PORTFOLIO INSIGHTS

Global Asset Allocation Views

Themes and implications from the Multi-Asset Solutions Strategy Summit

4Q 2017

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ASSET CLASS VIEWS (PAGE 3)

Asset class		Opportunity set	Change	Negative	Neutral	Positive
MAIN ASSET CLASSES		Equities/bonds		○ ○ ○	○	● ● ○
		Duration		○ ○ ●	○	○ ○ ○
		Credit		○ ○ ○	●	○ ○ ○
		Commodities		○ ○ ○	●	○ ○ ○
		Real estate		○ ○ ○	●	○ ○ ○
		Cash		○ ○ ●	○	○ ○ ○
PREFERENCE BY ASSET CLASS	EQUITIES	U.S. large cap		○ ○ ○	○	● ○ ○
		U.S. small cap		○ ○ ○	○	● ○ ○
		Europe ex-UK		○ ○ ○	○	● ○ ○
		UK	▲	○ ○ ○	●	○ ○ ○
		Japan		○ ○ ○	○	● ○ ○
		Asia Pacific ex-Japan		○ ○ ○	○	● ○ ○
		Emerging markets		○ ○ ○	○	● ○ ○
	REAL ESTATE	Direct real estate		○ ○ ○	●	○ ○ ○
		U.S. REITs		○ ○ ○	●	○ ○ ○
	SOVEREIGN FIXED INCOME	U.S. Treasuries		○ ○ ●	○	○ ○ ○
		U.S. TIPS		○ ○ ○	●	○ ○ ○
		Euro, core (Bund)		○ ● ●	○	○ ○ ○
		Euro, periphery (BTP)		○ ○ ○	●	○ ○ ○
		UK Gilts		○ ○ ●	○	○ ○ ○
		Japanese JGBs		○ ○ ○	●	○ ○ ○
		Canadian gov't bonds		○ ○ ●	○	○ ○ ○
		Australian gov't bonds	▼	○ ○ ○	●	○ ○ ○
	CREDIT	Investment grade		○ ○ ○	●	○ ○ ○
		U.S. high yield		○ ○ ○	○	● ○ ○
		European high yield		○ ○ ○	●	○ ○ ○
		Emerging markets debt	▲	○ ○ ○	○	● ○ ○
	FX	USD		○ ○ ○	●	○ ○ ○
		EUR		○ ○ ○	○	● ○ ○
		GBP	▼	○ ○ ●	○	○ ○ ○
		JPY	▲	○ ○ ○	●	○ ○ ○

IN BRIEF

- Summer worries over geopolitics and the slide in U.S. inflation data are amply offset by the continued and synchronized pick-up in global growth. Despite the relative maturity of the U.S. business cycle, recession risks remain muted and a combination of global earnings upgrades and loose financial conditions are supportive for stocks and other risky assets.
- Globally central banks remain in mostly dovish mood; and even with balance sheet normalization in the U.S. and tapering of quantitative easing in Europe set to start this autumn, policy around the world is still loose. Rates are set to rise, but only slowly, so we maintain a small underweight to duration together with a modest overweight to stocks—diversified across regions, with a slight preference for the eurozone and Japan. We remain neutral credit, where we expect carry not capital growth to provide the bulk of the returns.
- Equity returns in late cycle are typically positive unless financial conditions tighten sharply. The slow pace of rate normalization and lack of inflation pressure create a good environment for taking risk, but we remain watchful for any deterioration in data, in particular employment, business confidence and consumer lending metrics.

Bull markets, it is said, must climb a wall of worry, and the one we've been in since March 2009 seems a perfect lab test for this idea. This summer threw worries aplenty at the market. Geopolitical tension? Check. Puzzlingly low bond yields? Yep. Oil price scare? You got it. Inflation? Missing in action. But for all this, stock markets pushed on to all-time highs, and with the world economy now enjoying its best period of growth this decade we see further upside. This isn't to ignore entirely any tail risks, or to overlook the advanced age of this business cycle, but instead to reflect that in a period of synchronized above-trend growth and loose policy, risky assets probably have room to run.

Over 2017 growth data across the globe have generally surprised positively, and the momentum in the eurozone and Japan is particularly strong. Although the level of growth remains quite modest by historical standards, its breadth is encouraging, not least as the shift in growth leadership away from the U.S. toward the rest of the world has prompted a reversal in the U.S. dollar. At the start of the year, a further surge in USD was a profound concern to many investors. It threatened not only the nascent recovery in emerging market (EM) economies and commodity markets but also raised the specter of a rapid and destructive spiral toward supply-side constraints and sharply tighter policy for the U.S. economy. Instead, the U.S. appears to be sailing serenely into late cycle, with the combination of better global growth and muted inflation providing a fair wind.

Yet that same fair wind of subdued inflation, and the persistent easy policy that it enables, are prompting disquiet on other shores. Bond market participants—typically a more circumspect bunch than stock investors—fear that all might not be well in the economy. To be fair, the bond market has a better track record of shining the spotlight on economic issues than the stock market—so if there's divergence between the two, we should listen to what bonds are saying, right? We'd argue not.

This year's rally in U.S. Treasuries (USTs) was driven primarily by falling inflation and ongoing global central bank buying, not by stalling economic activity. There are secular factors—notably automation—that likely cap inflation by subduing labor costs, but many of the recent cyclical drags are transitory, and global central bank buying of bonds is slowing, not stopping. With these factors still defining the outlook for bond yields, it seems the stock market, not the bond market, is more aligned with the economic trajectory.

Given our positive view on growth, we maintain a pro-risk tilt in our asset allocation. As the U.S. economy moves into late cycle, we are naturally more attuned to any dip in higher frequency data, but currently we see little risk of recession in the next 12 months. As a result, we remain overweight (OW) stock-bond and underweight (UW) duration—albeit with slightly lower conviction in light of the failure of inflation expectations to advance alongside other macro data.

Correlation across regional indices remains low, favoring broad diversification across global equity markets. But at the margin our most favored regions remain the eurozone and Japan, ahead of the U.S. and emerging markets, with the UK our least preferred region. In bond markets we expect yields to grind higher over the fourth quarter and see U.S. Treasuries outperforming most other sovereign markets, in particular German Bunds, which look vulnerable given the robust level of eurozone growth.

Elsewhere we remain neutral on credit, real estate and commodities, and UW cash. In a distinctly mature credit cycle, returns from credit will come from carry rather than capital appreciation; nevertheless, we expect credit to outperform government bonds even if it lags stocks. Overall, we take a pro-risk stance in our portfolios but are mindful that with the economic cycle maturing, liquidity and diversification are paramount.

Overzealous policy tightening still represents the greatest threat to our pro-risk stance, but that risk seems to be receding. Indeed, with activity data positive but inflation subdued, the Federal Reserve's (Fed's) rates and balance sheet normalization plan seem to be subtly changing from "How much do we need to do?" to "How much can we get away with?" And as the last few years have shown us, modest growth, dovish language and easy financial conditions are the holy trinity of prolonged bull markets.

KEY THEMES AND THEIR IMPLICATIONS

Theme		Macro and asset class implications
GLOBAL THEMES	Global policy divergence	More apparent today in timing than direction, and more dominant in bond relative value views than in FX; favor UST over Bund
	Supply-side weakness	A tail risk at present since wage inflation remains muted, but if labor tightness bites, rate hikes could be sharply repriced
	Widespread technology adoption	Potential to add over a point to trend GDP over the decade, but will disrupt some sectors; tech stocks in a secular uptrend
DEVELOPED MARKETS THEMES	Maturing U.S. cycle	Late-cycle phase may last for some time, given limited inflation and policy pressure; remains a key support for U.S. stocks
	Europe: gradual growth recovery	Above-trend growth set to continue for a few quarters, and political risks are abating; supports EUR and eurozone equity
	Japan: beyond Abenomics	Japanese earnings detaching from currency, and corporate governance improving; JPY stable, Japanese equity supported
EMERGING MARKETS THEMES	Emerging market convergence	Domestic economic momentum building as weaker USD creates a tailwind; further upside likely for EM FX, debt and equity
	China in transition	Strong 1H17 data slowing a bit, but activity still solid; liberalization of CNY and financial markets continues incrementally

Source: J.P. Morgan Asset Management Multi-Asset Solutions; data as of September 2017. For illustrative purposes only.

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.

Max negative ● ● ● Neutral ● Max positive ● ● ●

Asset class	Opportunity set	Change	Negative	Neutral	Positive	Rationale
MAIN ASSET CLASSES	Equities/bonds		○ ○ ○	○	● ● ○	The best period of global growth since the crisis driving synchronized EPS upgrades
	Duration		○ ○ ●	○	○ ○ ○	Solid global growth pushes yields gradually higher; low inflation caps their upside
	Credit		○ ○ ○	●	○ ○ ○	In later cycle, credit is unlikely to beat stocks but can outperform government bonds
	Commodities		○ ○ ○	●	○ ○ ○	Metals and bulks well supported by macro outlook; oil constrained by supply glut
	Real estate		○ ○ ○	●	○ ○ ○	Real estate fairly valued on most metrics; getting later in cycle for real estate now
	Cash		○ ○ ●	○	○ ○ ○	Negative and near-negative rates a disincentive to holding cash
PREFERENCE BY ASSET CLASS – EQUITIES	U.S. large cap		○ ○ ○	○	● ○ ○	Weaker dollar implies some EPS upside; P/E quite high, but cash returns favorable
	U.S. small cap		○ ○ ○	○	● ○ ○	Valuations stretched vs. large cap, but will benefit in the event of any tax cuts
	Europe ex-UK		○ ○ ○	○	● ○ ○	Beneficiary of robust eurozone growth, but ultimately still a play on the banks
	UK	▲	○ ○ ○	●	○ ○ ○	Earnings revisions bottoming, and scope for GBP weakness to resume is a tailwind
	Japan		○ ○ ○	○	● ○ ○	Beginning to decorrelate from JPY as domestic growth momentum firms
	Asia Pacific ex-Japan		○ ○ ○	○	● ○ ○	Attractive valuations with positive growth momentum even as China slows slightly
	Emerging markets		○ ○ ○	○	● ○ ○	Structural improvement in EM economies plus weaker USD keeps uptrend in place
REAL ESTATE	Direct real estate		○ ○ ○	●	○ ○ ○	Late in cycle for real estate; pickup in supply well flagged but still a constraint
	U.S. REITs		○ ○ ○	●	○ ○ ○	Vulnerable to higher yields; valuations around fair but unlikely to beat stocks
SOVEREIGN FIXED INCOME	U.S. Treasuries		○ ○ ●	○	○ ○ ○	Preferred to Bunds, particularly on quant signals, but still likely to see yields rise
	U.S. TIPS		○ ○ ○	●	○ ○ ○	Inflation expectations have fallen significantly, but cyclical drags on CPI now passing
	Euro, core (Bund)		○ ● ●	○	○ ○ ○	ECB tapering likely in 4Q17; combines with robust growth outlook to push up yields
	Euro, periphery (BTP)		○ ○ ○	●	○ ○ ○	Decent carry pickup vs. Bunds; some lingering political risks but expensive to short
	UK Gilts		○ ○ ●	○	○ ○ ○	Very negative real yield offsets positive 4Q issuance calendar and weak UK growth
	Japanese JGBs		○ ○ ○	●	○ ○ ○	Yields pegged to near zero by BoJ; prefer to play Japan via currency or equity
	Canadian gov't bonds		○ ○ ●	○	○ ○ ○	Yield gap to U.S. has closed, but quant signals still favor U.S. over Canadian bonds
	Australian gov't bonds	▼	○ ○ ○	●	○ ○ ○	Positive real yield pickup vs. G4 bonds, but a crowded long and macro data improving
CREDIT	Investment grade		○ ○ ○	●	○ ○ ○	Spreads tight, but demand still solid; preferred to government bonds
	U.S. high yield		○ ○ ○	○	● ○ ○	Some sector-level stresses, but overall low recession risk keeps money in high yield
	European high yield		○ ○ ○	●	○ ○ ○	Expensive in absolute terms, but duration adjusted to U.S. HY still looks reasonable
	Emerging markets debt	▲	○ ○ ○	○	● ○ ○	EM balance sheets improving; attractive as a diversifier to other credit holdings
FX	USD		○ ○ ○	●	○ ○ ○	Scope to weaken in medium term, but Fed is underpriced and supportive near term
	EUR		○ ○ ○	○	● ○ ○	Positive growth momentum keeps EUR supported; still below long-term fair value
	GBP	▼	○ ○ ●	○	○ ○ ○	Slow progress on Brexit talks could come to a head in 4Q17 and weigh on GBP
	JPY	▲	○ ○ ○	●	○ ○ ○	Likely range-bound against USD with BoJ policy stable and domestic growth better

Source: J.P. Morgan Asset Management Multi-Asset Solutions; assessments are made using data and information up to September 2017. 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 USD 218 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 June 30, 2017.

NEXT STEPS

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

BBL: oil barrel; BoJ: Bank of Japan; CPI: Consumer Price Index; ECB: European Central Bank; EM: Emerging markets; DM: Developed markets; GDP: Gross domestic product; JGB: Japanese Government Bond; TIPS: Treasury Inflation Protected Securities

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