Global Asset Allocation Views

Insights and implications from the Multi-Asset Solutions Strategy Summit

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AUTHOR

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ASSET CLASS VIEWS (PAGE 3)

Underweight ● Neutral ● Overweight ●

Asset class		Opportunity set	UW	N	OW	Change	Conviction
MAIN ASSET CLASSES		Equities	○	○	●		High
		Duration	●	○	○		Low
		Credit	○	○	●		Low
		Cash	●	○	○		Moderate
PREFERENCE BY ASSET CLASS	EQUITIES	U.S.	○	○	●		Moderate
		Europe	○	○	●		Moderate
		UK	○	●	○		
		Japan	○	○	●		Moderate
		Emerging markets	○	●	○		
	FIXED INCOME	U.S. Treasuries	●	○	○		Low
		G4 ex-U.S. sovereigns	○	●	○		
		EMD hard currency	○	●	○	▼	
		EMD local FX	○	●	○	▼	
		Corporate investment grade	○	●	○		
		Corporate high yield	○	○	●		Low
	CURRENCY	USD	○	●	○		
		EUR	○	○	●		Low
		JPY	●	○	○		Moderate
		EM FX	○	○	●		Low

IN BRIEF

- The U.S. economy is moving toward mid cycle, while other developed markets remain largely in early cycle; signals that the Federal Reserve will eventually remove accommodation still leaves policy today extremely supportive but mitigates inflation fears.
- We are overweight (OW) stocks and favor cyclical regions; we also expect renewed focus on earnings quality and secular growth themes. We are OW Europe and Japan, more balanced between U.S. large and small cap, but feel it is too soon to return to emerging markets.
- We have a mild underweight (UW) to duration and have pared our OW to credit, reflecting our belief that rates along the yield curve will increase slowly and that credit spreads are already very tight. Moderately higher U.S. rates also point to more support for USD in 2H21.
- Our portfolios are set up for further upside in economic growth and risk asset returns; inflation risks are fading, but the risks relating to vaccine/virus data, earnings growth and policy continue to be areas we watch closely.

SINCE THE START OF 2021, GLOBAL EQUITIES HAVE ADVANCED 11% AND AGGREGATE 10-YEAR GOVERNMENT BOND YIELDS HAVE MOVED 40 BASIS POINTS (BPS) HIGHER. High frequency data suggest that economic activity is surging, aggregate household balance sheets are in good health, and economic output in developed markets is expected to surpass pre-pandemic levels by 3Q21.

The question, perhaps, might be why the Federal Reserve (Fed) has not been even more anxious to withdraw monetary stimulus than the somewhat hawkish tone at the June policy meeting implied. The answer lies in the high level of unemployment that has persisted since the pandemic lockdowns. True, economic reopening will mop up labor slack quickly. But getting people back to work and reinforcing the recovery remain policymakers' principal goals today.

At the same time, investors worry about the inflationary implications of massive monetary and fiscal stimulus. Yet asset markets were less than enthusiastic when the Fed made clear that it would not allow inflation to run away.

The Fed's tone was a hawkish surprise even as its current policy remains dovish. In the context of the prevailing economic data, the tone suggests that the U.S. economy is now in a mid-cycle phase. Mid-cycle dynamics tend to support stocks moving higher and rates rising along the yield curve – something we expect to see in this cycle, too. However, elevated inflation in the near term, pent-up demand and an excess of global liquidity imply that there may be upside risks to the normally steady grind of mid-cycle returns.

As the reopening trend spreads out from the U.S., we expect to see a prolonged period of above-trend global growth. Although economic indicators in the U.S. point to mid cycle, in Europe and Japan economies still appear to be in the early phase of the cycle. With capex strong and consumers poised to unleash meaningful pent-up demand – likely to be directed more toward the services side of the economy – we expect above-trend global growth to persist well into 2022. This will in turn lend solid support to corporate earnings.

Base effects, supply-chain disruption and the impact of fiscal stimulus have combined to push inflation higher, notably in the U.S. As we move toward autumn, we expect inflation to ease but upside risks to persist. Importantly, the Fed's marginally hawkish tone suggests that higher rates – when they materialize – will from here be led by rising real rates rather than further advances in inflation breakevens.

With the extremes of policy accommodation likely behind us, the global economic backdrop has slightly changed, taking on a more mid-cycle feel. Nevertheless, the surge of reopening activity and already-ample liquidity support a risk-on tilt in portfolios. We continue to overweight equities with fairly high conviction and underweight cash with moderate conviction. We also overweight credit, but at the margin we are reducing exposure, given tight spreads. And while we retain an underweight in duration, our conviction level is low, given central bank bond purchases.

Within equities, we keep our preference for cyclical markets in Europe and Japan, and at the margin have trimmed our tilt toward value-style stocks. While the value factor remains attractive relative to the growth factor, we are inclined to also focus a little more on the quality factor as we move into mid cycle. This leads us to reevaluate U.S. equities, where we believe quality of earnings and a renewed focus on secular growth themes may provide support in 2H21. By contrast, we think it is too early to rotate back toward emerging market stocks – particularly as the Fed's recent policy shift lends some near-term support to the dollar.

In fixed income, our duration underweights are concentrated in U.S. Treasuries, and our credit overweight continues to be expressed in U.S. high yield and crossover credit – albeit with lighter exposures. We continue to expect higher sovereign yields over the remainder of 2021 but see a much reduced risk of a disorderly bond market sell-off.

Above all, we look increasingly to diversify equity exposure across a range of markets, in keeping with the broadening of global growth. Corporate earnings failing to come through, unjustified policy tightening and new vaccine-resistant strains of COVID-19 all present downside risks. At the same time, consumer and corporate spending booms present topside risks – which could possibly be followed by an inflationary episode. But our core case remains above-trend growth well into 2022, driving further upside to global stocks and, eventually, to global yields.

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.

- Global growth above trend; U.S. now mid cycle; other developed markets in early cycle
- Inflation elevated for now, but set to return toward target in 2022
- Fiscal and monetary policy accommodative, but past maximum
- UW to duration, especially in U.S., as yields set to steadily rise in 2H21
- Dollar supported near-term by rates, but long-run trend still lower
- Strong EPS upside supports stocks, easing valuations in U.S.
- Stay OW equities with modest cyclical, value and ex-U.S. bias
- Renewed focus on secular growth themes
- Key risks: persistent inflation, new virus strains, policy tightening

Active allocation views

These asset class views apply to a 12- to 18-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	○	○	●		High	Further upside to top lines and earnings ahead given above-trend global growth backdrop
		Duration	●	○	○		Low	Solid growth means yields set to grind upward despite duration demand from global central banks
		Credit	○	○	●		Low	Limited scope for further spread compression, but carry still attractive in some parts of credit complex
		Cash	●	○	○		Moderate	Higher prevailing inflation and easy policy mean profoundly negative cash rates in many currencies
PREFERENCE BY ASSET CLASS	EQUITIES	U.S.	○	○	●		Moderate	Cyclical sectors well supported and earnings quality high; secular themes beginning to reassert
		Europe	○	○	●		Moderate	Meaningful upside potential for earnings as economy reopens, and attractive exposure to cyclicality
		UK	○	●	○			Becoming more attractive, but political risks linked to post-Brexit trade issues cast a shadow
		Japan	○	○	●		Moderate	Domestic economic outlook improving, underheld by investors and geared to global recovery
		Emerging markets	○	●	○			Likely held back by high growth style exposure and limited near-term further dollar downside
	FIXED INCOME	U.S. Treasuries	●	○	○		Low	Risk of taper tantrum reduced, but strong growth and more hawkish Fed tone argue for higher yields
		G4 ex-U.S. sovereigns	○	●	○			Ex-U.S. inflation pressure lower, and central banks more vocally committed to lower yields
		EMD hard currency	○	●	○	▼		EM economic outlook better, but long duration presents some headwind to returns
		EMD local FX	○	●	○	▼		Supported by global recovery and yields are attractive, but rates starting to rise in some EM countries
		Corporate investment grade	○	●	○			Tight spreads but ongoing demand, especially in longer maturities, likely from portfolio de-risking flow
		Corporate high yield	○	○	●		Low	Defaults remain subdued, but generally less attractive in most sectors, as spreads quite tight
	CURRENCY	USD	○	●	○			Overvalued with poor fundamentals, but for time being the more hawkish Fed tone is supportive
		EUR	○	○	●		Low	A further leg higher plausible as Europe starts to catch up to the global recovery in mid-2021
		JPY	●	○	○		Moderate	BoJ's ongoing commitment to easy policy could lead to some weakness as safe haven demand fades
		EM FX	○	○	●		Low	Preferred way to play continuing global growth support of EM economies

Source: J.P. Morgan Asset Management Multi-Asset Solutions; assessments are made using data and information up to June 2021. 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 290 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 March 31, 2021.

NEXT STEPS

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

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