

Global Asset Allocation Views

Insights and implications from the Multi-Asset Solutions Strategy Summit

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In brief

- Moderate growth, cooling inflation and less restrictive policy should be generally supportive to asset markets in 2024. We upgrade equities to a modest overweight, maintain a constructive view on duration and continue to find pockets of opportunity across the credit complex.
- While the economy surprised positively in 2023, growth was uneven and some sectors and regions endured rolling slowdowns. As growth cycles remain out of sync in 2024, there should be tradable differences among sectors and regions as well as a good outlook for stock selection alpha.
- We see positive U.S. stock performance broadening beyond tech as an improving U.S. inventory cycle boosts cyclical sectors. Japanese stocks remain attractive, given rerating potential driven by corporate governance reforms. Emerging market equities are cheap but so far lack clear catalysts for a rebound.
- The prospect of rate cuts in 2024 supports a duration overweight and a USD underweight. In credit, spreads are tight by historical standards but carry is attractive and we see opportunities in securitized credit, as well as in shorter-dated crossover credits and high yield.

The year ahead looks set to be characterized by an extension of the business cycle, a further cooling of inflation and the beginning of a rate easing cycle.

The strong fiscal thrust and surprisingly robust U.S. consumption patterns of 2023 will likely moderate. At the same time, the industrial cycle and activity in Asia and Europe are set to improve. Together, these factors point to global growth close to trend, continuation of the asynchronous cycle and less restrictive financial conditions — an environment that we believe will be generally supportive of stocks and bonds.

We expect U.S. GDP to grow at 1.8% over the full year of 2024 and for headline inflation to continue moderating to close to the Federal Reserve (Fed) target of 2% by year-end. This environment allows for rate cuts over 2024, as signaled by the Fed in December, which in turn could be positive for both stocks and bonds.

In our view, we do not need heroic growth expectations for risk assets to move higher in 2024. To that end, we upgrade equities to a modest overweight, maintain a constructive view on duration and continue to find pockets of opportunity across the credit complex.

Global stocks rallied over 17% in 2023, but this masks meaningful regional and sectoral dispersion. A 44% rebound in U.S. tech stocks this year — after their 28% slump in 2022 — propelled the S&P 500 to gains of 22%. But just as tech was recovering, parts of the transportation and logistics sectors reported sharp slowdowns in earnings. While the global economy avoided

recession in 2023, a number of sectors and regions endured rolling slowdowns.

A backdrop where economic cycles are out of sync increases dispersion of returns; in 2023 the result was a strong year for active alpha. With this environment set to continue in 2024, the outlook for stock selection alpha remains favorable.

Our estimate of around 7% growth in earnings next year, with multiples supported by lower rates, likely sees the S&P 500 test the 5,000 level in 2024. We also expect that positive performance broadens beyond the tech sector as an improving U.S. inventory cycle boosts cyclical sectors.

Japanese stocks remain attractive, given improving nominal growth in Japan and scope for valuation expansion as corporate governance reforms mandated by the Tokyo Stock Exchange support shareholder returns. European growth, meanwhile, remains sluggish going into 2024, but there are signs that leading indicators, like confidence and purchasing manager surveys, are turning. Should this improvement broaden out, it may be supportive of European Union equities, but for the time being, we prefer to play a European rebound via the currency.

Emerging market (EM) equities are cheap but so far lack clear catalysts for a rebound. To warm up to EM stocks, and particularly to China, we would want to see sustained earnings improvements, a clear turn in the global goods cycle, tangible support for the Chinese property sector and further thawing of geopolitics and trade between Washington and Beijing.

The prospect of a cutting cycle in 2024 supports a duration overweight. Following the Fed's dovish pivot,

the trajectory of yields is clearly downwards. With U.S. 10-year yields just below 4% we are toward the lower end of a 50bps to 75bps trading range which we expect to hold until the rate cuts actually begin in 2024; from there we expect yields to track steadily downwards.

Our duration overweight is focused on the U.S. — which also provides protection should growth disappoint — but we are more cautious on duration in Europe and Japan. We are skeptical that European rates will be cut ahead of U.S. rates, and as a result German Bunds look more vulnerable to a backup in yields. Meanwhile, we expect the Bank of Japan (BoJ) to raise rates and make further moves to end bond purchases, in turn putting upward pressure on Japanese Government Bond (JGB) yields in early 2024.

Aggregate credit spreads are tight by historical standards, with U.S. high yield (HY) spreads at 365bps and U.S. investment grade (IG) at 100bps. But we see opportunities in securitized credit, as well as in shorter-dated crossover credits and HY, which continue to trade at a discount to par. By contrast, longer-duration IG appears quite rich. Should our base case of moderating growth but no recession play out in 2024, all-in yields in credit could continue to offer attractive carry.

In sum, there is sufficient resilience in the economy to extend the cycle. As central banks move from hiking to cutting in 2024, we expect both stocks and bonds to benefit. Amid receding inflation, stock-bond correlations should eventually fall toward neutral levels — in turn improving the diversification potential in multi-asset portfolios. But for the time being, moderate growth and less restrictive policy are supportive for asset returns in the first half of 2024.

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.

- Growth moderates close to trend as U.S. cools and EU, Asia improve
- Slowing inflation points to rate cuts in 2024, total of 4–6 cuts by end of 2025
- Supports a duration OW with yields set to fall steadily as rate cuts begin
- Prefer U.S. Treasuries to other G4 as ECB follows Fed and BoJ set to hike
- Carry attractive in credit; may see spreads tighter as recession risk fades
- Equities outlook improving as earnings downgrade cycle bottoms
- Prefer U.S. equity, given cash generation, and Japan, given rerating potential
- USD set to weaken in soft landing and as growth broadens out globally
- Key risks: Central banks leave rates elevated too long, corporate caution extends, sharp additional tightening of credit conditions

Active allocation views

These asset class views apply to a 6- to 12-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.

Asset class		Opportunity set	UW	N	OW	Change	Conviction	
					● Underweight ● Neutral ● Overweight			
Main asset classes	Equities		○	○	●	▲	Moderate	Earnings downgrade cycle has turned, and multiples supported by easier monetary conditions
	Duration		○	○	●		Moderate	Peak in yields behind us as we move to cutting cycle; yields may decline slowly, but >4% coupon is attractive
	Credit		○	○	●		Moderate	Carry attractive in base case of no recession; some spread tightening potential in high yield
	Cash		●	○	○	▼	High	Cash returns set to fall as cutting cycle begins; long-term USD rates likely nearer 2.5% than 5.5%
Preference by asset class	Equities	U.S. large cap	○	○	●		Moderate	7% EPS growth and valuations supported by falling rates; can see S&P test 5,000 by year-end 2024
		U.S. small cap	○	●	○			Outlook improving as recession risk fades, but favor profitable firms with low leverage, given elevated financing rates
		Europe	●	○	○		Low	Macro data stabilizing in Europe, but sector-neutral P/E (14x) at long-term average and margins above pre-COVID levels
		UK	○	○	●		Low	Cheap, defensive market; supported by valuations and flows in quantitative model and positive gearing to commodities
		Japan	○	○	●		Moderate	Room to run further, given solid domestic growth, corporate governance reform driving up ROE and light positioning
		China	○	●	○			Domestic growth and property sector remain weak, with limited signs of policy support or a convincing turn in earnings
		EM ex-China	●	○	○		Moderate	Improving at the margin, with earnings outlook showing signs of bottoming, but flows remain a headwind
	Fixed income	U.S. Treasuries	○	○	●		Moderate	Yields in the low 4s attractive ahead of Fed cuts; potential returns of 10%-20% should growth disappoint
		G4 ex-U.S. sovereigns	○	●	○	▼		Bunds <2.2% too rich if EU growth improves and ECB cuts more slowly; BoJ tightening may see JGB yields retest 100bps
		EMD hard currency	●	○	○		Low	Spreads of 400bps close to year lows; prefer carry in developed market IG, but EMD HY can tighten if growth improves
		EMD local FX	○	●	○			Yields >6% are still elevated vs. 2021 lows; room for FX appreciation based on narrowing rate and growth differentials
		Corporate investment grade	○	●	○	▼		Spreads are tight and show limited room for further decline; marginal benefit relative to all-in sovereign yields
		Corporate high yield	○	○	●	▲	Low	Modest scope for spread tightening and fundamentals supportive; limited rise in defaults means carry looks attractive
	Currency	USD	●	○	○	▼	Moderate	Soft landing and growth recovery in regions outside U.S. would imply a softer USD; Fed cuts further reduce support
		EUR	○	○	●	▲	Low	ECB unlikely to cut as fast as priced; coupled with 2024 growth, recovery in the eurozone should lend support to EUR
		JPY	○	○	●		Low	Modest strengthening of JPY plausible as macro improves and BoJ moves on from negative rates early in 2024
		EM FX	○	●	○			Mixed picture: Better global growth a support, but easier Fed policy and better Chinese growth needed for appreciation

Source: J.P. Morgan Asset Management Multi-Asset Solutions; assessments are made using data and information up to December 2023. For illustrative purposes only.

Diversification does not guarantee investment returns and does not eliminate the risk of loss. Diversification among investment options and asset classes may help to reduce overall volatility.

Multi-Asset Solutions

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As of September 30, 2023.

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
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