INVIEW

GLOBAL HOUSE VIEW & INVESTMENT PERSPECTIVES

AUGUST 2022

DISCIPLINED BY NATURE. FLEXIBLE BY DESIGN.
The icons alongside represent our investment process. Through a disciplined provision of investment policy and security selection at the global level, regional portfolio management teams have the flexibility to construct portfolios to meet the specific requirements of our clients.

HIGHLIGHTED IN THIS PUBLICATION:

- GLOBAL STRATEGIC ASSET ALLOCATION
- GLOBAL SECURITY SELECTION
- REGIONAL ASSET ALLOCATION
- REGIONAL PORTFOLIO CONSTRUCTION

Editorial

Welcome to the August edition of *Inview: Global House View*. In this publication we consider significant developments in the world's markets, and discuss our key convictions and themes for the coming months.

Moz Afzal
Chief Investment Officer

Central banks are in a difficult situation. Inflation remains stubbornly high, despite massive increases in policy rates across the world. And the likelihood that the global economy, or at least large parts of it, will slip into recession later this year or in 2023 has been gradually rising for some time. While the US may be able to avoid this outcome, other economies will not be as lucky.

Monetary policy makers across the world are paying little attention to the worsening outlook for the real economy and instead continue to push up interest rates rapidly. Why do they do so, and what conclusions should investors draw?

One important reason is that central banks are concerned about their reputation. Across the world they are viewed as having made a serious misjudgement in failing to anticipate the sharp increase in inflationary pressures over the past two years. Inflation fell at the start of the pandemic in the spring of 2020 and was expected to rise temporarily twelve months later as the base effect kicked in. However, the scale of the increase and its persistence has taken most central banks by surprise. Indeed, in recent months inflation has moved even higher as the Russian invasion of Ukraine has further pushed up energy and food prices.

With inflation at levels not seen for decades, central banks are widely seen as having been asleep at the wheel. Many commentators argue that central bankers have been too slow to recognise the risk of surging inflation and tighten policy in response. To regain their credibility, central banks are now focusing single-mindedly on curbing inflation, even at the risk of triggering a slowdown in growth or perhaps even a recession.

That has direct implications for investors. Central banks are unlikely to scale back their plans to tighten monetary conditions until they see clear evidence that inflation is receding. That probably means that they will want to see three months or so of declining inflation before considering a pause in rate increases. Since fluctuations in energy prices can trigger large price increases that can mask the underlying inflation trend, they are likely to focus squarely on the latter.

In the context of expected continued monetary policy tightening, albeit at a more gradual pace than in the first half of 2022, how should investors' portfolios be positioned? A cautious overweight in equities over bonds seems appropriate in our view, not least because markets appear to have started to focus on the nearing of the end of the tightening phase. However, the geographical allocation should favour emerging markets, particularly those where monetary policy has room for becoming more supportive although we are more cautious on Chinese equities. Among fixed income assets, the rebound in yields justifies a more balanced exposure than earlier in the year, with preference for high quality corporates that should withstand well the tightening of financing conditions. Finally, in view of the still high degree of uncertainty, an adequate exposure to safe assets like the Swiss franc and gold remains warranted.

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Global Asset Allocation: Summary

Equities

- Equities rebounded in July, particularly in the US, with major equity markets moving into key resistance levels. We are happy to keep our moderate preference for equities for now.
- The US economy is slowing. However the main indicators are not yet consistent with a recession so we hold our tactically neutral view. Within the US, smaller companies' earnings have been much better than expected and in the current rate environment, we expect small caps to perform better in the second half of the year.
- Japan remains one of our preferred markets, with corporate profitability continuing to rise.
- We are growing more cautious on Asia in the short term, particularly China. The lack of more meaningful policy plans from the Chinese government, particularly around property support, has been disappointing.
- Our trend and momentum model shows that consumer discretionary has moved into an uptrend recently although the sector is still not exhibiting momentum. The healthcare sector currently appears attractive in our view given that it is a defensive growth sector.

Fixed Income

- No allocation changes were made but emerging market debt is one area we are keeping an eye on, with EM spreads widening in July.
- We are comfortable with the range that the 10-year US Treasury is in, holding our neutral tactical view.
- European corporate bonds look good in our opinion due to wider spreads following the start of European Central Bank rate hiking; spreads are already pricing in a recessionary environment. We are more neutral on longer-dated euro government bonds.
- We favour convertible bonds as a catch-up trade and note that they have been rallying alongside the equity market rebound.

Alternative Investments

- Equity Market Neutral strategies are favoured, particularly with a market backdrop of both volatility and factor rotation. We continue to recommend a combination of systematic and discretionary managers to diversify model styles and factors.
- We are more cautious strategically on Directional Long Short equity as we consider other Hedge Fund strategies to be better positioned for absolute returns in this volatile market.
- The deteriorating global economic outlook is expected to weigh on demand for commodities, having seen crude oil return back below pre-Ukraine invasion levels and so we hold both a strategic and tactical neutral position.

Currencies

- The US dollar has continued to strengthen alongside expectations of Federal Reserve tightening.
- The yen has seen a dramatic weakening and so we could lean more into this in the short term.
- The pound has seen a high level of volatility but has generally been on the stronger side. We reaffirm our tactical overweight on the currency as we expect the Bank of England to continue to tighten monetary policy aggressively while the fed funds rate may peak sooner than the policy rate for other central banks.

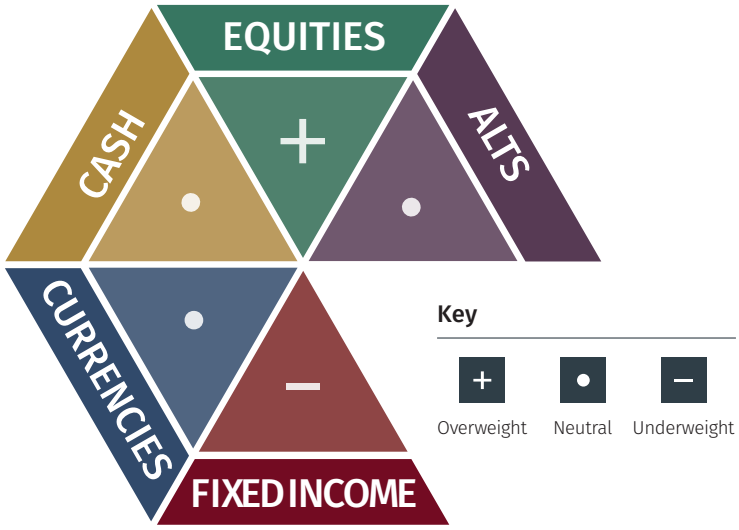
Sector allocation (✚ overweight, ▬ underweight, ● neutral)

Sector	July 2022 Weight	Change	Aug. 2022 Weight
Consumer Discretionary	✚	↔	✚
Consumer Staples	✚	↔	✚
Energy	●	↔	●
Financials	●	↔	●
Healthcare	✚	↔	✚
Industrials	▬	↔	▬
Information Technology	✚	↔	✚
Materials	▬	↔	▬
Real Estate	●	↔	●
Telecoms	●	↔	●
Utilities	▬	↔	▬

Global Asset Allocation: 12-Month Strategic Outlook

Based on a balanced mandate, the matrix below shows our long-term house view on investment strategy.

Overall Asset Allocation Views



Asset Class Breakdown

	EQUITIES	FIXED INCOME	ALTS	CURRENCIES	CASH
+ Overweight	North America Japan Asia Pacific ex-Japan	Convertible Preferred & Hybrid	Hedge Funds Equity Market Neutral Hedge Funds Relative Value Hedge Funds Macro Infrastructure		
• Neutral	Europe Europe ex-UK ex-Switzerland United Kingdom Switzerland E. Europe, ME & Africa Latin America	Investment Grade Corporate High Yield Emerging Markets Other	Commodities / Mining Equity Property / REITS Insurance-linked Securities Other Volatility	USD EUR GBP AUD JPY RMB CHF	Money Market
– Underweight		Sovereign (US) Sovereign (Other)	Hedge Funds Directional Equity		Cash

Global Asset Allocation: 3-Month Tactical Outlook

Based on a balanced mandate, the matrix below shows our short-term house view on investment strategy.

Asset Class Breakdown

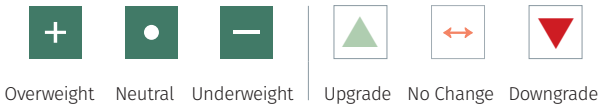
Note: The highlighted boxes indicate a difference from our 12-month strategic outlook.

	EQUITIES	FIXED INCOME	ALTS	CURRENCIES	CASH
+ Overweight	Japan Asia Pacific ex-Japan E. Europe, ME & Africa Latin America	Investment Grade Corporate Convertible High Yield Preferred & Hybrid	Hedge Funds Equity Market Neutral Hedge Funds Macro Property / REITS Other Volatility Infrastructure	GBP AUD RMB	
• Neutral	North America Europe Europe ex-UK ex-Switzerland Switzerland	Sovereign (US) Emerging Markets	Hedge Funds Directional Equity Hedge Funds Relative Value Commodities / Mining Equity Insurance-linked Securities	USD EUR JPY CHF	Money Market Cash
− Underweight	United Kingdom	Sovereign (Other) Other			

Equity Allocation Grid

Based on a balanced mandate, the table below provides our long-term (strategic) and short-term (tactical) house view on investment strategy.

Key



Sub-Asset Class	Strategic 12-month		Tactical 3-month		Sub-Asset Class Additional Guidance
	View	Change	View	Change	
North America	+	↔	●	↔	Previously we downgraded US equities on a tactical basis to neutral, despite the US having a potential for a short-term recovery. This was based on the probability that the Fed is unable to engineer a "soft landing" of the economy, risks around the US mid-term elections and the outlook for the US dollar. After the worst first half of the year in decades, US stocks had a strong July. Growth stocks outperformed value stocks during the month, but they continue to underperform year-to-date. We would be adding to growth stocks given good earnings results. Smaller companies' earnings have been much better than expected and we expect small caps to perform better in the second half given the softening inflation environment.
Europe	●	↔	●	↔	We continue to closely monitor our allocation to European equities given a more favourable rate environment and attractive valuations in our view. However, its exposure to the Russia-Ukraine war and the spike in energy prices remain a concern, and we are not yet ready to upgrade. We still have a bias towards quality growth companies as we think they will continue to be the long term winners and this has started to come through as economic uncertainty persists.
Europe ex- UK ex- Switz.	●	↔	●	↔	We continue to closely monitor our allocation to European equities given a more favourable rate environment and attractive valuations in our view. However, its exposure to the Russia-Ukraine war and the spike in energy prices remain a concern, and we are not yet ready to upgrade. We still have a bias towards quality growth companies as we think they will continue to be the long term winners and this has started to come through as economic uncertainty persists.
United Kingdom	●	↔	−	↔	UK equities continue to outperform in 2022, consistent with the strength of value stocks, although they were one of the weakest amongst developed markets in July. Valuations have improved slightly but the UK market still looks more expensive in relation to other regions, although still far from previous history. Monetary tightening is already underway as inflation remains high and could hamper consumer spending. We are waiting for momentum in the region to turn more positive.

Source: Refinitiv. Data for year to date as at 31 July 2022. **Past performance is not necessarily a guide to the future.**

Equity Allocation Grid

Based on a balanced mandate, the table below provides our long-term (strategic) and short-term (tactical) house view on investment strategy.

Key

+	●	−	▲	↔	▼
Overweight	Neutral	Underweight	Upgrade	No Change	Downgrade

Sub-Asset Class	Strategic 12-month		Tactical 3-month		Sub-Asset Class Additional Guidance
	View	Change	View	Change	
Switzerland	●	↔	●	↔	Swiss equities have a growth bias relative to European equities due to their defensive characteristics i.e. large index weights in consumer staples and pharma. We would proactively re-balance into mid-caps right now despite economic uncertainty in Europe and also due to the stretched valuation in the larger companies.
Japan	+	↔	+	↔	Stock selection in Japan has been quite critical with growth names previously leading, but there had been a clear leadership flip more to value companies. We would not necessarily chase this move, but it does warrant a more balanced profile going forward. We continue to gain confidence in Japanese equities as strong earnings, attractive valuations, and a competitive yen reinforce our overweight positioning. Policy in Japan remains supportive and could become a tailwind for markets.
Asia Pacific ex-Japan	+	↔	+	↔	We have been positive on China, and it has been one of the better performing markets since making that call. However we note that we are waiting on a catalyst for stocks, such as more concrete plans from the government around the property sector and the rest of the economy, and without this we may have to adjust positioning. The ASEAN markets remain underweight for us. With oil prices coming down, we are less concerned about India than we were a few months back.
Eastern Europe, Middle East and Africa	●	↔	+	↔	Valuations in emerging markets continue to look attractive relative to other parts of the market. As we move more into a mid-cycle positioning EEMEA markets could benefit from positive momentum. This does not include holdings from Russia which continue to be subject to sanctions given the invasion of Ukraine.
Latin America	●	↔	+	↔	Latin American stocks have been some of the better performers this year but there is still large dispersion within the region. Brazilian stocks have benefited on a relative basis from a positive economic environment and rising commodity prices. Latin American economies have benefitted from rising commodity prices, and should be relatively less impacted by the war in Ukraine. Valuations still provide good entry point relative to other markets.

Source: Refinitiv. Data for year to date as at 31 July 2022. **Past performance is not necessarily a guide to the future.**

Fixed Income Allocation Grid

Based on a balanced mandate, the table below provides our long-term (strategic) and short-term (tactical) house view on investment strategy.

Key

+	•	–	▲	↔	▼
Overweight	Neutral	Underweight	Upgrade	No Change	Downgrade

Sub-Asset Class	Strategic 12-month		Tactical 3-month		Sub-Asset Class Additional Guidance
	View	Change	View	Change	
Sovereign (US)	–	↔	•	↔	The allocation to sovereign fixed income has been split to reflect a more positive view on US Treasuries and benefit from rising yields as markets anticipate further rate hikes from the Federal Reserve. We maintain a preference for the 3 to 5 year part of the US curve. Positioning in this part of the curve would still reflect an underweight duration versus the 7-year average of the market.
Sovereign (Other)	–	↔	–	↔	Fixed income markets had a disappointing performance in the first half of 2022. Markets continue to expect further monetary tightening from central banks. For the time being we have only upgraded the view on US, while remaining underweight in the rest of the sovereigns space. Once the ECB tightens monetary policy more we could start to look into the region for high quality.
Investment Grade Corporate	•	↔	+	↔	Credit yields have moved higher, although by less than Treasuries, possibly reflecting improved market sentiment. We upgraded IG credit from neutral to overweight on a tactical basis a couple of months ago, reflecting the attractiveness of BBB-rated spreads over US Treasuries and better nominal yields. Valuations are attractive as spreads are in the top quartile of their historical range.
Convertible	+	↔	+	↔	The Converts space has generally performed well on a relative basis in the current environment, given the continued undervaluation of implied volatility and as investors look for equity sensitivity with a floor. We expect a decent risk / reward trade off for Converts in the current environment, and they offer a good catch up trade in our view.
High Yield	•	↔	+	↔	We maintained the overweight position in high yield bonds based on the lower duration in this part of the market. We favour BB and B-rated companies where nominal yields remain attractive. We would avoid CCC-rated credits for the time being. Balance sheets have improved and maturity profiles are longer, making them more attractive. Over the coming months good alpha opportunities might be created, so selectivity will be key.
Preferred & Hybrid	+	↔	+	↔	Preferred and Hybrid debt is higher beta. However as much of it is related to the financial sector and bank debt - AT1 and Cocos for example - we feel that the asset class is more attractive than high yield, so we are overweight the sector.
Emerging Markets	•	↔	•	↔	We previously had a strong bias for China 10-year government bonds, however these are no longer as attractive compared to 12 months ago, so we would not add to exposure. We are evaluating our Emerging Market debt positioning and could turn more cautious given the slowing global economy and higher rates. Selectivity will be key in this space.

Alternatives Allocation Grid

Based on a balanced mandate, the table below provides our long-term (strategic) and short-term (tactical) house view on investment strategy.

Key

+	●	−	▲	↔	▼
Overweight	Neutral	Underweight	Upgrade	No Change	Downgrade

Sub-Asset Class	Strategic 12-month		Tactical 3-month		Sub-Asset Class Additional Guidance
	View	Change	View	Change	
Hedge: Directional Equity	−	↔	●	↔	We recommend caution in Directional Long Short equity. Our expectation is that this group could outperform negative traditional equity market indexes on a relative basis but consider other HF strategies to be better positioned for absolute returns in this volatile environment. We are aware of opportunities from market rallies and there are specific names we would gravitate towards for higher up capture potential.
Hedge: Equity Market Neutral	+	↔	+	↔	Our strong preference is for Equity Market Neutral approaches, particularly with a market backdrop of both volatility and factor rotation. Market neutral managers have seen a mix of both long and short alpha generation during 1H. We continue to recommend a combination of systematic and discretionary managers to diversify model styles and factors.
Hedge: Relative Value	+	↔	●	↔	Within Relative Value, our preference is for (dynamic) Multi-Strategy RV/Arbitrage approaches which have the flexibility to move risk around the opportunity set across asset classes and sub-strategies. Pure Convertible Arbitrage and Merger Arbitrage approaches have been under stress all year from liquidity, equity market and credit deterioration and, although we believe some compelling idiosyncratic opportunities are appearing in CB Arb, we remain aware of the possibility of wider credit spreads in the months ahead.
Hedge: Macro	+	↔	+	↔	We have a strong preference for Systematic CTAs, specifically the medium-term Trend-Followers and shorter-term Trading Strategies. We continue to expect that both these sub-strategies will provide substantial diversification benefits to long-biased equity/bond portfolios in the current bearish regime. Trend-Following CTAs are currently positioned net short in equity indices and bonds and net long USD and Commodities, while shorter term strategies benefit from wider weekly price ranges (volatility), which assists both directional and mean reversion approaches
Commodities / Mining Equity	●	↔	●	↔	We previously downgraded Commodities and Mining Equity to Neutral on a tactical basis. Industrial metals have collapsed in recent months and they currently look more vulnerable. Soft commodities have corrected, with technicals looking more vulnerable. Oil and gold are the only commodities that remain supported in current market conditions and therefore justify maintaining a Neutral position on a tactical basis. Structurally we still prefer Copper and Copper-related investments.
Property / REITS	●	↔	+	↔	We previously upgraded Property/REITS from Neutral to overweight on a tactical basis. Interest rates are low and improvements in employment and economic activity provide a positive backdrop for the sector. We maintain a preference for residential property and logistics. We are underweight on commercial and retail real estate.
Insurance-linked Securities	●	↔	●	↔	Cat yield spreads and the asset class generally has been un-loved for many years and we are becoming more interested in the asset class, given its diversification properties.
Other (Volatility)	●	↔	+	↔	Implied volatilities in equities, FX and commodities have been rising recently given recent geopolitical events, allowing for interesting yield opportunities. We previously upgraded volatility on a tactical basis to overweight to reflect the possibilities for portfolio hedging.
Infrastructure	+	↔	+	↔	We are overweight in infrastructure as both Europe and the US start to develop long term infrastructure policies. The EU Recovery Fund and the Biden infrastructure plans are positive for the asset class. The infrastructure space can also offer protection for portfolios over rising inflation.

Currency and Cash Allocation Grids

Based on a balanced mandate, the table below provides our long-term (strategic) and short-term (tactical) house view on investment strategy.

Key

+	•	–	▲	↔	▼
Overweight	Neutral	Underweight	Upgrade	No Change	Downgrade

Sub-Asset Class	Strategic 12-month		Tactical 3-month		Sub-Asset Class Additional Guidance
	View	Change	View	Change	
USD	•	↔	•	↔	After a strong 2021, the US dollar has strengthened as expectations of Fed tightening have firmed. In May the US dollar has weakened against other developed currencies, prompting a strengthening of the euro, which is consistent with the outlook for monetary policy. Over a longer time frame, the curve has flattened which will continue to re-enforce the dollar strength.
EUR	•	↔	•	↔	Valuation of the EUR against the USD has strengthened over the last month. Our valuation models reflect that the EUR/USD remains in line with fundamentals, based on PPP estimates. We have adjusted our target downward to 1.10 to 1.15. This is consistent with our expectation that although the ECB will start hiking rates in the next month, it will do so at a slower pace than the Fed. Market positioning remains fairly neutral, consistent with our view.
GBP	•	↔	+	↔	We reaffirm our short-term overweight on the GBP and maintain a target of 1.30 for the GBP/USD. Expect the BoE to follow through on their announcements to tighten monetary policy aggressively in the coming months. With the Fed peaking rates earlier than other central banks, we expect this will weaken the USD.
AUD	•	↔	+	↔	Fundamentals remain supportive of commodity-sensitive currencies, reflecting a better scenario for the AUD, however the slow-down in China is a headwind. The increase by the RBA and the continued rate increase guidance is positive.
JPY	•	↔	•	↔	Different to previous episodes of rising geopolitical risk, this time the JPY did not behave as a safe haven currency in recent weeks. Given the recent weakness of the JPY, we now adjusting our target to levels close to 125.
RMB	•	↔	+	↔	The RMB remains one of our favourite currencies given the backdrop of announced further policy support. However, we have turned more cautious on the short-term over the weakness of the Chinese economy and how much has been delivered by the government.
CHF	•	↔	•	↔	The recent actions from the SNB and the ECB current warrant a more Neutral positioning on the CHF on a tactical basis. However, despite the high levels of uncertainty surrounding the fundamentals for the European economy, we remain relatively constructive on the EUR/CHF on a strategic basis.

Sub-Asset Class	Strategic 12-month		Tactical 3-month		Sub-Asset Class Additional Guidance
	View	Change	View	Change	
Money market	•	↔	•	↔	We have elevated cash levels for now, and looking for opportunities in fixed income.
Cash	–	↔	•	↔	We have elevated cash levels for now, and looking for opportunities in fixed income.

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