

Global Convictions & Outlook

Asset Class Research with a Long-Term Perspective

Morningstar Investment Management LLC

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Asset-Class Convictions

The goal of assigning a conviction level to an asset class is to distill the attractiveness of an investment opportunity into a single rank. The term “conviction” derives from the Latin verb “convincere,” which means to argue.

In assigning an asset-class conviction, an analyst trades off the aspects of an investment opportunity that argue for and against it, culminating in the expression of a conviction level. The conviction level is expressed on a five-point scale (Low, Low to Medium, Medium, Medium to High, and High).

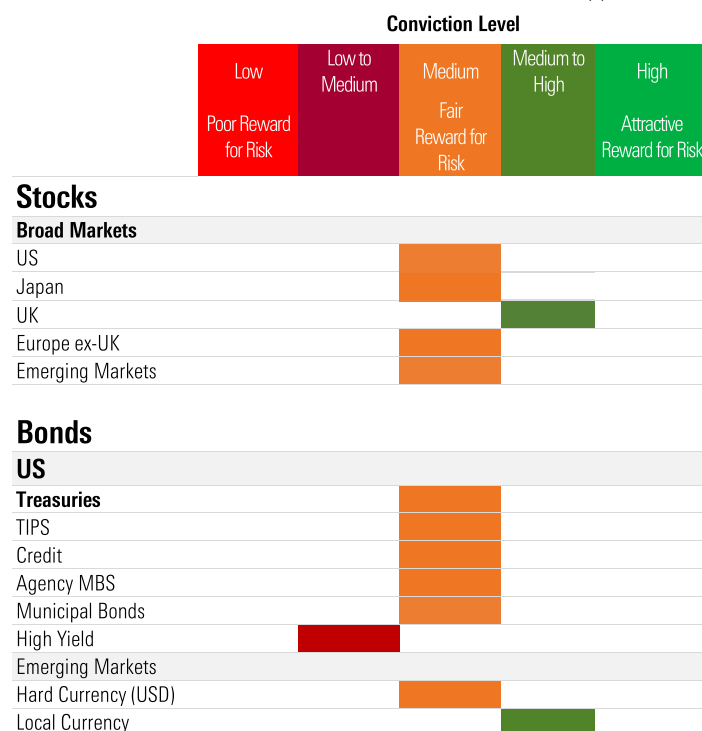
Our conviction scoring system is based on four criteria: absolute valuation; relative valuation; contrarian indicators; and fundamental risk.

The first quarter of the year delivered a mixed bag for investors. US equities declined across the market-cap spectrum, with growth stocks facing particularly intense pressure. Yet diversification proved its worth: US value stocks rose 4.4%, and non-US markets also delivered gains—especially in Europe, where several country indexes hit new 52-week highs. Emerging markets finished the quarter in positive territory, and bonds broadly advanced across sectors.

But as investors know, the tone shifted sharply after quarter-end. On April 3 and 4, US equities suffered their steepest two-day decline since the onset of the COVID crisis, dropping 10.9%.

In short, the landscape today looks very different than it did just a few weeks ago.

Exhibit 1. Our Convictions Continue to Evolve, with Select Opportunities Evident



Source: Morningstar Investment Management. As of April 2025. For illustrative purposes only and subject to change.

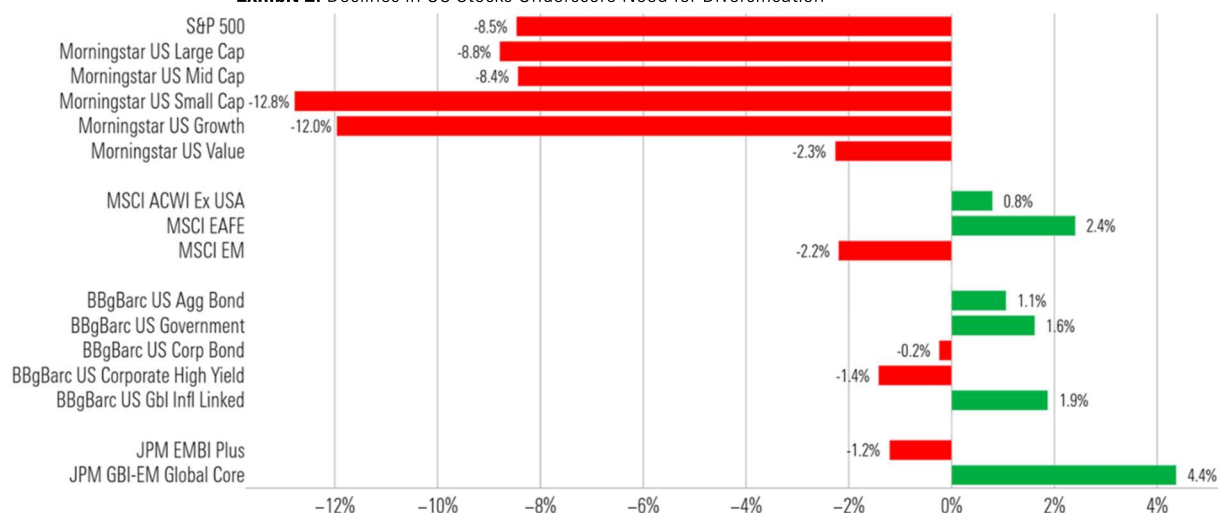
Broad Investment Backdrop

The first quarter served as a powerful reminder that markets don't move in straight lines. That reality became even more apparent just days after quarter-end, when US stocks briefly dipped into bear market territory on an intraday basis—down 20% from recent highs.

The trigger was clear: renewed concerns over tariffs. While many details remain unresolved—and are likely to stay that way for some time—markets don't wait for full clarity. Instead, they immediately begin pricing in an uncertain future.

That uncertainty is reflected in market performance through April 14, with US equities firmly in negative territory. While non-US stocks also declined in response to the tariff headlines, the picture is more balanced globally. European equities remain positive year to date, and while emerging markets are down roughly 2%, they continue to demonstrate strong relative performance compared to the US. Meanwhile, bonds have shown resilience and continue to offer value for investors in this environment.

Exhibit 2. Declines in US Stocks Underscore Need for Diversification



Source: Clearnomics, Morningstar, MSCI, Bloomberg, JPMorgan. Data as of April 14, 2025. Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Reference to specific asset classes should not be viewed as a recommendation to buy or sell any specific security in those asset classes.

Looking ahead, the future remains unpredictable—but that's nothing new. Uncertainty is a constant in investing. While certain asset classes, such as short-term Treasury bills, offer more stability and predictability, that *certainly* often comes at a cost: over time, they're unlikely to beat inflation, limiting an investor's ability to grow purchasing power.

In short, risk is an unavoidable part of investing—especially for those seeking to beat inflation over time. That's why our approach remains grounded in three enduring principles: diversification, valuation discipline, and a long-term perspective.

Volatility, while uncomfortable in the short term, often creates longer-term opportunity. From a portfolio positioning standpoint, we've long believed it's better to prepare for market swings than to react to them. Entering the year, our US equity exposure was tilted defensively, with meaningful allocations to sectors like healthcare and consumer staples. These areas held up relatively well during the recent market pullback, which now gives us the flexibility to selectively reallocate into segments that experienced more significant declines.

Looking across global markets, we continue to identify potential opportunities, including: US small caps, European equities (particularly the UK), emerging markets, select sector-specific opportunities, and areas within fixed income.

Many of these asset classes are trading at discounts relative to our estimates of intrinsic value. While valuations are not a tool for precise market timing, they remain one of the most reliable indicators of future return potential for long-term investors.

Asset-Allocation Research (as of April 2025)

EQUITY MARKETS

Asset Class	Conviction	Rationale
US Equities • Consumer Staples • Financials • Healthcare • Utilities • Communication Services	Medium Medium Medium Low to Medium Medium	Backdrop The first quarter of 2025 served as a powerful reminder that US stocks aren’t the only game in town. Large-cap stocks fell more than 4%, while small caps dropped nearly 9%. And since quarter-end, things have gotten worse. The unveiling of sweeping US tariffs in early April sparked the steepest two-day decline in equities since March 2020. Volatility has returned—and given that it tends to cluster, this choppy environment may be with us for a while. Still, perspective is essential. Pullbacks and corrections, while uncomfortable, are a normal part of the market cycle. Since 1980, US large caps have experienced average intra-year declines of more than 14%, yet finished higher in 34 of those 44 years. Volatility isn’t new—and it’s not something investors can avoid. It’s something that must be managed through. Importantly, not all signals are negative. Recent earnings from bellwethers like American Express and Bank of America suggest that the consumer remains strong. In their words, “<i>consumers continue to push money into the economy,</i>” even after the announcement of tariffs. Could that change? Absolutely. But stepping back, history shows that periods of uncertainty often present opportunities for long-term investors. Rather than fearing volatility, it’s better to see it for what it is: a feature of markets, not a flaw—and when navigated thoughtfully, a potential opening to put capital to work. Outlook Our conviction for the US equity market is Medium. At a deeper level, valuation spreads—the disparity in valuation levels between sectors—are where we see opportunity. Two themes stand out in particular: value-oriented stocks and defensive sectors. Within financials—a predominantly value-oriented sector—our research continues to highlight large US banks as relatively attractive, though not without risk. Should a recession take hold, this sector would likely come under pressure. We also see opportunity in the communication services sector, which includes both traditional value-leaning telecom providers and more widely recognized names like Alphabet, Meta, and Netflix. While our recent sector update suggests the opportunity in this sector is not as compelling as it was at year-end 2022, valuations remain reasonable on an absolute basis and relatively attractive compared to more growth-oriented sectors. Lastly, defensive sectors—most notably healthcare—have improved in our relative rankings. Given their lower correlation with economic cycles, they can potentially help offset equity risk. We’ve already seen signs of this dynamic at work, with recent tariff-driven turmoil hitting cyclical assets harder. All this reinforces a key point: maintaining a long-term perspective remains essential for investor success, especially during periods of heightened market volatility.

Asset Class	Conviction	Rationale
Europe ex-UK Equities	Medium	Backdrop The performance trends of the past decade flipped last quarter, as international stocks saw one of their strongest stretches of outperformance over US equities in recent memory. Eurozone equities ex-UK gained nearly 7% in the first quarter, though they've since given up some of those gains amid April's market turbulence, leaving the asset class up roughly 1.5% year to date. While Europe's more attractive valuations have been in place for some time, what's changing now is the earnings trajectory—finally showing signs of improvement. An emerging consideration is the fiscal policy divergence between regions: The US appears to be drifting toward fiscal restraint, while Europe is moving in the opposite direction. One clear example is the significant increases in defense spending across several European countries, which could support growth and potentially corporate profitability. Taken together, these shifts offer a compelling reason for global investors to stay engaged. If leadership in global markets continues to broaden, the eurozone may be well positioned to benefit. Outlook While we generally like European equities, we find a divergence among sectors with more attractive opportunities among Energy, Consumer Staples and Consumer Discretionary, while we find less opportunities among Industrials and Communication Services.
UK Equities	Medium-to-High	Backdrop UK equities rose more than 10% in the first quarter and have held up well during the April selloff—leaving the market up nearly 9% year to date. While many of the same themes driving broader European markets are at play, the UK also brings some distinct advantages to the table. Notably, the UK offers one of the highest dividend yields among developed markets—driven by a mix of attractive valuations and meaningful equity income opportunities. Its sector composition, which leans more value-oriented and less tech-heavy than the US, adds useful diversification—especially as market leadership continues to broaden. Looking ahead, the investment case for the UK appears to be strengthening. A supportive macro backdrop—featuring rising GDP, easing inflation, and potential rate cuts—positions UK equities as a compelling opportunity within developed markets. Outlook Overall, we view UK equities as moderately attractive. We maintain a neutral view on asset-class valuation while finding moderately attractive opportunities at the stock level. Market sentiment remains very unpopular, providing potential opportunities for contrarian investors. Compared with other developed markets, such as in the US, we expect a more favorable prospective reward/risk in UK equities.
Australian Equities	Medium	Backdrop Australian equities declined 1.7% in the first quarter and remain slightly negative for the year through mid-April. While the market has held up relatively well compared to US large-cap stocks, it ranks in the bottom quartile of global country returns so far in 2025. Much of this performance continues to reflect Australia's sector makeup—particularly its heavy exposure to materials and mining. As ever, China's demand for key commodities like iron ore and coal remains a central driver. If global economic growth slows, commodity demand could weaken, posing additional headwinds for Australia's equity market. Outlook Australian shares retain a Medium conviction. Financials (and banks specifically) are firmly pricing in a soft landing scenario for the economy, but global trade uncertainty has thrown a wrench into matters. Tariffs are weighing on consumer confidence and, while consumer fears of further interest rate rises have eased, progress on alleviating cost-of-living pressures has been slow. With inflation back in the 2%-3% target band, the RBA has begun cutting rates and this is likely to continue through 2025. One good outcome from the tighter monetary stance over the past few years is that central banks now have more ammunition should there be a deterioration in economic conditions—and that is a luxury they haven't had for much of the past decade.

Asset Class	Conviction	Rationale
Japan Equities	Medium	Backdrop Japan’s equity market outpaced the US in the first quarter, gaining 2.4% in dollar terms and remained positive before the US tariff announcement — no small feat given the global volatility in early 2025. We have seen a material impact post-tariff decision across many global equity markets and Japan is no different. The prominent global companies in Japan’s market are dealing with significant uncertainty as we wait for geopolitical clarity. While Japanese equities have historically been prone to sharp swings, this latest stretch has been more constructive. Investors continue to respond positively to corporate reforms aimed at boosting shareholder value, including mandates to improve capital efficiency and raise company valuations. Notably, global interest remains strong. After decades of underperformance, Japan appears to be rewriting part of its investment story, supported by both structural reforms and improving sentiment. Outlook While much of the structural tailwind is now behind us, we still see scope for a continuation of improving shareholder interests, rising dividend payouts, and board independence. Japanese stocks also carry attractive diversifying properties that can help in broad market setbacks. Japanese equities hold a Medium conviction score.

Asset Class	Conviction	Rationale
Emerging-Markets Equities China Equities	Medium Medium	Backdrop Emerging markets posted a 4% gain in the first quarter, though those returns have faded in early April. Still, emerging-market equities remain flat year-to-date — an important contrast to US large-cap stocks, which are down 12% over the same period, which goes through mid-April. Going deeper, China was a clear standout, gaining 15% in Q1 and holding onto a 5% year-to-date return. While questions remain around the durability of China's economy, one emerging narrative is its growing role in the global AI race. In fact, China’s position as a true competitor to the US in AI development has added a new dimension to the investment case. Broadly speaking, emerging markets rarely follow a smooth or predictable path. Volatility is the norm, not the exception. But recent policy efforts, longer-term structural tailwinds, and cheaper valuations give us reason to remain engaged. For investors willing to look beyond the short term, emerging markets continue to offer differentiated drivers of growth and potential opportunity — especially relative to more richly valued US stocks. Outlook We retain our conviction at Medium. We consider emerging-markets equities to be among our preferred equity regions (alongside selected European equities). Many structural (and cyclical) challenges remain for the Chinese economy, but recent performance shows how low expectations had become. We expect Chinese companies to deliver moderate earnings growth over the next decade and remain favorable towards key consumer-facing Chinese technology companies.



FIXED INCOME

Asset Class	Conviction	Rationale
Developed-Markets Sovereign • US Treasuries • Euro Government • UK Gilts • Japan • Australia	Medium Low to Medium Medium Low to Medium Medium	Backdrop High-quality bonds delivered when it counted. After a tough few years—when many questioned their role in diversified portfolios—US government bonds returned nearly 3% in the first quarter and remain up about 2% through mid-April, helping steady portfolios amid renewed stock market volatility. Looking ahead, the futures market is pricing in four Fed rate cuts this year, though that outlook could shift quickly with incoming economic data. Expectations for rate cuts are rising, but so are concerns that tariffs could stoke future inflation. That may help explain the recent jump in the 10-year Treasury yield—from 3.9% in early April to 4.5% by mid-month—a reminder that volatility also remains present in the bond market. Still, with yields at higher starting levels than just a few years ago, bonds are once again offering both income and potential price gains. In short, they’re doing their job for investors—and may play an even more prominent role if equity market volatility persists. Outlook Although rates moved lower in the first quarter, bond yields across major developed markets remain elevated compared to recent history, suggesting more favorable forward-looking return prospects. In many cases, yields now outpace inflation, resulting in positive real returns. Robust government bond yields bode well for long-term return generation, and we expect fixed income to maintain a meaningful role in diversified portfolios. Heightened tariff-related uncertainty has fuelled volatility in global bond markets and caused dislocations along the yield curve. Since the US tariff announcement on April 2, a bear steepening has emerged—characterized by a sharper decline in short-term yields compared to long-term yields—enhancing the relative appeal of longer-dated bonds. However, the potential for significant drawdowns in longer-duration assets underscores the need for a gradual and measured approach to increasing allocations to the long end. While there may be a point at which materially adding duration becomes appropriate, any such move should be carefully timed given the evolving stance of central banks and the risk of persistently high inflation.

Asset Class	Conviction	Rationale
Investment-Grade Credit • US • European Corporates • UK Corporates • Australian Corporates	Medium Medium Medium Medium	Backdrop Much of the discussion surrounding developed-market sovereign bonds also applies to investment-grade (IG) bonds. IG bonds posted a 2.5% gain in Q1 and remain up nearly 1% year to date. With yields sitting near multiyear highs, IG credit provides a compelling income buffer should rates stabilize or decline. Spreads have widened slightly above long-term averages—largely reflecting elevated trade policy uncertainty—but remain well below the peaks seen during 2008’s crisis. All told, investment-grade credit continues to anchor diversified portfolios by delivering steady income, modest price appreciation potential, and lower volatility relative to equities. Outlook All-in yields for both local and global investment grade corporate bonds remain attractive. A key element is credit spreads—the difference between corporate bond yields and government bond yields—which have widened amid the recent tariff-induced volatilities but not enough to be deemed attractive. In this regard, one should be careful of lower-rated companies with high debt levels, as a heightened default cycle can’t be ruled out. In summary, this space has improved, but the inherent appeal remains muted relative to government bonds. We see some attraction as a middle ground—providing some extra yield versus government bonds and a duration profile that can help in portfolio construction.

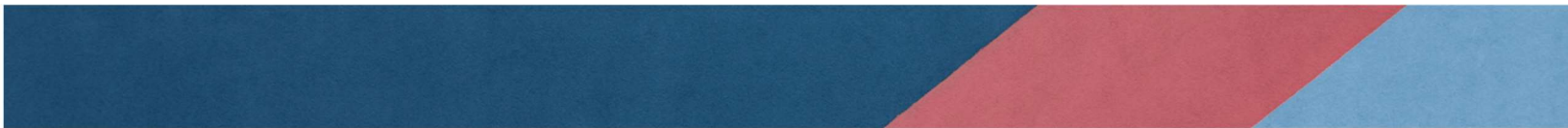
Asset Class	Conviction	Rationale
High-Yield Credit • US High Yield • European High Yield	Low to Medium Low to Medium	Backdrop High-yield bonds delivered a solid first-quarter gain of 1.1% and remain up +0.1% year to date through mid-April. Despite a decline in all-in yields since the end of 2024, yields in the US and European high-yield markets remain in the high single-digit to low double-digit range, reflecting the additional credit risk assumed by investors. While fundamentals remain resilient, lower-quality issuers are more vulnerable to an economic slowdown and face heightened sensitivity to spread widening—particularly given the historically tight spread levels entering this period of volatility. Outlook Our overall conviction remains Low to Medium. The recent widening in credit spreads has not been sufficient to present a compelling buying opportunity. Given the ongoing uncertainty and elevated market volatility, we wouldn't be surprised to see further spikes in spreads. That said, the overall quality of high-yield issuers has improved over the past decade, and their fundamentals remain on solid footing. As a result, these issuers should be better positioned to withstand a severe economic downturn than in previous cycles.

Asset Class	Conviction	Rationale
Emerging-Markets Bonds • Local Currency • Hard Currency	Medium to High Medium	Backdrop Emerging-markets bonds were positive in the quarter, up 2%, and are up 0.6% year to date. Yields remain compelling, often in the high single digits—Brazil's 5-year bonds yield around 14%, Mexico's 10-year around 10%—offering attractive real returns versus local inflation near 4%. While EM credit carries higher volatility, the yield cushion is substantial, thanks in large part to more aggressive rate hikes by many emerging-market central banks. As inflation trends improve across these economies, the resilience of the asset class has strengthened, and its diversification benefits remain particularly valuable in a what appears to be a more difficult environment for equities. Outlook Emerging-markets debt in local currency, which we still prefer over hard currency, continues to offer healthy absolute yields, accounting for the added risk. Our view remains that many emerging-markets sovereigns—though with notable exceptions—have improved their fundamental strength compared to history. This includes improved current account balances, enhanced reserves, movement to orthodox monetary policy, and a build-out of a local investor base allowing for a shift to local currency funding. In addition, the aggregation of emerging-markets currencies also looks undervalued overall and could offer a tailwind over time. The area can be volatile, yet even allowing for some pessimistic assumptions, our research suggests that investors could see upside if they're willing to risk short-term volatility. In other words, we think investors can expect to be compensated for this risk over time, especially for local-currency bonds.

Asset Class	Conviction	Rationale
US Agency MBS	Medium	Backdrop US mortgage-backed securities (MBS) delivered a strong quarter, returning 3.0%—the second-best performance among fixed income sectors—and are up 2.0% year to date. The MBS market still presents an interesting investment opportunity, as new issuance (supply) has been effectively frozen. New MBS supply often comes in two forms: 1) home sales and 2) refinances. Using data from Bankrate, the average existing mortgage rate in the US is around 3.7%, while the rate on a new mortgage is around 7%. Given that backdrop, refinancing has ground to a halt, leaving home sales as the only source of new supply. With issuance limited and spreads still attractive, selective exposure to MBS can enhance income and serve as a valuable diversifier in a low-supply environment. Outlook Overall, valuations remain more attractive than those of corporate bonds, despite spread widening across both markets. While elevated interest rate volatility typically weighs on the asset class, a gradual pace of rate cuts would likely keep prepayment activity subdued, helping to support spread levels. Issuance should also stay muted due to high mortgage rates and a shortage of affordable housing, which could further bolster the asset class.

Asset Class	Conviction	Rationale
Global Inflation-Linked Bonds US TIPS	Medium	Backdrop TIPS delivered a standout quarter, rising 4.0%—the best performance among fixed-income categories—and are up 3.0% year to date through mid-April. While headline inflation readings have moderated, lingering tariff uncertainties and the risk of upside surprises continue to underscore the need for inflation protection. With a real-yield cushion intact, TIPS remain uniquely positioned to benefit if inflation reaccelerates, offering both portfolio ballast and a hedge against unexpected price pressures. Outlook Elevated real yields provide a favorable entry point for long-term investors seeking inflation-adjusted income. Tariff risks and potential energy price shocks keep the case for inflation hedging alive, even if near-term inflation moderates. One important consideration is duration risk, where inflation-linked bonds are often longer-dated securities with meaningful interest-rate sensitivity.

Asset Class	Conviction	Rationale
US Municipal Bonds	Medium	Backdrop Municipal bonds slipped modestly in Q1, returning -0.6%, and extended those losses to nearly 2% through mid-April. Rising Treasury yields and slower-than-expected Fed easing weighed on muni valuations, while seasonal supply pressures added headwinds. That said, tax-exempt yields now sit near multiyear highs for many rating tiers, creating more attractive income opportunities for long-term investors. Looking ahead, any Fed rate cuts or stabilizing Treasury yields could help munis recoup some of these early year losses, but in the meantime, the higher starting yields offer a cushion for holders. Outlook Yields on high-quality municipal bonds have trended higher amid tariff-related turmoil and elevated supply, making them more attractive on a tax-adjusted basis. Considering the uncertain economic environment, we expect volatility to persist. However, given the higher-quality nature of municipal securities, downside risks look manageable compared to similar-quality corporate bonds. Fundamentals of state and local governments have held up better than expected in the wake of the pandemic. That said, uncertainty around further interest-rate increases and high inflation could lead to further outflows, which can hinder the performance of the overall asset class.



OTHER ASSETS

Asset Class	Conviction	Rationale
Global Infrastructure US Energy Infra & MLPs	Low-to-Medium Low-to-Medium	Backdrop Global infrastructure represents a wide collection of income-producing assets, which includes utilities, airports, rail, and energy-related holdings. Over the first quarter of 2025, infrastructure delivered mid single-digit returns, comprised of generally high single digit returns for utilities and flat returns for the more economically sensitive transport infrastructure stocks. An area that has been showing strength and remains appealing in our view: oil and gas master limited partnerships (MLPs). MLPs are publicly traded partnerships focusing on energy infrastructure, serving as “the pipes and plumbing” that move oil and gas. They trade like stocks, on exchanges, derive 90% of their revenue from energy activities, and pass along the bulk of their earnings through distributions. Those distributions mean a hefty yield bolsters the total return for these companies, but they also carry reasonable valuations compared to the broader US energy market, greater capital discipline in recent times, and stronger balance sheets. Adding it all up, we believe there is potential upside — though maybe not as great as that of oil producers — should energy prices climb out of their current rut. Outlook As an income-focused asset class, we continue to see the outlook for infrastructure as being strongly influenced by the outlook for interest rates. Utilities comprise a significant weight within infrastructure. We see greater earnings growth potential for utilities from AI datacenter growth and the transition to renewable energy infrastructure. However, we also see an uncertain road ahead for utilities, as companies need to balance their infrastructure spending plans against ensuring they receive attractive returns on these new investments in the face of higher interest rates, construction costs, and electricity bills for customers. Following a period of relative outperformance over the past year, we see utilities valuations as comparatively priced to transportation infrastructure.
Listed Property - US REITs - Global REITs	Low-to-Medium Low-to-Medium	Backdrop US real estate equities bucked the broader market trend, climbing nearly 4% in Q1. Despite giving back some gains in April’s sell-off, they remain marginally positive at 0.1% year-to-date — a small gain, but more importantly, it underscores the diversification value from real estate. During the first quarter, real estate segments seen to be more sensitive to economic growth and/or AI-linked spending, such as hotels, office, and data centers, performed poorly, while other real estate segments held up better. Outlook REITs continue to remain dually exposed to economic conditions — both from a top-line rental growth perspective and a funding conditions perspective. Interest-rate movements have been the primary driver of performance in recent years; looking ahead, economic growth dynamics and tariff risks will play an increasingly important role in this sector’s outlook. We see real estate presenting reasonable value at the present time, but continue to note that investors need to tread carefully due to this asset class carrying highly leveraged balance sheets and/or large property development exposure while construction costs remain high.

Alternatives
Alternatives continue to provide a nice ballast, especially pronounced recently as equities sold off. Of course, this depends on the strategy being adopted. Our view remains that alternative offerings should exhibit genuinely diversifying characteristics (i.e., low correlations to stocks and bonds), with reasonable costs and liquidity. More specifically, with rising bond yields implicating both stocks and bonds in similar ways, alternative assets can appeal given that returns from this asset class tend to have a lower direct relationship with the performance of those traditional asset classes.

Currency
While currencies are notoriously volatile, we tend to think of currency positioning via the lens of portfolio robustness (focusing on those currencies with defensive characteristics where sensible), but also as a potential source of upside at extremes. Looking ahead, we continue to see merit in currencies outside the US dollar. The yen has the potential to provide diversification qualities and help preserve capital in times of extreme economic and market stress, as well as offer potential upside.

Cash
Cash rates have improved, offering positive real yields in many developed markets. In the current environment, we see cash serving three purposes. First, cash helps reduce the sensitivity to interest-rate rises, especially relative to long-dated bonds, which is still an important risk to manage. Second, cash should help buffer from any future volatility resulting from a fall in equity markets. And third, cash provides ample liquidity to take advantage of investment opportunities as they arise. That said, as equity and bond markets have repriced lower, we see opportunities to keep money at work.

Disclosures

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