INVIEW

GLOBAL HOUSE VIEW & INVESTMENT PERSPECTIVES

SEPTEMBER 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 September 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

The message from the Kansas City Fed's annual symposium in Jackson Hole couldn't be clearer. Central banks across the world will continue to raise interest rates, with few exceptions. Indeed, it seems likely that the pace of tightening may even accelerate.

Thus, markets expect the Federal Reserve to raise interest rates by another 150 bps by the end of the year and the ECB by a similar amount, if not more. This is a very rapid tightening of monetary policy. While a review of US tightening cycles since 1980 (disregarding the slow tightening in 2015) suggests that normally the Federal Reserve raises interest rates by around 300 bps over 15 months, this year it might raise rates by 400 bps in nine months. Anything that changes that quickly must be watched very closely.

Of course, such a rapid tightening might be necessary. However, a recession is forecast in the UK and looks increasingly likely in the eurozone. And while the US economy may be doing fine so far, interest rates moving 75 or 150 basis points higher may quickly change that.

The shocks that central banks have had to deal with have been unprecedented and almost all have contributed to a sharp rise in inflation. Given the nature of the shocks, there was little central banks could have done to prevent that outcome. Nevertheless, central bankers appear stung by criticism that they have failed to maintain low and stable inflation.

They are quick to emphasize that long-run inflation expectations, which are measures of their credibility, have risen in many countries in recent months. However, in many cases they have gone up because expected inflation over the next one or two years has risen, suggesting that observers view the increase in interest rates as largely temporary.

But the risk now is that central banks see raising interest rates rapidly and by large amounts, despite the obvious risk of triggering a recession, as a way for them to prove their mettle and restore their credibility. That may be true, but two wrongs don't make a right.

The expected aggressive tightening of monetary policy pushed market volatility higher again in August. For investors, the positive is that a lot of bad news seem to be already discounted in asset prices. Hence, in our view a diversified portfolio should maintain a slight overweight to equities over fixed income assets.

In terms of preferred markets, in our view the US and emerging Asia should be favoured at the expense of European markets, which are more exposed to fallout from the war in Ukraine and the resulting energy crisis and whose central banks are in the early stages of monetary policy normalisation. In contrast, the US Federal Reserve is more likely to slow the pace of rate increases in the last quarter of the year. Bond yields have risen again and become more attractive as a result, particularly for high quality corporates. Finally, the ongoing high degree of uncertainty warrants an adequate exposure to safe assets, including the Swiss franc and gold.

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Global Asset Allocation: Summary

Equities

- Europe is entering a tough period, facing rising gas prices, a high risk of recession as well as uncertainty surrounding ECB policy. European banks have also started to underperform relative to the rest of the market and so we are tactically downgrading our European equity position to underweight.
- With the downgrade to European equities, we are upgrading our US positioning back up to overweight on a tactical basis. This is supported by the recent pullback in valuations, as well as the Federal Reserve coming closer to the peak in its interest rate cycle.
- Japan looks interesting from a sterling, dollar or euro perspective. Trends in earnings, valuations and technicals appear positive and we will watch this closely.
- A downgrade of Asia ex-Japan equities was considered. However, given moves by Chinese authorities to support the real estate sector as well as interest rate cuts, we hold our overweight for now. The trends in India continue to look positive in our view.
- UK equities continue to outperform other developed markets year-to-date, but valuations appear more expensive relative to other areas.

Fixed Income

- The end of a rate cycle is usually associated with a credit event. Nothing is currently clearly identifiable, but we remain vigilant and maintain the underweight in fixed income.
- In our view, investment grade credit looks attractive and so we hold our overweight positioning. Given that we're entering into a slow growth period for Europe, we are more cautious on credit within Europe, but certainly in high quality, investment grade credit we would be overweight there as well on a relative basis.
- If US high yield spreads moved below 400 basis points then that would encourage us to be more conservative, but overall we are still overweight.

Alternative Investments

- The outlook for oil is mixed, with demand dropping on slowing economic growth, while inventories are at a low level with the possibility of OPEC further cutting production if prices fall too far. Meanwhile the outlook for industrial metals remains positive in our view, with low copper inventories having the potential to trigger a rebound in prices should there be a pickup in economic activity.
- We remain both strategically and tactically overweight on infrastructure, which can offer protection for portfolios in a world of rising inflation.

Currencies

- Technicals for the US dollar continue to look very strong. The rise in the US dollar is also reflective of the worsening outlook for the eurozone and the UK. We expect the dollar to stabilise as the Fed reaches a peak in rates.

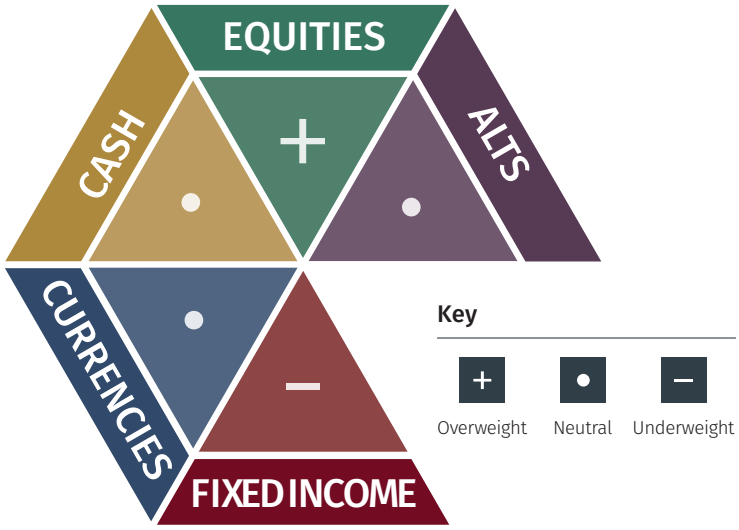
Sector allocation (✚ overweight, ▬ underweight, ● neutral)

Sector	Aug. 2022 Weight	Change	Sep. 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

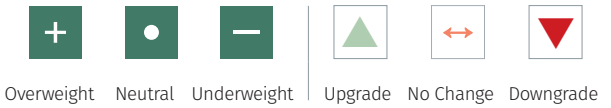
Note: The highlighted boxes indicate a difference from our 12-month strategic outlook.

	EQUITIES	FIXED INCOME	ALTS	CURRENCIES	CASH
+ Overweight	North America 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	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	Europe Europe ex-UK ex-Switzerland 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	+	↔	+	▲	We are upgrading US equities from neutral to overweight on a tactical basis. This is supported by the recent pullback in valuations, as well as the Federal Reserve coming closer to the peak of interest rate expectations. In addition, September and October are historically strong months for US equities in midterm election years. Growth stocks continue to underperform value stocks year-to-date, however we expect a pivot to large cap growth stocks as they typically perform better in a slowing economic environment. 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	•	↔	–	▼	Europe is entering a tough period with winter approaching, high gas prices, high risk of recession and uncertainty surrounding ECB policy. This is enough for traders to maintain short positions, while trend models are uniformly negative on Europe. With this we are tactically downgrading Europe to underweight. We still have a bias towards quality growth companies as we think they have the potential to continue to be the long term winners and this has started to come through as economic uncertainty persists.
Europe ex- UK ex- Switz.	•	↔	–	▼	Europe is entering a tough period with winter approaching, high gas prices, high risk of recession and uncertainty surrounding ECB policy. This is enough for traders to maintain short positions, while trend models are uniformly negative on Europe. With this we are tactically downgrading Europe to underweight. We still have a bias towards quality growth companies as we think they have the potential to 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. 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 August 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. Chinese authorities have recently announced supportive measures to the real estate sector as well as cutting interest rates, but more support is needed and we will continue to monitor this closely. 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 in general 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 August 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 and a challenging environment remains. 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. The ECB has started tightening policy and there is uncertainty over the pace at which they will continue to raise interest rates. We maintain a cautious view on Europe and UK at the moment.
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	•	↔	+	↔	US high yield spreads falling below 400 basis points encourages us to a more conservative high yield weighting. For the time being we maintain 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, in our view. 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. Volatility Arbitrage is starting to become a more appealing strategy but given that the current bear market has so far developed in an unusually orderly manner, it concerns us that there may be a spike (tail risk) in the months ahead that might hurt this (and other RV/Arb) strategies.
Hedge: Macro	+	↔	+	↔	We have a strong preference for Systematic Commodity Trading Advisors (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. 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. Industrial metals have declined in recent months due to recession fears but the outlook remains positive, with low inventories of copper having the potential to trigger a rebound in prices should there be a pickup in economic activity. 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	•	↔	•	↔	The US dollar has continued to strengthen as expectations of Fed tightening have firmed. The rise in the US dollar is also reflective of the worsening outlook for the eurozone and the UK. Over a longer time frame, the curve has flattened which will continue to re-enforce the dollar strength. We expect the dollar to stabilise as the Fed reaches a peak in rates.
EUR	•	↔	•	↔	We are waiting for the point where the Fed will start to signal a pause in rates while the ECB will continue hiking, in which we would expect dollar weakness. In the short term we are targeting a range of 1-1.05.
GBP	•	↔	+	↔	We reaffirm our short-term overweight on the GBP and maintain a target of 1.30 for the GBP/USD. We 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 and support the pound.
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. Given the recent weakness of the JPY, and the expectations of US monetary policy to peak in the coming months, we are now adjusting our target to levels close to 135.
RMB	•	↔	+	↔	The RMB remains one of our favourite currencies given the backdrop of announced further policy support. However, we have turned more cautious over the weakness of the Chinese economy and how much has been delivered by the government.
CHF	•	↔	•	↔	The actions from the SNB and the ECB currently 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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