Global Asset Allocation Views

Insights and implications from the Multi-Asset Solutions Strategy Summit

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In brief

- We expect moderate economic growth, declining inflation, and looser central bank policy this year.
- Our pro-risk stance in portfolios is expressed through overweights to equities and credit.
- We are neutral on duration due to potential range-bound trading.
- We underweight cash due to expectations for easier policy, which creates reinvestment risk.
- Equity markets present opportunities for alpha in sector/region selection.
- We favor U.S. cyclical sectors, Japan, and emerging markets (excluding China).
- Within fixed income, we prefer shorter-dated U.S. high yield, non-agency mortgages, and securitized credit.
- We have a positive outlook for risk assets overall, although there is the potential for a short-term consolidation in stocks.

The end of last year saw the Federal Reserve (Fed) finally pivot towards an easier policy stance – signaling that rate cuts were in the cards for 2024 — a view that was reinforced at the March meeting. As it has become clear that policy rates have likely peaked for this cycle, risk assets have performed well, with equities moving to all-time-highs and credit spreads approaching their cycle tights.

We anticipate U.S. real GDP growth of around 2% for 2024 — a touch above trend and in line with the current pace. Inflation is set to cool gradually, with headline CPI reaching the low 2s by year- end. This should in turn prompt the Fed to deliver two or three rate cuts this year, likely starting at the June meeting. Globally, we expect activity in Europe to pick up from a low base, offsetting the slight drag from moderating U.S. growth.

This environment supports a pro-risk stance. In our multi-asset portfolios, we overweight credit and equity. Meanwhile we are neutral duration as bonds will likely trade in a range, but the promise of rate cuts probably caps the risk of bond yields moving sharply higher.

With interest rates set to decline this year we underweight cash, managing the negative carry of this position through targeted trades in credit and FX. Differences in policy timing and growth rates across the globe also create meaningful relative value opportunities, as well as greater potential to capture security selection alpha via our end managers.

We acknowledge one key risk to this benign base case: inflation becomes "sticky" at current levels, or worse still, reaccelerates. This would give the Fed and other central banks reason to delay rate cuts, or in the very worst-case return to a more hawkish policy setting. While recent U.S. inflation prints surprised to the upside, we believe that the most important drivers of inflation, notably shelter, are trending lower. Nevertheless, we continue to closely watch labor markets for any signs of a pick-up in wage inflation which has, so far, remained muted.

As investors have repriced economic risk from looming recession to soft landing, the S&P 500 has rallied more than 1,000 points since October. While the business cycle probably has some way to run, the economy is not in early cycle. As a result, we expect more modest earnings growth and valuation expansion, but remain constructive on stocks over the intermediate term.

In the shorter run, it may be the case that technical momentum and excessive optimism over the pace of rate cuts could have pushed stocks a little too far, too fast. To be clear, we see ample room for positive earnings growth over the next year or two, but we also see signs that recent price momentum may fade. Thus, we slightly trim equity overweights, at the margin, with a view to using any consolidation to take risk up once again.

We continue to find attractive relative value and stock selection opportunities across equity markets and favor tilts toward high quality, cash compounding names.

The recent broadening of market leadership away from the mega-cap technology sector is encouraging for both the long-run market trend and the potential for active alpha. On a regional basis we prefer the U.S. and Japan, but we also note an improved outlook for emerging markets (EM) ex-China. While Europe offers some attractive stock selection opportunities, the region screens less well than some others.

Credit spreads have tightened in line with the rally in equity markets. But while the technical factors that drive equity markets look stretched, some of the key technical factors for credit — notably investor appetite for new supply — remain supportive. If equity markets consolidate, credit spreads may widen a little; but new issues are attracting strong demand and requiring limited concessions to investors. This suggests that credit will probably hold up well in our core economic scenario.

Returns from credit at this stage are likely to come mostly from coupon carry rather than spread tightening. The source of return may seem pedestrian, but in a portfolio context, credit can play an important role. Allocators can use credit to manage negative carry positions such as our underweight to cash. Within the credit complex, we favor shorter dated U.S. high yield, non-agency mortgages, and securitized credit.

The potential for riskless rates to fall as policy rates decline lends further support for credit and leads us to play duration from the long side. Ahead of the first Fed

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 resilient as U.S. cools while EU, Asia improve; fading recession risk
- Broad policy rate cuts begin mid-year as inflation moderates
- Rangebound yields support a neutral stance on duration
- Fading recession risk makes credit compelling; limited scope for spread compression but carry very attractive
- Further upside for equities in intermediate term underpinned by earnings
- Prefer U.S. equity, given quality and cash generation, and Japan given rerating potential
- Key risks: Inflation or wages reaccelerate leading to hawkish policy, corporate caution, sharp tightening of credit conditions

cut we see the 10-year U.S. Treasury trading between 3.75% and 4.50%. That said, despite recent price action taking us to the top end of this range, we remain neutral on duration, as the carry penalty of 17 bps per year is offset by just a 25 bps rally in yields.

We do not anticipate a sharp dip in U.S. yields, absent a significant weakening of growth. Instead, we see more opportunity in relative value positions in government bonds, alongside more actively trading the ranges. We prefer the U.S., core and peripheral eurozone, and Australia; Canada and Japan are our favored underweights.

Policy rates of 5.5% in USD and 4% in Europe continue to encourage some investors to consider simply sitting in cash. This is far from a riskless trade. True, holding cash does avoid some elements of market risk. But at the same time a cash position carries significant reinvestment risk. We believe that given good opportunities for both beta and alpha in all the main asset classes, cash becomes a default underweight — though it is critical to manage the associated negative carry.

As policy rates begin to fall around mid-year, we also anticipate that rates volatility will decline further. Volatility in other asset markets is already in line with average levels observed during economic expansions. While we could see short-lived spikes in volatility should stocks consolidate, we believe that cross-asset volatility will remain generally subdued this year.

Together with further declines in inflation, this volatility environment also suggests that cross-asset correlations could fall modestly. Although we do not foresee a reversion to negative stock-bond correlation, any dip in correlation will further strengthen diversification opportunities for asset allocators.

In sum, an environment of moderating growth and inflation, policy rate cuts and continued low volatility supports a risk-on stance. As any investor will attest, markets can overextend at times, and in the short term we may see some evidence of this pattern in stocks. Nevertheless, we maintain high conviction that we are in an environment that is broadly supportive for risk taking, and so continue to look for opportunities to add to positions on any consolidation.

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.

● Underweight ● Neutral ● Overweight

Asset class		Opportunity set	UW	N	OW	Change	Conviction	
Main asset classes		Equities	○	○	●		Moderate	Resilient and broadening growth support earnings, multiples look high but likely boosted by easier monetary conditions
		Duration	○	●	○	▼		Peak in yields behind us but sticky inflation is a risk; a shallow cutting cycle means yields may decline slowly; expect a tight range to hold
		Credit	○	○	●		Moderate	Carry attractive in base case and fading recession risks; not expecting much spread tightening
		Cash	●	○	○		High	Cash returns set to fall as cutting cycle begins; long-term USD rates likely closer to 3% than 5.5%
Preference by asset class	Equities	U.S. large cap	○	○	●		Moderate	Resilient nominal growth helps revenues, valuations supported by Fed cutting cycle; growth exposure a benefit; watch for momentum loss
		U.S. small cap	○	●	○			Outlook improving as recession risk fades, but favor profitable firms with low leverage, given elevated financing rates
		Europe	○	●	○	▲		Macro data stabilizing in Europe, but valuations and margins above pre-COVID levels
		UK	○	●	○	▼		Cheap, defensive market with a positive gearing to commodities but has lacked a catalyst
		Japan	○	○	●		Moderate	Room to run further, given solid nominal GDP growth, corporate governance reform driving up ROE and light positioning
		China	●	○	○	▼	Low	Domestic growth and property sector remain weak, with limited signs of policy support or a convincing turn in earnings
		EM ex-China	○	○	●	▲	Low	Improving due to better semiconductor cycle, with earnings outlook showing signs of bottoming; has started to price this in
	Fixed income	U.S. Treasuries	○	●	○	▼		Yield curve likely to steepen as Fed cuts; UST 10y caught in a range, and with reduced recession risk the scope for a strong bond rally is limited
		G4 ex-U.S. sovereigns	○	●	○			Non-U.S. duration exposure could benefit if growth remains soft and CBs cut more than expected; BoJ tightening may see JGB yields retest 100bps
		EMD hard currency	○	●	○			Spreads near 350bps back to early 2022 levels; prefer carry in developed market IG, but EMD HY can tighten if growth improves
		EMD local FX	○	○	●	▲	Low	Yields >6% are still elevated vs. early 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; moderate benefit relative to all-in sovereign yields
		Corporate high yield	○	○	●		High	Limited scope for spread tightening but fundamentals supportive; low recession risk should keep defaults in check, carry looks attractive
	Currency	USD	○	●	○	▲		Growth and rate differentials may not narrow as much as expected, preventing material decline in USD
		EUR	○	○	●		Low	Market pricing ECB policy to ease in line with Fed, bottoming growth and upside risk could lend support to EUR
		JPY	○	●	○	▼		Modest strengthening of JPY plausible as macro improves and BoJ continues gradual policy normalization
		CHF	●	○	○	▼	Low	SNB leading DM central banks in the easing cycle; softer growth projections, and less intervention could lead to CHF weakness

Source: J.P. Morgan Asset Management Multi-Asset Solutions; assessments are made using data and information up to March 2024. 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

J.P. Morgan Multi-Asset Solutions manages over USD 242 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, 2023.

Next steps

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

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