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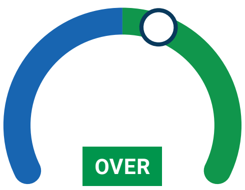
When Markets Diverge, Opportunities Emerge

The global economic and market outlook suggests diverging paths among regions and sectors. Last year, overall global growth looked stagnant, but trends this year suggest potential for a soft landing instead of a recession – mainly due to the continuing strength in the U.S. economy. But that resilience comes with risks: most notably, the potential for hotter inflation.

The diverging macroeconomic outlook creates compelling opportunities among asset classes.

OVERALL RISK

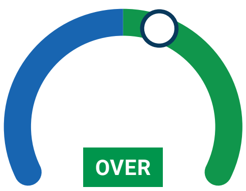


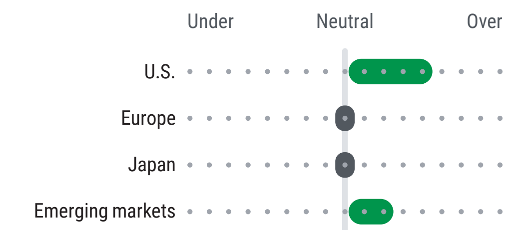
We are slightly overweight risk as we see early signs of a potential soft landing in the global economy. However, continued U.S. resilience presents the risk of sticky inflation. We expect regional divergence in monetary policy as the outlooks for inflation and growth differ by country. We favor higher quality exposures across asset classes and emphasize diversification in the current environment.

POSITIONING

OPPORTUNITIES

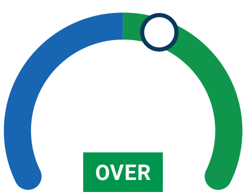
EQUITIES

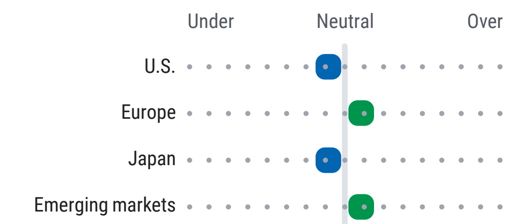




We are marginally constructive on equities, with a preference for higher quality and an overweight to the U.S. given signs of continued economic strength and expectations for EPS growth to broaden. We are neutral Europe given weaker earnings expectations and greater exposure to China. We are overweight select emerging markets, particularly in Asia, as we see potential upside supported by reasonable valuations and a recovery in semiconductor sales.

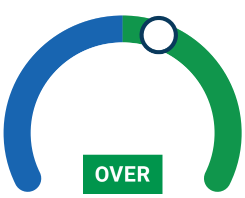
RATES

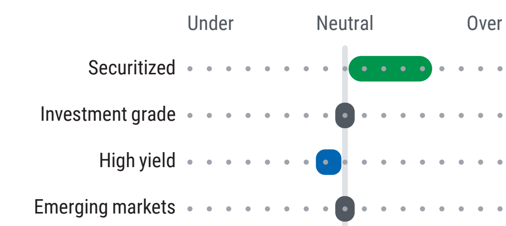




We are slightly overweight duration amid high starting yields and capital appreciation potential. We prefer developed ex-U.S. markets with lower inflation risks and greater downside growth risks, like Australia, Canada, and Europe. We are underweight the U.S. given continued economic resilience. We are underweight Japan as the BOJ begins hiking rates to combat rising inflation. In emerging markets, we are overweight local rates in countries with high real rates and room to cut.

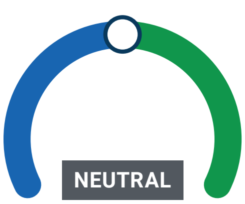
CREDIT

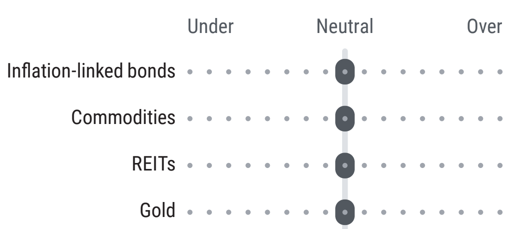




We are overweight credit, driven by a preference for securitized. We emphasize positions in senior non-agency MBS and tranches of select ABS, which we believe are supported by resilient fundamentals and attractive valuation profiles. In corporate credit, we are neutral investment grade as starting yields are strong, but spreads appear tight. We are underweight high yield amid rich spread levels and expectations for default rates to increase off recent lows.

REAL ASSETS





While we see upside risks to inflation in the U.S. in particular, we are neutral real assets. As we await further clarity on the near-term path of inflation, we are neutral on inflation-linked bonds and gold and prefer to gain exposure to inflation through equities. We are neutral commodities amid continued geopolitical threats from wars in Europe and the Middle East. We are also neutral REITs given high economic cyclicality and sensitivity to still-elevated interest rates.

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CURRENCIES

We are overweight the U.S. Dollar amid economic resilience, relatively high carry and less demanding valuations versus recent history. We are underweight the Euro given the potential for weaker growth and more central bank easing. We are overweight the Japanese Yen as further BOJ tightening should improve carry, plus the Yen provides a risk-off hedge. In emerging markets, we are overweight select high-yielding currencies that typically offer compelling valuation and quality profiles.

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