low double digits – positive results but much less than eye-popping earnings growth numbers might suggest to the casual observer.

We expect to read a lot of commentary about how the stock market is underperforming the wider economy, the mirror image of last year's discussion of the stock market's outperformance of the wider economy.

We also expect further bouts of volatility – albeit within a declining trend – as the market continues to transition from a valuation-expansion driven regime to one that is driven by earnings growth. This would not be unusual for this stage of the cycle.

Equity volatility is also likely to respond to moves in bond markets, where rising bond yields present a key risk to our positive equity view. As we've said before, if bond yields rise for the "right reasons" – that is, better growth as opposed to tighter policy – equity markets should tolerate the move, perhaps after some bouts of volatility. But if bond yields rise unexpectedly due to high inflation or a hawkish policy change, then equities will likely struggle. Another potential headwind for equity markets could come from higher corporate tax rates, which might begin to hit earnings expectations. For the moment, we'd expect the impact to be modest, but that could change, particularly in the U.S., where a Democratic Congress and White House will likely include higher taxes in future legislation. Tax hikes might also

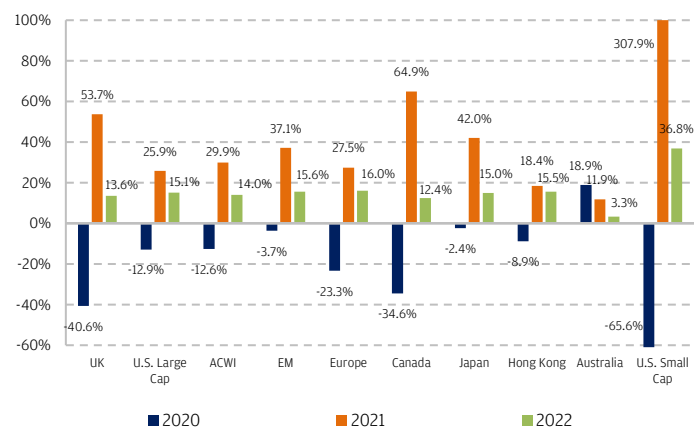
impact relative regional performance, broadly holding back regions with rising corporate tax rates.

### Earnings

Strong earnings growth will drive equity returns this year, in our view. After EPS for the global MSCI ACWI index fell around 13% in 2020, it is expected to grow by around 30% in 2021 (Exhibit 15). Notably, by the end of this year global EPS should come in around 10% above its level in late 2019, before the pandemic. Unsurprisingly, 2021 growth rates are expected to be higher in the regions where earnings suffered most during 2020. Growth expectations for 2021 thus incorporate an element of both recovery and additional growth beyond the pre-crisis baseline.

#### Global EPS is expected to grow by around 30% this year

EXHIBIT 15: EARNINGS PER SHARE GROWTH BY YEAR, %



Source: Datastream, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

We see further scope for 2021 EPS forecasts to move higher, providing additional momentum to equities and sentiment. Earnings revisions ratios (the ratio of bottom-up analyst upgrades to downgrades) have moved into substantial upgrade territory across most regions. This hints at the beginning of a new upgrade cycle, although so far increases in 2021 EPS expectations have been modest. Over the last six months, they have risen by 7% globally, including 6% in the U.S., 2% in the euro area, 9% in Japan and 7% in emerging markets. This should leave ample scope for further upgrades to come. It is not unusual for bottom-up analysts to be behind the curve around cyclical turning points, owing to factors such as behavioral effects, the difficulty in quantifying operational gearing at the firm level and a heightened level of uncertainty. In addition, forecasters likely

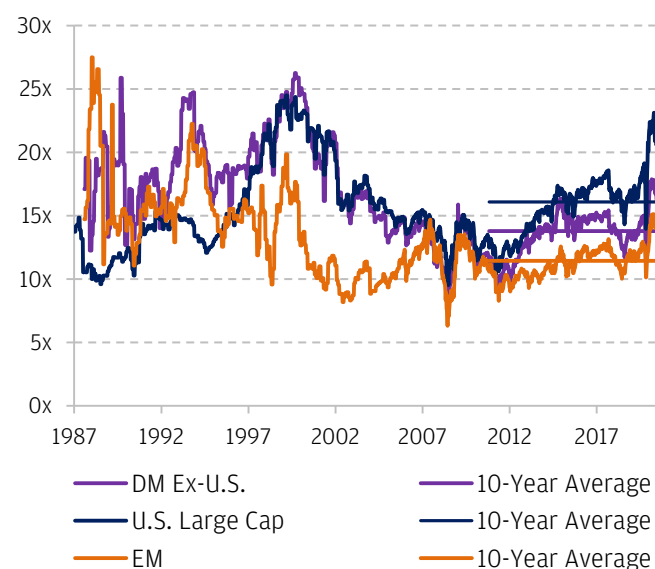
have not yet had enough time to incorporate the impact of the USD 1.9 trillion U.S. fiscal stimulus package - whose effects will impact companies inside and outside the U.S. A recent run of record-breaking earnings seasons across regions is revealing: For the past three quarters, companies in the U.S., Europe and Japan have beaten bottom-up analysts' expectations in record numbers and by unprecedented amounts, at both the top and bottom lines.

### Valuations

Still, valuations will constrain equity returns over the coming year. As Exhibit 16 shows, in simple forward-PE terms equity valuations remain very elevated, but they are now peaking as rising forward earnings have begun to offset price gains. As we've seen for much of this cycle, valuations are most stretched in the U.S. equity market, where the current P/E of 22.1x is just 3x below the highs of the dot-com bubble and 7x above the 40-year average.

#### Absolute levels of stock market valuations remain elevated

EXHIBIT 16: 12-MONTH FORWARD P/E RATIOS ACROSS REGIONS



Source: Datastream, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

Most other measures of global equity valuations - cyclically adjusted P/E ratios, price-to-book ratios, dividend yields - signal that equities are expensive. But another class of metric tells a different story, comparing equity yields to the levels of interest rates or bond yields. Our preferred metric here is the equity risk premium (ERP). In the U.S., we estimate, ERP has dropped to just

below 6% for the first time in two years (Exhibit 17). This reflects both rising bond yields (making bonds look cheaper) and falling U.S. dividend yields, now down to just 1.5% (driven more by rising share prices than dividend cuts). Still, this leaves ERP only slightly below its post-global financial crisis average of 6.2%. It is still well above the longer-run average of 4.8%. Overall, the level of ERP suggests that equities can rise much further before they look outright expensive relative to bonds. Conversely, equities should be able to digest further rises in bond yields through a compressing ERP, especially if bond yields moved higher because of stronger economic growth. In practice, we are likely to see ERP compress as a result of both factors: rising bond yields and equity prices.

Equity yields are still attractive vs. bond yields, but less so

EXHIBIT 17: EQUITY RISK PREMIUM, U.S., %



Source: Bloomberg, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

Relative Value

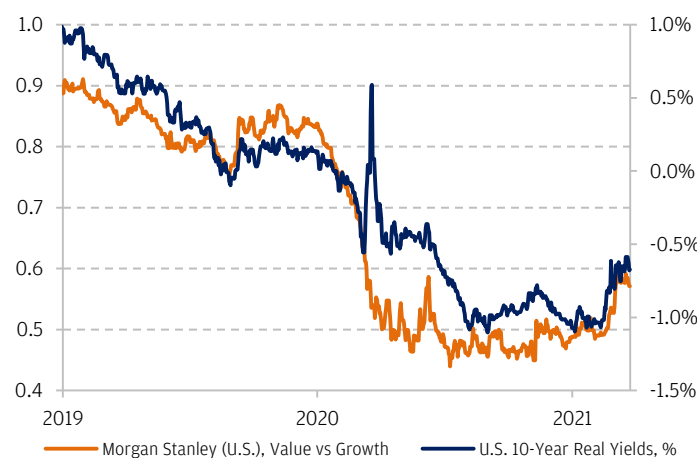
Styles

Ever since the market troughed in 2020, investors have focused on what has come to be known as the “reopening trade.” Over the middle of last year, high quality cyclicals, companies that seemed likely to survive the pandemic, did well. Then, toward the end of 2020, lower quality cyclicals and portions of the value style outperformed, following positive announcements about vaccine efficacy. In the first quarter of 2021, the value style began to outperform more significantly, taking its cue from the sharp move in real rates. In previous cycles, nominal yields served as a good guide for the performance of value vs. growth stocks, but recently, real rates have been a more important

factor (Exhibit 18). This may reflect the greater role of mega cap tech stocks in the growth style: The relative value of the “secular growth” in EPS that these stocks offer is very sensitive to moves in real rates.

Higher real rates have supported value stocks’ performance over the past quarter

EXHIBIT 18: VALUE VS. GROWTH AND REAL RATES



Source: Bloomberg, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

We think value stocks can continue to perform well. They should benefit from the global macroeconomic recovery, marginally higher government bond yields and the baton-passing from a valuations- to earnings-driven market. And despite the recent rally, the relative performance of financials, the key value sector, still has significant runway to recoup losses from 2020.

Cyclical stocks continued their advance this quarter, following the end of the global recession, a reduction in perceived left-tail risks related to the economy and new focus on the EPS recovery across equity markets. Key cyclical sectors, energy and industrials, have moved the market higher over the past three months. We continue to like cyclical stocks, though we note that some of the higher quality portions of this style look quite expensive. In general, we think the cyclical vs. defensive trade is further advanced than the value vs. growth trade. Breakeven rates have provided a guide for the cyclical vs. defensive rotation, and at over 2.3% in the U.S., the risk-reward to the cyclical trade looks better in other regions, such as Europe or Japan.

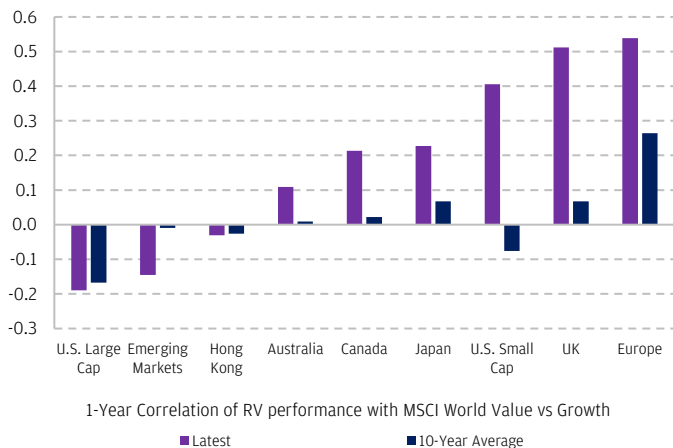
**U.S.**

We continue to like U.S. stocks, with a significant preference for U.S. small caps over U.S. large caps. U.S. small cap stocks function as a play on the U.S. domestic economy, and with fiscal stimulus and vaccine rollout more supportive in the U.S. than anywhere else, we think a preference for small caps makes sense. Though U.S. small caps are expensive on an absolute basis, they look cheap vs. U.S. large caps. We think they should continue to outperform as growing optimism about reopening becomes the dominant theme in the U.S. equity market.

To be sure, U.S. large cap stocks are high quality; offer strong, diversified earnings growth; and are well supported by U.S. fiscal and monetary stimulus. However, the dominance of the “growth” parts of the U.S. large cap index make them less attractive at this juncture. In our opportunity set, U.S. large cap stocks are the least correlated to the value style, and the relative performance of the market should lag as yields move higher (Exhibit 19).

**U.S. large cap stocks are more ‘growth’ than ‘value’ and are less attractive at the moment as a result**

EXHIBIT 19: VALUE VS. GROWTH CORRELATIONS TO KEY MARKETS



Source: Bloomberg, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

**Europe**

Overall, we remain positive on euro area equities. They significantly underperformed in 2020, hit by renewed waves of COVID-19 and longer than expected lockdowns. However, since the U.S. election European stocks have begun outperforming (Exhibit 20) despite a slower vaccine rollout, a weaker fiscal response and extended lockdowns. Europe is a good expression

of the value style, and we believe the market can continue to outperform as investors move past peak negativity surrounding vaccine supply and begin to focus on the region’s EPS recovery. On current measures, Europe should have enough vaccines to cover over 100% of its population by the end of Q3, suggesting that vaccine demand, rather than supply, may be the bigger risk to monitor.

**European stocks have outperformed since the U.S. election**

EXHIBIT 20: EUROPE VS. ACWI



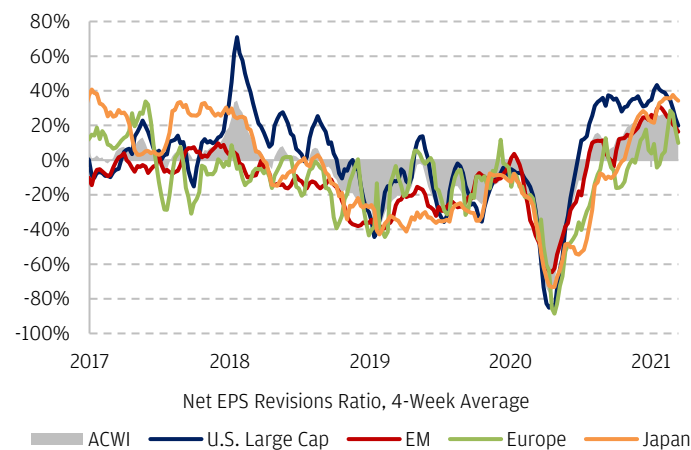
Source: Bloomberg, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

**Japan**

Our positive outlook on Japanese equities is an expression of our preference for cyclical markets. By sector weighting, Japan ranks as the most cyclical major market, at over 60% when broken down to industry groups. The biggest sectors in the TOPIX are industrials and consumer discretionary, the latter dominated by exposure to auto companies. Though the auto sector faces supply-chain issues due to chip and petrochemical shortages, Japan’s earnings revisions are the strongest among our major markets (Exhibit 21). The relative performance of the Japanese market also tends to benefit from a weaker JPY. Japan’s vaccine rollout is sluggish, though, and renewed restrictions remain a key risk.

## Japan's earnings revision ratio is particularly strong

EXHIBIT 21: EARNINGS REVISION RATIOS, 4-WEEK



Source: Datastream, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

### Emerging Markets

We downgraded emerging markets to neutral at our March Strategy Summit. Over the second half of last year, emerging market stocks looked attractive. That reflected a weaker U.S. dollar, the first-in-first-out dynamic of Asian economies with regard to the pandemic and a strong recovery in the global goods cycle, with demand for semiconductors particularly healthy. Today, those factors are less supportive. The U.S. dollar downtrend has moderated, the pricing of the growth recovery in Asia is well advanced, and semiconductor stocks have begun to move lower from elevated levels, despite ongoing supply constraints for the chips themselves. The emerging markets index has a large exposure to Chinese internet names, which trade with the growth style and thus make the index less attractive today. Certainly, emerging market stocks will benefit from the strength of the global macroeconomic recovery and robust commodity prices. But we are focusing on the changing composition of the emerging markets index and are happier taking equity risk elsewhere.

### UK

The UK market's defensive characteristics have left it struggling to keep pace in the cyclical recovery. Though UK equities have significant exposure to financials and energy, the largest sector in the FTSE 100 is consumer staples, which has been flat over the past three months. We can see reasons for the UK market to do well, namely that pound sterling has begun to depreciate, the

market is cheap and the market is correlated to the value style. However, with earnings revisions in the middle of the pack and the UK's defensive exposure less attractive, Europe and Japan seem like better markets to own. Finally, we note that while the UK vaccine rollout is going very well, this is less relevant to the FTSE 100, which earns a large majority of its revenue abroad.

### CREDIT

Despite tight spreads, we remain modestly overweight credit in our multi-asset portfolios, with a preference for U.S. high yield, followed by emerging markets debt (EMD). At our December Strategy Summit, credit spreads looked less compelling to us, largely because of valuations. We saw less of an opportunity for capital return than for carry. Since then, corporate investment grade credit spreads have remained little changed even as underlying yields rose sharply. At the same time, lower quality credit spreads narrowed meaningfully. Since December, about two-thirds of U.S. high yield's excess returns - that is, removing the duration exposure and underlying risk-free yield - have come by way of tighter spreads. During this period, spreads tightened about 50bps, essentially fast-forwarding expected returns for the whole of 2021. Now, to an even greater degree, credit's chief appeal is carry, as the scope for a right tail of significant capital appreciation has further receded.

But so, too, has the left tail. The surprising pace of spread compression coincided with drastically improving fundamentals, including reassuring economic data, accelerating vaccine rollouts and U.S. fiscal stimulus. Among higher yielding corporates, defaults have slowed to a very modest pace. Expectations for 2021 now look like an average nonrecessionary year rather than the extended tail of defaults that were broadly seen as likely as of December. Ratings upgrades are accelerating. Issuance has been heavy, but we see little sign of declining lending standards.

In our view, spreads on lower quality credits thus offer attractive carry and potentially modest further spread tightening, for relatively limited risk and volatility. In short, lower quality credit offers returns that are still attractive on a risk-adjusted basis and keeps a place for modest credit positioning in multi-asset portfolios.



### The risk of rising yields?

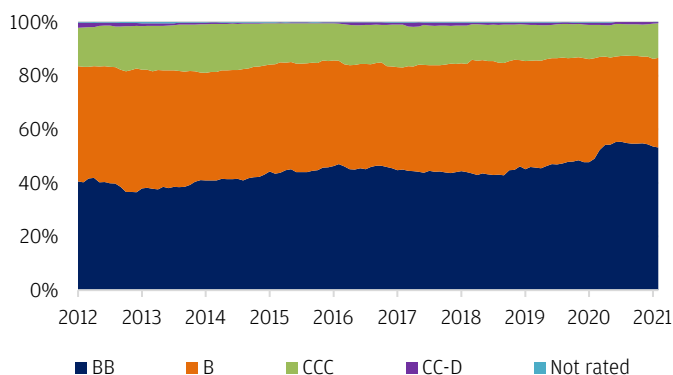
Of course, rising yields directly affect credit total returns. Case in point: Duration exposure explains the worst-ever start of the year for U.S. investment grade, down 4.8% through March 29. We also note less direct impacts of rising yields. First, they affect some borrowers' ability to repay. This is probably a negligible risk for most U.S. corporates, despite their high leverage. But it may be a meaningful concern for some emerging markets sovereign debt issuers, which face additional headwinds from downward pressures on their local currencies and, often in response, tighter local domestic monetary policy. In addition, rising rates may introduce short-term volatility via technical effects like investor outflows and a rush to accelerate issuance before yields rise further. This is a greater concern for typically longer-duration, less volatile credits like investment grade.

### U.S. corporate debt

We see little remaining value in U.S. investment grade, where tight spreads offer little scope for further tightening. U.S. high yield spreads, besides offering a decent carry pickup, might well compress modestly further over the next several months, upward of 50bps in an upside scenario, as the global economy continues to recover. Although option-adjusted HY spreads are hovering at their tights of the last decade, high yield now includes an increasing concentration of relatively higher quality BBs, a trend that predates the introduction of many fallen angels during the pandemic recession (**Exhibit 22**). As a result, credit spreads may well narrow beyond their tights of the last cycle.

For U.S. high yield, average quality has been improving for several years

EXHIBIT 22: U.S. HIGH YIELD QUALITY SPECTRUM BY MARKET WEIGHT



Source: Barclays Indices, J.P. Morgan Securities, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

Looking across sectors, BB rated bonds have the potential for an upgrade to investment grade (granted, the fallen angels among them have notably outperformed so far in the recovery). We would still avoid Bs, which provide the most exposure to negative convexity. CCCs offer the most direct cyclical upside.

Leveraged loans offer similar valuations and expected returns as high yield bonds. Loans currently yield about 2% less than high yield, but while rising rates are a headwind for HY, they are a tailwind for floating rate loans. As yields have risen in the last two months, investors have pivoted increasingly to short-duration and floating rate assets, and that trend will likely continue. That might be a modest additional tailwind for loan spread compression, even as issuance shifts to match the demand. Even so, the upside is limited: Loan prices are typically capped at USD 100-USD 101, and already about 90% of the market is priced at above USD 98.

### European corporate debt

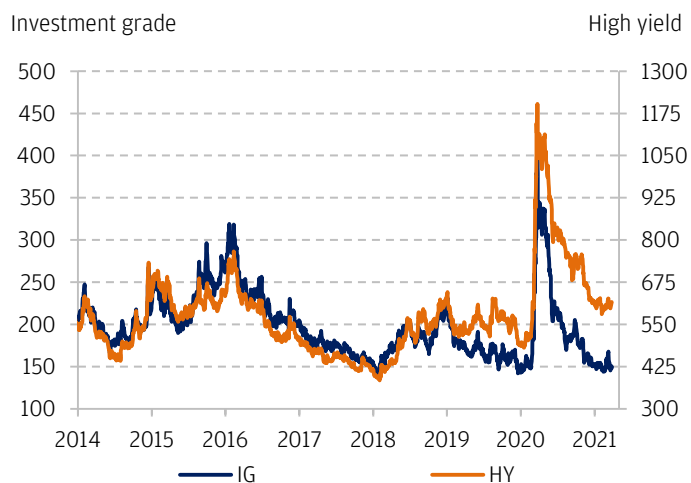
Euro area economic fundamentals are slightly weaker than in the U.S., but average credit quality is higher, most meaningfully for high yield. Technical downward pressure on spreads is potentially greater, as ECB purchases represent a reliable source of net demand for euro investment grade credit. Indeed, the ECB is still absorbing a majority of net IG issuance, a tailwind for both euro investment grade and high yield. Underlying yield volatility is less of a concern in the euro area. But we note that when euro corporates are hedged into dollars they offer less yield than their U.S. counterparts, thanks to a relatively steep U.S. yield curve.

### Emerging markets debt

Sovereign emerging markets debt spreads might look superficially attractive at the index level (**Exhibit 23**), but that index includes a long tail of low quality and some distressed issuers. In contrast to the rosy fundamentals for U.S. high yield, EMD issuers tend to be more susceptible to the risk of rising dollar yields, especially as EM economies have taken on more debt during the pandemic and, in some cases, will likely lag DM economies in vaccine rollouts and reopening efforts. Deep value in EMD is concentrated in problematic lower quality issuers. Lebanon alone contributes 39bps of the 350bps index spread, despite its modest 2.7% weight in the EMBI Global Diversified Index.

For emerging markets sovereign debt, high yield is where scope for further spread compression is

EXHIBIT 23: J.P. MORGAN EMBI GLOBAL DIVERSIFIED SOVEREIGN SPREAD



Source: J.P. Morgan Securities, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

Among EMD sovereigns, the larger, usually higher quality and more developed issuers, on average, boast improved attractive fundamentals. These include a reduced dependence on external funding and exposure to rising rates. Many of these larger issuers have also refinanced a lot of debt into their own currency, an increasing share of which is now held domestically. Even the “fragile five” of the 2013 taper tantrum infamy – Brazil, India, Indonesia, South Africa and Turkey – have structurally improved current account balances and are now rated at or close to investment grade. But EMD investment grade spreads have almost fully recovered to their pre-pandemic tights (Exhibit 24).

Emerging markets sovereign high yield appears historically cheap relative to U.S. high yield, but this comparison masks an underlying difference in quality

EXHIBIT 24: SPREAD DIFFERENTIAL, U.S. HY OAS - EMD HY SOVEREIGN SPREAD



Source: Bloomberg, J.P. Morgan Securities, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

Adjusting for quality and distress erases much of EMD’s apparent valuations discount, but EMD still offers reasonable upside. A global economic recovery should be a net positive for the asset class. Finally, we see muted risk of a taper tantrum event, in part because investor positioning is not as concentrated today as it was in 2013.

Beyond EMD sovereigns, EM corporate issuers of U.S. dollar debt also appear attractive, particularly when comparing EM high yielders vs. U.S. high yield. EM issuers’ earnings should recover strongly, and their shorter duration vs. sovereigns means investors take on less rate-related risk. The outlook for EMD local currency debt, concentrated in Asia, is somewhat more uncertain: Recovering global growth will likely push up local interest rates but also perhaps local FX rates.

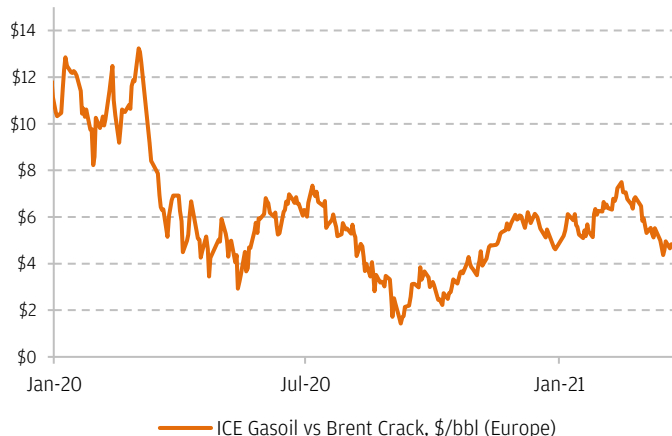
COMMODITIES

Oil prices have moved notably higher since November 2020 as price appreciation reflected a recovering demand environment amid curtailed supply. Starting 2021 at USD 50/bbl, Brent oil rallied sharply and in early March briefly touched USD 70/bbl. Later in the month, following the extension of lockdowns in Europe, prices started moving sharply lower as declines were exacerbated by a reset of investor positioning.

Recovery in demand continues to be the central issue in the oil market. Oil-intensive activity has partially rebounded from a period of severe weakness following the coronavirus outbreak, with the speed of that rebound uneven across economic sectors and geographies. The medium-term demand picture is still positive: The International Energy Agency expects world oil demand to rebound by over 5 million bpd in 2021, after contracting nearly 9 million bpd in 2020. However, over the shorter term, market participants are focused on the implications of another wave of lockdowns, especially in Europe, where gasoil cracks have fallen to lows last seen in October 2020 (**Exhibit 25**).

**Gasoil cracks have pointed to renewed worries about the demand outlook in Europe**

EXHIBIT 25: EUROPEAN GASOIL CRACKS



Source: Bloomberg, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

The supply environment has also supported oil prices. In March, OPEC-plus surprised the market when it announced it would continue supply cuts, keeping the market tighter for longer. The decision to hold back on tapering supply cuts likely reflected continued uncertainty around the pace of demand recovery. In the past, when OPEC-plus kept the oil market tight and prices higher, it risked losing market share to the U.S. shale sector. Today, OPEC-plus energy ministers contend that capital discipline in the shale patch suggests only a limited supply recovery. So far, that contention has been proven correct, but increasing activity in the U.S. shale sector is the key theme to watch in coming quarters. Publicly traded U.S. production companies have held their drilling and completions budgets relatively static, but we see early signs of a pickup in production from harder-to-track private operators.

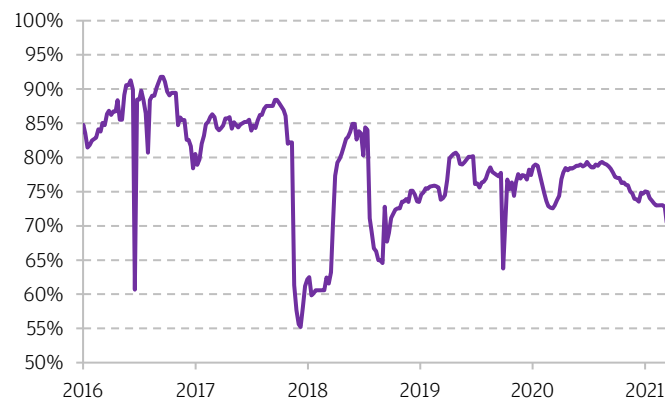
In sum, we think that oil prices can continue to move higher as economies reopen, the supply response stays muted and demand in areas such as jet fuel continues to rebuild.

After rallying sharply over the course of 2020, iron ore prices moved sideways over the first quarter. Several drivers of ferrous metals markets have begun to look less positive.

First, environmental policy in Tangshan, a key steel-producing region, has restricted sintering activity. As a result, the operating rate of blast furnaces in the region has sharply declined (**Exhibit 26**). This policy is temporary, but investors are wary of what shifts in Chinese environmental policy might mean for the heavily polluting steel industry, and for iron ore demand by extension. Second, we note early signs that Brazilian supply is recovering. One of the key themes in the iron ore market over the past two years has been the persistent underdelivery of Brazilian iron ore coming to market following the Brumadinho dam accident. However, in the early months of 2021 shipments have been more in line with guidance from key operators in the region. This suggests the start of a recovery path. Third, China’s credit impulse has turned more toward neutral, which in the past has been a headwind for industrial metals.

**Environmental policy in China is negatively impacting iron ore demand**

EXHIBIT 26: OPERATING RATE OF BLAST FURNACES IN TANGSHAN, CHINA



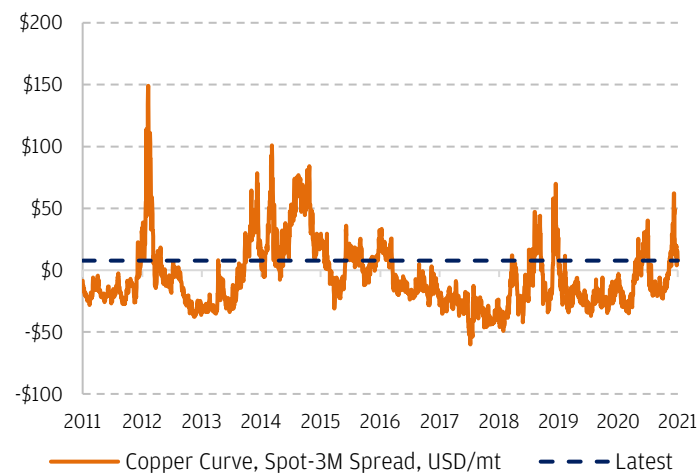
Source: Bloomberg, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

That said, iron ore remains supported by healthy ex-China steel demand and the broader macroeconomic recovery. But given the scale of iron ore’s appreciation in 2020, and noting the softening in fundamental data, we aim to seek exposure to other parts of the metals complex.

Copper’s bull market continued over the first quarter of 2021, with investors increasingly focused on copper’s role in de-carbonization. Wind and solar power, as well as electric vehicles and their batteries, are all copper-intensive. As a result, as the global economy undertakes a clean energy transition, copper demand looks set to increase markedly. Beyond this long-term, secular support for copper, shorter-term factors, including speculative inflows and a healthy end-use demand environment from consumer goods, have also been supportive. This can be seen in the short-maturity copper curve, which remains elevated (Exhibit 27).

**Copper demand remains strong, with the spot-to-three-month spread remaining elevated**

EXHIBIT 27: COPPER CURVE



Source: Bloomberg, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.

We do see some early signs that these supports are becoming less robust. Inventories, though low by historical standards, are rising. Spot buying has eased somewhat, especially in China, and the U.S. dollar has moved marginally higher in recent months. The softening in the China credit impulse is relevant for copper, too, even though it tends to be a metal used later in the construction cycle. Increases in copper demand due to environmental policy will be significant over coming years, but today China’s industrial economy remains the key driver. Cyclical and secular supports for copper look likely to support the metal through Q2, but in the second half of the year, when copper supply is set to increase marginally, the picture may be less positive.

## PORTFOLIO IMPLICATIONS

Our positive economic outlook, together with our expectation that central bank policy will remain accommodative through 2021, lead us to a pro-risk tilt in our multi-asset portfolios. Nevertheless, we acknowledge that the pathway for asset returns in 2021 will differ markedly from last year. For a start, although central banks have reaffirmed their “lower for [considerably] longer” policy, they’ve not pushed back on higher rates in the belly of curves – pointing to ongoing upward momentum in longer-dated yields.

Meanwhile, in equity and credit markets, the pricing out of last year’s “disaster discount” is well behind us and with it the sharp and indiscriminate upward lurch in risk asset markets. This year, equity market leadership is shifting to those sectors, styles and regions more positively geared to steeper curves. And credit spreads have tightened much faster than in any previous recovery, suggesting that the bulk of ex ante returns in the asset class must now come from carry. The policy environment will likely determine the path of asset returns this year, which will also have meaningful implications for both volatility and correlation – and in turn portfolio construction.

The current policy environment results in extremely easy financial conditions plus steeper yield curves. We believe that this is set to persist, and even with inflation likely to rise modestly we expect real rates to remain negative in all but the very longest tenors. Over the last 20 years, such an environment tended to support traditional 60/40 portfolios very well: Accommodative policy buoyed stocks, and sufficient yield and roll carry in bonds lent some support. However, today the low prevailing level of yields acts as a major headwind for bonds. Still, with short-dated rates set to remain low, the gradual repricing of growth that is leading curves to steepen will start to bring in some natural demand for duration.

In our view, U.S. 10-year yields at around 2% may be an important psychological level for investors to feel more comfortable in balanced stock-bond portfolios. For the time being, the low level of yields creates the paradox that some investors may well not feel quite ready to lean into riskier assets when the natural portfolio hedge offered by bonds is unattractive. There is also a lingering fear that the ongoing repricing of growth into yields morphs into a less constructive

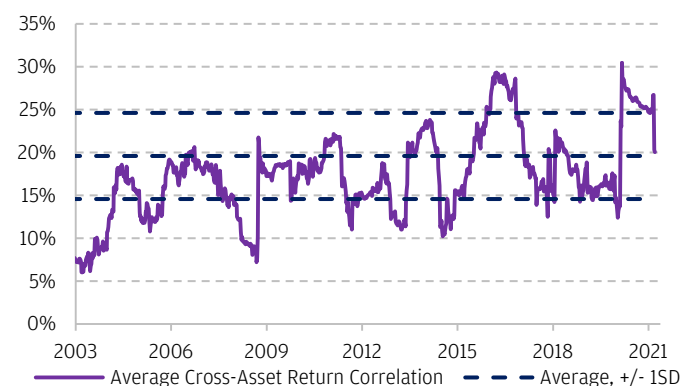
repricing of policy, in turn unduly tightening financial conditions. While we do not think this is likely given central bank rhetoric, such concerns will likely continue to curb risk-taking to a small degree.

A side effect of consistent and easy policy is a dampening of volatility. This doesn’t prevent sporadic jumps in volatility, but by and large the gradual decline of baseline volatility (as measured by the VIX, for example) presents a favorable environment for risk-taking. However, the ongoing rotation across sectors and styles suggests that even if volatility at the index level is contained, volatility within the index may be elevated. As investors take a more clinical and targeted approach to allocating risk – particularly to the extent it involves sector, regional and style decisions – it will be crucial to evaluate how intra-index volatility might contribute to overall tracking error.

The rotation seen across sectors and styles also extends to individual securities, implying an improving environment for alpha creation. It also suggests that correlation – at least within indices – is likely to remain low for some time. Across asset classes, the correlation environment has normalized to a good extent as the market slump of 1Q20 begins to exit the price histories (**Exhibit 28**). With correlation less elevated, constructing a diversified portfolio becomes less problematic. Nevertheless, the level of stock-bond correlation is still a critical metric for most investors – not least given the tail risk concerns around inflation, since historically inflation scares tend to coincide with a rise in stock-bond correlations.

### On a cross-asset basis, correlation across returns has dropped sharply

EXHIBIT 28: 360-DAY CROSS-ASSET CORRELATION



Source: Bloomberg, J.P. Morgan Asset Management Multi-Asset Solutions; data as of March 2021.



In sum, the policy, volatility and correlation environments are broadly supportive of a risk-on stance in portfolios. Still, the poor outlook for sovereign bond returns compromises their attractiveness in building balanced portfolios. This factor, together with the risk of sharp rotation within indices even as headline volatility is muted, serves to moderate the overall level of risk investors may be willing to take. In turn, this reinforces our premise that while the trajectory for risk assets is positive, the pace will be more restrained than it was in 2020.



## Multi-Asset Solutions Key Insights & “Big Ideas”

The Key Insights and “Big Ideas” are discussed in depth at our Strategy Summit and collectively reflect the core views of the portfolio managers and research teams within Multi-Asset Solutions. They represent 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.

- Global growth above trend: U.S. will lead in 1H, broadening in 2H
- Headline CPI to be volatile, but core remains contained in 2021
- Fiscal and monetary stimulus persists into the new cycle
- Higher yields reflect better growth rather than tighter policy
- Dollar downtrend pauses in 1H21, but downside risks remain
- EPS growth, not multiple expansion, drives returns for 2021
- Prefer stocks to bonds, favor small cap, value and cyclicals
- Tech, long-duration equity, emerging markets and U.S. large cap less favored

## 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.

Underweight ● Neutral ● Overweight ●

Asset class	Opportunity set	UW	N	OW	Change	Conviction		
MAIN ASSET CLASSES	Equities	○	○	●		High	Strong earnings recovery continues; scope for rerating in banks, resources and cap goods	
	Duration	●	○	○	▼	Low	Improving growth driving yields up; front ends anchored but potential for steeper curves	
	Credit	○	○	●		Low	Returns led by carry, not spread compression, but remain attractive in risk-adjusted terms	
	Cash	●	○	○		Moderate	Central banks reaffirming lower-for-longer policies keeps real cash rates negative in 2021	
PREFERENCE BY ASSET CLASS	EQUITIES	U.S.	○	○	●		Low	Supported by U.S. economic strength, but prefer small cap or equal-weighted S&P 500
		Europe	○	○	●		Moderate	Vaccine issues flagged, soft data improving, scope for cyclical EPS recovery to strengthen
		UK	○	●	○			Post-Brexit issues still messy, but commodity strength and UK rebound supportive for FTSE
		Japan	○	○	●		Moderate	Attractive value and cyclical tilts; soft JPY and above-trend global growth point to upside
		Emerging markets	○	●	○	▼		Too tilted to growth style, tech sector and long-duration stocks to outperform in 2021
	FIXED INCOME	U.S. Treasuries	●	○	○	▼	Low	No pushback from Fed on higher yields; growth still underpriced at current rates
		G4 ex-U.S. sovereigns	○	●	○	▲		Ex-U.S. inflation pressure lower, and central banks more vocally committed to lower yields
		EMD hard currency	○	○	●		Low	EM economic outlook continues to improve, but long duration some headwind to returns
		EMD local FX	○	○	●		Low	Improving commodity prices and global recovery supportive, as is attractive yield pickup
		Corporate investment grade	○	●	○			Spreads tight, but rebalancing flow likely supportive for IG, especially at longer end
		Corporate high yield	○	○	●		Moderate	Mostly a carry play, but realized defaults set to be low, thus some scope for tighter spreads
	CURRENCY	USD	○	●	○	▲		Buoyed by U.S. economic strength; remains overvalued but likely supported through 1H21
		EUR	○	○	●		Low	A further leg higher plausible as Europe starts to catch up to the global recovery in midyear
JPY		●	○	○	▼	Moderate	BoJ likely to remain accommodative; low rates and volatility make JPY a carry funder	
EM FX		○	○	●		Low	Preferred way to play continuing global growth support of EM economies	

Source: J.P. Morgan Asset Management Multi-Asset Solutions; assessments are made using data and information up to March 2021. 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.



## Global Multi-Asset Strategy:



**John Bilton**

*Head of Global Multi-Asset Strategy*

*Multi-Asset Solutions*



**Thushka Maharaj**

*Global Strategist*

*Multi-Asset Solutions*



**Michael Albrecht**

*Global Strategist*

*Multi-Asset Solutions*



**Tim Lintern**

*Global Strategist*

*Multi-Asset Solutions*



**Michael Hood**

*Global Strategist*

*Multi-Asset Solutions*



**Patrik Schowitz**

*Global Strategist*

*Multi-Asset Solutions*



**Sylvia Sheng**

*Global Strategist*

*Multi-Asset Solutions*



**Michael Akinyele**

*Global Strategist*

*Multi-Asset Solutions*

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