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.

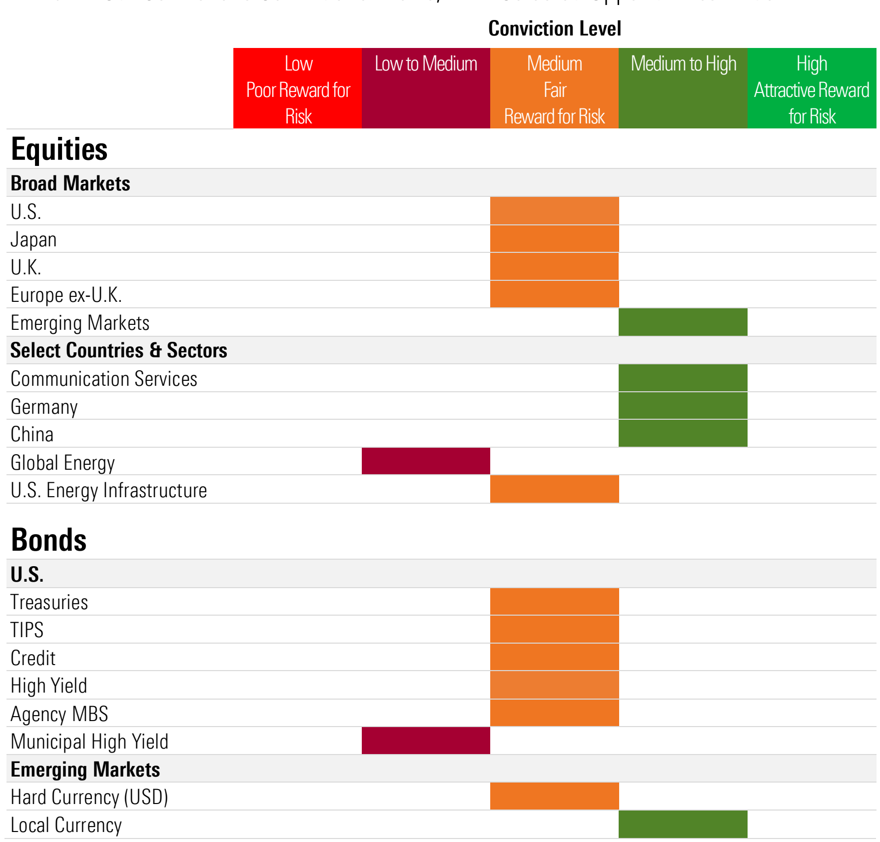
In assigning an asset class conviction, an analyst trades off the aspects of an investment opportunity that argue for and against it, culminating in the expression of a conviction level. The conviction level is expressed on a five-point scale (Low, Low to Medium, Medium, Medium to High, and High).

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

It is hard to imagine a more brutal year than 2022, which saw global stocks and bonds down by double digits, although the longer-term picture is much more balanced. A key variable that many investors are watching in 2023 is the degree to which corporate earnings remain buoyant. Investors seem to be upbeat about the near term though, with markets starting the year positively despite recessionary pre-conditions and an uptick in layoffs from major corporations.

Heading into 2023, bearish sentiment among investors is coming off a very low base, with some of the worst recorded data since tracking started 35 years ago. With a contrarian lens, this could be a positive. However, while the overall valuation landscape has undoubtedly improved, there are many assets which remain around fair value. In such an environment, we continue to balance opportunities against risks.

Exhibit 1 Our Convictions Continue to Evolve, With Selected Opportunities Evident[1]



1 Source: Morningstar Investment Management calculation, as of Jan. 15, 2023. For illustrative purposes only and subject to change.

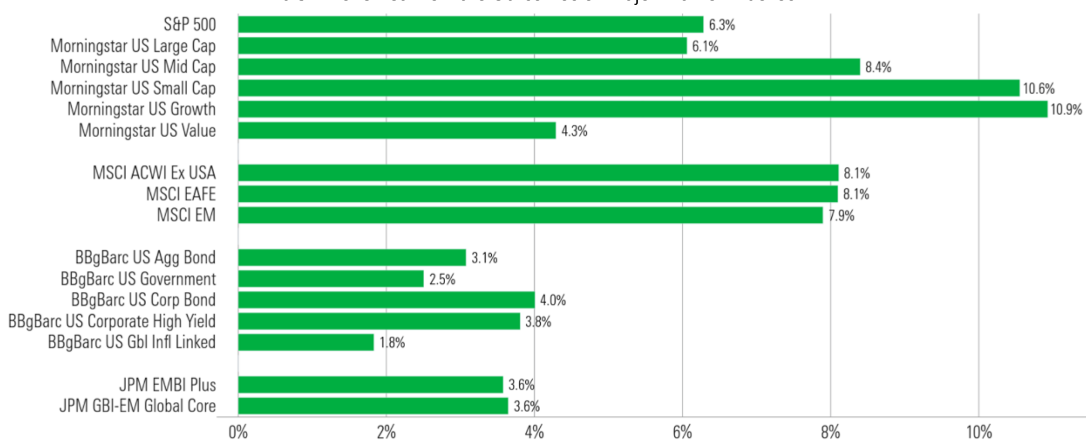
Overall Market Context

In recent times, inflation has shown signs of peaking, which is allowing central banks to pare back on their aggressive interest-rate hikes. However, eyes remain on the deteriorating state of the economy and corporate earnings, with higher interest rates pinching both households and companies alike. The Federal Reserve (along with many other central banks) raised interest rates seven times in 2022, but the hikes are getting smaller in size, perhaps offering a small sign the worst of inflation is behind us.

As important perspective, over the course of the last year, investors have been subjected to volatile conditions and there were few places to hide. Nearly every corner of the financial markets posted big losses. Only a very narrow section of the stock market—truly defensive names such as stable, high-dividend payers, or energy-related assets—offered shelter from the storm—but some of this has reversed. Among equities, investors have become less tolerant of companies that don't generate profits. As a clear observation of this shift, the Morningstar US Growth index fell 36.7% in 2022, with former darlings in technology, consumer discretionary, and communications services all suffering. On the other hand, value stocks benefited from a revitalized energy sector and a collection of defensive stocks in the healthcare, consumer staples and utilities sectors. In contrast to growth stocks, the year-end rally left the Morningstar US Value index down just 0.7% in 2022.

However, early 2023 has seen a partial reversal, with positive outcomes through January.

Exhibit 2 2023 Year-to-Date Outcomes of Major Market Indexes



Source: Clearnomics, Morningstar, MSCI, Bloomberg, JP Morgan, as of January 31, 2023. 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.

What doesn't show in the above is that energy stocks were the clear winners in recent memory, posting one of their best years on record in 2022. This supported markets like the U.K., with the FTSE 100 remarkably posting healthy gains in local currency terms, despite economic and political concerns. Emerging markets had suffered from Russian stocks becoming uninvestable, along with weakness in China and South Korea, but have bounced meaningfully from these woes. European stocks also suffered amid the Ukraine/Russia war and could not overcome the headwinds, although have pared back a healthy portion of these losses.

While bonds have historically served as a key diversifier for investors during many stock market selloffs, that wasn't the case in 2022. It also hasn't been the case thus far in early 2023, with stocks and bonds rallying together. On many measures, bonds had their worst year in decades in 2022, with much of the damage attributed to higher interest rates. That said, the fourth quarter and early into 2023 saw a meaningful comeback for bonds, too, especially at the riskier end such as high yield and emerging-markets bonds.

Moving ahead, much of the "macro" issues are unknowable and it is therefore dangerous to presume a certain pathway. To overcome these temptations, an investor must think probabilistically. The correct question is not "what is the market going to do next?" but rather "are assets priced reasonably for the current environment?" That's what we attempt to answer herein.

Valuation-Driven Asset-Allocation Views (as of January 15th, 2023)

EQUITY MARKETS

Asset Class	Conviction
U.S. Equities	**Medium**
• Consumer Staples	Low to Medium
• Healthcare	Medium
• Energy Infrastructure	Medium
• Financials	Medium

Rationale

Backdrop

U.S. stocks suffered their most significant bear market since the financial crisis in 2022. Large-cap stocks entered technical bear market territory in the early part of the year and hovered in that trading range through year-end. With the exception of energy stocks, there were few places to hide. Even technology stocks, the big winners of the last decade, served a reminder that nothing works forever as many technology companies saw equity values decline in a similar fashion to the technology crash of 2000.

The good news? The stock market doesn't look through the rear-view mirror; it is always forward looking and attempting to price in future probabilities. As we look forward, a significant amount of negativity has been priced into equity values, and that could potentially create opportunity for investors in the future.

Outlook

It's important to note that our conviction for the US equity market as a whole, remains a Medium overall conviction – which implies a balanced approach is warranted. The scores across two key "pillars" – absolute valuation and relative valuation—have improved moderately, while scores for contrarian indicators and fundamental risk remained unchanged. The weak stock market backdrop, as characterized above, certainly played a role in improving the outlook in this market. This is not to say that we consider U.S. equities to be an outright bargain—we don't. But our process tells us that the situation has moderately improved, which is reflected in our conviction.

At a deeper level, valuation spreads—the disparity in valuation levels between sectors—has narrowed. More pointedly, in this environment we see fewer opportunities to be granular. In 2020-21, we identified opportunities clustered in more cyclical (or economically sensitive) areas of the market. Specifically, regarding energy stocks: our valuation approach incorporates a mean-reversion framework for energy prices longer-term, which leads us to conclude that energy producers in particular have become fairly valued, but we acknowledge that a prolonged period of structurally higher commodity prices has not been fully priced into these shares and also that companies have shown fairly strong capital discipline even as pricing has firmed, which is a significant, positive departure from previous cycles. Energy infrastructure shares remain relatively appealing within the energy sector. On financials, our research leads us to believe that large U.S. banks are still relatively attractive. The last area on our radar is defensive sectors, most notably healthcare, which have improved in our relative rankings and could help offset equity risk as it is not highly correlated with economic cycles. Regarding technology stocks, we don't assess these stocks with a broad brush, though our own sentiment index would suggest the extreme popularity has subsided. We acknowledge that valuations have improved; with that said, the sector in aggregate has been "over-earning" relative to its own history (meaning, profit margins of late have been elevated versus long-term averages) for good reason in some ways. So, care is required in this space, especially with interest-rate rises and valuation multiple implications from those increases.

All this is to say—a long-term perspective remains a critical ingredient for investor success. This is perhaps even more relevant during periods of market volatility.

Asset Class	Conviction	Rationale
Europe ex-U.K. Equities • European Communications • European Energy • European Financials • European Healthcare • Germany	**Medium** Medium Low to Medium Medium to High Low to Medium Medium to High	**Backdrop** European stocks faced a perfect storm of uncertainty last year dealing with a difficult backdrop of inflation, speculation around energy supplies, and a war raging in Ukraine. This news was reflected in the price of the Euro, which hit parity with the U.S. dollar for the first time since 2002. Going forward, attractive valuations and interesting opportunities are available to European investors. While valuation comparisons between countries aren't a perfect science, certain industry groups in Europe have some of the most reasonable valuations in the developed world. **Outlook** While we generally like European stocks, we find attractive opportunities when we dig into country and sector differentials. For example, we've reaffirmed our attraction to German stocks which remain an appealing area despite the impact of the Russian conflict. In aggregate, we find German stocks offer solid balance sheets and potential upside to earnings—without eye-popping valuations. At a sector level, our positive view on European integrated-energy companies has moderated following recent strength, as it no longer offers the same valuation appeal. European banks, on the other hand, look more attractive on our analysis.

Asset Class	Conviction	Rationale
U.K. Equities	**Medium**	**Backdrop** The U.K dealt with the same issues plaguing broader Europe, but also observed significant political volatility, which included the resignation of a Prime Minister after only 45 days last October, the shortest tenure in history. Conventional wisdom might indicate this should have been a negative catalyst for U.K. equity markets, but that was not the case. U.K. equities were insulated from these events by large exposure to energy and financial stocks, industries that were beneficiaries of higher oil prices and higher interest rates. U.K. equities were also buffered from domestic issues, given many U.K. based business derive large portions of their revenues offshore. **Outlook** Our overall conviction score for the U.K. remains at Medium. While relative valuations remain at Medium to High, absolute valuations have fallen to a Low to Medium reflecting recent performance. This means our long-standing belief that investors were being well compensated for the risk of investing in U.K. stocks has softened, coming more in line with international peers. That said, they remain a solid dividend play, where we have seen many companies reinstate their dividends, although most are targeting more conservative payout policies going forward. While revenue is cyclical given the underlying key sectors of Financials, Energy and Materials, we believe it is stable. Both operating and financial leverage are also stable. From a fundamental standpoint, we note that most U.K. corporates are high-quality businesses, although certain scenarios pose a risk to corporate profitability.

Asset Class	Conviction	Rationale
Australian Equities	**Medium**	**Backdrop** Australian equities fell in 2022 but held up better than many other developed country equity markets. Australian equities were vulnerable to the same recipe of inflation, higher interest rates, and recession fears seen across the globe. Whether an economic recession comes to fruition is unknown, but Australia does appear vulnerable to an earnings recession given the starting point for earnings and profit margins are at historically high levels. **Outlook** Australian shares retain a Medium conviction, in line with many major global peers according to our analysis. While opportunities do exist at a more granular level—especially for those willing to invest differently to the index—we continue to see greater merit in global exposure, including Germany, China, and other select emerging markets. It would take a further decline in prices before we see outright attraction in this asset class.

Asset Class	Conviction	Rationale
Japan Equities	**Medium**	**Backdrop**
• Japan Financials	Medium	Japanese equities were one of the better performing equity markets last year. In the U.S. and Europe, surging inflation is considered an economic threat. For a country like Japan who has a recent history of disinflation and low wage gains, inflation could be a catalyst for breaking that cycle, creating an opportunity for the Bank of Japan to move away from quantitative easing.
		Outlook
		We continue to see merit in Japanese equities. For the most part, our conviction in Japanese stocks is built on some major structural change taking place at a corporate level. While much of this 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. Sentiment toward Japanese financials has improved significantly over recent months as the Bank of Japan's have made adjustments to their prolonged quantitative-easing program, a step toward interest-rate normalization. With some of the valuation opportunity realized the conviction has been downgraded to Medium.

Asset Class	Conviction	Rationale
Emerging-Markets Equities	**Medium to High**	**Backdrop**
• China Equities	Medium to High	Emerging markets remained challenged by high inflation, volatile currencies, and in certain cases, political strife. However, the structural story around emerging markets remains intact. Emerging markets represent 80% of the world's population and nearly 70% of the world's GDP growth, but only 10% of the total global equity market cap. A burgeoning middle class continues to develop in emerging markets and should present interesting opportunities for investors, albeit with higher volatility.
• Brazil Equities	Medium to High	
		Outlook
		We retain our conviction at Medium to High. We consider emerging-markets equities to be among our preferred equity regions (alongside selected European equities), although recent strength softens this view. Some of this strength corresponded with increased investor optimism toward China, following a softening in the regulatory pressure being applied to Chinese-tech companies together with a re-opening after COVID spikes hit major metropolitan areas.
		We also need to remember that emerging markets are heterogeneous. Investors tend to bucket emerging markets as one, but often the real opportunities present themselves at a country, sector, or regional level.

Asset Class	Conviction	Rationale
Global Sectors		**Backdrop**
• Energy	Low to Medium	Inflation and interest rates have been the biggest forces hanging over financial markets the past year. From a sector perspective, there's an uneven distribution when it comes to winners and losers from those forces. Energy companies have been significant winners from inflation as oil prices are one of the largest components of the inflation index. In comparison, technology has struggled as higher interest rates have led to a higher cost of capital.
• Financials	Medium	
• Communication Services	Medium to High	
		Outlook
		The opportunity to add value via sector positioning has narrowed. That said, we continue to see opportunities, especially at the defensive end. Let's start with energy stocks, given their extraordinary run. This sector was among our highest-ranking opportunity last year and has enjoyed a period of elevated commodity prices. However, this opportunity has narrowed.
		Communication services continue to have one of the most attractive opportunities among the sectors we cover, despite a move higher in the early part of this year. Encompassing internet media companies, media and entertainment companies, and telecom services providers the sector had been impacted by rising discount rates together with macroeconomic concerns. While we do see a potentially more significant level of fundamental risk present in the sector as opposed to other asset classes, valuations (both absolute and relative) as well as contrarian elements tip the scales on our conviction in favor of Medium to High overall.
		Defensive value-oriented areas of the market continue to live up to their reputation and have held up relatively well during the downdraft. Sectors include healthcare, utilities, and consumer staples, all of which provide services that are required in both good and bad times. Generally, stocks in these categories are less volatile and less affected by the ups and downs of long-term market cycles. This could be important if we see a broad-based decline in corporate earnings.

FIXED INCOME

Asset Class	Conviction
Developed-Markets Sovereign	
• U.S. Treasuries	Medium
• Euro Government	Low-to-Medium
• U.K. Gilts	Low to Medium
• Japan	Medium
• Australia	Medium

Rationale

Backdrop

Government bonds (both globally and locally) suffered through a historically bad year. The reason? Low starting bond yields provided no cushion to buffer the pain from rising interest rates. Good news comes in the form of yields that have reset higher. Higher yields will ultimately translate to higher future returns.

Outlook

The material increase in bond yields has improved the forward-looking prospects, which applies positively to the U.S., U.K., and Australia. Europe is also rising from a very low base, although the absolute yields remain broadly unattractive. In all cases, yields fail to cover current inflation, but that ought to be expected given the environment. However, yields are now in excess of our long-term inflation expectations.

Going slightly deeper, the ability to add income to portfolios while mitigating duration/default risk looks attractive to us currently. Rising government bonds are a positive for future return generation, and we expect this asset class to continue playing a role for investors.

That said, overall, we feel that managing duration risk makes sense in most scenarios. We are cognizant of the rather sizeable drawdown in government bonds in 2022 and adding materially to duration might make sense at some point, but any changes should be measured and deliberate, given the fast-changing response from central banks.

In this sense, government bonds are in an odd spot. On the one hand, the global macro environment is widely uncertain with a range of outcomes. The domestic economy is challenged with slowing growth and surging inflation that has the potential to reduce aggregate demand. To complicate matters, central banks have been late to make decisions to address inflation that could ultimately lead them to a tough bridge – fight inflation aggressively or do what you can to maintain the economic recovery. Unfortunately, at this stage, these decisions seem to be mutually exclusive.

Further, given the delicate nature of both the domestic and global economy, long-term sovereign bonds seem appropriate to hedge against risks, whether that is aggressive central bank action, a weakening of demand, or both.

Asset Class	Conviction
Investment-Grade Credit	
• U.S.	Medium
• European Corporates	Low to Medium
• U.K. Corporates	Low to Medium
• Australian Corporates	Medium

Rationale

Backdrop

Corporate bonds struggled to overcome the challenge of rising rates. But like government bonds, the payback will come in the form of higher interest rates.

For full year 2022, investment-grade credit supply was $1.4 trillion, down 16% versus 2021 and the lightest amount of issuance since 2019. Companies have been hesitant to issue new debt and pay the higher interest associated with it.

Outlook

Both locally and globally, the higher yields have improved the attractiveness of this asset class over the long run, albeit from a low base. A key element is credit spreads—the difference between corporate-bond yields and government-bond yields—which have moved closer to fair value in our analysis, although 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.

From a fundamental standpoint, the Federal Reserve's increased involvement in this asset class had provided a backstop, although withdrawal of that support, increasing leverage ratios, and the possibility of higher yields are a cause for concern over the medium to long term.

In summary, this space has improved, but the inherent appeal remains muted. 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		
• U.S. High Yield	Medium	
• European High Yield	Medium	

Backdrop
High-yield bonds were not immune to the pain of rising interest rates, but there are now parts of the high-yield bond market in U.S. and Europe yielding high single digits, and in some cases, low double digits.

Risk will be significantly higher in these types of bonds, but to some investors, these yields could draw in money that previously would've been invested in stocks. It's been a long time since bonds have competed with stocks for investor dollars.

Outlook
Improved valuation, both on an absolute and relative basis, leads to our overall conviction of Medium. In our view, this bears watching—but it's not a "fat pitch" opportunity yet. While headline default risks are still deemed to be low, this could change with central banks tightening conditions and recessionary preconditions festering. A shorter duration profile relative to other bonds is also a potential positive in a rising-rate environment.

Asset Class	Conviction	Rationale
Emerging-Markets Bonds		
• Local Currency	Medium to High	
• Hard Currency	Medium	

Backdrop
Emerging-market bonds participated in the "risk on" rally to conclude the year but struggled throughout the year as fundamentals across emerging markets have been challenging, particularly when factoring in volatile currencies. Like high yield bonds, headline yields are rising to enticing levels in the high single digit range. This reflects the reality that many emerging-market central banks have raised interest rates far in excess of their developed market counterparts to combat inflation pressures.

Central bank tightening cycles, global growth and inflation concerns, and China's reopening will all play key roles in determining where emerging-market bonds go from here.

Outlook
Emerging-market 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-market 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-market currencies also look undervalued overall and could offer a tailwind over time.

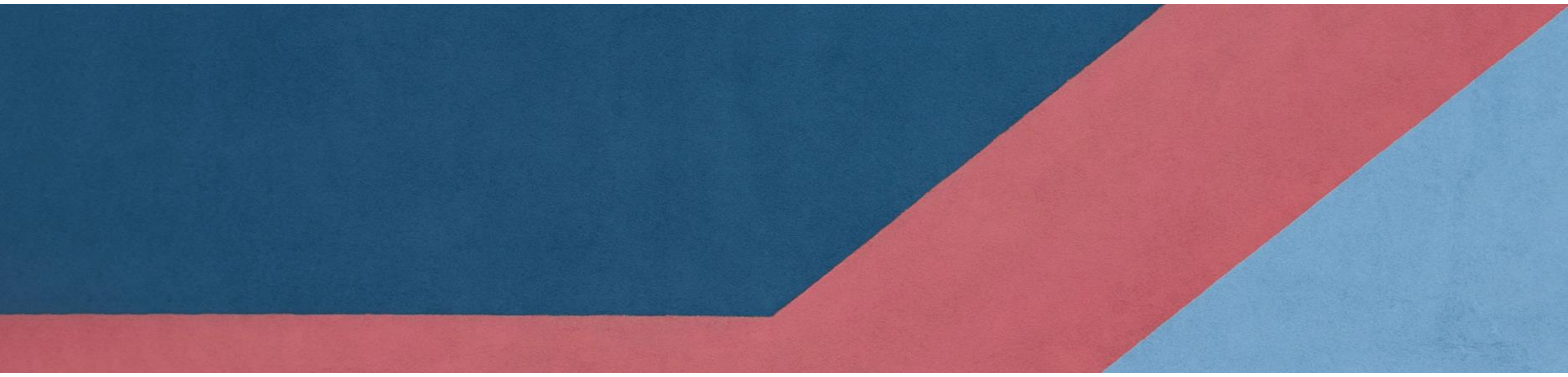
The area can be volatile, yet even allowing for some pessimistic assumptions, our research suggests that investors could see upside if they're willing to risk short-term volatility. In other words, we think investors can expect to be compensated for this risk over time, especially for local-currency bonds.

Asset Class	Conviction	Rationale
U.S. Agency MBS	**Medium**	

Backdrop
U.S. mortgage-backed securities (MBS) were negative in 2022. The mortgage-backed securities market has grinded to a halt, driven by continued weakness in the housing market, which resulted in diminished turnover and cash-out activity. Prepayments continued to decline in the second half of 2022 as mortgage rates went north of 6%, a multi-decade high.

Outlook
Overall, considerable weakness has been experienced while fundamentals remain solid. Given the sharp rally in mortgage rates and significant duration extension, the attractiveness of this asset class has improved. Investors will continue to watch inflation and the result it has on overall consumer demand. The idea of slowing economic activity should support higher-rated assets such as Agency MBS as there is little inherent default risk. That said, further spread widening may take place before it turns in investors favor.

Asset Class	Conviction	Rationale
Global Inflation-Linked Bonds • U.S. TIPS	 Medium	**Backdrop** Inflation-linked bonds (TIPS) sold off with the broader bond market last year. This was confusing to many investors as TIPS didn't serve as an inflation hedge. There are a couple reasons for this: TIPS help protect from unexpected inflation, which we had more of in 2021 than we did in 2022 despite the record prints on actual inflation last year. The second reason for negative performance was rising rates. When rates rise suddenly, TIPS will act more like a bond than an inflation hedge. **Outlook** The increase in yields dwarfed the increase in inflation last year, a situation that is unlikely to repeat this year. TIPS should benefit from higher interest rates. In addition, recent trends in inflation indicate it may be falling from peak levels, yet it wouldn't take much for markets to reprice inflation should something give. One important consideration is duration risk, where inflation-linked bonds are often longer-dated securities with meaningful interest-rate sensitivity.



OTHER ASSETS

Asset Class	Conviction	Rationale
U.S. Municipal Bonds	**Medium**	**Backdrop** Municipal bonds suffered with the rest of their bond market peers last year. The supply of new municipal bonds is declining as few state and local governments are interested in refunding existing bonds at low yields and issuing new bonds paying higher yields. As a result, the supply of municipal bonds is likely to remain tight for the foreseeable future. **Outlook** Yields on high-quality municipal bonds have trended higher and look 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.

Asset Class	Conviction	Rationale
Global Infrastructure	**Low to Medium**	**Backdrop**
• U.S. Energy Infra & MLPs	Medium	Global infrastructure represents a wide collection of income producing assets, which includes airports, rail, and energy-related holdings. Long duration assets that exhibit more sensitivity to rising interest rates were amongst the worst performers last year – this included Communications Infrastructure and Toll Roads. Energy-related investments (MLPs) benefitted from a strong year in the energy industry. It's worth noting valuations have come in enough where these assets are not as attractive as they were in previous years. But there remains the potential for private investors to buy these assets out given their attractive income profiles. **Outlook** While infrastructure has generally become more attractively priced, due to rising interest rate and recession concerns (the latter mainly negatively impacting railroads and airports), we continue to see better value in other areas of the equities market. Oil prices are significantly higher, and energy infrastructure equity prices have rebounded strongly—which has served, at the margin, to mute our historically-positive view of this asset class. That said, we continue to see some appeal given the relatively high dividend yields and continued demand recovery. We also cite further governance and capital-allocation discipline. Specifically, our expectation is for a meaningful reduction in capital expenditures by energy infrastructure companies, with overall spend being reduced towards maintenance, or steady-state levels. Headwinds remain amid the push to address climate change, but the transition to renewable energy is likely to be a long path, potentially allowing for an extended period of robust free-cash-flow generation for the industry—which we anticipate will be used to strengthen balance sheets and return cash to shareholders.

Asset Class	Conviction	Rationale
Listed Property		**Backdrop**
• U.S. REITs	Low to Medium	Global real estate investment trusts (GREITs) have been a mixed bag of performance. Rising interest rates, higher debt service, and inflation leading to higher construction costs are key themes hanging over the asset class. GREITs have seen a wide dispersion in performance between the top performing and lowest performing sub-industries. Industrial warehouses were a large winner in recent years but observed a tremendous slowdown last year as e-commerce growth fell from peak levels, and rising interest rates negatively impacted valuation multiples for this higher "growth" industry group within real estate. Residential REITs were another area that performed poorly due to rising interest rates. Retail REITs and Hotels, which performed poorly during the COVID-impacted period, and are seen to represent the "value" oriented areas of real estate, held up better in 2022. **Outlook** While moves to reopen global economies have broadly progressed, we believe that earnings risks remain elevated. Investors in office REITs face a more depressed rental-growth outlook over the short term and an uncertain outlook over the medium to long term due to uneven work patterns between employees working from home versus working physically in an office building. For industrial warehouses, there is a risk that increasing supply of property space could exceed demand over the medium-term. With debt funding costs and construction costs on the rise, investors need to be wary of trusts exhibiting highly leveraged balance sheets and/or large property development exposure. Following price falls in 2022, listed property is starting to present better value in pockets, but as a broad group, global listed property remains relatively unattractively valued compared to broader equities.
• Global REITs	Low to Medium	
• Australian REITs	Low to Medium	

Alternatives

Alternatives offered a partial ballast during the 2022 setback. Of course, this depends on the strategy being adopted. Our view remains that alternative offerings should exhibit genuinely diversifying assets 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 traditional asset classes such as equities and bonds.

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 see merit in currencies outside the U.S. dollar, although recent falls in the U.S. dollar moderates this view. The yen has the potential to provide diversification qualities and potentially help preserve capital in times of extreme economic and market stress, as well as provide potential upside.

Cash

Cash rates have improved, but remain well below the inflation rate, so losing money in real terms. However, we balance this view, as the market vulnerabilities are worth protecting against. More pointedly, 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.

Disclosures

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About Indexes

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