Mulit-Asset Solutions Monthly Strategy Report

Global markets and multi-asset portfolios

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IN BRIEF

- Greater economic resilience in the fourth quarter of 2020 and smoother vaccine rollouts have removed some of the downside risks we had seen on the horizon.
- U.S. consumer spending reaccelerated early this year, a trend we expect to be supported by further fiscal stimulus measures.
- We upgrade our U.S. economic growth forecasts to reflect the new round of fiscal stimulus Congress is likely to pass in the next month. This further cements our above-trend growth outlook for both the U.S. and the global economy and introduces upside risks to our already positive outlook.
- Our multi-asset portfolios overweight equities and credit relative to government bonds. The favorable shift in the distribution of risks to the growth outlook underscores this pro-risk stance.
- We prefer to express our positive risk views through equities rather than through an underweight to duration as central banks are likely to anchor bond yields. Within equities, we like cyclical exposure in emerging markets, U.S. small caps, Europe and Japan.

The tick chart and views expressed in this note reflect the information and data available up to December 2020.

EXHIBIT 1: MAS ASSET CLASS VIEWS FROM DEC STRATEGY SUMMIT

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

MARKETS REACT AS GROWTH RISKS SHIFT TO THE UPSIDE

As we look across the global economy, we see growing evidence that developed economies are proving more resilient to lockdown restrictions in 2021 than they did in early 2020. Current forms of lockdown are also doing less damage than many observers feared. Case in point: In 4Q 2020, the UK's GDP print was positive, despite tighter restrictions. This resilience, first seen in Asian economies, is now evident in developed economies, eroding certain downside risks we had foreseen on the horizon.

The U.S. economy wobbled at the end of 2020. Consumer spending edged down in November and December and employment declined in the final four weeks of the year. Nonetheless, fourth quarter GDP climbed a solid 4% quarter-over-quarter, seasonally annual adjusted rate (q/q, saar) thanks to support from business capex and residential investment as well as strong consumption in October. The drop in employment, meanwhile, mostly owed to low-paying restaurant jobs—higher-wage posts actually rose. In turn, the rising trend in household labor income remained in place.

That favorable backdrop for households interacted with a new round of stimulus checks at the start of 2021 to produce a surge in retail sales in January. On the whole, it appears that consumer spending reaccelerated in early 2021, and we expect ongoing strength in household demand to support above-trend U.S. growth for the next few quarters.

Vaccine rollouts picking up pace

Rapid and widespread dissemination of vaccines is setting the foundation for strong growth momentum once economies start reopening—another unambiguously positive development. Vaccine rollouts have been particularly brisk across the U.S. and UK. Latest U.S. data indicate that if the current pace of dose administration persists, close to 75% of the U.S. population aged 16 and older could be fully vaccinated by early September. What's more, that pace could accelerate in the coming months. Experts now project that 16% of the global population could be vaccinated by the end of 2021. Critically, the projected rollout is likely to be broad-based across geographies. If it is, that would be a remarkable achievement against a deadly virus that only emerged about a year ago.

We note other economic tailwinds heading into the second quarter. The U.S. Congress, working with the new Biden administration, is now preparing another round of fiscal stimulus that will likely be approved within the next month. Although it will fall short of the White House's original proposal, it seems set to top USD1 trillion, or more than 4% of GDP. We do not expect the stimulus to deliver an equivalently sized boost to the economy. That's partly because some of the stimulus will likely be disbursed over time--such as in aid to state and local governments--and partly because we assign fairly low multipliers to some aspects of the spending. Still, we are revising upward our U.S. growth forecast for this year by about a percentage point and now think GDP will climb at roughly a 6% pace in 2021.

We see the risk to our expectations tilted to the high side. The economy remains mostly in early-cycle mode. Although it is progressing quickly through that phase of the expansion, we do not see significant near-term probability of a recession—outside of the somewhat unquantifiable remaining threats related to the virus. Nor do we envision a material pullback in private sector spending. Growth could plausibly exceed our projections in two ways. First, fiscal stimulus could prove more effective (that is, display higher multipliers) than we think. Second, while the saving rate will likely drift lower over time, we do not expect households to spend much of the stockpile of "excess savings" they have accumulated over the past year. If they use the money to bring their balance sheets back toward pre-shock levels, the economy could run considerably hotter.

Looking ahead, we expect the accommodative policy backdrop to support asset markets. At their March meeting, Federal Reserve (Fed) policymakers are set to revise upward their own near-term growth outlook, following their December forecast of a 4.2% GDP gain in 2021. That revision, though, seems unlikely to trigger any change in policy settings or forward guidance. Most Federal Open Market Committee (FOMC) members assign a low coefficient to slack in the economy when making inflation forecasts. Moreover, the Fed no longer places much weight on its own inflation forecasts and instead prioritizes realized inflation, which remains moderate. Finally, last year's adoption of an average inflation targeting framework implies greater willingness to let price increases move higher over time, partly to head off the possibility that the pandemic shock, coming after a decade of below-target outcomes, pushes down inflation expectations and makes the eventual achievement of the Fed's goal that much harder.

Expectations that economic activity will rebound in the second half have fueled a global reflation narrative among market participants that continued apace this month. Risk assets showed continued strength across multiple asset classes, bolstered by strong Q4 earnings results and economic activity more resilient than expected. Notably, within equities, cyclical markets outperformed. In keeping with this reflation trade, yields on global bond markets have risen while yield curves steepened. Ten-year U.S. Treasury (UST) yields led this move higher; yields are now above 1.2% and the yield curve slope is back to 2017 levels.

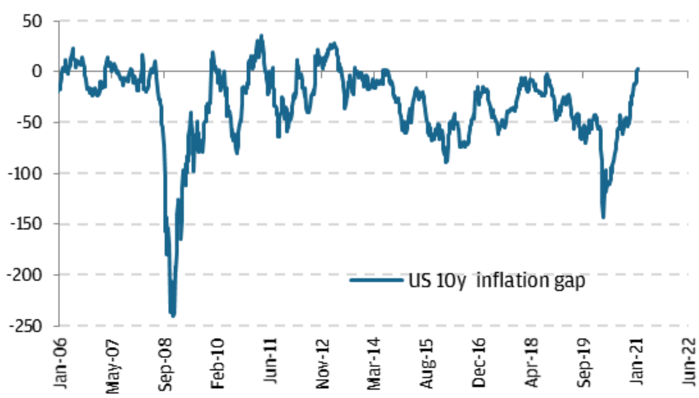
ASSET ALLOCATION IMPLICATIONS

We maintain a pro-risk stance with a positive outlook on the global economy in 2021. The recent fiscal stimulus measures reinforce our view that the U.S. economy will grow, if anything, significantly above trend this year. Better vaccine rollouts and strengthening economic resilience amid restrictions have come together to reduce negative tail risks and are simultaneously interacting to introduce upside risks to our outlook.

Bond yields have recently risen in line with the upgrade to the growth outlook and particularly on news of larger proposed U.S. fiscal stimulus. We expect a further gradual rise in yields that reflects the better growth outlook and the improving distribution of risks for the economy. We now expect the yield on the 10-year UST to trade in a higher range of 1.20%-1.60% (vs 1.0%-1.4% previously). This reflects more substantial U.S. fiscal stimulus and a more favorable economic backdrop than we had expected. Bond markets have already repriced an improved growth outlook to a large degree –10-year UST yields rose over 70 basis points (bps) since November. Inflation pricing has also moved sharply (**Exhibit 1**) to price in the improving economic backdrop with 5y5y inflation swaps now as high as 2.4%and the gap between market expectations converging to long term economist forecasts. From here we expect more moderate yield moves.

Inflation pricing has moved sharply to price in the improving economic backdrop

EXHIBIT 1: 10-YEAR MARKET IMPLIED INFLATION BREAKEVENS VS. ECONOMIST FORECASTS FOR 10-YEAR INFLATION EXPECTATIONS (CPI)



Source: Bloomberg, Federal Reserve of Philadelphia, J.P. Morgan Asset Management; data as of January 2021. For illustrative purposes only.

Crucially, we do not expect the rise in bond yields to choke off or disrupt the rally in risk assets. Central banks, including the Fed, will tread very carefully to prevent a rise in bond yields triggering disruption in other asset classes. While the inflation outlook remains subdued and global demand for yield and income is predominant, we expect bond yield rises to be gradual and contained. As a result, our multi-asset portfolios are either neutral or mildly underweight bonds, depending on their overall risk exposures. On balance, we prefer to express our positive view on growth through an overweight to equities rather than a significant position in duration.

Our broad based positive view on equities extends to credit, reinforced by our quantitative models. Within equities we favor cyclical exposure through overweights to emerging markets, U.S. small caps, Europe and Japan. As the recovery broadens out, we see greater scope for these other regions' equity markets to catch up to U.S. large caps. Recently we have started to see pockets of outperformance in certain value sectors, including financials and energy. We continue to prefer cyclicality in this early stage of the expansion but are watching bond yields closely as higher yields and steeper curves are a necessary requirement for a wholesale, sustained rotation from growth to value.

MULTI-ASSET SOLUTIONS

J.P. Morgan Multi-Asset Solutions manages over USD 290 billion in assets and draws upon the unparalleled breadth and depth of expertise and investment capabilities of the organization. Our asset allocation research and insights are the foundation of our investment process, which is supported by a global research team of 20-plus dedicated research professionals with decades of combined experience in a diverse range of disciplines.

Multi-Asset Solutions' asset allocation views are the product of a rigorous and disciplined process that integrates:

- Qualitative insights that encompass macro-thematic insights, business-cycle views and systematic and irregular market opportunities
- Quantitative analysis that considers market inefficiencies, intra- and cross-asset class models, relative value and market directional strategies
- Strategy Summits and ongoing dialogue in which research and investor teams debate, challenge and develop the firm's asset allocation views

As of December 31, 2020.

NEXT STEPS

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

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