



NEUBERGER BERMAN

Asset Allocation Committee Outlook 1Q22

Hike Rates and Carry On

A fundamentally robust economy and a positive earnings and default outlook make the case for holding risky assets through 2022, in our view. But the likely transition to structurally higher inflation and higher interest rates, plus the risk of central bank policy errors, could be a recipe for elevated volatility. For the Asset Allocation Committee, that means 2022 is a year to focus on income or “carry” from risky assets, while adjusting portfolios to help cushion against, and take advantage of, potential price volatility.

ABOUT THE ASSET ALLOCATION COMMITTEE

Neuberger Berman's Asset Allocation Committee meets every quarter to poll its members on their outlook for the next 12 months on each of the asset classes noted and, through debate and discussion, to refine our market outlook. The panel covers the gamut of investments and markets, bringing together diverse industry knowledge, with an average of 29 years of experience.

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Market Views

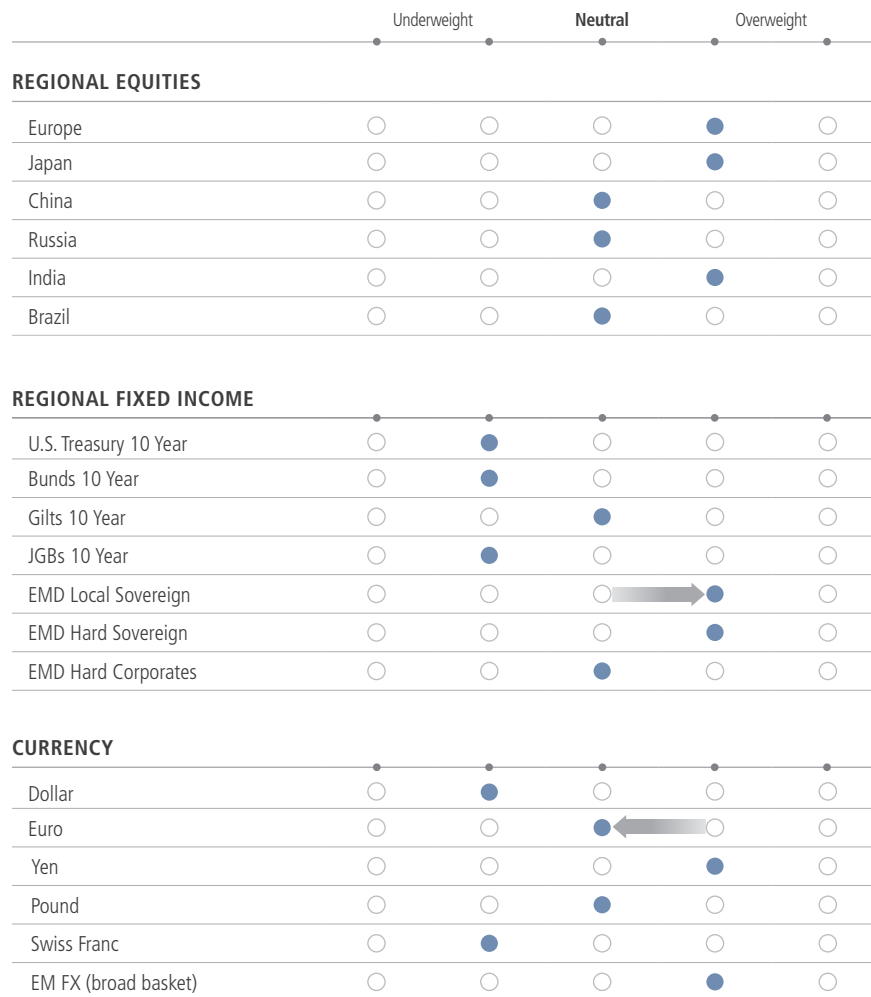
Based on 12-Month Outlook for Each Asset Class

	Underweight		Neutral	Overweight	
	●	●	●	●	●
EQUITY					
Global Equities	○	○	○	●	○
U.S. All Cap	○	○	●	○	○
U.S. Large Cap	○	●	○	○	○
U.S. Small and Mid Cap	○	○	○	●	○
Developed Market—Non-U.S. Equities	○	○	○	●	○
Emerging Markets Equities	○	○	●	○	○
FIXED INCOME					
Cash	○	○	●	○	○
Global Bonds	○	●	○	○	○
Investment Grade Fixed Income	○	●	○	○	○
U.S. Government Securities	○	●	○	○	○
Investment Grade Corporates	○	○	●	○	○
Agency MBS	○	○	●	○	○
ABS / CMBS	○	○	●	○	○
Municipal Bonds	○	○	●	○	○
U.S. TIPS	○	○	●	○	○
High Yield Corporates	○	○	○	●	○
Non U.S. Developed Market Bonds	○	●	○	○	○
Emerging Markets Debt	○	○	○	●	○
REAL AND ALTERNATIVE ASSETS					
Commodities	○	○	○	●	○
Hedged Strategies	○	○	●	○	○
Private Equity	○	○	○	●	○
Private Debt	○	○	○	●	○
Private Real Estate	○	○	○	●	○

As of 1Q 2022. Views shown reflect near-term tactical asset allocation views and are based on a hypothetical reference portfolio. Nothing herein constitutes a recommendation, investment advice or a suggestion to engage in or refrain from any investment-related course of action. See disclosures at the end of this publication, which includes additional information regarding the Asset Allocation Committee and the views expressed.

Regional Focus

Fixed Income, Equities and Currency



"The path of inflation is likely to be the key to asset prices in 2022 – 3. Central banks have lived in a 1 – 3% world for decades, and now they're looking at 5 – 6%. The focus of research papers of the past 20 years has been the problem of disinflation. It could be a real shock to the whole system."

Thanos Bardas | Senior Portfolio Manager and Global Co-Head of Investment Grade

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“Where do we see the risks? Twelve or 18 months ago, it would have been coronavirus. Now, we regard the pandemic as a disruptive rather than potentially catastrophic risk. Instead, persistent inflation and the potential for central bank policy errors are our top concerns.”

Erik L. Knutzen, CFA, CAIA

Chief Investment Officer—Multi-Asset Class

Hike Rates and Carry On

As we enter the new year, most of the global economy appears fundamentally in good shape, as demand continues to recover from the pandemic and supply chains are gradually restored. That outlook makes the case for holding risky assets. There appears to be little risk to income or “carry” from dividends and coupons, in particular, as analysts’ forecasts for earnings and defaults remain positive. The Asset Allocation Committee (“AAC” or “Committee”) is less sanguine about price volatility, however. Despite the recent spread of the Omicron variant, our primary concern is no longer the coronavirus, which, against vaccines and anti-viral treatments, can be disruptive but seems unlikely to result in the major lockdowns of 2020. Instead, our concern centers on the likely transition to an environment of persistent high inflation and higher interest rates. Higher discount rates imply lower present values for equities and bonds, particularly given current valuations. Pricing in a risk premium for central bank policy errors is likely to add to the potential volatility, in our view. For the AAC, that means 2022 is a year to focus on income from risky assets, while adjusting portfolios to help cushion against, and take advantage of, potential price volatility.

The International Monetary Fund forecasts 4.9% growth for the global economy in 2022. For the U.S., the Federal Reserve (“Fed”) expects 4.0% growth. Many confidence-related, lagging elements of GDP growth, such as inventories and capex, have yet to catch up with long-term trends. According to FactSet, analysts expect S&P 500 Index earnings to grow by 9.2% this year. Fitch Ratings anticipates a mere 1% default rate for U.S. high yield.

In short, business is expected to hum along nicely, with little apparent threat to dividend and coupon income. The AAC shares this outlook on fundamentals, but we are less sanguine about potential downside and volatility in asset prices as we move into 2022.

Inflation and Central Bank Policy Top the Risks

Where do we see the risks? Twelve or 18 months ago, it would have been coronavirus. Now, we regard the pandemic as a disruptive rather than potentially catastrophic risk. Instead, persistent inflation and the potential for central bank policy errors are our top concerns.

We saw the same reprioritization of risks by central banks in December’s flurry of activity. In Europe, Norway and the U.K. had among the highest recorded numbers of Omicron variant cases, but both of their central banks raised rates to combat inflation—Norges Bank for the second time in this cycle and the Bank of England (BoE) for the first time in more than three years.

Elsewhere, the European Central Bank (ECB) almost doubled its estimate for Eurozone headline inflation in 2022, to 3.2%, and announced that it would taper its Pandemic Emergency Purchase Program by March (albeit cushioning the blow by planning a temporary expansion of its existing asset purchase program). Even the Bank of Japan signaled an end to its corporate bond and commercial paper purchases in the first quarter of this year.

In the U.S., the Fed doubled the pace of its tapering, committing to end all asset purchases by March (the minutes of its December meeting, published in the New Year, also revealed an appetite for a rapid runoff of the central bank's balance sheet, or "quantitative tightening"). Its "dot plot" of rate forecasts now suggests there will be three rate hikes in 2022. This is a remarkable change of tone: as recently as September, it was not even sure there would be one. Chair Jerome Powell also sounded notably more hawkish on inflation and the jobs market, and the Fed's 2022 headline inflation forecast for 2022 was revised up from 2.2% to 2.6%.

The persistence of high inflation in the second half of 2021 has persuaded policymakers that they have to act, and their projections suggest that they are confident they can tame it next year—but not get it back to their long-term targets. We believe that creates a lot of uncertainty for investors for three reasons.

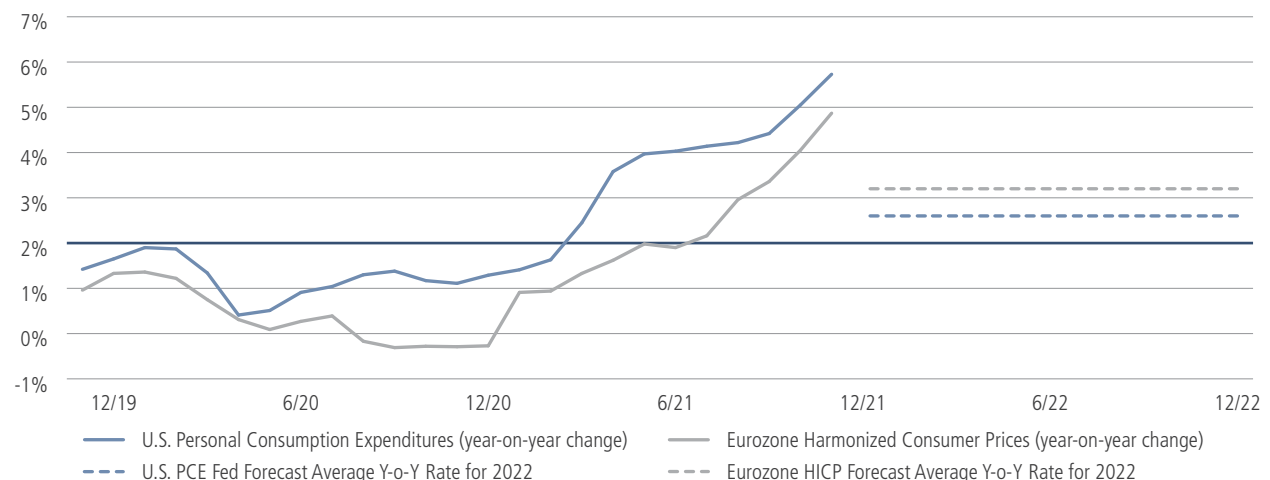
First, it has been at least a generation since the major central banks have faced this level of inflation pressure; the overwhelming weight of institutional thinking has been on how to combat disinflationary forces. Second, if today's inflationary forces are mainly supply- rather than demand-driven, it is not clear that central banks have the tools to address them without simply slowing growth. And third, structural forces may be causing more persistent high inflation, from China's economic reorientation and the re-thinking of global supply chains to the fight against climate change.

Cyclical, Value, Income, Liquidity Risk

What does that mean for our asset-class views?

Simple arithmetic suggests that higher discount rates are likely to translate into lower valuations for both equities and bonds. Historical correlation suggests that a 0.15% rise in real rates translates into a point off of the S&P 500 Index multiple, for example. Add on a risk premium for the uncertainty around central bank policy and the path of inflation, and the steady income we anticipate for 2022 could be accompanied by elevated volatility in asset prices.

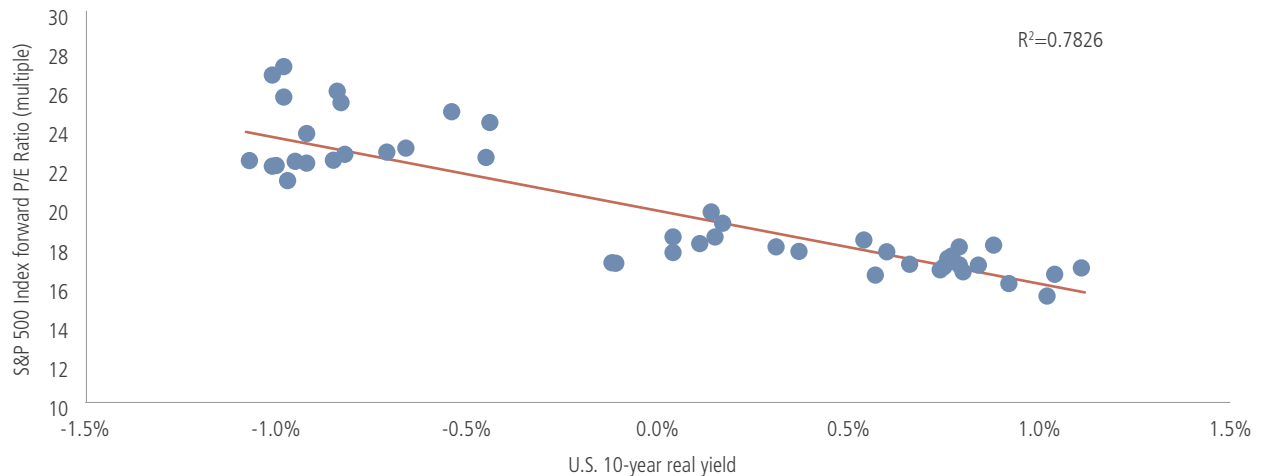
LOWER INFLATION, BUT STILL WELL ABOVE 2%, IS FORECAST FOR 2022



Source: FactSet, U.S. Federal Reserve, European Central Bank. Data as of December 21, 2021. For illustrative purposes only. Nothing herein constitutes a prediction of future economic or market environments. Due to a variety of factors, actual events, including the characteristic of economic or market environments may vary significantly from any views expressed.

REAL RATES APPEAR TO BE A MAJOR DETERMINANT OF EQUITY MARKET PERFORMANCE

End-month S&P 500 price-to-earnings ratios and U.S. 10-year real yields, January 2018 to October 2021



Source: Bloomberg, Goldman Sachs, FactSet, Neuberger Berman. For illustrative purposes only. Nothing herein constitutes a prediction or projection of future events or future market behavior. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

Based on economic fundamentals, the AAC retains its moderately positive view on risky assets. It favors equities over credit—particularly as credit may be more sensitive to a withdrawal of central bank liquidity and higher rates; and it favors credit over government bonds.

Within equities, however, we particularly favor value over growth for its potential to help buffer against downside risk to multiples, and its lower interest-rate sensitivity. So far, mainstream large-cap growth has been resilient in the face of potentially tighter monetary conditions, but we have started to see re-pricing on the more leveraged parts of the spectrum, such as pre-profitability IT and biotech. Most of all, we see an opportunity for a comeback in a subset of value, equity income: it has tended to exhibit even less interest-rate sensitivity; and should volatility become elevated, we think investors are likely to place a premium on a steady, growing stream of dividends.

Within credit, we retain a general tilt to high yield while acknowledging a little more caution. The likelihood of a low default rate must be considered alongside the potential for volatility and pockets of illiquidity. It follows that we think performance this year will be due more to carry than spread tightening, and that

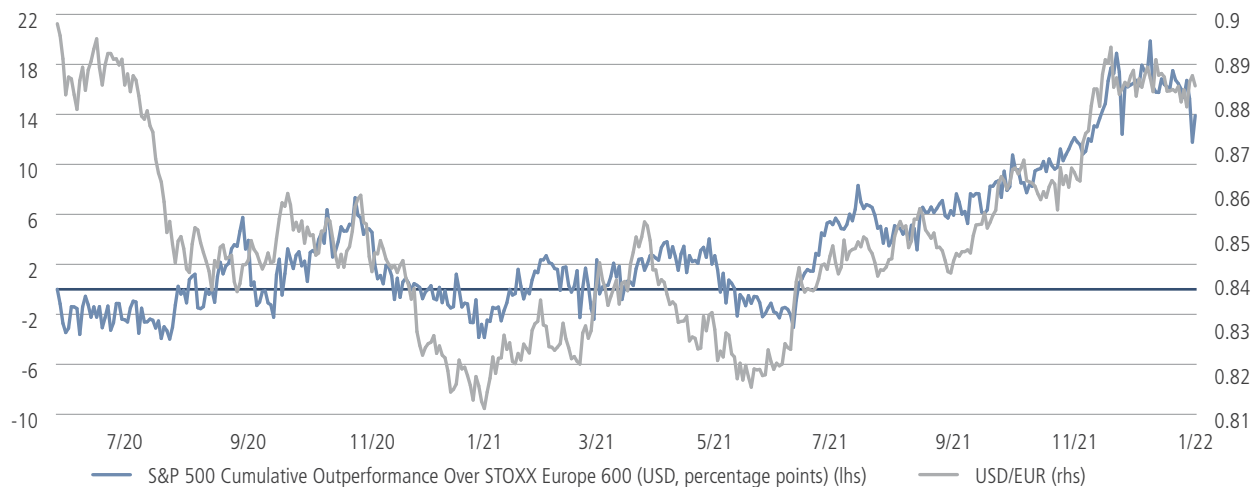
tactical trading on spread widening may be necessary to generate incremental return opportunities. As in equities, lower interest-rate sensitivity, or shorter duration, is a priority: we believe it is more prudent to seek additional return potential from liquidity risk rather than interest-rate risk, leading to a positive view on loans and private debt, which offer floating rates and also the potential for robust demand to feed the ongoing private equity and M&A recovery.

A Preference for Non-U.S. Developed Markets

Regionally, the outlook remains complex.

In our view, a mid-cycle expansion should help support the more cyclical non-U.S. economies and markets, just as we expect it to help support more cyclical sectors. The strengthening U.S. dollar of the past seven months has been a major factor preventing non-U.S. outperformance, but we see signs of an end to that momentum: European and U.S. inflation forecasts are now fairly aligned and, particularly with President Joe Biden's "Build Back Better" stimulus now in doubt, there is greater potential for non-U.S. economies to raise their share of global GDP growth. We therefore remain overweight in our views on European and Japanese equities (and underweight Bunds and Japanese government bonds).

A WEAKER U.S. DOLLAR COULD FAVOR NON-U.S. MARKETS



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This would normally be a favorable background for emerging markets. On this occasion, however, the AAC has decided to downgrade emerging markets equities to neutral.

There are a number of factors behind this decision: many emerging countries have already been forced further into their rate-hiking cycles than their developed-world peers; political and policy uncertainty is rising, notably in Latin America and Turkey, but also in emerging Europe; the emerging world is highly exposed to slowing growth in China; and it has fewer options for mitigating the ongoing impact of the coronavirus pandemic. The AAC's overweight view on emerging markets debt remains in place, but our estimation of tail risk has risen: this view will be held with caution until there is more clarity on the path of global growth and the U.S. dollar.

Mitigating and Taking Advantage of Volatility

With equity and bond valuations stretched and at risk from rising real rates, the Committee reiterates its positive views on alternative investments that can potentially offer uncorrelated

returns, excess returns generated away from the volatility of the public markets, mitigation of traditional asset class volatility, or returns derived from volatility itself.

We upgraded our underweight view on hedged strategies to neutral, with a particular focus on market-neutral and uncorrelated approaches, including insurance-linked strategies. The view might have been more positive were it not for the difficulties many macro investors have experienced over the past two years: dispersion between managers has been extreme.

We maintain our overweight view on commodities, as a portfolio diversifier and for exposure to further potential inflation surprises.

Private markets remain in favor, partly because they do not re-price with the same volatile frequency as the public markets; partly because valuations generally remain attractive relative to those in public markets; but mainly because private equity managers have more ways to improve operations and margins than public equity managers, and are therefore less reliant on multiple expansion for returns.

COULD WE BE RETURNING TO A HIGHER-VOLATILITY ENVIRONMENT?

CBOE S&P 500 Volatility Index (VIX)



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Finally, for those looking for potential sweet spots in the search for income in a volatile environment, the Committee takes a positive view on equity index put option writing. Writing puts is akin to selling insurance to equity investors, for a premium, against downside risk and elevated volatility. It has a long history of generating equity-like returns with meaningfully lower volatility, and it has tended to perform particularly well during periods of elevated volatility, when put option buyers are willing to pay more for insurance. Incidentally, now that traded options are available on Bitcoin, more adventurous asset allocators might wish to explore the very high premiums available for writing puts on this relatively new, extraordinarily volatile digital asset.

There is perhaps no better example of how put writing can generate carry from sometimes extreme volatility expectations, which, in our view, is what makes it especially interesting now. With the equity and credit income we anticipate over the next 12 months making the case for a positive view on risky assets, but with heightened uncertainty as interest rates adjust, we think those two words, carry and volatility, may sum up the year ahead.

UP FOR DEBATE: WE ANTICIPATE MORE VOLATILITY—BUT WHEN?

AAC members broadly agreed on two things this quarter: optimism that next year can be a tolerable year for risky assets, with the potential for price downside to be more than offset by earnings growth and carry; but concern that downside risk and elevated volatility are far more likely than in 2021, due to expectations for higher rates and tighter financial conditions as we grapple with inflation and move deeper into the middle part of the business cycle.

There was less agreement about when during the year the major bouts of volatility are likely to strike, however, and the debate centered on how the dynamics around inflation, central bank policy and the path of real rates might play out through the course of the year. Some Committee members anticipate volatile re-pricing in the first half of the year, with things calming down as the longer-term outlook clarifies in the second half. Others think that the potential trouble lies later in the year.

Those in the first camp point out that if the Fed gets tapering done by March, after confirming that it could then move straight onto rate normalization, it may have hiked rates twice by mid-year. Fixed income market pricing suggests that a hike in March is now more likely than not. The first hike could even be a statement-making 50 basis points. As liquidity drains from markets, nominal rates edge upwards and inflation begins to ease, these AAC members argue that real rates would rise, equity valuation multiples would contract, and investors would re-price for generally tighter financial conditions.

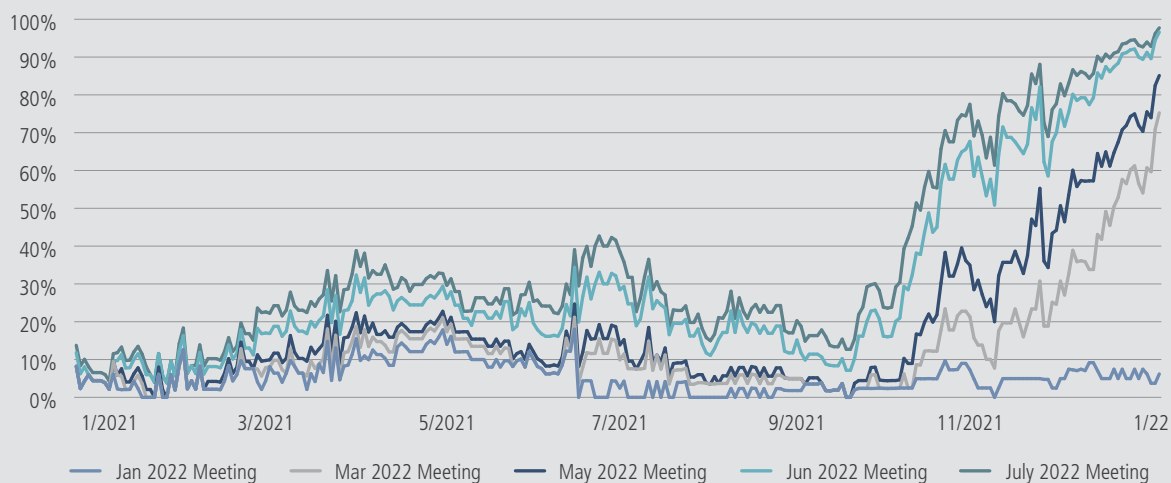
They believe investors ought to have all the information they need to reprice equities and bonds down to lower valuations before mid-year, and they see tapering and the subsequent runoff of the Fed's balance sheet as the key test of how much tightening, and at what pace, markets can bear.

The second camp expects investors to welcome central banks' decisive moves, seeing them as the short, sharp shock that will move us into a less inflationary mid-cycle expansion, with fewer subsequent rate hikes required. If victory can be declared that quickly, 2022 could be a smoother year than we expect. But the proponents of this view also note that fixed income markets, in line with central bank forecasts, have priced for a very big drop in inflation in the latter half of the year, and they are skeptical. Should inflation prove more stubborn than expected, investors may conclude that not just higher but positive real rates are required to gain control of inflation—which could pose a serious threat to economic growth. These AAC members suggest that this central bank-induced slowdown is the potential catalyst for more turbulent repricing, and that the real test will be the path of inflation through the third and fourth quarters.

While the AAC's strategic views are defined by its two points of consensus—an outlook for a tolerable year for carry from risky assets is likely to be accompanied by likely elevated price volatility—its tactical views will be informed by how this debate resolves itself as we move through 2022.

MARKETS ARE NOW PRICING FOR “LIFT-OFF” BY THE FED IN MARCH

Market-derived probability that at least one rise in the Fed Funds Rate will be completed by the time of each FOMC meeting



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UP FOR DEBATE: TIME FOR OPPORTUNISTIC INVESTING IN CHINA?

If inflation and central bank policy errors are our top-ranked risk, and coronavirus developments our third, China retains its place as our second-biggest concern. Its deliberate re-orientation away from fast growth toward more equally balanced economic activity and the rising heat of its geopolitical relations with the U.S. have the potential to affect markets beyond its own shores.

Last quarter, while some Committee members argued that this level of uncertainty made China itself an unattractive market, others countered that China has always been a policy-driven market, and that investors ought simply to follow the government and head for opportunities in sectors such as alternative energy, photovoltaics, wind power, smart vehicles and semiconductors.

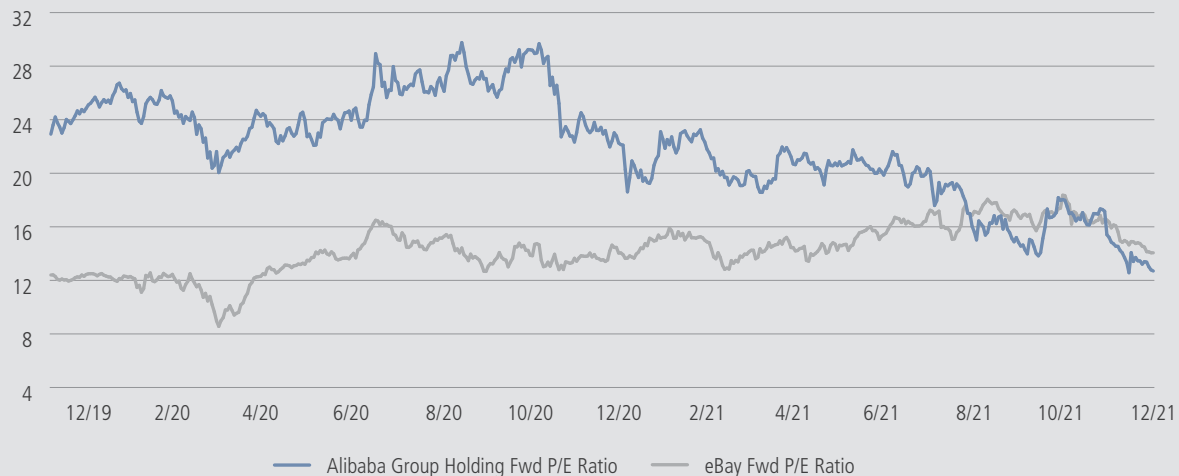
This quarter, a number of Committee members doubled down on the latter view, listing China equities and particularly China's

technology sector among their suggestions for opportunistic investment. They point to policy divergence from the West, as both monetary and fiscal policy loosen in response to stresses in the real estate debt sector and a resurgence of COVID-19 cases. They point to outperformance among smaller Chinese companies. They point to recovering property prices, which tend to feed into stock market prices. And they point to the low valuations of some of the companies perceived to be among the losers from the recent policy pivot. Overall, they argue that China may be a unique source of growth at a reasonable price in global public markets.

These views do not yet carry enough weight on the Committee to move our outlook for Chinese equities, but that may change as we watch for the impact of the latest stimulus in this market.

COULD CHINA'S TECH SUPERSTARS BE UNDERVALUED?

Next 12 months price-to-earnings ratios



Source: FactSet. Data as of December 21, 2021. For illustrative purposes only. This material is not intended as a formal research report and should not be relied upon as a basis for making an investment decision. The firm, its employees and advisory accounts may hold positions of any companies discussed. It should not be assumed that any investments in securities, companies, sectors or markets identified and described were or will be profitable. Nothing herein constitutes investment, legal, accounting or tax advice, or a recommendation to buy, sell or hold a security. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

FIXED INCOME

Investment Grade Fixed Income ◀▶

- The Committee maintained its underweight view.
- The prospect of more stubborn, supply-led inflation dynamics has started to push government bond yields back up, but there remains some way to go before they present attractive valuations or reliable diversification.

Non-U.S. Developed Market Bonds ◀▶

- The Committee maintained its underweight view.
- Yield curves remain suppressed and flat and we see more attractive value in high yield and equity markets.

High Yield Corporates ◀▶

- The Committee maintained its overweight view.
- The AAC believes that the continuing growth recovery and conservative management of corporate balance sheets will be supportive of credit markets in general, although returns are now likely to come through coupon income and tactical trading rather than persistent spread tightening.
- Rising rates and tight spreads make the outlook riskier, leaving this view under closer scrutiny as we navigate the coming months.

Emerging Markets Debt ◀▶

- The Committee maintained its overweight view.
- While our median return outlook for 2022 remains unchanged, we think the tail risks are growing.
- The pandemic still poses bigger risks to emerging than developed economies, and policy and political tail risk is growing in markets as diverse as Turkey, emerging Europe and Latin America.
- The view will be held with caution until there is more clarity on the path of growth and the U.S. dollar.

GLOBAL EQUITIES

U.S. Equities ◀▶

- The Committee maintained its underweight view on U.S. large caps and its overweight view on U.S. small- and mid-caps.
- The AAC believes that the continuing growth recovery will be supportive of higher quality small caps.
- U.S. large caps generally trade with high valuations and exhibit high interest-rate sensitivity, but the Committee maintains its preference for cyclical and value stocks within the U.S.
- Equity income offers relatively attractive value, very low sensitivity to interest rates, and a buffer against potential price volatility.

Non-U.S. Developed Market Equities ◀▶

- The Committee maintained its overweight view.
- While they are more highly geared to the growth recovery, Japanese and European equities remain relatively cheap and in our view that currently presents lower risk.
- Relative valuation improved during the second half of 2021, largely due to the reversal of many pro-cyclical and reflation-and-recovery trades, and the strengthening of the U.S. dollar, which we believe is overdone.
- On the margins, the AAC favors Japan, where we believe big changes in management attitudes to shareholder value are creating substantial opportunity.

Emerging Markets Equities ▼

- The Committee downgraded its view from overweight to neutral.
- The pandemic still poses bigger risks to emerging than developed economies, and emerging markets could be more exposed than other non-U.S. markets to tighter financial conditions.
- Some Committee members are beginning to look opportunistically at China after a year of policy-induced volatility and new monetary and fiscal stimulus.

REAL AND ALTERNATIVE ASSETS

Commodities ◀▶

- The Committee maintained its overweight view.
- Commodities increasingly appear to be one of the few reliable ways to hedge against the potential for persistent cost-push, supply-side inflation pressures.
- Energy stands out, and especially natural gas: on top of pandemic-related supply constraints, which have compounded years of underinvestment, the northern-hemisphere winter and a pick-up in seasonal travel looks likely to add demand pressure onto an already fragile market.

Hedge Funds ▲

- The Committee upgraded its view from underweight to neutral.
- With equity and bond valuations stretched and at risk from rising real rates, there is a growing role for alternative investments that have tended to exhibit uncorrelated returns, mitigate the volatility of traditional asset classes or take advantage of that volatility.
- The Committee is particularly focused on equity index put writing, which tends to perform well during periods of elevated volatility.
- The view might have been more positive were it not for the difficulties macro investors have had getting their calls right over the past two years: dispersion between managers has been extreme.

Private Equity ◀▶

- The Committee maintained its overweight view.
- While there are concerns about valuations, they remain attractive relative to public markets, and are driving deals in high-quality, fast-growing businesses with very low financial leverage; the ability to create value away from the potential volatility of the public markets may also provide some portfolio stability as the cycle matures.
- Despite some concerns about excess capital, many investors are constrained from increasing their allocations or making new commitments because they are already exceeding their limits, following many months of outperformance of public markets and early capital calls from managers that are finding abundant investment opportunities.

Private Debt ◀▶

- The Committee maintained its overweight view.
- Credit selection is important in a market that is increasingly borrower-friendly, with full valuations and already loose covenants loosening further; that said, valuations remain attractive relative to public-market high yield credit, and floating rates may provide a buffer against tightening monetary policy.

Private Real Estate ◀▶

- The Committee maintained its overweight view.
- The sector's inflation sensitivity is attractive, economic re-opening is removing a major headwind to this sector, and we believe post-pandemic growth dynamics will continue to support key sectors such as data centers, warehouses, industrial and multifamily residential.

Currencies

USD ◀▶

- The AAC maintained its underweight view.
- The currency is still overvalued based on purchasing power parity (PPP) metrics and faces headwinds from the U.S.'s twin deficits.
- The dollar could benefit from this being a U.S.-led recovery, however, especially as the Federal Reserve becomes more hawkish: this could also generate a feedback loop if higher long-dated yields trigger a flight to the safety of the dollar.

EUR ▼

- The AAC downgraded its view from overweight to neutral.
- The euro is undervalued based on purchasing power parity (PPP) metrics, and benefits from a large current account surplus and better 2022 growth expectations than the U.S., but a more hawkish Fed is providing support for the dollar and a meaningful shift in the stance of the European Central Bank seems unlikely at least until the disruption of the Omicron variant has passed.

JPY ◀▶

- The AAC maintained its overweight view.
- Both PPP and real exchange rates suggest the JPY is undervalued, market participants are now very short the currency, and hedged foreign investments are at their most attractive levels for years for JPY-based investors.
- The country's slow pace of vaccination could be a higher risk in the face of the spread of the Omicron variant of the coronavirus.

GBP ◀▶

- The AAC maintained its neutral view.
- The U.K.'s budget is growth-supporting this year, the BoE has become the first of the three four major central banks to hike rates, and the GBP still appears undervalued based on PPP measures.
- The view remains marginal, as market participants are long GBP, premature fiscal tightening remains on the table, and Brexit issues continue to present tail risks.

CHF ◀▶

- The AAC maintained its underweight view.
- The Swiss franc is still very overvalued on PPP measures, and market participants remain very long in their positioning despite this year's removal of many tail risks associated with the Eurozone.
- Risks to the view include Switzerland's large current account surplus and the potential for a flight from risk as the Fed embarks on tapering and rate hikes.

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